



Solvency II Single Group Solvency and Financial Condition Report

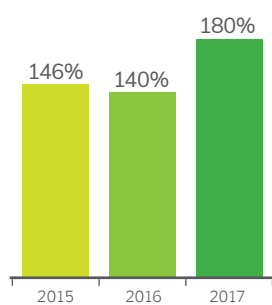
For the year ended 31 December 2017

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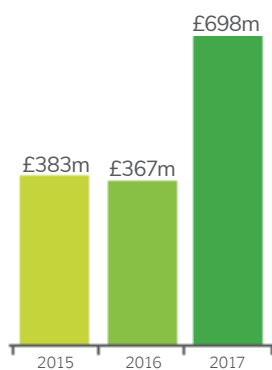
Solvency II Capital Coverage Ratio

180%



Group Capital Surplus

£698m



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Executive summary

Background

LV= has prepared this Solvency and Financial Condition Report (SFCR) to provide information on our solvency (i.e. our ability to pay liabilities – primarily current and future policyholder claims) and how we manage the financial strength of the Group.

The SFCR serves many types of stakeholders, with different levels of expertise and expectations. As a guide, the Policyholders' overview (Executive Summary, Company overview and Summary of material changes over the reporting period) aims to address the requirements of policyholders and we have done our best to make this understandable for everyone. The main body of the report and the appendices are aimed at analysts and investors. Some of the information in the main body of the report is quite technical, and the content is prescribed by complex regulations. A separate document containing Quantitative Reporting Templates (QRTs) is annexed to this SFCR. These are the publicly available detailed forms we submit to the PRA which contain financial information prescribed by the Solvency II regulations. The QRTs can be found at <https://www.lv.com/about-us/company-information/returns/regulatory-returns>.

Relevant information about the business of the Society and the Group is also provided in the Annual Report and Accounts for the year ended 31 December 2017 (the 'Report and Accounts'), a copy of which can be found at <https://lv.com/annual-report>.

Basis of preparation

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. LVFS has been 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 Society and the regulated subsidiary companies within the Group is included within Appendix 1.

In common with many in the industry, we present two cover ratios, an 'Investor View' for analysts and investors in our subordinated debt, that excludes the ring-fenced funds entirely, and a 'Regulatory View' where the ring-fenced funds are included but their surplus is excluded from the Group's surplus.

Summarised capital performance (Investor view)

At the end of 2017 the group capital surplus on a Solvency II Standard Formula basis is estimated to be £698 million (2016: £367 million) with a Capital Coverage Ratio (Investor view) of 180% (2016: 140%).

The key performance indicator we use to monitor our capital position is the Solvency II Capital Coverage Ratio.

Capital Coverage Ratio (CCR)

Explanation of measure

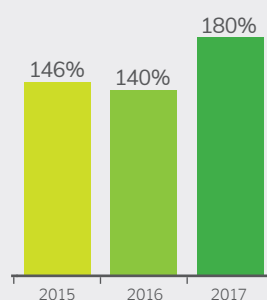
To ensure the sustainability of the group we monitor our Capital Coverage Ratio (CCR). Capital cover ratio is the ratio of our capital position (Own Funds) compared to our Solvency Capital Requirement (SCR), which indicates our ability to pay all our liabilities, including to policyholders, in a very extreme scenario (a 1 in 200 year event).

2017 Target

To ensure the Solvency II capital coverage ratio is above the group's risk appetite framework of £350 million (or about 140% as at 31 December 2017).

Performance

180%



Definitions

Capital generation

Capital generation is based on the Solvency II surplus capital generated from our business operations and presented after the impact of strategic projects and financing costs.

Operating capital generation

Operating capital generation is Capital generation adjusted to remove the effects of temporary volatility, from market movements and the static nature of TMTP, changes in defined benefit pension schemes and exceptional items.

Key

- Increase
- Decrease
- Total

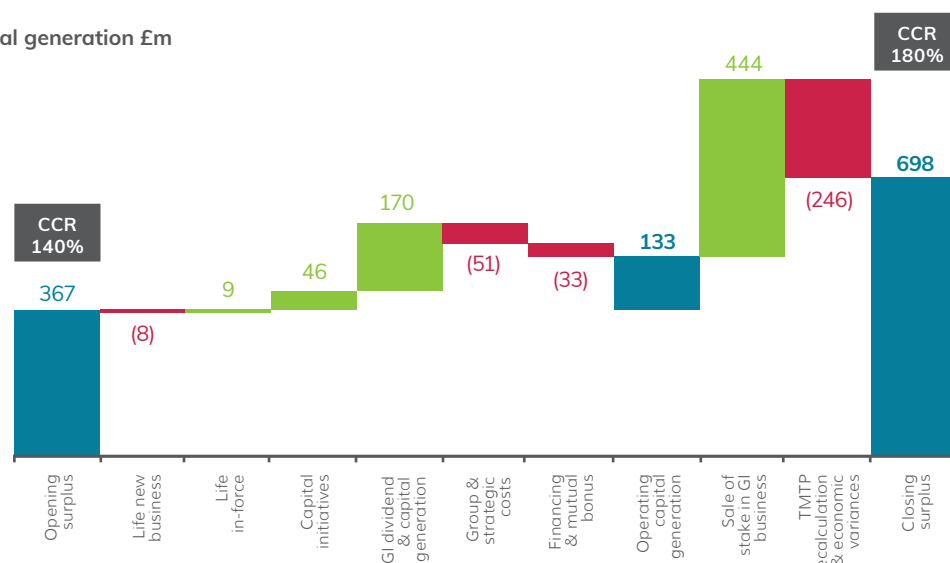
Capital reporting basis

The capital coverage ratio represents the ratio of eligible own funds over the Solvency Capital Requirement in accordance with the Solvency II regime. The 31 December 2017 figures are estimated and have not been subject to an external audit opinion.

The group capital resources table shows the estimated eligible own funds, Solvency Capital Requirement (SCR) and surplus funds of the group. Figures exclude RNPFN and Teachers ring-fenced funds. Calculations are based on the Standard Formula approach using the Volatility and Matching Adjustment (for eligible business) and TMTP recalculated as agreed by the PRA during the year.

During the year we monitor our capital generation and operating capital generation to ensure our capital position remains within risk appetite.

Capital generation £m



Our group surplus capital has increased by £331 million and capital coverage ratio improved by 40 percentage points to 180%. This includes the positive impact of the general insurance transaction with Allianz (£444 million, 51%), capital generated from the general insurance business over the year (£170 million, 20%) and the adverse impact of TMTP recalculation and economic variances (£246 million, 28%). We have also implemented various capital initiatives over the year to de-risk the Solvency II balance sheet, including the reinsurance of the OB pensions portfolio and closure of certain capital intensive product lines.

Capital performance

At the end of 2017 the group capital surplus on a Solvency II Standard Formula basis is estimated to be £698 million (2016: £367 million) with a Capital Coverage Ratio of 180% (2016: 140%).

Solvency II

Since 1 January 2016, the group has operated on a Standard Formula basis for calculating its regulatory capital position. An internal model application was submitted in early 2017, however in light of the changes to the risk profile that would be introduced by the transactions with Allianz and RGA at the end of the year (see more details on page 16), a recommendation was approved by the board not to proceed with the application and to continue using the Standard Formula method.

Since 2016, the group has applied the Matching Adjustment to the majority of its annuity business as an integral part of the group's approach to asset and liability management. The group also applies Transitional Measure on Technical Provisions (TMTP) and the Volatility Adjustment. The TMTP provides firms with relief over a period of up to 16 years from implementation of Solvency II from the financial impact on Technical Provisions of moving to the Solvency II regime. The TMTP amortises annually over 16 years.

The group complied with all regulatory capital requirements that it was subject to throughout the reporting period.

Group capital surplus

£m	2017	2016
Eligible own funds		
Tier 1	1,178	885
Tier 2	379	385
Tier 3	10	26
Total Eligible own funds	1,567	1,296
Solvency capital requirement (SCR)	869	929
Surplus	698	367
Capital coverage ratio (CCR)	180%	140%

Eligible own funds and SCR exclude amounts attributable to the RNPFN and Teachers ring-fenced funds. Including these funds would not change the capital surplus shown above as these funds do not require capital support. It would however dilute the CCR.

Eligible own funds include the positive benefit of TMTP of £528 million (2016: £837 million). TMTP is required to be recalculated at least every two years and there has been an industry-wide recalculation on 31 December 2017.

Definition

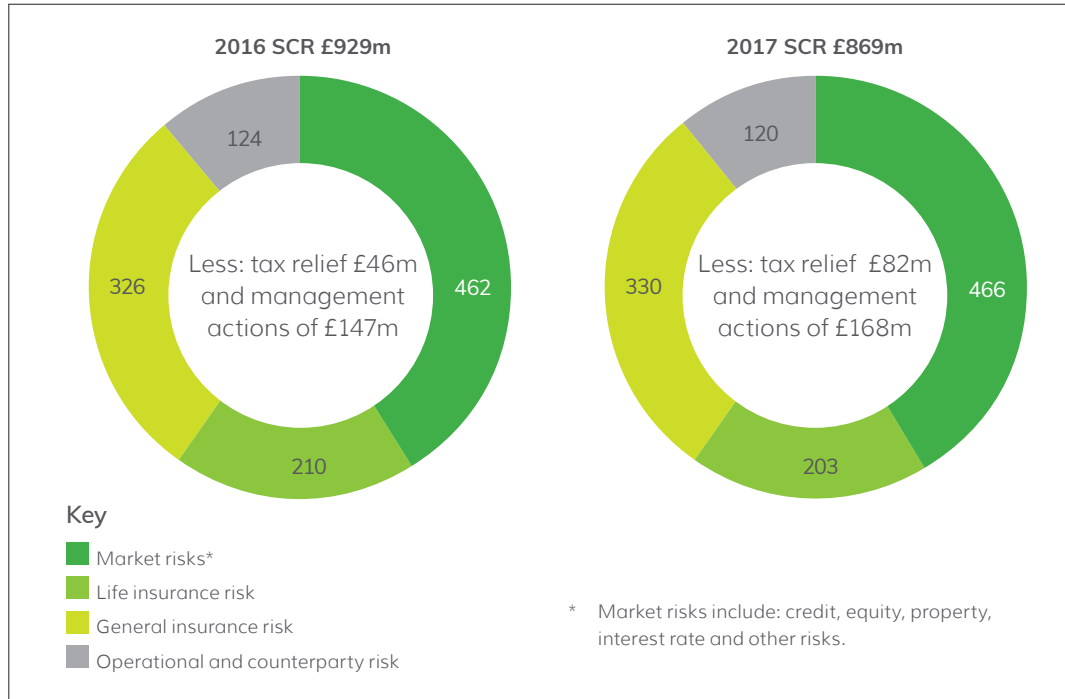
Tiers of Capital

There are three tiers of capital defined by Solvency II. The quality of capital is important as the higher the quality the more likely it will be available in the event that it is needed, for example to be able to pay out claims. Tier 1 capital primarily represents high quality capital which is generally more secure and capable of absorbing losses. Tier 2 capital represents our subordinated debt and Tier 3 capital is the lowest quality of capital (deferred tax assets).

Transitional Measure on Technical Provisions (TMTP)

The transitional measure smooths the transition from the previous solvency regime to the new Solvency II regime and spreads the capital impact over 16 years. Once approved by the PRA this is included within the valuation of technical provisions.

There was a £246 million reduction in surplus capital due to TMTP recalculation and step-down and economic variances. This adverse impact largely relates to the change in economic conditions in 2016 since the last TMTP recalculation on 31 August 2016 and not reflected through TMTP until the recalculation on 31 December 2017. The Society has updated its approach to stepping-down, with the annual step-down occurring on 31 December (previously 1 January) and allowed for in the year-end results. As such, TMTP has been stepped-down twice during 2017; 1 January 2017, £52 million in respect of 2016 run-off, and 31 December, £37 million in respect of 2017 run-off. The step-down as at 31 December 2017 is included within the wider capital generation analysis. The next step-down of TMTP will be on 31 December 2018.



Solvency Capital Requirement

Sensitivity analysis of Solvency II group capital surplus

The following table shows the sensitivity of the group's Solvency II capital surplus and capital coverage ratio to economic assumptions. All other assumptions remain unchanged for each sensitivity, except where these are directly affected by the revised economic conditions or where a management action that is allowed for in the SCR calculation is applicable for that sensitivity. The analysis also provides the benefit from a further recalculation of TMTP, following the stress event. The credit and gilt spread sensitivities represent a widening of yields on these asset classes relative to swap rates. The sensitivities below allow for the impact of the group's hedging strategy.

Changes in economic assumptions	No Further TMTP Recalculation		With Further TMTP Recalculation	
	Impact on surplus capital £m	Impact on CCR (%)	Impact on surplus capital £m	Impact on CCR (%)
Equity values fall by 25%	(89)	(10)	(89)	(10)
Credit spreads increase by 100bps	146	18	63	9
Gilt spreads increase by 50bps	(128)	(15)	(62)	(7)
Fixed interest yields fall by 100bps	(112)	(18)	82	3
Fixed interest yields increase by 100bps	91	15	(57)	(3)

The group's capital surplus position is affected by the sensitivities due to the following:

- A fall in equity values reduces the value of the group's defined benefit pension schemes, increases with-profits guarantee costs and reduces the benefit of future charges on unit-linked business; all of which are partially hedged to equity market movements. There is no benefit from TMTP recalculation to equity market movements as TMTP is predominantly driven by interest rate related market risks.
- A widening of credit spreads, relative to swaps, increases the value of the group's defined benefit pension schemes, reduces the value of liabilities using the Volatility Adjustment, offset by a reduction in corporate bond values. Following TMTP recalculation, the benefit reduces due to the loss of Volatility Adjustment and increased risk from future credit defaults associated with annuity business assumed under the previous solvency regime.

- A widening of gilt spreads, relative to swaps, reduces the value of the group's defined benefit pension schemes and the assets invested to support the Society's liabilities. The OB pensions reinsurance transaction has reduced the reliance on TMTP recalculations, hence improving surplus capital stability.
- Changes to fixed interest rate yields (both swap and gilt rates) lead to changes in the group's capital surplus position, as the Solvency II yield exposure is hedged on a post-TMTP recalculation basis. Following a TMTP recalculation, the residual exposure largely arises from the defined benefit pension schemes.

Capital management actions

During 2017 we took a number of actions to improve our capital position and to reduce the sensitivity of our capital position to market movements including:

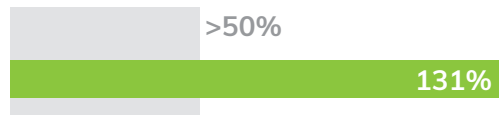
- sale of a 49% stake in our general insurance business and a fixed-price forward contract over sale of a further 20.9%, with an option to sell the remaining stake at a fixed price for two years;
- entered into a reinsurance treaty which substantially reduced the volatility and capital held for a block of with-profits annuities within our OB pensions portfolio;
- reduced the equity exposure within the general insurance companies;
- closure of certain capital-intensive product lines in our protection portfolio; and
- increased the scope of hedging for our flexible guarantee and unit-linked product lines.

Summary of compliance (Regulatory view)

The group, Society and its regulated subsidiaries were compliant with the Solvency II capital regulation requirements throughout the reporting period. At the end of 2017, the regulatory view SCR coverage ratio for the group was 171% (2016: 135%) and the Minimum consolidated Group SCR coverage ratio was 310% (2016: 261%). Not only have we met our capital requirements, but the quality of our capital is well above the requirements of the Solvency II rules.

The Solvency II regulations require capital to be of a sufficiently high quality, and the following rules apply:

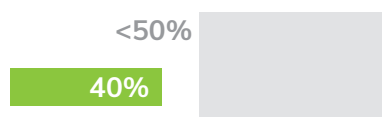
Of the SCR, at least 50% must be covered by Tier 1 capital. The group has complied with this and our SCR has 131% Tier 1 capital coverage.



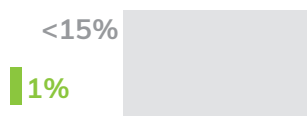
Of the Minimum consolidated Group SCR, at least 80% must be covered by Tier 1 capital. The group has complied with this and has a Tier 1 coverage ratio of 290%.



Tier 2 plus Tier 3 capital is limited to 50% of the SCR. The group has complied with this and our Tier 2 plus Tier 3 capital is only 40% of the SCR.



Tier 3 capital must be less than 15% of the SCR. The group has complied with this and Tier 3 capital is only 1% of the SCR.



Company Overview

LVFS is the UK's largest friendly society, with more than six million policies in-force policies and over one million members. We exist to grow the value of our business for the benefit of our members.

Throughout our 175 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.

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.

Our core purpose, strategy and business model

The world is constantly changing and it is important that we at LV= keep up with it. In order to do this our business needs to evolve. We know that the insurance industry is facing a big transformation with new business models, Fintech, investment in big data and start-ups shifting customer expectations. At the same time, customer lifestyles and working patterns are changing, leading to a range of emerging consumer needs relating to insurance and finances more generally. It is with this in mind that last year we introduced our new strategy. We call it our blueprint and we believe it is the best way to move forward at pace to maintain and grow our business.





What it means

We believe that everyone deserves to Live Confident, and we exist to help people to do that.

For us this means:

- Being proactive about preventing things going wrong, not just fixing them when they do.
- Fighting for and leading the way in doing things that are in our members' and customers' best interests.
- Being transparent, well-intentioned and absolutely honest in all that we do.



To deliver on that promise there are three things we must do:

- 1 Deliver Green Heart Experiences for our customers, colleagues and members by designing and delivering solutions that prevent as well as fix – and inspire total trust.
- 2 Build a business that is sustainably Lean & Strong so we can achieve our goals over the long term whilst continuing to grow member value.
- 3 Harness the latest technologies, evolve how we operate and bring in the new talent needed to ensure that we lead the industry today and into the future. We have termed this LV=3.0.



We will only succeed if everyone at LV= truly lives our values every day, so that:

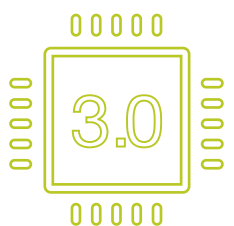
- We make it feel special
- We make every pound count
- We don't wait to be asked
- We fight for better



If we do all of this our customers will be able to live bigger lives; our people will be able to fulfil their aspirations; and LV= will be able to make an important and valued difference for longer. People and LV= will be able to Live Confident.



We still believe that our **Sharp with a Heart** philosophy gives us a clear point of difference and we will continue to do things that combine the competitive performance of a PLC with the trusted behaviours of a mutual.



Future strategic priorities for the group

Green Heart Experiences

- 1 Define and nurture the culture we need to thrive, delivering a highly engaged workforce and equipping us with the talent and capability to drive our strategy forward.
- 2 Strengthen and reposition our brand to build on its current strength and position as a modern mutual, with broader propositions aligned to our proposed growth strategy.

Lean & Strong

- 3 Deliver the core strategy to ensure financial and strategic sustainability, and deliver priority projects (e.g. a new ISA product)
- 4 Embed a strong risk management framework and culture, and comply with the regulatory changes being implemented within the General Data Protection Regulations (GDPR).

LV= 3.0

- 5 Build a strong and deep strategic partnership with Allianz both through the general insurance business and by identifying broader opportunities to leverage capabilities and work together.
- 6 Develop, agree and execute the strategy to deliver accelerated growth, with new proposition launches to establish the proof points for this strategy, a three year transformation plan defined, and successful development of Wealth Wizards.

Building a sustainable mutual

- 7 Underpinning these priorities is the work underway to create a sustainable mutual with a clearly defined social purpose, member reward strategy and an appropriate legal structure to enable the business to prosper in the long term and grow member value.

Business Model

The **LV= group** is run for the benefit of our members and is therefore different from other organisations which are owned by shareholders. We believe this difference is important in serving customers, engaging with employees and creating long-term value for our members.

Our members are customers who have certain longer-term financial products with us, such as life insurance, protection, investments or retirement policies. They have voting rights and can expect to influence the key decisions made in the Society. Eligible members may benefit from a share of any surplus profits which the group is able to allocate. They also have access to a number of additional benefits and services such as member discounts, the member care helpline and member support fund.

We aim to grow member value consistently over the longer term while managing the risk involved in doing so appropriately.

Our products comprise:

- **Retirement and protection products:** including savings and investments, and financial advice, covering peoples' lives and incomes;
- **Heritage legacy products:** focuses on savings and investment products that are no longer actively marketed, the majority of these being with-profits products.

Our product portfolio represents a careful balance of well-established, profitable lines and selective investments in growth lines, distributed to consumers, brokers, IFAs and sold directly. This mix of business lines and distribution channels provides us with diversification of risks and helps mitigate the impact of adverse market conditions and business cycles which affect specific products or distribution channels.

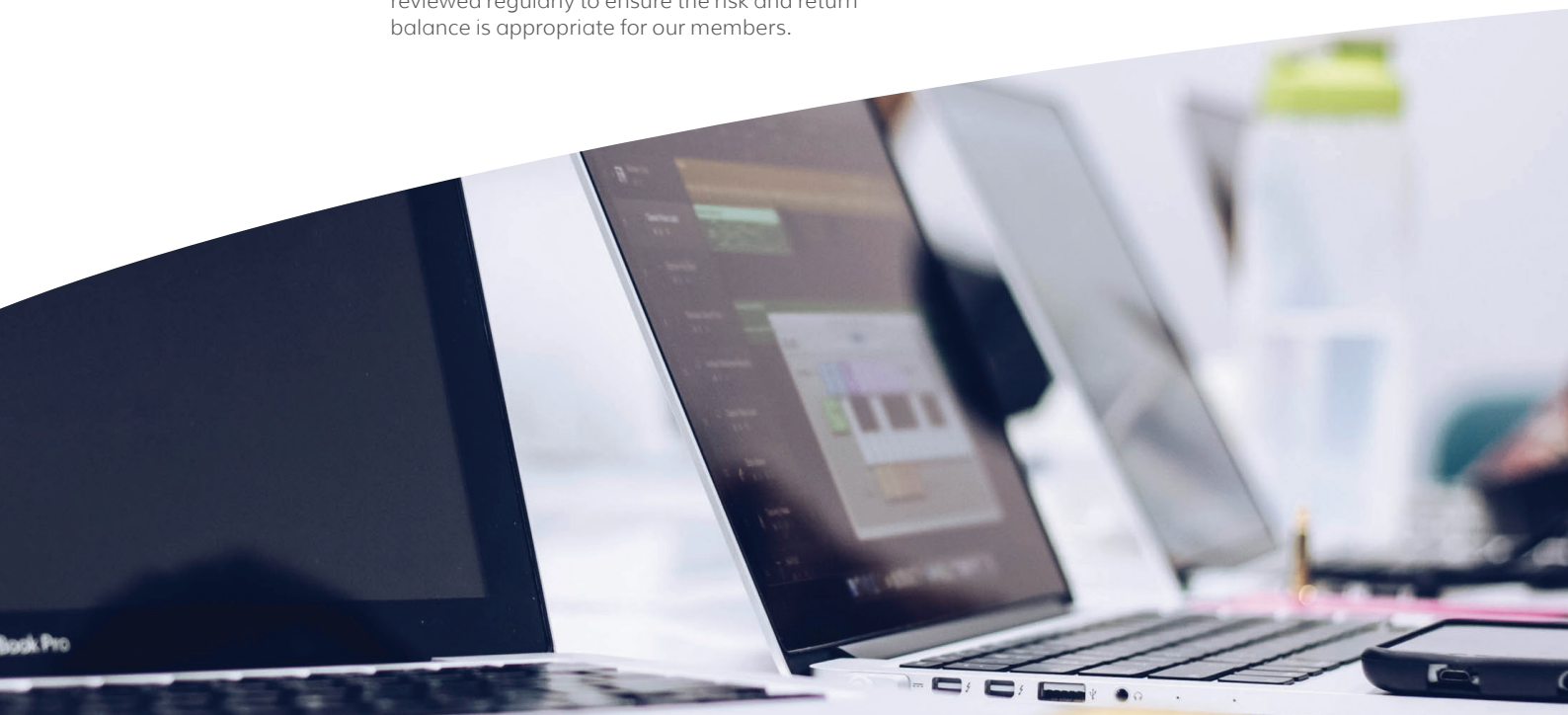
Our **members' funds** are managed on our behalf by our strategic partners, Columbia Threadneedle Investments, BlackRock and AgFe. This allows us to focus on our core expertise of risk-based insurance business while benefiting from the investment management expertise of our partners. The partnership arrangements are reviewed regularly to ensure the risk and return balance is appropriate for our members.

Surplus funds of the group are held in the **LV= Estate**. This is made up of unallocated divisible surplus accumulated in prior years. Estate own funds are invested to generate returns and provide the LV=group with a capital buffer.

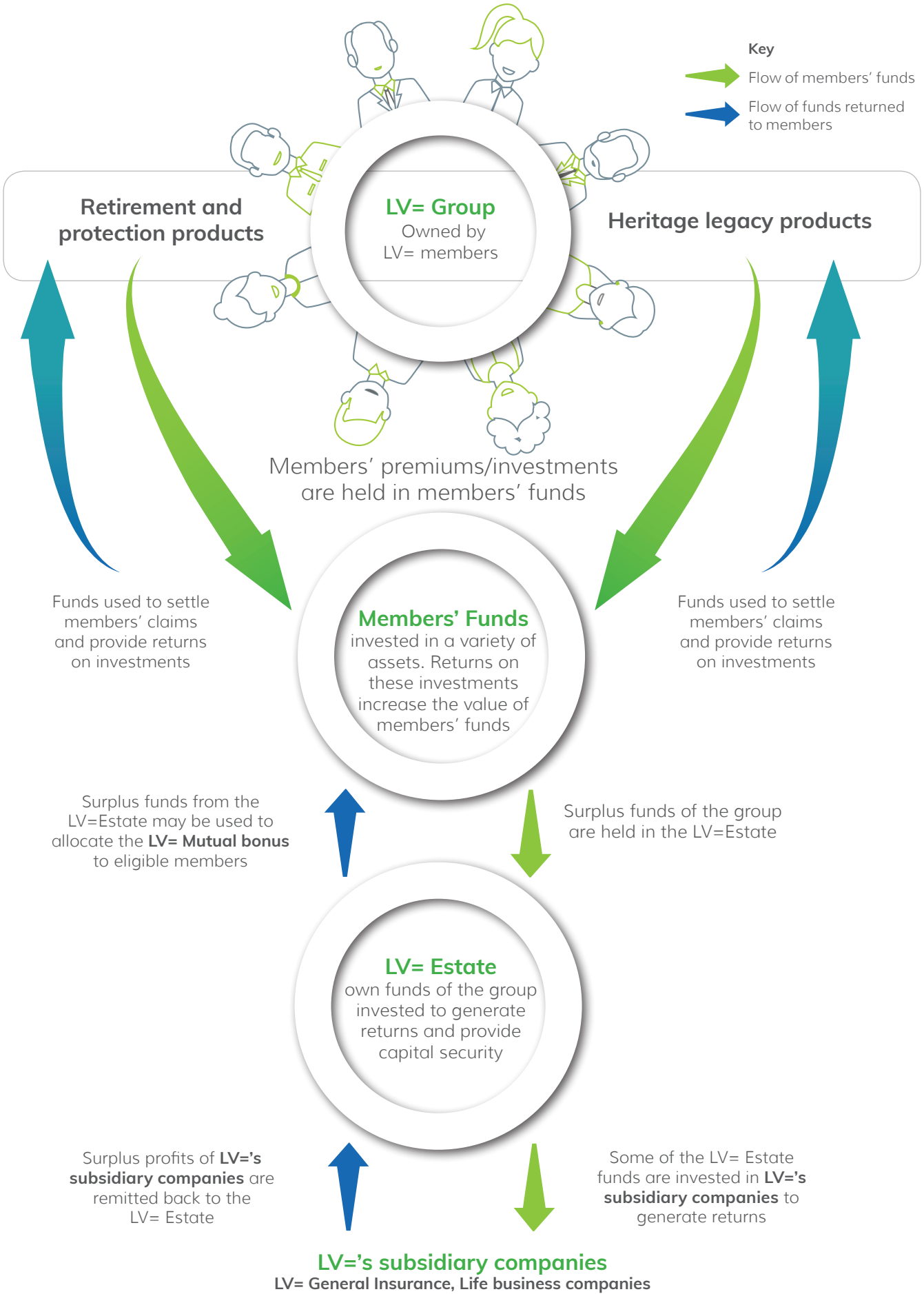
When the financial performance and financial and capital strength of the LV= group allows, surplus funds from the LV= Estate may be used to allocate the **LV= Mutual bonus** to eligible members.

As well as investing in the debt and equity of other companies, the LV= Estate has invested a significant proportion of its funds into **LV=s subsidiary companies**. The majority of this investment is in the LV= general insurance business, which sells a variety of products, including motor and home, to both personal and commercial customers, distributed directly or via brokers. Surplus profits of the **LV= general insurance business** are remitted back to the LV= Estate. Following the transaction with Allianz, LV= will receive 51% of any future distributed profits, until such time as there is a further sale of this investment. It has sold the renewal rights of its commercial broker lines business to Allianz as part of this transaction.

The LV= general insurance business provides the group with more than just remitted profits. In addition to diversification of risk, strategic advantages include the larger foot-fall of our successful general insurance business increasing brand awareness and the customer centric approach taken across the LV= businesses enhancing the opportunities for cross-selling and customer retention. Similarly the **Life business companies**, such as LV= Equity Release, LV= Commercial Mortgages and Wealth Wizards, provide the life business with wider strategic and capital advantages.



LV= Business model - A modern mutual



Our financial performance

Operating profit

The group has delivered an operating profit of £158 million (2016: £12 million loss), with strong results from its general insurance business and an improved life business result.

The general insurance business operating profit of £121 million is made up of underwriting profits of £103 million (2016: £70 million) and investment returns of £18 million (2016: £43 million). The improved underwriting result is even more pleasing given that we have strengthened reserve margins by an additional £31 million during the year.

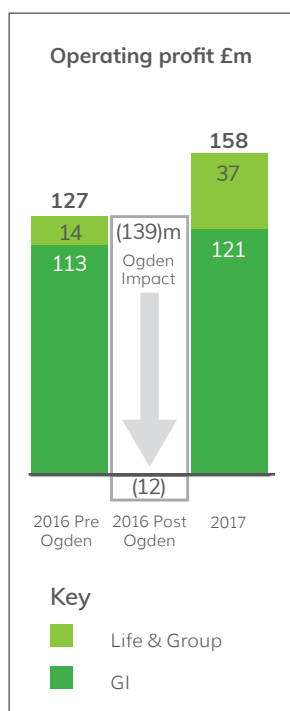
The improved life business operating profit of £37 million reflects an increase in new business contribution to £37 million (2016: £31 million), with continued positive contributions generated by flexible guarantee bond and protection products and an improvement in volumes and margins in pensions. A £26 million positive impact from model and basis changes has been largely offset by £19 million of adverse experience variances.

Profit before tax

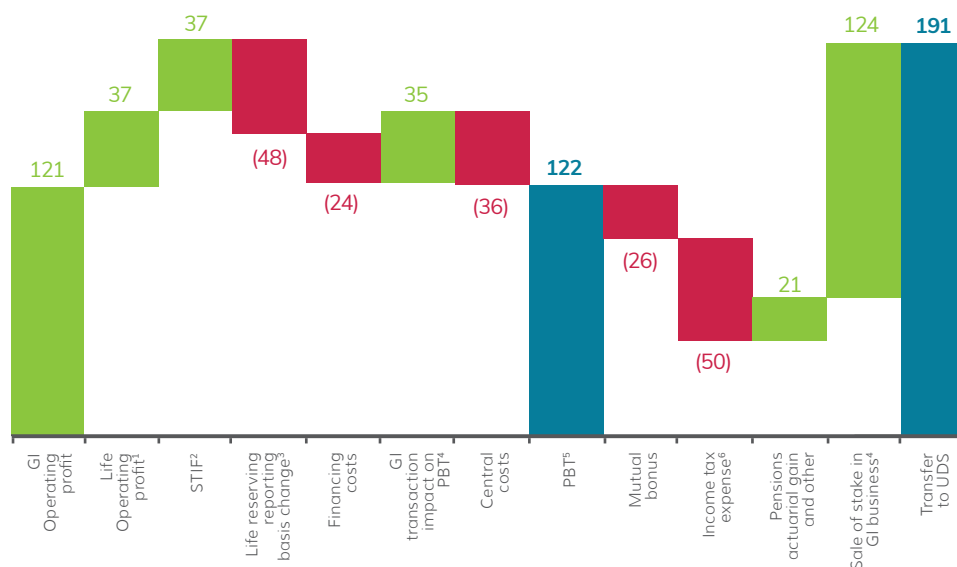
Profit Before Tax (PBT) of £122 million is a significant improvement over the prior year loss before tax of £49 million, which included a £139 million adverse impact from the Ogden rate change. Current year PBT is favourably impacted by growth in operating profit, the £35 million benefit of the general insurance transaction on PBT and £37 million favourable short-term investment fluctuations (2016: £14 million). Items adversely impacting PBT include a £48 million increase in reserves following a life reserving reporting basis change, £24 million interest on the subordinated debt (2016: £24 million) and £36 million of central costs (2016: £30 million) which include costs related to the strategic review, Solvency II costs and strategic spend on capital optimisation initiatives.

IFRS Surplus (UDS) generation

Unallocated divisible surplus (UDS) rose by £191 million and includes the profit from the Allianz transaction. A mutual bonus of £26 million was allocated to eligible members' policies during the year.



£m



Life reserving reporting basis change

During the year we have changed our life IFRS reserving reporting basis to better align with Solvency II. This involved applying the swap curve used in Solvency II as the definition of the risk-free rate, rather than the gilt rate curve used previously. This one-off change is recognised in 2017 and has adversely affected PBT by £48 million.

Notes

- Life business results are reported including heritage as these are now managed as one business.
- Short-term investment fluctuations and related items include the favourable impact of tax deducted from policy asset shares and the RNPfN fund totalling £24m (2016: £42m) and £13m relating to market movements.
- Change in accounting estimate to align IFRS reporting economic basis with Solvency II.
- The total positive impact of the general insurance transaction on the transfer to Unallocated Divisible Surplus (UDS) is £159m. Of this £52m relating to the sale of the commercial business renewal rights, and £17m costs are recognised in PBT; £124m relating to the sale of a 49% equity stake is taken directly to UDS.
- Profit/(loss) before tax (PBT): Our measure of PBT is defined as profit before tax, mutual bonus allocated, and transfer to Unallocated divisible surplus. This definition allows meaningful comparisons with the PBT disclosed by other companies.
- Income tax expense includes tax deducted from policy asset shares and the RNPfN fund totalling £24m and tax on trading businesses of £26m.

Our systems of governance

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).

Alignment of the board to the group's culture, values and governance arrangements

The role of the board is to set the tone from the top on the group's governance, culture and values and to be collectively responsible for the long-term success of the group. For the board this means not only ensuring that we comply with all relevant laws and regulations and ensuring that we have high standards of internal control and risk management, but that we run our business with integrity.

The board ensures that we truly live our values every day, delivering on 'Green Heart Experiences' for our customers, colleagues and members, harnessing the latest technologies and building a business that is sustainably lean and strong.

By doing this the board helps ensure that LV= will enable people to 'Live Confident'.

Working as a collective board

At the year-end, the board comprised an independent non-executive chairman, five independent non-executive directors and two executive directors (following the resignation of Steve Treloar on 28 December 2017) who collectively 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. As members of a unitary board, the non-executive directors meet, without the executive directors present, to constructively challenge and help develop proposals on strategy.

Changes to board composition

There have been a number changes at board level during the year under review:

Alan Cook joined the Society's board on 1 January 2017 as a non-executive director and chairman designate. Following a member vote at the AGM, Alan became chairman of the board in June 2017, replacing **Mark Austen** who had served four years as chairman and ten years on the board. Alan has extensive financial services experience across insurance, banking and investment.

Andy Parsons joined the Society in June 2017 as a board member and group finance director following the departure of **Philip Moore**. Andy has over 25 years' industry experience.

After six years, **Cath Keers** resigned from the board in July 2017. The board welcomed **Colin Ledlie** as a new non-executive director in August 2017. Colin has also joined the Audit, Risk and With-profits Committees.

Steve Treloar, who joined the Society in May 2016 as an LVFS board member, resigned from the board in December 2017 following the sale of a 49% stake in the general insurance business to Allianz. He remained on the board of Liverpool Victoria General Insurance Group Limited as chief executive.

In 2018 the board was pleased to welcome two new non-executive directors; **Alison Hutchinson** and **Luke Savage**. Alison joined the board on 1 January 2018 and has a strong background in financial services as well as IT, digital marketing and cyber security. Luke joined the board on 1 February 2018 and was most recently group chief financial officer at Standard Life and prior to that finance director at Lloyds of London for ten years.

The Board

Back row L to R

David Barral

David Neave

James Dean

Andy Parsons

Front row L to R

Colin Ledlie

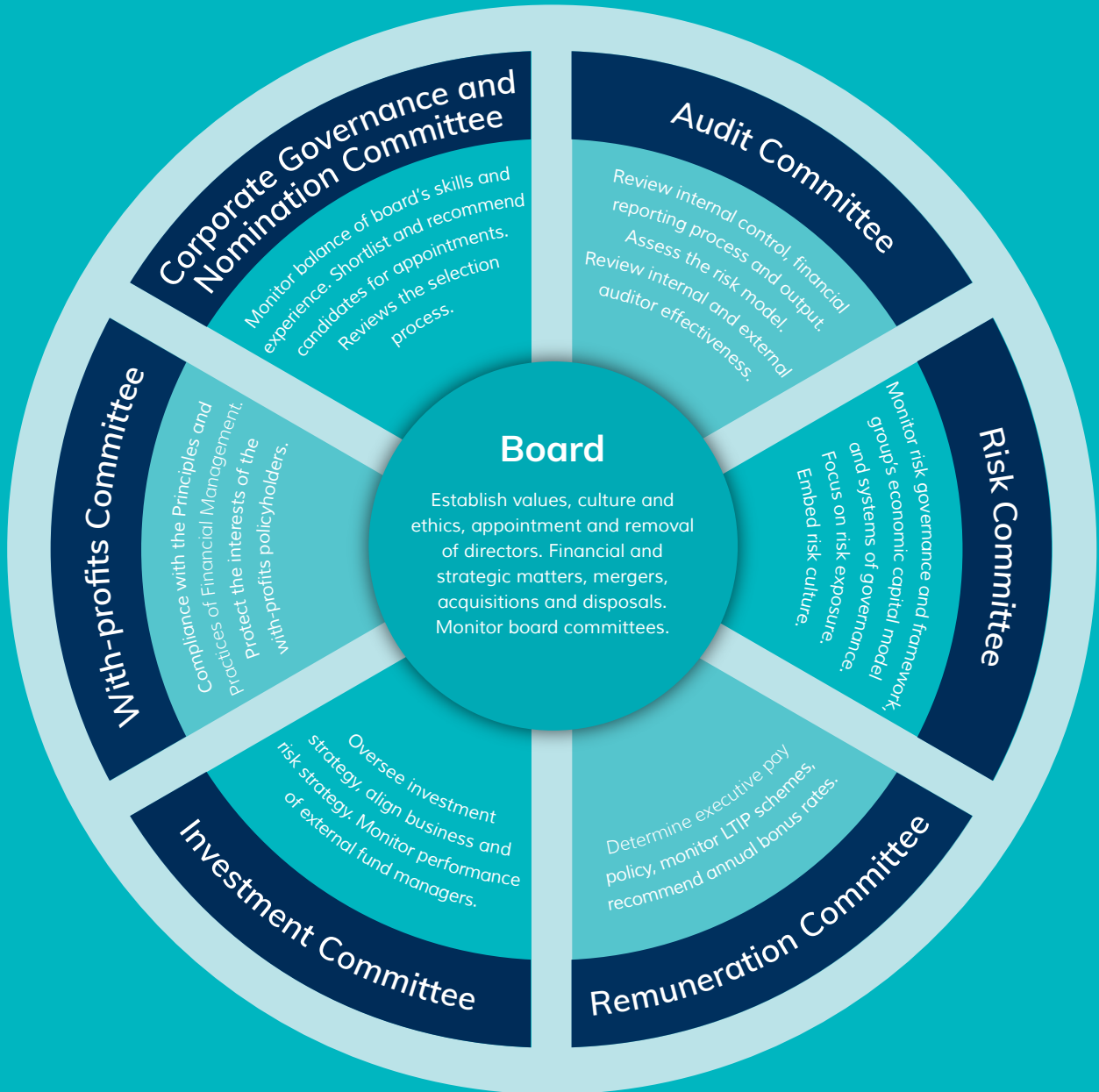
Caroline Burton

Alan Cook

Richard Rowney



Terms of reference for the board and its committees



Our risk management

Overall objectives

The LV= board is responsible for determining and controlling the nature and extent of the principal risks which the group faces, including those that would threaten its business model, future performance, solvency and/or liquidity positions. Board members discharge their duties in this respect through the monitoring of robust enterprise wide risk management and internal controls frameworks which cover the full range of risks to which LV= is exposed. These are supported by a suite of clear risk principles, policies and standards which are maintained and managed by experienced risk specialists under a three lines of defence model.

On behalf of the board, the Risk Committee regularly monitors the operation and effectiveness of such risk management and internal control systems which then enables the board and all LV= employees to make better informed business decisions that generate value for our members, whilst ensuring good customer outcomes and confidence for our stakeholders.

External environment

The wider external environment proved to be challenging during 2017. We continued to operate under a heightened level of uncertainty with political, financial and regulatory risks being the predominant themes over the year, exacerbated by the level of uncertainty around the outcome of the Brexit negotiations.

In March 2017 the UK government reduced the Ogden discount rate from 2.5% to -0.75%, which required the whole motor insurance industry to materially increase reserves held against future lump-sum personal injury claims. In September 2017 a government review into how the discount rate is set concluded that a revised methodology should be legislated for. We have welcomed the Government's recent publication of their Civil Liability Bill which seeks to address this, with an expectation that the planned outcome is a partial reversal of the previous reduction. However, there are a number of factors influencing this potential change meaning that its impact and timing remain uncertain.

There is also considerable uncertainty over the extent to which improvements in life expectancy experienced over the last 40 years will continue into the future. Indeed, despite continued medical advances, emerging lifestyle changes may begin to slow or even reverse this trend. We continue to monitor our own experience carefully and analyse external population data to identify emerging trends.

We expect the overall heightened level of uncertainty to continue throughout 2018 and will continue to operate a prudent investment philosophy with a clear focus on strong risk management. The sale of a 49% stake in our general insurance business for £500 million to Allianz at the end of 2017 has also established a strong solvency and liquidity base for the group which is able to withstand a wide range of potential stress conditions.

Our approach to risk management

The effective management of our risks is a fundamental building block which supports the delivery of our strategy, protects the value that we create for our members and helps us to identify opportunities where we can make the best use of our capital.

Our risk management practices are continually evolving in order to embrace industry practice; however our approach continues to revolve around the following key components:

- **A risk culture and governance structure** which facilitates and enables robust challenge and oversight and encourages all LV= employees to actively engage in risk management.
- **A risk appetite framework** which sets out the type and amount of risk the group is able and willing to accept.
- **An Enterprise Risk Management Framework (ERMF)** that sets out the principles, policies, minimum standards and operations for risk management across the group.
- **The Own Risk and Solvency Assessment (ORSA)** which is an ongoing process by which the board assesses the current and projected risk and solvency position of the group and its regulated entities.
- **A risk and control assessment process** which is used to identify, assess, control and report our risks in accordance with the risk appetite and ERMF.
- **Stress and scenario testing** which considers a range of severe yet plausible and reverse stress scenarios which are designed to challenge the continued financial and operational resilience of the group on a forward looking basis.

Our principal risks and uncertainties

LV= has defined three (increasingly granular) levels of principal risk categories (levels 1, 2 and 3) which represent a documented and agreed common risk taxonomy that is understood by the board and promotes consistency and comparability of reporting across the group. This risk categorisation framework is reviewed and approved annually by the Audit Committee and is supported by the principal risk ownership framework which provides clarity over risk accountabilities and improves the understanding between those who identify, model and make risk-based decisions. Together these frameworks also encourage easier and clearer aggregation of risks and capital by risk type.

Level 1 principal risks are all owned by the chief executive and represent the highest category of risks which are faced by the group, covering the following areas:

(Level 1) principal risk category	Principal risk description
Financial markets risk	Adverse movement in asset values, asset income, interest rates or inflation.
Life insurance risk	Life insurance experience is different to current best-estimate assumptions.
General insurance risk	General insurance experience is different to current best-estimate assumptions.
Credit counterparty risk	A counterparty defaults on its obligations or fails to meet them in a timely fashion.
Operational risk	Loss resulting from inadequate or failed internal processes, people and systems or from external events.
Liquidity risk	The risk that the group and/or its subsidiaries, though solvent, either do not have sufficient financial resources available to meet their obligations when they fall due, or can secure them only at excessive cost.
Group risk	The risk arising from the membership of the group, including potential conflicts of strategy, competition for financial resources from other businesses and the reputational impact from the activities of other parts of the group.
Strategic risk	Risks which can be quantified and understood, and which would have a major impact on the group's business model.

The group's principal risk categories are expected to remain relatively stable over time. Within the boundaries of this risk framework, and by using our risk and control assessment methodology, senior management will continually assess the more dynamic day-to-day risks faced by the business, from both a first and second line perspective. Aggregated, the most material of these are known as our top risks and are tracked monthly by senior management and by the board.

Summary of material changes over the reporting period

The two main material changes which had a significant impact on the group's capital position were:

- 1 General insurance business transaction – increase in surplus capital of £444 million.
- 2 OB pensions reinsurance arrangement – increase in surplus capital of £108 million, before TMTP recalculation

General insurance business transaction

A long-term transaction has been entered into with Allianz Holdings PLC that will ultimately result in Allianz owning a majority stake in the general insurance business. On 28 December 2017 LV= sold a 49% equity stake to Allianz. As part of the transaction the general insurance business exchanged for consideration the renewal rights on its commercial lines business for those on Allianz Insurance PLC's personal lines business. As part of the overall transaction there is a fixed price forward contract for £213 million regarding a further 20.9% equity stake and a fixed price put option for £520 million regarding the full remaining 51% stake that results in transfer of control to Allianz on or before 31 December 2019.

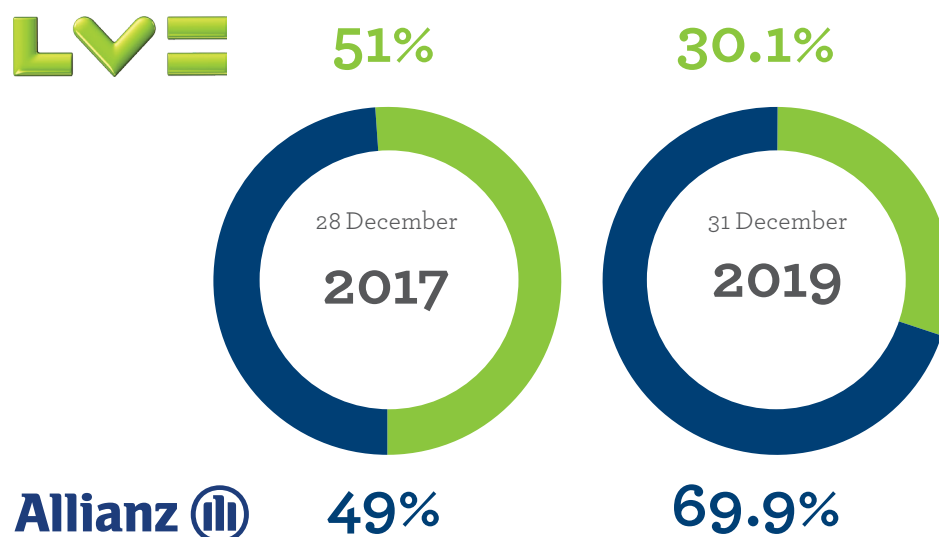
A gain of £35 million related to the general insurance transaction is recognised within PBT. This relates to the sale of the commercial lines renewal rights from Liverpool Victoria General Insurance Group (LVGIG) to Allianz and the costs associated with the overall transaction. The £124 million gain on sale of the 49% equity stake in LVGIG Ltd is recognised directly in the IFRS surplus (UDS) as a transaction with owners that does not result in a loss of control.

Overall the IFRS surplus (UDS) increased by £159 million as a result of the transaction in 2017 comprising:

- £124 million gain on sale of 49% equity stake in LVGIG Ltd, recognised directly in IFRS surplus (UDS)
- £52 million profit relating to the sale of commercial lines renewal rights
- £17 million transaction and related restructuring costs

The transaction with Allianz will allow LV= to continue to benefit from a growing personal lines general insurance business, while also enabling us to strengthen our capital position, leaving us well placed to continue to expand our life and pensions business and pursue new digital opportunities. The general insurance business will benefit from LV='s excellent brand and reputation in personal insurance and Allianz's financial strength and digital expertise, and a shared passion for customer service.

Ownership of the general insurance business



OB pensions reinsurance arrangement

In December 2017, the group reinsured a large portfolio of heritage deferred and immediate with-profits annuity policies (OB pensions), with RGA, a leading global life reinsurer. The agreement covers specified levels of benefits, thereby significantly reducing the level of market and longevity risk associated with the portfolio, and was executed at a price that was lower than the best estimate value of the liabilities. The group retains certain risks associated with the portfolio, primarily those related to expenses, discretionary benefits, changes to the policyholder take-up rate of the cash commutation option and some retained longevity risk.

Statements

The following sections of the Single Group SFCR make up the main body and appendices of the report. These sections are aimed at analysts and investors. Some of the information in these sections is technical and the content is prescribed by Solvency II regulations.

Statement of directors' responsibilities

Financial period ended 31 December 2017

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 14 June 2018 and signed on its behalf by:



.....
A M Parsons
Group Finance Director

14 June 2018

Liverpool Victoria Friendly Society Limited
County Gates
Bournemouth
BH1 2NF

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 2017:

- 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 2017, ('**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.17.01.02, 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, Liverpool Victoria Insurance Company Limited, Highway Insurance Company Limited, LV Protection Limited, Liverpool Victoria Life Company Limited and Teachers Assurance 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 templates S.05.01.02 and S.05.02.01 and Company templates S.05.01.02, S.05.02.01 and S.19.01.21;
- 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**');

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 2017 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Basis for opinion

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

Conclusions relating to going concern

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

- the directors' use of the going concern basis of accounting in the preparation of the Single Group-Wide Solvency and Financial Condition Report is not appropriate; or
- the directors have not disclosed in the Single Group-Wide Solvency and Financial Condition Report any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Single Group-Wide Solvency and Financial Condition Report is authorised for issue.

Emphasis of Matter - Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and 'Capital management' 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.

Other Information

The Directors are responsible for the Other Information.

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

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

Responsibilities of Directors for the 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 and determinations 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 Liverpool Victoria Friendly Society 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 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.

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Single Group-Wide Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the Single Group-Wide Solvency and Financial Condition Report.

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

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

Report on Other Legal and Regulatory Requirements

Other Information

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

The engagement partner on the audit resulting in this independent auditors' report is Andrew Hill.

A handwritten signature in blue ink, appearing to read "Andrew Hill" followed by the initials "UP".

PricewaterhouseCoopers LLP

Chartered Accountants

London

14 June 2018

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

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

- The following elements of Group template S.22.01.22
 - Column C0030 – Impact of transitional on technical provisions
- The following elements of Company template S.12.01.02
 - Rows R0110 to R0130 – Amount of transitional measure on technical provisions
- The following elements of Company template S.17.01.02
 - Rows R0290 to R0310 – Amount of transitional measure on technical provisions
- The following elements of Company template S.22.01.21
 - Column C0030 – Impact of transitional on technical provisions
- Elements of the Narrative Disclosures subject to audit identified as ‘unaudited’.

LV= GROUP SFCR

A. Business and Performance (LV Group)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Friendly Society Limited (LVFS) 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 details of the supervisory authorities responsible for financial supervision.

The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) are responsible for the financial supervision of the company, and the Group.

PRA

Address: 20 Moorgate
London
EC2R 6DA
Phone: 020 7601 4444

FCA

Address: 25 The North Colonnade
Canary Wharf
London
E14 5HS
Phone: 020 7066 1000

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 31 December 2017 are as follows:

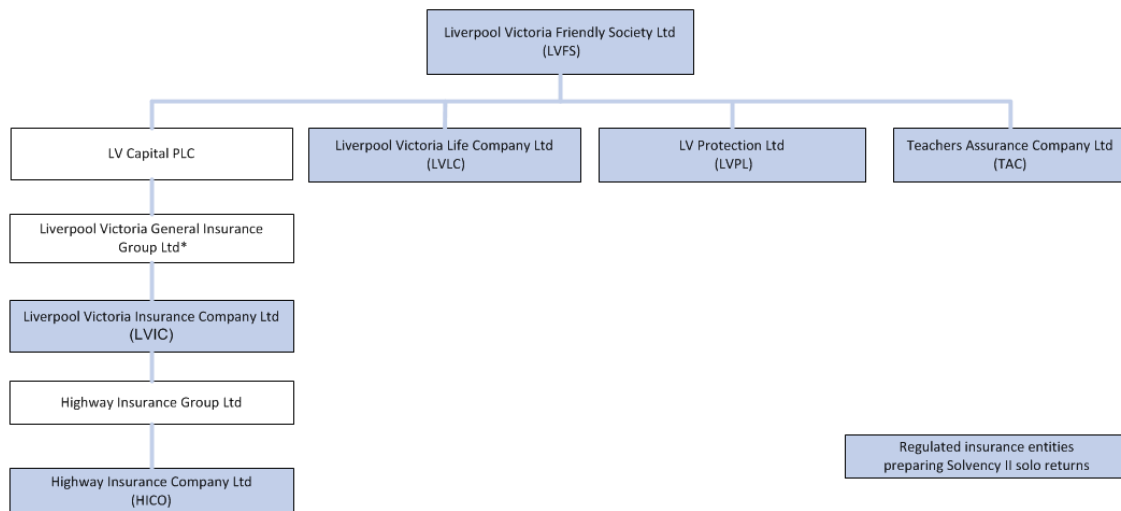
Name of Subsidiary	Principal activity	Percentage held
Frizzell Financial Services Limited	Property management	100%
Liverpool Victoria Financial Advice Services Limited	Financial advice services	100%
Liverpool Victoria Life Company Limited #	Life insurance	100%
LV Protection Limited #	Insurance	100%
LV Capital PLC	Holding company	100%
LV Equity Release Limited	Equity release lifetime mortgages	100%
LV Life Services Limited	Management services	100%
LV Commercial Mortgages Limited	Commercial mortgages	100%
NM Pensions Trustees Limited	Self-invested personal pension (SIPP)	100%
Teachers Property Limited	Property services	100%
Teachers Financial Services Limited	Insurance and financial intermediary	100%
Teachers Assurance Company Limited #	General insurance	100%
Teachers Management Services Limited	Management services	100%
Sovereign Unit Trust Managers Limited	Portfolio manager	100%
Liverpool Victoria General Insurance Group Limited *	General insurance holding company	51%
Liverpool Victoria Insurance Company Limited * #	General insurance	51%
Highway Insurance Company Limited * #	General insurance	51%
LV Repair Services Limited *	Repair Services	51%
LV Assistance Services Limited *	Road Rescue - Pay on use	51%
LV Insurance Management Limited*	Management services	51%
Highway Insurance Group Ltd *	General insurance holding company	51%
Wealth Wizards Limited	IT Software	70%
Wealth Wizards Benefit Limited *	Financial intermediary	70%
Wealth Wizards Advisers Limited *	Financial intermediary	70%

* 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 are 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, which is annexed to this SFCR.

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:



*49% owned by Allianz

The group prepares its financial statements on an IFRS basis and 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 conducts life and non-life business, under the Life and General Insurance operating segments, 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.

Life

The principal activity of the Life operating segment is the provision of Protection and Retirement Solutions products and managing the Heritage products. The core products offered in Protection are Life, Critical Illness and Income Protection Insurance. The core products offered in Retirement Solutions are Fixed-Term Annuities, Self-Invested Personal Pensions (SIPPs), Equity Release Mortgages and Flexible Guarantee Bonds. Heritage products include legacy with-profits business (both Ordinary Branch and Industrial Branch), the ring-fenced RNPFN Fund, containing the business acquired from the Royal National Pension Fund for Nurses in 2001, and the ring-fenced TA Fund, containing the with-profits business acquired from Teachers Provident Society Limited in 2016. The Heritage products are no longer actively marketed, although the Society continues to sell newer with-profits products via the Life business channels.

General Insurance

The non-life segment 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, Specialist Car, Fleet, Motorcycle and Commercial Vehicles. The Group also underwrites Road Rescue, Pet and Travel Insurance. During 2017, the Group ceased writing broker home business.

During 2017, the Group entered into a transaction whereby a majority stake in Liverpool Victoria General Insurance Group Limited (LVGIG) is to be sold to Allianz Holdings plc (Allianz) in two stages based on an agreed valuation for 100% of LVGIG of £1.020bn. The first stage was completed on 28 December 2017 with a minority interest of 49% sold. The second stage will complete by 31 December 2019 following settlement of a forward contract for an additional 20.9% stake. The Group also has a Put Option to sell its remaining interest in LVGIG to Allianz for an agreed price. Allianz is not able to enact the second stage of the transaction any earlier than 31 December 2019.

As part of the transaction, the LV Group and Allianz entered into two renewal rights agreements whereby, as at 28 December 2017, the Commercial broker lines business of the LVGIG Group was transferred to Allianz by way of a transfer of renewal rights in exchange for consideration received of £52m and the Personal lines business of Allianz Insurance plc was transferred to the LVGIG Group also by way of a transfer of renewal rights in exchange for consideration paid of £1m.

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

Business Performance

All income statement numbers presented in this section are based on the IFRS Financial Statements.

LV= Group P&L (£m)	2017	2016
General insurance	121	(26)
Life	37	13
Central items and other	-	1
Operating profit/(loss)	158	(12)
Centrally managed costs	(33)	(27)
Short-term investment fluctuations and related items	37	14
Change in long-term contract liabilities economic basis	(48)	-
Finance costs	(24)	(24)
Impact of general insurance transaction	35	-
Gain arising on Teachers acquisition	-	3
Amortisation of acquired intangibles	(3)	(3)
Profit/(loss) before tax	122	(49)
Mutual bonus	(26)	(17)
Income tax expense	(50)	(35)
Non-controlling interest	2	-
Pension scheme actuarial gain/(loss) net of tax	19	(2)
Sale of stake in general insurance business taken directly to UDS	124	-
Transfer to/(from) Unallocated divisible surplus (UDS)	191	(103)

Operating profit

The Group has delivered an operating profit of £158m (2016: £12m loss), with strong results from its General Insurance business and an improved Life business result.

The General Insurance business operating profit of £121m is made up of underwriting profits of £103m (2016: £70m pre-Ogden impact, £69m loss post-Ogden impact) and investment returns of £18m (2016: £43m). The significantly improved underwriting result is after a strengthening of £31m in the reserve margins.

The improved Life business operating profit of £37m reflects an increase in new business contribution to £37m (2016: £31m), with continued positive contributions generated by Flexible Guarantee Bond and Protection products and an improvement in volumes and margins in Pensions. A £26m positive impact from model and basis changes has been largely offset by £19m of adverse experience variances.

Profit before tax

Profit before tax of £122m is a significant improvement over the prior year loss before tax of £49m, which included a £139m adverse impact from the Ogden rate change. Current year profit before tax is favourably impacted by growth in operating profit, the £35m benefit of the general insurance transaction on profit before tax and £37m favourable short-term investment fluctuations (2016: £14m). Items adversely impacting profit before tax include a £48m increase in reserves following a life reserving reporting basis change, £24m interest on the subordinated debt (2016: £24m) and £33m of centrally managed costs (2016: £27m) which include costs related to the strategic cost reduction programme, Solvency II costs and strategic spend on capital optimisation initiatives.

IFRS Surplus (UDS) generation

During 2017, £191m was transferred to the Unallocated divisible surplus (UDS). This includes the £124m gain on sale of the 49% equity stake in LVGIG to Allianz, which was recognised directly in the UDS as a transaction with owners that does not result in a loss of control. A mutual bonus of £26m was allocated to eligible members' policies in respect of the year.

For further information on the results, please refer to the Report and Accounts.

Capital position and changes in risk profile

At 31 December 2017 the Group capital surplus on a standard formula basis was £698m (2016: £367m) with capital cover of 171% (2016: 135%), see table below for further details. The results shown below include the closed ring-fenced funds. The closed ring-fenced funds did not require capital support at the valuation date.

£m	2017	2016	Change
Own funds	1,676	1,411	265
SCR	978	1,044	(66)
Surplus capital	698	367	331
CCR	171%	135%	36%

The Group's risk profile and capital position was materially affected in the year by the following actions:

- Ordinary Branch (OB) Pensions Reinsurance (increase in surplus capital of £108m, before TMTP recalculation)
 - OB Pensions is a portfolio of with-profits deferred and in-payment annuities with onerous guarantees, where the majority of policies are still in their deferment phase. It attracted high levels of standard formula SCR capital due to the long-dated longevity risk and the optionality the policyholder has at retirement to take cash, rather than the annuity benefit. The risk margin associated with OB Pensions is also very material and sensitive to changes in interest rates.
 - On 2 December 2017, Liverpool Victoria Friendly Society Limited (LVFS) reinsured the majority of its OB Pensions deferred and in-payment annuities with Reinsurance Group of America (RGA). The transaction took the form of a funded longevity risk transfer and resulted in a reduction in the Group's exposure to post-vesting longevity risk with LVFS retaining the pre-vesting mortality and lapse risks, in particular the risk that fewer than expected policyholders take up the cash option as opposed to the guaranteed annuity. The transaction also reduced the gilt-swap spread risk that the Group is exposed to.
 - The day one impact of the transaction was mostly due to the impact on Own funds, which included a reduction in the Risk Margin. There was also a small reduction in the Society's post-diversified SCR, mostly due to the reduction in longevity risk offset by an increase in counterparty default risk. This is before recalculating TMTP.
- Sale of 49% stake in General Insurance business (increase in surplus capital of £444m)
 - On 28 December 2017, the Group sold a 49% stake in LVGIG Ltd (sold through its LV Capital PLC subsidiary) to Allianz. This generated proceeds of £500m for the Group, which were retained within LV Capital PLC. However, because the Group maintains a controlling interest in the business, the Solvency II Standard Formula presentation shows no reduction in the non-life underwriting risk SCR because the minority interest deduction is applied to the Own Funds only.
 - In addition, renewal rights on its general insurance commercial lines business were also sold to Allianz (sold through its general insurance subsidiaries).
 - The overall impact of the transaction was to increase Group surplus by £444m, primarily due to the increase in Own Funds as a result of the proceeds of the transaction.
- TMTP recalculation and step-down (reduction in surplus capital of £451m)
 - The Society recalculated TMTP as at 31 December 2017 following the OB Pensions reinsurance transaction and to coincide with the PRA's first biennial recalculation requirement. The effect of recalculation was to significantly reduce the level of TMTP, primarily due to changes in economic conditions following the prior recalculation on 31 August 2016.
 - The Society has updated its approach to stepping-down TMTP, with the annual step-down in TMTP occurring on 31 December (previously on 1 January) and allowed for in the year-end results. Therefore, the TMTP at year-end 2017 reflects two step downs in TMTP compared with year-end 2016.
 - The overall impact of TMTP recalculation and step-downs was to reduce TMTP from £910m to £574m, an impact of £336m. The overall reduction in surplus capital of £451m is larger as this includes the impact of the change in the mutual bonus clawback management action, where this was removed from the risk margin, increasing TMTP. The FRR test continues to result in no restriction at the date of TMTP recalculation.
- The closure of derivative positions held in respect of the gilt-spread hedge and swaption collar strategy. This reduced the interest rate risk the Group is exposed to on a post-TMTP recalculation basis, but increased it on a pre-TMTP recalculation basis.

System of Governance

The material changes to the system of governance during the reporting period are as follows:

- A new Liverpool Victoria General Insurance Group (LVGIG) Risk Committee was established;
- A new LVGIG Nomination and Remuneration Committee was established; and
- As a result of the above, the terms of reference and membership of the LVGIG Audit Committee were changed.

The table below summarises the changes in membership of the LVFS Board (the parent company of the Group) in the year:

A Cook appointed 1 January 2017
A Parsons appointed 30 June 2017
C Ledlie appointed 1 August 2017
S Treloar resigned 28 December 2017
P W Moore resigned 29 June 2017
M Austen resigned 20 June 2017
C Keers resigned 20 June 2017

Legal and regulatory environment

The wider external environment proved to be challenging during 2017. The Group continued to operate under a heightened level of uncertainty with political, financial and regulatory risks being the predominant themes over the year, exacerbated by the level of uncertainty around the outcome of the Brexit negotiations.

In March 2017 the UK government reduced the Ogden discount rate from 2.5% to -0.75%, which required the whole motor insurance industry to materially increase reserves held against future lump-sum personal injury claims. In September 2017 a government review into how the discount rate is set concluded that a revised methodology should be legislated for. LV= have welcomed the Government's recent publication of their Civil Liability Bill which seeks to address this, with an expectation that the planned outcome is a partial reversal of the previous reduction. However, there are a number of factors influencing this potential change meaning that its impact and timing remain uncertain.

The overall heightened level of uncertainty is expected to continue throughout 2018 and the Group will continue to operate a prudent investment philosophy with a clear focus on strong risk management.

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:

Segment revenue and expenses

All revenues disclosed in the tables below are external.

Year ended 31 December 2017	General insurance £m	Life £m	Central items and other £m	Total £m
Gross earned premiums	1,604	835	-	2,439
Premiums ceded to reinsurers	(363)	(1,092)	-	(1,455)
Net earned premiums	1,241	(257)	-	984
Investment and other income	121	786	(36)	871
Total segmental income	1,362	529	(36)	1,855
Gross benefits and claims	(1,155)	(872)	-	(2,027)
Claims ceded to reinsurers	298	237	-	535
Net benefits and claims	(857)	(635)	-	(1,492)
Net change in contract liabilities	-	367	-	367
Other expenses	(341)	(202)	(65)	(608)
Total segmental expenses	(1,198)	(470)	(65)	(1,733)
Profit/(loss) before tax, mutual bonus and UDS transfer	164	59	(101)	122

Year ended 31 December 2016	General insurance £m	Life £m	Central items and other £m	Total £m
Gross earned premiums	1,530	1,230	-	2,760
Premiums ceded to reinsurers	(340)	(261)	-	(601)
Net earned premiums	1,190	969	-	2,159
Investment and other income	84	1,427	(33)	1,478
Total segmental income	1,274	2,396	(33)	3,637
Gross benefits and claims	(1,275)	(861)	-	(2,136)
Claims ceded to reinsurers	303	237	-	540
Net benefits and claims	(972)	(624)	-	(1,596)
Net change in contract liabilities	-	(1,488)	(6)	(1,494)
Other expenses	(332)	(220)	(44)	(596)
Total segmental expenses	(1,304)	(2,332)	(50)	(3,686)
(Loss)/profit before tax, mutual bonus and UDS transfer	(30)	64	(83)	(49)

All material lines of business are underwritten in the UK.

Net earned premiums

Group	2017 £m	2016 £m
Gross earned premiums		
Long-term insurance and participating investment contracts		
Single premium		
New business		
Investments and savings	420	561
Pensions and annuities	151	423
Regular premium		
New business		
Life and health protection	37	37
Existing in-force business		
Investments and savings	33	31
Pensions and annuities	9	10
Life and health protection	185	166
General insurance contracts		
Motor	1,081	1,067
Commercial	283	268
Household	143	161
Other	89	83
Change in unearned premiums provision	8	(47)
Gross earned premiums	2,439	2,760
Premiums ceded to reinsurers		
Long-term insurance premiums	(1,092)	(261)
General insurance business	(361)	(345)
Change in unearned premiums provision	(2)	5
	(1,455)	(601)
Net earned premiums	984	2,159

2017 gross earned premiums of £2,439m fell by 12% compared to 2016 predominantly driven by falls in the retirement business, including the cessation of enhanced annuity sales during 2016 and also reduced new business flexible guarantee bond sales. General insurance premiums are broadly in line with 2016. In December 2017 the Group entered into a reinsurance arrangement in respect of the OB Pension portfolio. This has increased premiums ceded to reinsurers by £829m.

Net benefits and claims

Group	2017			2016		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Long-term insurance and participating investment contracts						
Benefits and claims paid	868	(237)	631	858	(237)	621
Change in the provision for claims	4	-	4	3	-	3
General insurance contracts						
Claims paid	1,010	(227)	783	1,000	(217)	783
Claims handling costs	65	-	65	67	-	67
Change in the provision for claims	80	(71)	9	208	(86)	122
	2,027	(535)	1,492	2,136	(540)	1,596

2017 net benefits and claims from long-term insurance and participating investment contracts are broadly in line with 2016. Net benefits and claims for general insurance contracts have reduced to £857m (2016: £972m), driven by the higher change in the provision for claims in 2016 following the Ogden rate announcement.

Net change in contract liabilities

Group	2017 £m	2016 £m
Gross increase in long-term contract liabilities		
Increase in long-term insurance contract liabilities - participating	(191)	(813)
Increase in investment contract liabilities - participating	(51)	(21)
Increase in long-term insurance contract liabilities - non-participating	(117)	(417)
Increase in investment contract liabilities - non-participating	(234)	(303)
Increase in long-term linked insurance contract liabilities	(23)	(54)
	(616)	(1,608)
Mutual bonus	26	17
	(590)	(1,591)
Increase in long-term contract liabilities ceded to reinsurers		
Increase in long-term insurance contract liabilities relating to non-participating contracts	143	47
Increase in long-term insurance contract liabilities relating to participating contracts	857	-
Increase in long-term linked insurance contract liabilities	35	47
	1,035	94
(Decrease)/increase in non-participating value of in-force business	(30)	3
Net change in contract liabilities before change in economic basis	415	(1,494)
Change in economic basis	(48)	-
Net change in contract liabilities	367	(1,494)

The gross increase in long-term contract liabilities has reduced from £1,591m in 2016 to £590m in 2017 driven by the lower levels of policyholders' investment gains, lower levels of new business during 2017 and the one-off impact of the Teachers acquisition in 2016. The net change in contract liabilities was also impacted by the £933m increase in reinsurance in respect of the OB Pension portfolio.

Other operating and administrative expenses

Group	2017 £m	2016 £m
Commission paid on acquisition of business	201	207
Movement in deferred acquisition costs	7	(3)
Amortisation and impairment of intangible assets	13	6
Depreciation on property and equipment	7	6
Loss on disposal of property and equipment	1	-
Investment management expenses and charges	17	21
Auditors' remuneration	2	3
Employee benefits expense	255	263
Internal staff costs capitalised as attributable costs of IT assets	(16)	(15)
Rent, rates and other facilities expense	20	19
Marketing and advertising	27	33
Other staff costs	48	35
IT costs	40	43
Fees	85	79
Other expenses	18	18
Claims handling cost recognised in Gross benefits and claims	(69)	(72)
Gross operating and administrative expenses	656	643
Expenses recoverable from reinsurers	(72)	(72)
Net operating and administrative expenses	584	571

2017 net operating and administrative expenses are broadly in line with 2016 at £584m.

Solvency II lines of business

In addition to the above, the material Solvency II lines of business by reference to IFRS gross written premiums, a component of underwriting performance, are outlined below based on gross written premium analysed within Quantitative Reporting Template (QRT) S.05.01.02, which is annexed to this SFCR.

Life insurance

The Group's long-term business segment includes participating insurance and investment business and non-participating insurance and investment business. The Group's long-term business represents 48% of total gross written premiums. The material life insurance Solvency II lines of business for the year ended 31 December 2017 are as follows, based on contribution to life insurance business gross written premiums:

- Insurance with-profit participation – 31%
- Index-linked and unit-linked insurance – 44%
- Other life insurance – 21%
- Health – 4%

Gross written premiums collected under non-participating investment contracts are deposit accounted rather than accounted for through the income statement under IFRS. Consequently non-participating investment business is not captured within IFRS gross written premiums within QRT S.05.01.02 'Premiums, claims and expenses by line of business'.

Non-life insurance

The Group's general insurance business represents 52% of total gross written premiums. The material non-life insurance Solvency II lines of business for the year ended 31 December 2017 are as follows, based on contribution to non-life insurance business gross written premiums:

- Motor vehicle liability insurance – 58%
- Other motor insurance – 19%
- Fire and other damage to property insurance – 15%
- Assistance – 4%
- General liability insurance – 2%
- Legal expenses insurance – 2%

A.3 Investment performance

a) Income and expenses with respect to investment activities

Components of investment activities

Investment income is 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 of £17m (2016: £21m) are reported in Other operating and administrative expenses. These expenses are directly attributable to investment activities.

Investment performance

The following tables summarise the investment performance, on an IFRS basis:

Investment income

Group	2017 £m	2016 £m
Income from investments at fair value through income:		
- Dividend income	117	107
- Interest income from debt and fixed interest securities	210	251
- Interest on loans secured on residential property	36	36
- Interest on loans secured on commercial property	9	7
Interest on loans and receivables	2	-
	374	401

Investment income has reduced to £374m (2016: £401m), driven by the £41m decrease in interest income from debt and fixed interest securities reflecting the fall in yields during the year.

Net gains on investments

Group	2017 £m	2016 £m
Investment properties	3	-
Investments at fair value through income:		
- Debt securities	(28)	385
- Equity securities	430	584
- Derivatives at fair value through income	(52)	(40)
- Loans and mortgages	4	77
- Other	3	-
	360	1,006

Net gains on investments of £360m are driven by the gains in equity securities as markets continued to rise in 2017. The higher net gains on investments in 2016 reflected the impact of a more pronounced fall in yields, driving increases in the value of debt securities, and a strong increase in UK equity markets.

b) Gains and losses recognised directly in equity

The Group has entered into a transaction whereby a majority stake in LVGIG is sold to Allianz in two stages based on an agreed valuation of 100% of LVGIG of £1.020bn. The first stage was completed on 28 December 2017 with a minority interest of 49% sold; the second stage will complete by 31 December 2019 following settlement of the forward contract for an additional 20.9% unless the Group exercises its Put Option over its remaining shareholding earlier. Allianz is not able to enact the second stage of the transaction any earlier than 31 December 2019.

At 31 December 2017 the Group has retained control of LVGIG and continues to consolidate these subsidiaries. The Group will reassess whether it retains control on an ongoing basis if facts and circumstances change. A non-controlling interest has been recognised as a liability in the Statement of Financial Position. The sale of the 49% non-controlling interest is reported directly within the Unallocated divisible surplus as a transaction with owners that does not result in a loss of control.

Sale and purchase agreement

The following table summarises the transaction at first completion:

	£m
Sales proceeds received for 49% stake	500
Less: 49% of net asset value of LVGIG Group (Non-controlling interest)	(376)
Gain on sale of non-controlling interest in LVGIG taken directly to UDS	124

c) Information about any investments in securitisation

There are no investments in securitisation (2016: £8m).

A.4 Performance of other activities

The results of other activities are as follows:

Finance costs

Group	2017	2016
	£m	£m
Interest expense on subordinated liabilities	23	23
Other interest expense	1	1
	24	24

In 2013 the Society issued £350m of Fixed Rate Reset Subordinated Notes at par. The directly related costs of £4m incurred to issue the Notes have been capitalised as part of the carrying value and are being amortised using the effective interest rate basis over the period to the first call date in 2023. The effective interest rate on the £350m liability is 6.654% resulting in a £23m finance charge for the year.

The Notes have a maturity date of 22 May 2043 but the issuer 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% (£23m) 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.

Other income

Group	2017	2016
	£m	£m
Interest income	32	30
Unit linked income	-	1
Fee and commission income	26	21
Other income	27	16
	85	68

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. In addition there is credit hire income received.

Leasing arrangements

Finance lease commitments

Finance lease commitments with a present value of £19m (2016: £20m) relate to a property with a remaining lease term of 23 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.

Operating lease commitments

Operating lease commitments of £14m (2016: £19m) relate to leases for various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

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 organisation 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 describes how this works in detail.

Unless otherwise stated, the risk management and internal control systems described in this section are implemented consistently across the Group.

Adequacy of the governance structure

The Group monitors and assesses its system of governance on an ongoing basis. There have been no significant findings during the reporting period which have indicated to the Board that the system of governance is not adequate. 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 confirmed its compliance with the Code, with the exception of two decisions approved by the Board; to allow Mark Austen (Chairman until June 2017) 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 for the Society and its members.

B.1 General information on the system of governance

Governance structure

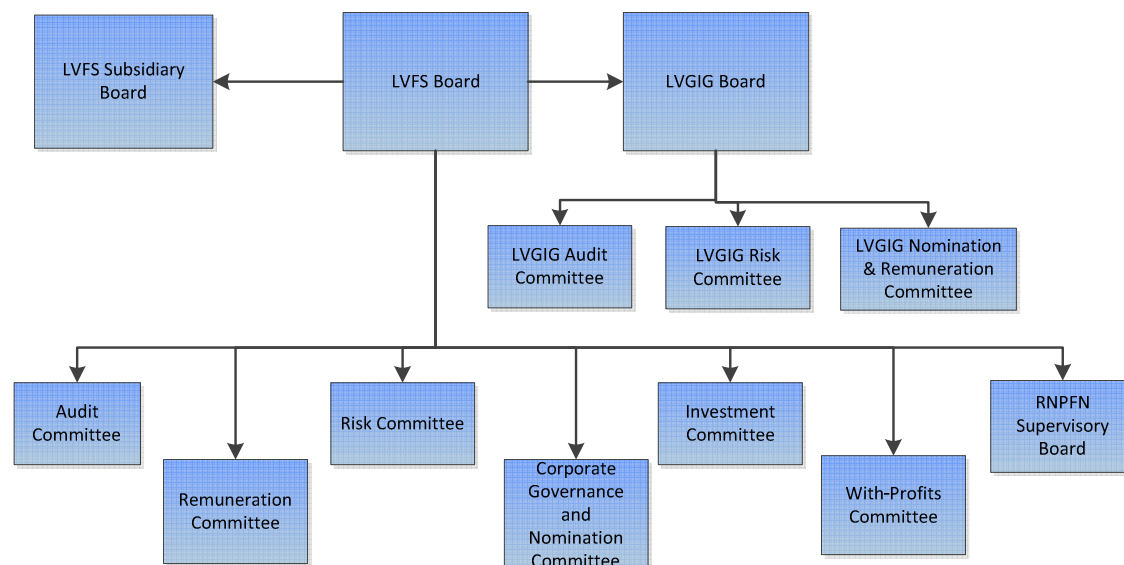
Liverpool Victoria Friendly Society (LVFS) is the ultimate parent undertaking of the Group. The LVFS Board is ultimately accountable to the members (owners) of the Society and exercises stewardship over its subsidiaries through its right to appoint subsidiary Board members and through the reservation 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 two 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 Boards either reserve decision making powers to themselves, or delegate these powers to a Board approved sub-committee or to the Group or GI Chief Executive Officer. A full description of the LVFS Board's role and responsibilities is set out in the Board section of the 2017 Annual Report and Accounts. Material changes to the system of governance during the reporting period are as follows:

- The LVFS Nomination Committee changed its name to the Corporate Governance and Nomination Committee;
- A new Liverpool Victoria General Insurance Group (LVGIG) Risk Committee was established;
- A new LVGIG Nomination and Remuneration Committee was established;
- As a result of the above, the terms of reference and membership of the LVGIG Audit Committee were changed.

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 an LVFS 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:

<p>Risk Management function</p>	<p>Reporting to the Chief Risk Officer, 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.</p> <p>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.</p> <p>A detailed account of all Risk Management activity is provided in section B.3 below.</p>
<p>Compliance function</p>	<p>The Compliance Function reports to the Chief Risk Officer 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.</p> <p>Further details of Compliance Function responsibilities and activities are included within section B.4 below.</p>
<p>Internal Audit function</p>	<p>Internal Audit act as the third line of defence, providing independent and objective assurance to the Group Audit Committee, LVGIG 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.</p> <p>A detailed account of the function's operations and responsibilities is provided in section B.5 below.</p>
<p>Actuarial function</p>	<p>The Actuarial function, which covers both Life and GI business, reports to the Chief Risk Officer. Their key responsibilities include:</p> <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. <p>Further details are provided in section B.6 below.</p>

The Group has a Remuneration Committee consisting of three non-executive directors of the Society, at least two of which shall be independent non-executive directors. Its main responsibilities are to recommend to the LVFS 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 the Group Annual Bonus scheme, the Group operate a balanced scorecard of measures, under which in 2017 financial criteria accounted for 55% of the overall pot, and non-financial measures accounted 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.

The Group 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 2018 awards will be based on a range of financial and non-financial performance measures covering a three year performance period. In determining whether 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 a number of senior managers and executives 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, the balance will be deferred from the annual bonus. Deferred variable remuneration will be deferred over a period of at least 3 years, with clawback and malus provisions applying where appropriate. In addition, the Group conducts an annual review of all Solvency II employee performance, looking at how personal objectives have been achieved through a risk and audit lens. Their findings are presented to the Remuneration Committee for consideration, who may then apply adjustments to individual variable pay as appropriate.

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 75-91 of the 2017 Annual Report and 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, an attestation exercise is conducted across all senior management including key function holders, as part of the 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 LV= Board is responsible for determining and controlling the nature and extent of the principal risks which the Group faces, including those that would threaten its business model, future performance, solvency and/or liquidity positions. Board members discharge their duties in this respect through the monitoring of robust enterprise wide risk management and internal controls frameworks which cover the full range of risks to which LV= is exposed. These are supported by a suite of clear risk principles, policies and standards which are maintained and managed by experienced risk specialists under a three lines of defence model.

On behalf of the LV= Board, the Risk Committee regularly monitors the operation and effectiveness of such risk management and internal control systems which then enables the Board and all LV= employees to make better informed business decisions that generate value for LV= members, whilst ensuring good customer outcomes and confidence to the Group's stakeholders. Similarly the LVGIG Risk Committee monitors the effectiveness of risk management for the LVGIG Board.

Risk Management Framework

The effective management of the Group's risks is a fundamental building block which supports the delivery of the Group's strategy, protects the value created for members and helps to identify opportunities to make the best use of the Group's capital.

The Group's risk management practices are continually evolving in order to embrace industry practice; however the approach continues to revolve around the following key components:

- **A risk culture and governance structure** which facilitates and enables robust challenge and oversight and encourages all LV= employees to actively engage in risk management;
- **A risk appetite framework** which sets out the type and amount of risk the Group is able and willing to accept.
- **An Enterprise Risk Management Framework (ERMF)** which sets out the principles, policies, minimum standards and operations for risk management across the Group;
- **The Own Risk and Solvency Assessment (ORSA)** which is an ongoing regulatory process by which the Board assesses the current and projected risk and solvency position of the Group and its regulated entities;
- **A risk and control assessment process** which is used to identify, assess, control and report risks in accordance with the risk appetite and ERMF;
- **Stress and scenario testing** which considers a range of severe yet plausible and reverse stress scenarios which are designed to challenge the continued financial and operational resilience of the Group on a forward looking basis.

The Group operates an ERMF, which brings together risk management strategies, objectives, processes, and reporting procedures.

The ERMF has been developed by Group Risk Management. It is reviewed at least annually, with changes approved by the Chief Risk Officer and the Risk Committee. The key elements of the framework and its implementation are described further in the sections below.

Risk Culture and Governance Structure

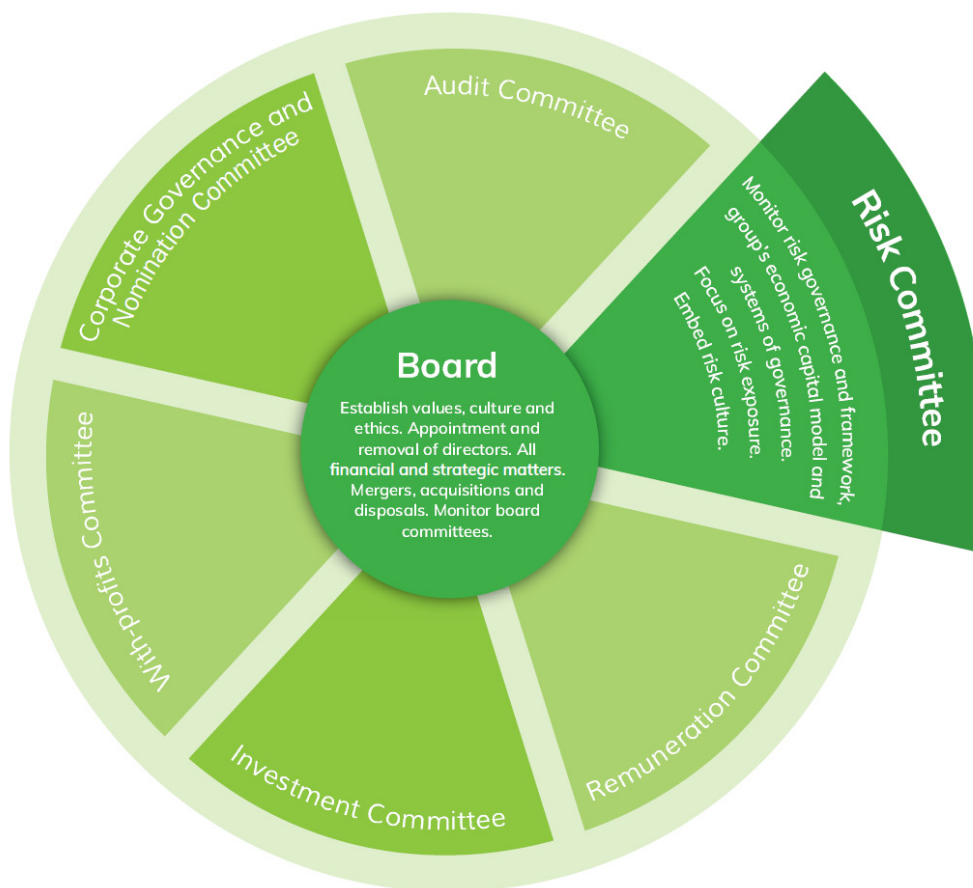
Over a number of years, the Group's risk management approach and engagement with the business has sought to embed a culture of risk ownership and accountability throughout the Group, supported by a robust risk framework and governance infrastructure which delivers the necessary risk management capability. The fundamental building blocks which enable the risk management approach are described below:

Risk culture: The way that the Group employees think and act as individuals and as a business. It encompasses the Group's attitudes, capabilities and behaviours such as "tone from the top", risk transparency, risk competency, and is achieved through rewarding appropriate risk behaviours. This culture drives how the Group identify, understand and openly discuss, and act upon, both current and future risks;

Risk mandate: To support the risk management approach, the Group operate the 'three lines of defence' (3LOD) operating model which maintains a clear distinction between:

- **First line of defence – Run** the business and are accountable for the day-to-day risk taking and management;
- **Second line of defence – Protect** the business and are accountable for advice, oversight and challenge;
- **Third line of defence – Reassure** the business and are accountable for providing independent assurance.

Risk governance: The Group’s risk governance framework operates through Group-wide risk policies and business standards which are aligned to a formal committee governance structure incorporating clearly defined roles, responsibilities and delegated authorities. The diagram below outlines the current risk committee governance arrangements:



The Board is able to discharge its responsibilities with respect to risk governance, mandate and culture through the operation of the Risk Committee. This body makes recommendations to the Board in respect of leadership, direction and oversight of the Group’s risks appetite, risk tolerance and risk management frameworks. In doing so, it plays a key role in delivering effective risk oversight as well as being responsible for review and challenge of the Group’s regulatory and internal control policies and procedures and its compliance monitoring plan.

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.

Group Risk Management 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.

Risk appetite framework

The value of the business comprises the net value of the assets and liabilities (balance sheet value) plus its brand and reputation (franchise value). The Group’s risk appetite framework has therefore been developed to focus on safeguarding these value drivers and the Board regularly reviews its appetite for risk within this context. During 2017 the Group operated within five Board-approved risk appetite dimensions each supported by a qualitative risk appetite statement, as outlined in the table below:

Risk appetite dimension	Risk appetite statement
Financial strength	LV= will hold a level of capital surplus ¹ that is equivalent to being assessed as an S&P 'A' rated firm.
Solvency strength	LV= 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	LV= will hold sufficient liquid capital resources to ensure it can meet its liquidity requirements in stressed circumstances.
Reputation and capability	LV= 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	LV= 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.

These risk appetite statements are designed to set out the risks that the Board believe that the Group are capable of managing in order to generate a return; the risks that the Group can support but which are shared with third parties; and the risks the Group seek to avoid or minimise.

Each risk appetite statement is supported by risk limits (or tolerances) and triggers which provide a suite of early warning indicators for when risks start to deteriorate, allowing timely actions to be initiated.

The management of risk against risk appetite is brought to life and embedded across the organisation through the application of risk principles, policies and standards which are laid out within the ERMF.

¹ Note: the Risk Committee, alongside the Audit Committee, considered the Group's application to use an internal model for assessing its regulatory capital requirements. In light of the changes to the risk profile that would be introduced by the transactions with Allianz and RGA at the end of the year, a recommendation was made to the Board not to proceed with the application and to continue using the Standard Formula method.

Enterprise Risk Management Framework

The Group’s ERMF is designed to enable and support the safe delivery of the Group’s strategy and business objectives within risk appetite. It comprises a suite of documented governance, internal control and risk management principles and policies with clear lines of accountability around principal risk ownership, attestation and control. The ERMF is made up of the following elements:



Risk principles: Fundamental values and statements representing the Group’s approach to consideration of risk. The principles ultimately support the safe delivery of the strategy and plan (e.g. Board statements on risk preferences and aversions);

Risk Management policies: Clear requirements and rules which have been designed to ensure that the risk principles are appropriately delivered. They establish a framework within which the Board’s requirements for risk management are delivered and executed (e.g. risk appetite limits and risk capital constraints);

Minimum risk standards: The minimum requirements within which the business must operate in order to demonstrate the development and management of the Group’s risk-taking activity in line with the risk principles and policies (e.g. calculation methodologies and reporting requirements);

Operations: The core functions of the Group which ensure that the business is managed and monitored within agreed boundaries. These comprise of activities and processes which are owned by the business in order to monitor and manage the underlying risks.

The Board and senior management seek and obtain confirmation over the appropriateness and effectiveness of the ERMF design, execution and monitoring through a process of attestation. This process takes place on an on-going basis with regular oversight and review as part of the operation of the three lines of defence.

The overall system of governance and ERMF is owned and maintained by the Chief Risk Officer on behalf of the Board, with accountability for the definition, design, monitoring and maintenance of any associated risk sub-frameworks clearly described within the Group Risk Management organisational design. It also provides both the context and architecture for the Group’s risk and control assessment process.

Own Risk & Solvency Assessment (ORSA)

The Group's ORSA further embeds effective risk management into all areas of the business. As shown in the following diagram, it captures a number of activities such as the regular identification and review of LV's risks and the current and future assessment of the solvency and liquidity position of the Group.



The ORSA is not a one-off process. Individual activities take place throughout the year, with outputs providing a forward looking assessment of the risk and capital position of the Group, included within regular management information.

Formal ORSA reporting takes place on an annual basis (with quarterly updates presented to the risk committee to keep the Board apprised of the Group's evolving risk profile and risk management initiatives).

The annual ORSA report is produced for the Board and represents a key part of the strategic planning cycle informing the Board's assessment of Group strategy, sustainability and ongoing viability.

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.

Risk and control assessment process

The risk and control assessment process is made up of four key stages which are set out within the figure below. Each step comprises a number of established sub-processes within LVFS, as determined by the ERMF and generates a suite of risk registers plus associated action plans (where necessary):



Identify - To identify and categorise risks in accordance with the Group's risk taxonomy;

Assess - To quantify the materiality of each risk against a suite of financial and non-financial measures and in accordance with risk appetite;

Control - To identify and/or design and implement controls to mitigate each material risk; and

Report - To regularly monitor and report upon the effectiveness of controls in mitigating material risk exposures and where necessary escalate control failures and put in place remedial measures. 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.

Breaches are escalated to Group governance committees if appropriate. Where appropriate, risks are quantified in terms of capital. At least quarterly, Group Risk Management 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.

This process happens throughout the year across all areas of the business, with support provided by Group Risk Management. Outputs are captured on a centralised risk management system and are presented quarterly to the relevant executive risk committees, with overall monitoring and oversight exercised by the Risk Committee.

In accordance with the ERMF, the risk and control assessment process has been designed to bring to life the linkages between the Group's overarching internal control framework and the associated risk categorisation, principal risk ownership and risk appetite frameworks. It is also designed to identify risks before they materialise. This allows time to engage with the risk, understand it and respond accordingly. The emerging risk process is then used to inform the stress testing and capital adequacy assessments across the Group as part of the ORSA.

Stress and scenario testing

As part of the regular ORSA activities, financial risk modelling is used to assess the amount of each risk type against its risk appetite. This modelling is aligned to the Group's capital metrics to allow the Board to understand the capital requirements and key drivers associated with the principal risks.

Stress tests are performed to assess the capital resilience of the Group under a range of severe but plausible scenarios covering areas such as: general macro-economic downturn, stresses to the business model (both pre and post the Allianz transaction), emerging regulatory impacts, sector-specific and company-specific risks, risk concentrations and emerging competitor and customer challenges.

These tests allow the Board to review and challenge the strategic plan and risk management strategy on a forward looking basis. This includes an assessment of the impact and effectiveness of mitigating management actions designed to maintain or restore capital, liquidity and solvency to within risk appetite.

The de-risking of the balance sheet, described in Section A.1, has helped to reduce the Group's sensitivity to certain stress scenarios. In the scenarios tested during 2017, sufficient actions were available to management to maintain the viability of the Group over the three year period of assessment.

In addition, reverse stress tests which determine particular points of failure not only confirm the Group's ongoing resilience to extreme events, but are also used to inform the setting of the capital risk appetite buffers (over and above the regulatory capital requirement) in order to protect the Group against future shocks and stresses. For 2017, reverse stress scenarios have included a major disruption to the general insurance business; a material increase in longevity and further significant volatility in financial markets.

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. Section B3 sets out the key risk management elements of this internal control system.

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.

Group compliance

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 Chief Risk Officer:

- Director of Compliance – whose primary responsibilities relate to advising on conduct risk compliance and oversight of non-prudential regulatory change²; and
- Life and General insurance Chief Actuaries – who are responsible for advising the Chief Risk Officer and the Director of Compliance on compliance with actuarial matters, including the impact of regulatory change on actuarial activities.

The Group Compliance team 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 Chief Risk Officer 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:

² The Chief Risk Officer retains accountability for advising the business on compliance with prudential risk matters, including the impact of prudential regulatory change on the Group's risk profile.

- 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 is 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 and LVGIG Audit Committees through the Audit Committees' 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 the Audit Committees 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 Boards 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 the 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 Chartered Institute of Internal Auditors (including the CIAA 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 Group and LVGIG Audit Committees 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 Group and LVGIG Audit Committees in meeting their statutory and regulatory reporting responsibilities.

The Internal Audit Director has a direct reporting line to the Chairman of the Group and LVGIG Audit Committees and Group Chief Executive, and also has unrestricted access to the Chairman of the Boards. The Chairman of the Group Audit Committee 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 CIIA 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.

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 the Actuarial Reporting team, which sits within the Group Finance Function, reporting to the Group Finance Director, independently of the Chief Risk Officer. The Actuarial Methodology team, which also sits within the Group Finance Function, reporting to the Group Finance Director, propose the methodology and assumptions to use for the calculation of the technical provisions, which are then reviewed by the Life Chief Actuary. 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 LVGIG Board for approval.

The Actuarial Function also contributes to the oversight and challenge of the Group Economic Capital 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 the Group’s claims management capability.

These partners provide several benefits for the Group, including cost efficiency and access to improved technology within the Group’s 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)

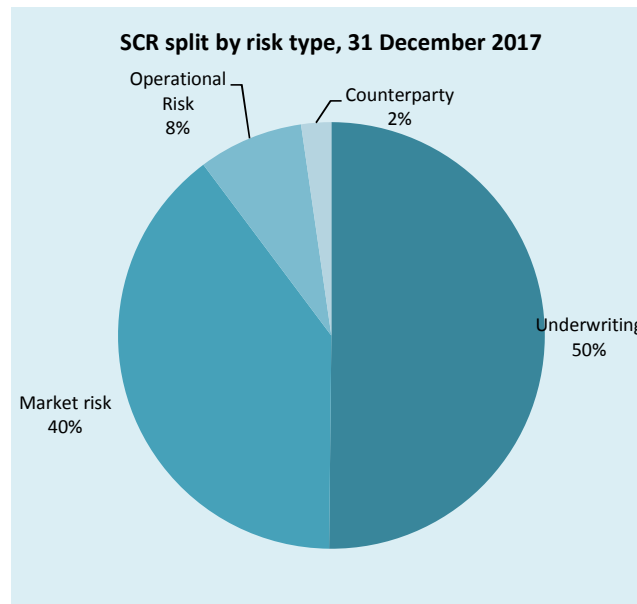
C.1 Overview

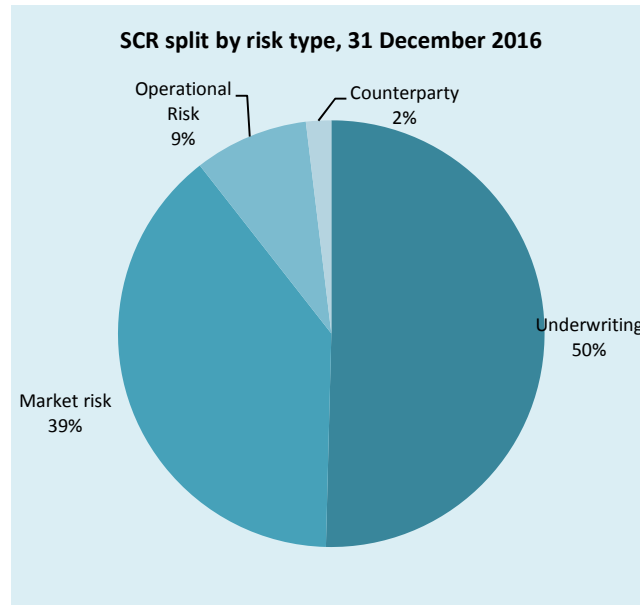
C.1.1 Overview of risk exposures

The Group'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 Group manages its risk using a range of techniques, including European Insurance and Occupational Pensions Authority (EIOPA) prescribed Standard Formula capital calculations, internal views of risk and sensitivity testing. A number of committees, attended by senior stakeholders, meet regularly to consider the Group'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 PRA.

The chart below shows the 31 December 2017 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The results for 31 December 2016 are provided for comparison. Reference to the SCR in this and later sections is to the final post-diversified SCR unless stated otherwise. The amount of SCR illustrated below is £1,228m (2016: £1,236m). This differs from the total SCR reported in section E.2 as it excludes the loss absorbing capacity of deferred tax and mutual bonus claw back management action in order to aide comparison. The mutual bonus claw back management action results in a significant reduction in a small number of selected risks within the SCR calculation and so distorts any comparison between risks and between different year-ends where the selected risks differ.





The weighting of the high level risk categories shown within the SCR appear not to have materially changed from 2016. However, this is due to the Solvency II treatment of the Group's majority interest in its general insurance subsidiaries. The Group sold 49% of its general insurance business on 28 December 2018 but under Solvency II the resulting decrease in underwriting risk is not reflected in the SCR but is instead reflected through an adjustment to Own Funds. See also section C.2.2.

C.1.2 Measurement of risk exposures

The Group measures its risk exposures using a variety of metrics. These metrics are reported to senior management, the Audit Committee and the Board. 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 Group's risk appetite.

The Group uses the following metrics:

- Regulatory capital is measured using the Standard Formula approach prescribed by EIOPA, and reported to the PRA on a quarterly basis.
- The Group maintains its own internal view of capital measurement, which informs risk appetite surrounding regulatory surplus capital. 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. An 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

The Group operates 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. Within the agreement, there are a number of investment guidelines which reflect the risk appetite limits and investment management parameters. All investment guidelines are approved by the Board or a delegated authority of the 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 Group 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 Group has a diverse and balanced mix of business and risk exposures.

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

- investing in a range of assets governed by investment mandates and asset counterparty limits set by the Group;
- using various hedging and asset liability matching strategies to reduce market risk;
- managing counterparty risk through risk limits on exposure and concentration; and
- limiting excess concentrations of underwriting risk through a range of reinsurance strategies.

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.

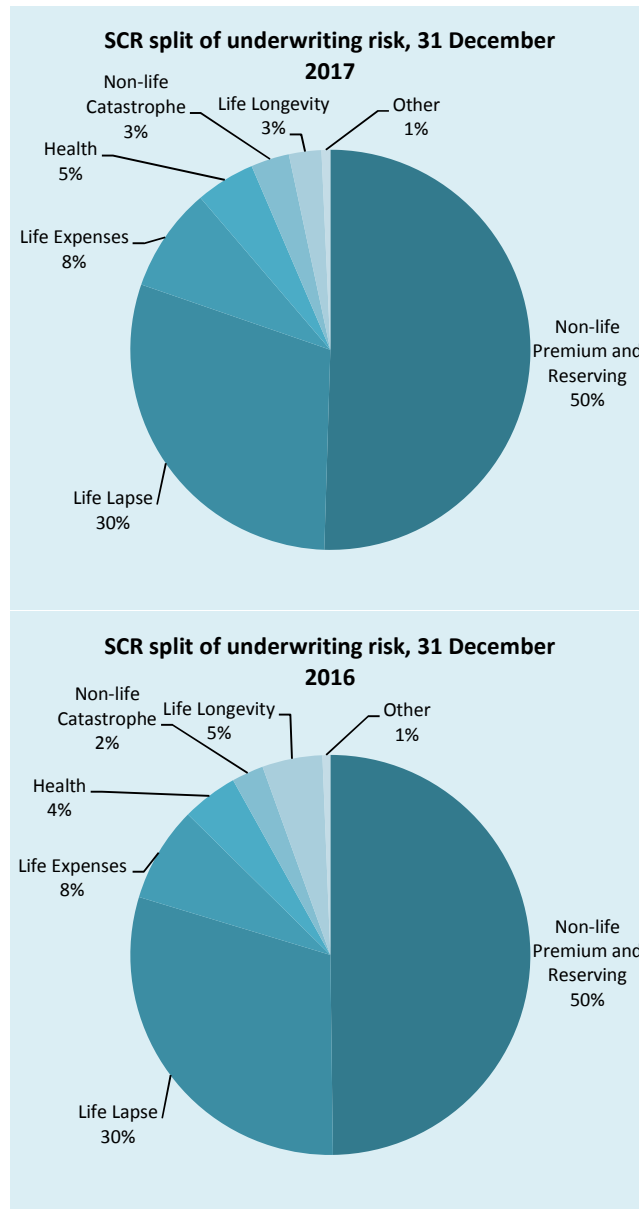
Where material, further information on risk concentrations relating to particular risks are given in sections C.2 to C.6 below. In addition, the appendices provide further information on specific risk concentrations that apply to individual entities of the Group.

C.2 Underwriting risk

In determining the price of its insurance products and when reporting the financial results relating to these products, the Group makes a number of assumptions related to the future amount and timing of payments. Underwriting risk arises from the actual outcome being different to these assumptions.

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 31 December 2017 split of underwriting risks within the SCR. The results for 31 December 2016 are provided for comparison. The amount of SCR illustrated below is £616m (2016: £623m). This differs from the underwriting risk capital shown in section E.2 as it excludes the mutual bonus claw back management action and fully allows for diversification within the SCR calculation in order to aid comparison. The mutual bonus claw back management action results in a significant reduction in a small number of selected risks within the SCR calculation and so distorts any comparison between risks and between different year-ends where the selected risks differ.



As explained in section C.1, whilst the proportion of non-life risks appears not to have changed materially, this is due to the Solvency II treatment of the Group's majority interest in its general insurance subsidiaries. The Group sold 49% of its general insurance business over the reporting period but, as required by Solvency II, the resulting decrease in Non-life premium and reserving risk is not reflected in the SCR (but is reflected through an adjustment to Own Funds). This is explained further in section C.2.2.

Non-life premium and reserving risk does, however, continue to be a significant area of risk for the Group. This risk category predominantly 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 which are covered under non-life catastrophe risk.

Lapse risk is generally a significant risk across the life insurance industry, due to the long-term nature of life business. As a result, lapse rates on material product lines are closely monitored. Lapse risk also captures the risk associated to the take-up of policyholder options, notably the option to take a cash lump sum at retirement instead of the annuity on Ordinary Branch Pensions ('OB Pensions') deferred annuity with-profits business. The cost of fewer policyholders taking cash at retirement has a material contribution to the lapse risk of the Group. 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.

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.

Longevity risk arises primarily from immediate and deferred annuities. A significant amount of OB Pensions business, a with-profits deferred annuity product, was reinsured during 2017. This has reduced the amount of longevity risk the Group is exposed to. Periodic payment orders under non-life business are also included; these represent the award of an annuity to an individual following a motor insurance claim.

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 Group, being either small in nature, reinsured or diversified against other sources of risk.

C.2.2 Material changes over the reporting period

Non-Life Underwriting Risk

On 28 December 2017, the Group entered into a Strategic Partnership with Allianz which included the transfer of 49% of its general insurance business to Allianz. This significantly reduced the Group's exposure to general insurance underwriting risk.

Life and Health Underwriting Risk

A significant amount of risk attached to OB Pensions business was reinsured during 2017. This has reduced the Group's exposure to longevity risk. The Group retains all forms of pre/at retirement mortality and lapse risk (including risk of differing cash take-up rates), as well as expense, operational, and the longevity risk associated with expenses and higher levels of annuity than expected.

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 rates. These risks are captured within the underwriting risk modules.

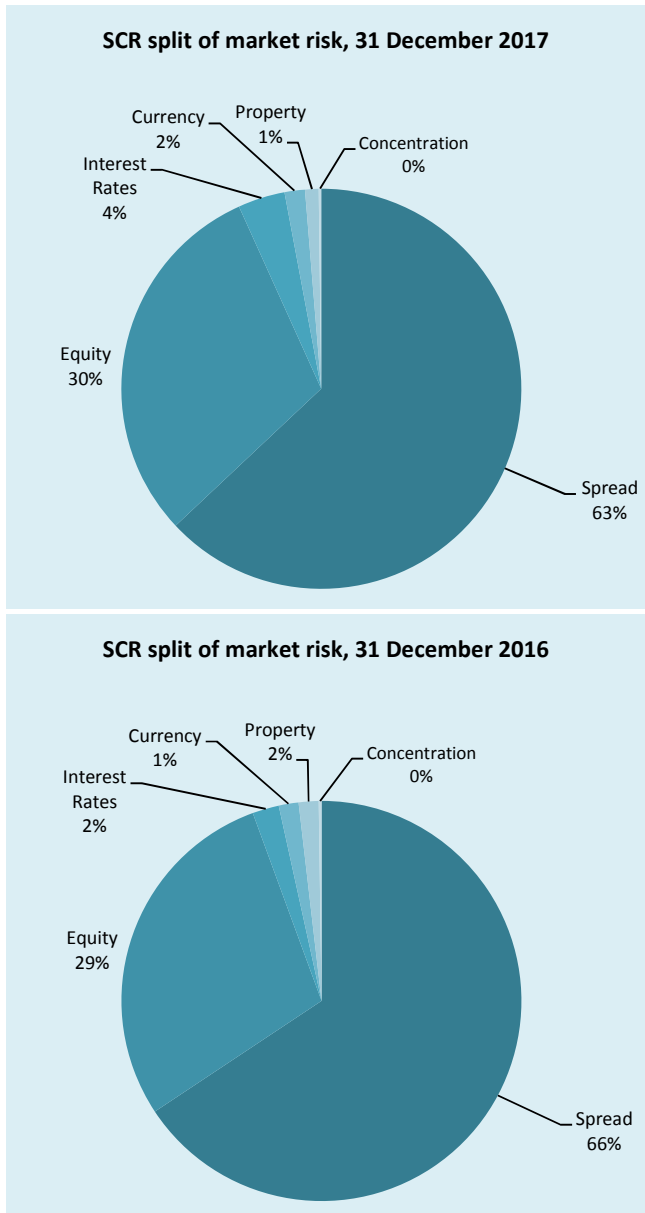
On the non-life side, the Group is exposed to legislative changes which by their nature tend to impact whole sections of the business. Recent examples of these are 2013 Legal Aid, Sentencing and Punishment of Offender Act (LASPO), which reduced legal fees associated with motor insurance claims, Ministry of Justice reforms and the 2017 Ogden discount rate change, which led to a significant increase to the amount provisioned for certain personal injury claims. These impacts are to some extent moderated by reinsurance.

C.3 Market risk

Market risk arises as part of the general investment performance and product pricing. The risk to the Group arises from the performance of the investments being different from that assumed in the planning and pricing processes.

C.3.1 Market risk exposure

As an institutional investor, the Group invests in a range of assets, governed by mandates and limits set by the Group. The chart below shows the 31 December 2017 split of market risks within the Standard Formula SCR. The results for 31 December 2016 are provided for comparison. The amount of SCR illustrated below is £486m (2016: £482m). This differs from the market risk capital shown in section E.2 as it excludes the mutual bonus claw back management action and fully allows for diversification within the SCR calculation, in order to aide comparison. The mutual bonus claw back management action results in a significant reduction in a small number of selected risks within the SCR calculation and so distorts any comparison between risks and between different year-ends where the selected risks differ.



Spread risk is a significant risk for the Group 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 also invest a significant proportion of their assets in corporate bonds. Spread risk also arises from the Group's equity release mortgage loans, due to the treatment under Standard Formula calculation of the SCR. 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.

The Group has only a limited exposure to currency (foreign exchange) risk through its investment in overseas assets.

A small amount of commercial property risk arises mainly from the with-profits business and from the Group's pension schemes. Note that residential property risk also arises from the Group's equity release mortgage portfolio but this is not reflected within the Standard Formula calculation of the SCR and is instead monitored using the Group's internal view of capital.

Sensitivities to key market risks are provided in section C.8.1.

C.3.2 Material changes over the reporting period

As noted previously, the Group entered a Strategic Partnership with Allianz which included the transfer of 49% of its general insurance business on 28 December 2017 in exchange for a significant amount of assets. This increased the assets held by the Group and the Group is exposed to market risk on these assets amounting to £3m within the SCR.

C.3.3 Risk mitigation techniques

The Group uses derivatives as part of its management of market risk and these are currently being used to manage interest rate, equity risk and currency 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 and equity investments within the general insurance subsidiaries are managed using futures contracts.
Interest rates	<p>A number of strategies are employed by the Group to manage interest rate risk.</p> <p>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.</p> <p>Transitional measures on technical provisions (“TMTP”) is utilised by LVFS and used to manage interest rate risk to the Solvency II balance sheet.</p>
Inflation	Inflation exposure across the Group and within the defined benefit pension schemes is managed using inflation linked assets and inflation swaps.
Currency	Currency risk is managed by the use of exposure limits and authorisation controls operated within the Group’s risk management framework.

Spread risk is not mitigated but managed in-line with Group policies.

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

Credit counterparty risk arises from the holding of certain investment assets, hedging, reinsuring certain product related risks to third parties, and from normal trade credit such as brokers and premium finance. The risk to the Group is that a counterparty defaults on its obligations or fails to meet them in a timely manner.

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 significantly impact the Group's capital position.
- The default of insurance intermediaries on money owed to the Group.

C.4.2 Risk mitigation techniques

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 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.4.3 Material changes over the reporting period

The group's exposure to RGA has increased as a result of the reinsurance of OB Pensions business. However, the capital associated to this is small (£2m) because the arrangement is collateralised.

There were no other material changes to credit counterparty risk during 2017.

C.4.4 Risk concentrations

In order to limit its exposure to a single default, the Group 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 the Group's Risk Appetite.

C.5 Liquidity risk

Liquidity Risk is the risk that LV= Group and/or its subsidiaries, though solvent, either do not have sufficient financial resources available to meet their obligations when they fall due, or can secure them only at excessive cost. This may arise either because of the nature of the investments held or adverse market conditions.

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 that, across the Group, LV= must be able to meet its BAU and stressed liquidity requirements from high quality liquid assets. Adherence to the risk policy and monitoring of the liquidity cover ratio is performed by the 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.

There were no material changes to liquidity risk during 2017.

The Group is not exposed to concentrations of liquidity risk.

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 the end of 2017 was £289m (2016: £270m). The expected profit in future premiums primarily results from our LVFS Protection business, where we expect to receive future premiums for the benefits promised within the contracts.

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 the Group.

The most material operational risks the group is exposed to, and how these are managed, are detailed below.

Top risk	Risk management actions
<p>Political and regulatory uncertainty The risk of failure to achieve the group business plan due to material and prolonged uncertainty within the political and regulatory landscape.</p>	<p>The Group continues to remain alert to the risks associated with the UK political and regulatory uncertainty. For example, the outcome of the Brexit negotiations remains unclear and the UK's political landscape changed during 2017 with the establishment of a minority government. The full impact of this period of political uncertainty is as yet unknown, although there may be increased market volatility over the coming months. LV= continues to give careful consideration to these risks through its ongoing emerging risk process which is prominent in its risk oversight.</p>
<p>Regulatory challenges Failure to comply with current (known) or future (unknown) regulation or legislation resulting in regulatory censure (e.g. fines or enforcement).</p>	<p>The Group aims to ensure that it meets all of its regulatory commitments, especially against a backdrop of the challenging regulatory change agenda (e.g. GDPR, Universal Credit). The Group remains alert to the changing agenda and continues to monitor the impact of potential changes across all risk categories.</p>
<p>UK health and social provision The inherent risk that treatment of private (insurance) provision benefits under Universal Credit may have an adverse impact on the life and health insurance industry, particularly around the individual income protection market where LV= is recognised as a market leader.</p>	<p>The Group continues to liaise with the relevant Government departments and the industry to quantify the potential impact and implications of Universal Credit on existing and prospective (income) protection policyholders. As LV= lobbies for fair treatment for policyholders from Government, it continues to hold awareness and training sessions internally and externally and is reviewing its claims proposition and communications to existing policyholders. Furthermore, as Universal Credit is rolled out across the country, the Group is addressing any individual LV= policyholder claimant issues as they arise on a case-by-case basis.</p>
<p>Conduct risk The risk that conduct risk controls are ineffective for new business and/or legacy books contain a material number of cases where there is evidence of customer detriment due to mis-selling.</p>	<p>The Group continues to consider all aspects of conduct risk and the potential impact of customer detriment in everything it does. During 2017, the Group updated its conduct risk framework and suite of associated management information. Control enhancements and structural changes have also been made to enable senior management and the Risk Committee to provide greater challenge and support around the conduct risk agenda. These activities will continue into 2018.</p>
<p>Information security / cyber security The risk that LV= does not have a sufficiently robust strategy and control infrastructure in place to protect itself against, or recover from, an event which results in the loss, misuse or reduction in the confidentiality, integrity or availability of its customer data.</p>	<p>The Group continues to remain alert to and seeks to minimise the threat from cyber risk. Recent high profile ransomware attacks around the world show this threat to be both real and increasing. Cyber security therefore continues to feature within the Group's top risks in order to reflect the heightened risk environment and level of additional vigilance undertaken in order to maintain its security architecture framework.</p>
<p>IT change delivery The risk of reduced availability, lack of stability and/or total failure of critical IT systems as a result of a failure to execute IT change effectively.</p>	<p>The Group continues to be alert to the increasing demands placed upon its IT infrastructure, especially with the approaching IT systems separation under the strategic partnership with Allianz. To address the issue of stretch across the change portfolio a monthly summary of project activity is presented to the group executive committee, who apply a start/stop/continue lens to prioritise project activity.</p> <p>This has been further supported by a regular review of critical change milestones and a central review of the strategic investment budget allocations.</p>
<p>Delivery risk The risk that key strategic initiatives, business objectives and/or regulatory obligations are not met due to loss of key staff or the demands of the change portfolio exceeding the available capacity.</p>	<p>The Group continues to experience and initiate a high degree of internal change whilst also managing its business-as-usual commitments. In order to achieve this successfully, the Group regularly reviews its capacity and resourcing requirements, responding to any pressure points through a combination of careful capacity planning, reprioritisation and/or resource management. LV= also has a number of key initiatives in place to ensure that the wellbeing of its staff is monitored and that its teams are supported.</p>

In addition, the Group considers the following principal categories of operational risk:

- Fraud and crime
- Financial processes
- Change management
- Information security
- Business interruption
- Legal and regulatory
- Customer/conduct
- People, processes, and IT systems
- Outsourcing

As the operational risk capital requirements within the Standard Formula do not reflect the complexity of the actual Group risks, the Group 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. This requires a significant amount of expert judgement, particularly to identify and assess the likelihood of scenarios occurring. 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.

There were no material changes to operational risk during 2017.

LV= outsources a number of operational activities. In order to minimise dependency on a single supplier, the Group actively identifies and monitors key suppliers and has business continuity plans in place in the event that the stakeholder fails.

The Group operates several offices in various geographical locations around the UK and has business continuity plans in place to ensure that critical business functions will continue in the event that an office is no longer useable.

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 C.5. In addition, risks may arise from unanticipated 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 annual submissions of the Group's Own Risk and Solvency Assessment.

C.8 Sensitivities

This section sets out the Group's sensitivity to various economic and demographic assumptions. 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. They should only be treated as estimates which give a broad indication of the direction and magnitude of the change in surplus capital. The estimates have been calculated using a combination of analysis and expert judgement and include some approximations where these are not material to the final results.

C.8.1 Economic sensitivities

Market risk arises as part of the general investment performance and product pricing. The risk to the Group arises from the performance of the investments being different from that assumed in the planning and pricing processes. The estimated impact on Group surplus capital to a range of economic changes is shown below. These have been aligned with the sensitivities disclosed within the Report and Accounts.

The following sensitivities are performed:

- An immediate 25% decrease in the market values of equities.
- An immediate 100 bps decrease in all fixed interest rates.
- An immediate 100 bps increase in all fixed interest rates.
- An immediate 50 bps increase in gilt interest rates but with swap rates remaining fixed. Note that the risk of gilt-swap spreads widening is not captured as part of SCR.
- An immediate 100 bps increase in corporate bond interest rates but with gilt and swap rates remaining fixed. Unlike the SCR calculation, the impact on the volatility adjustment has been taken into account in calculating this sensitivity.

The sensitivities assume that the TMTP is not recalculated. If there was an extreme stress that caused a material change in the Group's risk profile, then the TMTP might be recalculated (subject to the approval of the PRA), which could reduce some of the sensitivities shown. Furthermore, the sensitivities assume no management actions are taken, above those already modelled as part of the valuation of technical provisions and SCR, in order to mitigate any adverse impacts.

Surplus capital at 31 Dec 2017:		698		
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
25% market fall in equities	(89)	(1)	(10)%	61%
100 bp fall in interest rates	(112)	64	(18)%	605%
100 bp rise in interest rates	91	(45)	15%	(490)%
50 bp rise in gilt swap spreads	(128)	3	(15)%	n/a
100 bp rise in credit spreads	146	(13)	18%	(48)%

The equity sensitivity reduces the value of the Group's assets, including those in the defined benefit pension schemes. It also increases the guarantees costs associated with with-profits business.

The interest rate sensitivities impact all fixed interest assets held by the Group such as government and corporate bonds and interest rate derivatives. It also impacts 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 which leads to a material sensitivity.

The gilt-swap spread sensitivity is an increase in gilt interest rates but with swap rates remaining fixed. Many of the assets held by the Group are government or corporate bonds, and are therefore linked to gilt yields. In contrast, swap rates are used to calculate liabilities, SCR and Risk Margin so the impact on this side of the balance sheet is only through an assumed increase in the volatility adjustment and matching adjustment. A widening of gilt spreads, relative to swaps, therefore reduces the value of the Group's assets by more than that of its liabilities which leads to a material sensitivity.

The credit spread sensitivity as a percentage of the post-diversified credit spread SCR is negative because of the difference in approach between the sensitivity and the SCR calculation. Credit spreads widening causes the value of corporate bond assets held by the Group to fall which causes a reduction in surplus within the SCR calculation. However, in reality, the volatility adjustment and discount rate used to value defined benefit schemes' liabilities increase in the event of credit spreads widening. In the sensitivity calculation this has been taken into account and has a beneficial impact because it reduces the value of liabilities which more than offsets the reduction in value of assets. However, the calculation of the SCR does not permit the recalculation of the volatility adjustment or defined benefit schemes' liability discount rate and so this benefit is ignored.

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 generally pay an income until death.

The sensitivities shown below are in respect of the Solvency II Surplus (excluding the RNPFN and Teachers ring-fenced 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.

The following sensitivities are performed:

- 15% increase to mortality rates for protection business which is generally exposed to higher than expected deaths.
- 20% decrease to mortality rates for products other than protection business where the Group is generally exposed to lower than expected deaths.
- 50% increase to lapse rates for all products. Early retirements are excluded from this sensitivity.
- 50% decrease to lapse rates for all products. Early retirements are excluded from this sensitivity.
- 50% decrease in OB Pension cash-take up rates at retirement.

The mortality stresses refer to the assumed rate of future mortality, and represent a percentage change in the volume of death claims.

The lapse stresses are calculated in a similar way and represent a percentage change in the volume of lapses or surrenders.

As per the economic stresses, the sensitivities assume that TMTP is not recalculated and that no management actions are taken, above those already modelled as part of the valuation of technical provisions and SCR, in order to mitigate any adverse impacts. Note that the sensitivities do not allow for change in the Risk Margin which is generally hedged by changes in the TMTP when recalculated. The sensitivities should only be treated as estimates which give a broad indication of the direction and magnitude of the impact of the sensitivity.

Surplus capital at 31 Dec 2017:		698		
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
15% increase in mortality rates (protection business only)	(8)	0	(1)%	741%
20% decrease in mortality rates (excluding protection business)	(44)	0	(5)%	273%
50% increase in lapses*	(16)	26	(2)%	8%
50% decrease in lapses*	22	(24)	2%	21%
50% decrease in OB Pension cash-take-up rates at retirement	(61)	(12)	(6)%	

* Early retirements have been excluded from this sensitivity.

For the increase in mortality rates, the exposure comes from products where claims are paid out on death. For these products, higher mortality rates increase the amount of claims paid out. The impact of this sensitivity on surplus is significantly higher than the SCR capital held in respect of mortality risk primarily because, within the SCR, mortality risk significantly diversifies with other risks.

For the decrease in mortality rates, the majority of the exposure comes from the deferred and in-payment annuities, where an income is paid for as long as the policyholder survives. The impact of a reduction in mortality rates has reduced over the reporting period. This is primarily due to the reinsurance on OB Pensions, as described in section C.2.1. The impact of this sensitivity on surplus is higher than the SCR capital held in respect of mortality risk primarily because, within the SCR, longevity risk significantly diversifies with other risks.

For the 50% increase in lapses, the majority of the exposure comes from changes to the SCR. Under Solvency II, the SCR lapse stress is applied as a proportion of the existing lapse assumption. Therefore, an increase to lapse rates increases the size of this stress. The impact of this sensitivity on surplus is significantly lower than the SCR capital held in respect of lapse risk primarily because, within the SCR, only those policies which would cause a strain to the Society are used in the calculation.

Similarly, for the 50% decrease in lapses, the benefit to surplus comes primarily from a reduction in the SCR. The impact of this sensitivity on surplus is significantly lower than the SCR capital held in respect of lapse risk primarily because, within the SCR, only those policies which would cause a strain to the Society are used in the calculation.

The 50% decrease in OB Pension cash-take up rates at retirement results in a higher proportion of policyholders taking the guaranteed annuity option.

Non-life business

Sensitivities for the non-life business are discussed in each of the LVIC SFCR and Highway SFCR, Section C.6.

C.9 Additional information on risk profile

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

D. Valuation for Solvency Purposes (LV Group)

D.1 Assets

Assets on a Solvency II basis	2017	2016
Assets	£m	£m
Deferred tax assets	10	26
Pension benefit surplus	178	134
Property, plant & equipment held for own use	40	43
Investments (other than assets held for index-linked and unit-linked contracts):		
Property (other than for own use)	3	5
Holdings in related undertakings, including participations	99	142
Equities	941	872
Bonds	6,182	6,671
Collective Investments Undertakings	3,768	3,194
Derivatives	81	179
Deposits other than cash equivalents	69	97
Other Investments	3	-
Assets held for index-linked and unit-linked contracts	2,485	2,001
Loans and mortgages	868	884
Reinsurance recoverables	2,312	1,181
Insurance and intermediaries receivables	10	5
Reinsurance receivables	19	11
Loans & Receivables (not insurance)	44	36
Cash and cash equivalents	101	175
Any other assets, not elsewhere shown	45	64
Total assets	17,258	15,720

For solvency II 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.

		2017			
		IFRS	Presentational adjustments	Solvency II Valuation adjustment	Solvency II
Reconciliation between IFRS and Solvency II value		£m	£m	£m	£m
Assets	Note				
Goodwill	1	220	-	(220)	-
Deferred acquisition costs	2	95	-	(95)	-
Intangible assets	1	95	-	(95)	-
Deferred tax assets	3	-	-	10	10
Pension benefit surplus	4	178	-	-	178
Property, plant & equipment held for own use	#	37	-	3	40
Investments (other than assets held for index-linked and unit-linked contracts):					
Property (other than for own use)	#	3	-	-	3
Holdings in related undertakings, including participations	5,6	-	91	8	99
Equities	6	3,780	(2,839)	-	941
Bonds	6	5,104	1,078	-	6,182
Collective Investments Undertakings		4,099	(331)	-	3,768
Derivatives	7	81	-	-	81
Deposits other than cash equivalents	6	-	69	-	69
Other Investments	6	3	-	-	3
Assets held for index-linked and unit-linked contracts	8	-	2,485	-	2,485
Loans and mortgages	9	867	1	-	868
Reinsurance recoverables	10	2,305	594	(587)	2,312
Insurance and intermediaries receivables	11	272	-	(262)	10
Reinsurance receivables	#	36	-	(17)	19
Loans & Receivables (not insurance)	12	258	(214)	-	44
Cash and cash equivalents	13	974	(873)	-	101
Any other assets, not elsewhere shown	14	124	(79)	-	45
Total assets		18,531	(18)	(1,255)	17,258

= Disclosure note not provided as solvency II 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 be demonstrated that 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 expenses are included within the Technical Provisions valuation if they fall within the projected timeframes (see D.2 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

	£m
Deferred tax assets - IFRS	-
Presentational adjustment	-
Solvency II valuation adjustment	10
Deferred tax assets - solvency II valuation	10

There are a number of changes that are made to the LVIC and Highway IFRS Balance Sheet in moving to the Solvency II basis 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 subordinated debt.

The impact of these changes is that there is a decrease in the Solvency II taxable profits of LVIC and Highway of £51m with a consequent £10m taxation impact. 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 DTA established over this period is based on the announced Corporation Tax rates, as follows:

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2018	41	19.00%	8
2019	7	19.00%	1
2020	3	17.25%	1
Total	51		10

4. Pensions Benefit Surplus

For solvency II 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 II 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	91
Adjusted equity method valuation differences	8
Participations - solvency II valuation	99

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

6. Investments

For solvency II 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 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 31 December 2017.

	QMP £m	QMPS £m	AVM £m	AEM £m	Total £m
Property	-	-	3	-	3
Holdings in related undertakings	-	-	-	99	99
Equities	898	-	43	-	941
Bonds	3,167	3,015	-	-	6,182
Collective Investment Undertakings	3,701	67	-	-	3,768
Derivatives	-	81	-	-	81
Deposits other than cash equivalents	69	-	-	-	69
Other investments	-	-	3	-	3
Investments (other than assets held for index-linked and unit-linked funds)	7,835	3,163	49	99	11,146
Loans and mortgages (see note 9 below)	-	200	668	-	868
Total	7,835	3,363	717	99	12,014

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 II valuation	81	(193)	(112)

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

9. Loans and Mortgages

For solvency II 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	667
Commercial mortgages	200
Total included in Financial assets at fair value through income - IFRS	867
Presentational adjustment for accrued interest	1
Total Loans and Mortgages - solvency II valuation	868

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 a full definition of AVM and Section D.4). 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 II. (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 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 Section D.2 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	272
Solvency II valuation adjustments	(262)
Total Insurance and intermediaries - solvency II valuation	10

For solvency II 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 D.2 Technical Provisions)

12. Loans and Receivables (not insurance)

For solvency II valuation purposes, loans and receivables are valued consistently with IFRS. On the Solvency II balance sheet, the reverse repurchase agreements and cash collateral pledged are classified under investments and any receivables for linked assets are classified under Assets held for index-linked and unit-linked contracts.

	£m
Reverse repurchase agreements	200
Cash Collateral pledged	10
Investment receivables	26
Other receivables	22
Loans and Receivables (not insurance) - IFRS	258
Presentational adjustments to Investments and unit linked assets	(214)
Total Loans and Receivables (not insurance) - solvency II valuation	44

13. Cash and cash equivalents

For solvency II 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.

14. Any other assets, not shown elsewhere

For solvency II 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	85
Other prepayments and accrued income	39
Prepayments and accrued income - IFRS	124
Presentational adjustments to investments	(79)
Total Any other assets, not elsewhere shown - solvency II valuation	45

D.2 Technical provisions

D.2.1 Technical provisions by line of business

Total Technical Provisions by line of business:

Line of Business	2017 £m	2016 £m
Motor vehicle liability	1,703	1,642
Other motor insurance	52	69
Fire and property damage	138	168
General liability insurance	78	68
Other Non-Life insurance	15	13
Total Non-Life insurance obligations	1,986	1,960
Insurance with-profits participation	5,821	5,352
Index-linked and unit-linked insurance	3,037	2,517
Other life insurance (including Health)	3,624	3,446
PPOs not health	168	173
Total Life insurance obligations	12,650	11,488
Total Group Technical Provisions	14,636	13,448

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

The following table sets out the Group technical provisions split by Solvency II lines of material business as at 31 December 2017.

Line of Business	31 December 2017 - £m			
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP) Unaudited	Total Technical Provisions
Motor vehicle liability	1,646	57	-	1,703
Other motor insurance	50	2	-	52
Fire and property damage	134	4	-	138
General liability insurance	75	3	-	78
Other Non-Life insurance	14	1	-	15
Total Non-Life insurance obligations	1,919	67	-	1,986
Insurance with-profits participation	5,841	154	(174)	5,821
Index-linked and unit-linked insurance	3,037	42	(42)	3,037
Other life insurance (including Health)	3,846	136	(358)	3,624
PPOs not health	148	20	-	168
Total Life insurance obligations	12,872	352	(574)	12,650
Total Group Technical Provisions	14,791	419	(574)	14,636

The impact on the MCR and Eligible Own Funds to meet the MCR are found in the section E.2.1 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 (D.2.2.1 for Non-life business and D.2.2.2 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 Periodic Payment Orders (PPO) 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 Standard Actuarial Techniques for more developed accident periods, 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 known 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. Following a re-calibration exercise carried out this year, the IBNR amounts are then adjusted to allow for the explicit uplift for PPO IBNR.

For PPO claims a cashflow model is used to project cashflows for both claims that have settled on a PPO basis and those identified as having the potential to settle as a PPO in the future. This model projects both gross and reinsurance cashflows separately. The models used for PPOs are deterministic and for settled PPOs the settled amounts are known. 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 calculation of the Premium Provision requires a set of assumptions to be made. 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 Premium Provision is calculated in a single model. The model projects all relevant cashflows for each line of business and discounts these using the relevant yield curve. The Premium Provision requires cashflow projections for all items associated with in-force business, i.e. premium (net of IPT), claims and expenses (acquisition, administration and claims handling) and other ancillary income. The Premium Provision is calculated separately for each Solvency II Line of Business. The calculations are performed on an aggregated basis as opposed to an individual policy basis.

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 approach used to derive the ENIDs loading has considered a combination of a mean load statistical approach for the attritional claims and a set of stresses and scenarios for large claims, PPOs and weather events. The statistical approach for attritional claims builds on a presentation at the Institute and Faculty of Actuaries 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.

The Risk Margin is calculated in line with the Solvency II regulations. Further details are provided in the individual 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

Best Estimate Liability

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 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 90bps.

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, OB Pensions and Unit Linked Pensions policies as well as the business acquired from Teachers Provident Society).

The VA prescribed by EIOPA was 18bps 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 31 December 2017. 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 1 January 2017, reducing the Group surplus by £52m. The second step down occurred as at 31 December 2017, reducing the Group surplus by a further £37m.

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 the S.22.01.22 QRT annexed to this report, 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	14,636	574	42	189
Basic own funds	1,676	(539)	(42)	(191)
Eligible own funds to meet Solvency Capital Requirement	1,676	(539)	(42)	(191)
Solvency Capital Requirement	978	1	4	43

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 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 Group’s Principles and Practices of Financial Management.

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 2017 is shown in the tables below.

LVFS

Product	Base Percentage	Mortality Tables
Enhanced Annuities	95%	RMV00 CMI_2016 1.5% LT/RFV00 CMI_2016 1.25% LT with enhancements
Standard Annuities	95%	RMV00 CMI_2016 1.5% LT/RFV00 CMI_2016 1.25% LT
Annuities (Ex-Teachers)	65% M/95% F	RMV00 CMI_2016 1.5% LT/RFV00 CMI_2016 1.25% LT
Deferred Annuities (Pre-vesting)	130%	AMC00 CMI_2016 1.5% LT/AFC00 CMI_2016 1.25% LT
Deferred Annuities (Post-vesting)	116%	RMV00 CMI_2016 1.5% LT/RFV00 CMI_2016 1.25% LT
Term Assurances (FPP)	85.95%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2016 1.50%(male)/1.25%(female) LT
Term Assurances (LVLI)	89.20%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2016 1.50%(male)/1.25%(female) LT
Term Assurances (LVFS)	Various	AM92/AF92
IB Endowment/Whole of Life Assurance	80% tapered to 100% at later ages	ELT16
Whole of Life Assurances (50+)	100%	AMC00/AFC00 adjusted CMI_2016 1.50%(male)/1.25%(female) LT
Whole of Life Assurances (Lifetime+)	100%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2016 1.50%(male)/1.25%(female) LT

RNPFN Fund

Product	Base Percentage	Mortality Tables
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

TA Fund

Product	Base Percentage	Mortality Tables
CWP	50% M/65% F	AM92/AF92
UWP	50% M/65% F	AM92/AF92

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.

Future mortality improvements are now allowed for using the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) 2016 projection model with period smoothing parameter, together with long-term improvement rates of 1.5% for males and 1.25% for females, tapering linearly to zero between the ages of 85 and 110. Previously, future mortality improvements were allowed for using the CMI 2013 projection model with long-term improvement rates of 1.5% for both males and females, tapering linearly to zero between the ages of 90 and 120.

For annuities in the RNPFN 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 use of the 2009 model reflects the basis on which the business is reinsured.

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 set of persistency rates is used to cover external transfers, early retirements, full encashments and partial encashments not covered by drawdown.

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 maintenance unit costs that are 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 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 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 to 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. 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.
- The greatest area of uncertainty pertinent to the Non-Life business is the future level of the Ogden Discount Rate (ODR). As at the 2017 year end, the IFRS Actuarial Best Estimate (ABE) and SII Technical Provisions ingest the current ODR of -0.75% with no allowance for future movement. There is the potential for the ODR to increase, however the timing and quantum of any future increase are unknown.
- The main areas of uncertainty on personal injury claims are around the level of reserve redundancies to be expected from the current personal injury claims and the extent to which this differs from the level of redundancy currently allowed for; the frequency and severity of IBNR personal injury claims; and the likelihood of claims settling as PPOs. All of the above areas of uncertainty have been exacerbated by the change in ODR.
- The main area of uncertainty on Non-injury claims is the level of claims inflation. There are many contributing factors to this including the effect of the changing cost of imported parts, the changing mix of the Group's portfolio and the increasing sophistication of vehicle technology.
- Finally, a general area of uncertainty always present is the effect on incurred development patterns of changes made to case reserving philosophy and the claims settlement process.

D.2.3 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	1,986	2,339	(353)
Insurance with-profits participation	5,821	6,019	(198)
Index-linked and unit-linked insurance	3,037	3,048	(11)
Other life insurance (including Health)	3,624	4,286	(662)
PPOs not health	168	88	80
Total Life insurance obligations	12,650	13,441	(791)
Total Group Technical Provisions	14,636	15,780	(1,144)

Note: The IFRS value excludes outstanding claims, stranded costs and equity release provision of £100m.

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:

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:

- Past Deferred Acquisition Costs (DAC) 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 SII. 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 Unearned Premium Reserve (UPR) (net of DAC and Premium receivables) under IFRS is inadmissible under Solvency II. However, this is replaced by the premium provision.

Life business

Discount rates: Whilst the risk-free reference curve under IFRS has been aligned to the rates prescribed by EIOPA for use under Solvency II (derived from swap rates), there are differences due to additions to the risk-free rates. Under Solvency II, the Society makes use of the VA and MA, 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, where the VA is applied, the movement in the EIOPA-curve with the VA is the primary difference between Solvency II and IFRS (other than the Risk Margin and TMTP).

Prudent margins: 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: These exist under Solvency II but not IFRS.

D.2.3.1 Description of Reinsurance Recoverables

Non-Life business

The Non-Life business enters into a number of reinsurance contracts. 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. The Group has entered into a quota share arrangement for losses occurring with effective date of 1 January 2016, covering each of the three calendar years to 31 December 2018.

At present, there are no special purposes vehicles in place for the Group's reinsurance.

Life business

The BEL is calculated gross without deduction of amounts recoverable from reinsurance contracts. The calculation of recoverable amounts is carried out separately for reinsurance contracts as follows:

- the value of unitised funds invested via the reinsurance arrangement with Managed Pension Funds Limited; and
- for all other business, the probability-weighted average of the discounted future cash flows allowing for contract boundaries.

The amounts recoverable are then adjusted to allow for the default risk associated with the reinsurance counterparties.

The assumptions and models used were the same as those used for the BEL, described earlier in this section.

Reinsurance recoverables are 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.

D.2.3.2 Material Changes in Assumptions

Non-Life business

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.

A re-calibration exercise was carried out this year on large claims that are yet to be reported. This has meant a number of changes in assumptions since the 2016 year-end:

- Claim frequency and severity assumptions were changed as a result of the re-calibration. This resulted in a favourable impact on the Technical Provisions net of Excess of Loss reinsurance.
- In addition, reinsurance loss ratios on large claims at 2017 year-end for the Premium Provision calculation were set using the reinsurance recovery rate derived in the re-calibration and the actual 2018 reinsurance premium rates.
- This exercise also involved the establishment of a PPO IBNYR allowance.

Note there has been no change in the assumed Ogden discount rate between the 2016 and 2017 year-ends. The best estimate assumption remains at -0.75% p.a. The likelihood and timing of a change in the Ogden discount rate will continue to be assessed throughout the year and if deemed reasonable, a change in the assumed rate employed within the IFRS ABE and SII Technical Provisions will be considered and taken through the appropriate governance ahead of being implemented.

Life business

Equity Release prepayment rates have been increased for terms 3 to 14 years. This corresponds to observed higher levels of prepayments compared to the previous year's assumptions.

Future mortality improvements are allowed for based on the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) 2016 projection model. Previously the 2013 CMI model was used.

Flat, aggregate lapse rates that applied to the LVFS unit-linked pensions have been replaced with separate rates for lapse (varying by age) and drawdown (at an increased level). These changes have impacted the level and sensitivity of persistency risk capital.

The calculation of the insurance contract liabilities is impacted by changes in unit costs. A review of the methodology has been carried out in 2017 and the revised expense assumptions have been adopted.

D.3 Other liabilities

Other liabilities on a Solvency II basis	2017	2016
	£m	£m
Provisions other than technical provisions	20	11
Pension benefit obligation	-	1
Deferred tax liabilities	96	73
Derivatives	193	259
Debts owed to credit institutions	62	116
Financial liabilities other than debt owed to credit institutions	-	1
Insurance and intermediaries payables	64	65
Reinsurance payables	8	2
Payables (trade, not insurance)	256	233
Subordinated liabilities	379	385
Any other liabilities, not elsewhere shown	70	11
Total Other Liabilities	1,148	1,157

Reconciliation between IFRS and Solvency II valuation	Note	2017			
		IFRS	Presentation adjustment	Solvency II valuation adjustment	Solvency II
		£m	£m	£m	£m
Provisions other than technical provisions	#	20	-	-	20
Pension benefit obligation	#	-	-	-	-
Deferred tax liabilities	1	97	-	(1)	96
Derivatives	#	193	-	-	193
Debts owed to credit institutions	2	62	-	-	62
Financial liabilities other than debt owed to credit institutions	#	-	-	-	-
Insurance and intermediaries payables	3	19	-	45	64
Reinsurance payables	4	31	-	(23)	8
Payables (trade, not insurance)	5	288	(18)	(14)	256
Subordinated liabilities	6	358	-	21	379
Any other liabilities, not elsewhere shown	7	20	-	50	70
Total Other Liabilities		1,088	(18)	78	1,148

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

Supporting Notes

1. Deferred tax liability

IFRS Deferred Tax Liabilities (DTL) at 31 December 2017 are £97m and relate to timing differences recognised on unrealised gains and the pension scheme. Solvency II Deferred Tax Liabilities are £96m. The movement from the IFRS DTL reflects the removal of the LVIC IFRS DTL Goodwill under Solvency II (£1m).

2. Debts owed to credit institutions

For solvency II 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	-	-	-	62	-	62	

3. Insurance and intermediaries payables

For Solvency II valuation purposes, insurance and intermediaries payables 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 II purposes are reclassified to insurance and intermediaries payables.

Under IFRS, insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

Insurance and intermediaries payables	£m
Due to policyholders	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 – solvency II 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	

4. Reinsurance payables

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

Under IFRS, reinsurance payables are recognised when due. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Reinsurance payables	£m
Due to reinsurers	31
Total reinsurance payables - IFRS	31
Reinsurance payables reclassified to technical provisions	(23)
Total reinsurance payables - solvency II valuation	8

5. Payables (trade, not insurance)

For Solvency II valuation purposes, payables (trade, not insurance) are valued consistently with IFRS and then adjusted to remove the MIB levy as part of the technical provisions calculation.

Under IFRS, trade payables are recognised when due. Trade payables are initially recognised at fair value and subsequently held at amortised cost.

Payables (trade, not insurance)	£m
Bank overdrafts	11
Trade payables	17
Other taxes and social security costs	56
Other creditors	42
Finance lease liabilities	19
Accruals and deferred income	143
Payables (trade, not insurance) - IFRS	288
Presentational adjustments (including accrued income to Investments)	(18)
Solvency II valuation adjustments- Reclassification of payables to technical provisions	(14)
Payables (trade, not insurance) - solvency II valuation	256

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)	213	4	2	22	-	241

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 II 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)	348
Subordinated notes (EUR 12m)	10
Subordinated liabilities - IFRS	358
Solvency II valuation adjustments	21
Subordinated liabilities - solvency II valuation	379

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 elsewhere shown

For Solvency II purposes, current corporation tax is valued consistently with IFRS. On the Solvency II balance sheet, the Expense reserve is included in the value of Any other liabilities, not shown elsewhere.

	£m
Current corporation tax	20
Any other liabilities, not shown elsewhere - IFRS	20
Expense reserve reclassified from technical provisions	50
Total Any other liabilities, not elsewhere shown - solvency II valuation	70

8. Contingent liabilities

There are no material contingent liabilities to be recognised for solvency II 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 the table below:

		2017		
		Reasonably possible alternative assumptions		
Description	Unobservable input	Current fair value	Increase in fair value	Decrease in fair value
		£m	£m	£m
Loans secured on residential property	Discount rates +/- 50bps	667	33	(30)

For Equity release mortgages (£667m), please refer to Section D Assets Note 9 Loans and Mortgages, sub-heading Equity release mortgages for the valuation basis.

- Unlisted equity (£133m) 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 (£3m) 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 (£40m) is generally valued at the IFRS carrying value, based on cost less accumulated depreciation with assets written down to their recoverable amount where this is less than the carrying value. The IFRS carrying value is deemed to be materially the same as fair value, except in the case of own use properties which have been revalued upwards by £3m as part of the Solvency II valuation.

Non-life Segment

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

- 1) 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.
- 2) 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.

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 II 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 II 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.

b) Measurement and monitoring of capital

Method 1 as referred to in Article 230 of the 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. The Group's key capital management 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 with 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 subordinated liabilities. Tier 2 includes cumulative preference shares, and subordinated 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	1,236	-	-	1,236
Reconciliation reserve	(92)	-	-	(92)
Subordinated liabilities	-	379	-	379
Deferred tax assets	-	-	10	10
Minority interests	143	-	-	143
Total Basic Own Funds	1,287	379	10	1,676
Total Basic Own Funds after deductions	1,287	379	10	1,676

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 policyholders together with the free assets of the Group. Any profit or 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 subordinated liabilities, which are included as Tier 2 capital within own funds, together with the valuation methodology are given in section D.3, note 6

Minority interest

During 2017, LV= formed a strategic partnership with Allianz and their minority interest is reported in the Own Funds QRT.

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 Tier 3 capital.

Changes in own funds during the reporting period

	LVFS Group		
	1 January 2017	Movement	31 December 2017
	£m	£m	£m
Eligible own funds			
Tier 1 capital	1,000	287	1,287
Tier 2 capital	385	(6)	379
Tier 3 capital	26	(16)	10
Total capital	1,411	265	1,676
Made up by:			
Surplus funds	1,117	119	1,236
Deferred tax	26	(16)	10
Reconciliation reserve	(115)	23	(92)
Subordinated liabilities	385	(6)	379
Minority interests	(2)	145	143
Total capital	1,411	265	1,676
Total eligible own funds to meet SCR	1,411	265	1,676

- 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 the 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	1,287	379	10	1,676
Total eligible Own Funds to meet the Group SCR	1,287	379	10	1,676

Total available Own Funds to meet minimum Group SCR	1,287	379		1,666
Capital restrictions	-	(281)		(281)
Total eligible Own Funds to meet the minimum Group SCR	1,287	98		1,385

No Own Funds have 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.

	2017	2016
	£m	£m
IFRS Unallocated divisible surplus	1,189	998
Deduct deferred acquisition costs, goodwill and other intangible assets and liabilities	(410)	(393)
Add subordinated debt treated as available capital	379	385
Insurance contract valuation differences	305	505
Difference in non-controlling interest calculations	279	-
Deferred tax adjustments	10	24
Other	6	(19)
Less net eligible own funds relating to ring-fenced funds	(192)	(204)
Eligible own funds to meet SCR (excluding ring-fenced funds)	1,566	1,296
RNPFN – eligible own funds	125	139
Restriction of own funds in respect of RNPFN	(34)	(42)
Teachers – eligible own funds	67	65
Restriction of own funds in respect of Teachers	(48)	(47)
Total Basic own funds (excluding ring-fenced fund surplus)	1,676	1,411

Differences in the asset and liability valuation methodology used for solvency II 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 1 January 2016.

g) Consolidation of Group's own funds

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 policyholder 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 and net deferred tax assets. For further information refer to the Valuation for Assets and Liabilities sections 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.

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

E.2 SCR and MCR

E.2.1 Group SCR and Minimum Consolidated Group SCR

The Group 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 31 December 2017 was £978m (31 December 2016: £1,044m). A breakdown of how the SCR has changed over the reporting period is shown in section E.2.2 below.

The minimum consolidated Group SCR as at 31 December 2017 was £444m (2016: £416m).

The minimum consolidated Group SCR is the sum of MCRs of the individual entities (see sections E.2.1 of appendices for further information).

The reason for the increase in the minimum consolidated Group SCR over the year is primarily due to the increased LVFS solo MCR.

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 Group SCR by risk. 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 matching adjustment, RNPFN and Teachers ring-fenced funds. The capital requirements for these funds are calculated in isolation and added to the remaining part of LVFS, with no credit being taken for diversification between them. The risks allow for the mutual bonus claw back management action and so the results here are not directly comparable with those presented in section C of this report.

Risk Module (all figures in £m)	2017	2016
Market risk	487	476
Credit counterparty risk	51	45
Life underwriting risk	227	315
Health underwriting risk	90	86
Non-Life underwriting risk	478	473
Total before diversification	1,333	1,395
Diversification	(371)	(414)
Basic Solvency Capital Requirement	962	981
Operational risk	98	107
Loss absorbing capacity of deferred taxes	(82)	(46)
Non-insurance regulated entities	-	2
Solvency Capital Requirement	978	1,044

Non-life underwriting risk SCR has not materially changed over the year and does not reflect the 49% sale of the general insurance business within the group. The effect of the sale is reflected within the Own Funds via the Minority Interest Deduction.

Life underwriting risk SCR has materially reduced over the period. This was driven by a change in methodology in respect of the Mutual Bonus clawback management action which, on a Group basis, was not applied to expense risk at 31 December 2016 but was applied to expense risk at 31 December 2017. There was also a material reduction in longevity risk due to the reinsurance of OB Pensions business.

The loss absorbing capacity of deferred taxes has increased primarily due to the recognition of tax in the general insurance business.

E.2.3 Diversification benefit

Diversification benefit within the SCR emerges from relative sizes of the risks and the correlation assumptions between them. As a result of using the Standard Formula approach to assess the Group SCR, 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 which offers another material source of diversification benefit within the SCR.

E.2.4 Basis of calculation

The Group uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and minimum group consolidated SCR 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 MCRs and SCRs 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.

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	LV 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
TMTP	Transitional Measures on Technical Provisions
TPS	Teachers Provident Society (a RFF)
UK	United Kingdom
VA	Volatility Adjustment

Appendix 1

LV= Regulated Entity SFCRs

LVFS Solo SFCR.....	98
LVLC SFCR.....	134
LVPL SFCR.....	151
LVIC SFCR.....	169
HIGHWAY SFCR.....	195
TAC SFCR.....	221

LVFS Solo SFCR

A. Business and Performance (LVFS - Solo)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Friendly Society Limited (LVFS) 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 A.1 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 Society, and the Group.

For the contact details of the PRA please see part b) in chapter A.1 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 A.1 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 A.1 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 undertaking's position within the group please see part e) in chapter A.1 of the Group section of this report.

f) Material lines of business and material geographic areas.

LVFS mainly underwrites life insurance contracts within the UK.

LVFS conducts life assurance business through its Life operating segment. The principal activity is the provision of Protection and Retirement Solutions products and managing the Heritage products. The core products offered in Protection are Life, Critical Illness and Income Protection Insurance. The core products offered in Retirement Solutions are Fixed-Term Annuities, Self-Invested Personal Pensions (SIPPs), Equity Release Mortgages and Flexible Guarantee Bonds. Heritage products include legacy with-profits business (both Ordinary Branch and Industrial Branch), the ring-fenced RNPFN Fund, containing the business acquired from the Royal National Pension Fund for Nurses in 2001, and the ring-fenced TA Fund, containing the with-profits business acquired from Teachers Provident Society Limited in 2016. The Heritage products are no longer actively marketed, although the Society continues to sell newer with-profits products via the Life business channels.

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

Business and Performance

The income statement numbers presented in the table below are based on the IFRS Financial Statements.

LVFS Solo P&L (£m)	2017	2016
Gross earned premium	835	1,228
Premiums ceded to reinsurers	(1,092)	(261)
Net earned premiums	(257)	967
Investment income	430	406
Net gains on investments	379	1,013
Gain arising on Teachers acquisition	-	3
Other income	22	12
Total income	574	2,401
Net benefits and claims	(634)	(622)
Net change in contract liabilities	415	(1,494)
Change in economic basis	(48)	-
Finance costs	(23)	(23)
Net operating and administrative expenses	(222)	(215)
Total benefits, claims and expenses	(512)	(2,354)
Profit before tax, mutual bonus and UDS transfer	62	47
Mutual bonus	(26)	(17)
Income tax expense	(24)	(45)
Pension scheme actuarial gain/(loss) net of tax	19	(2)
Transfer to/(from) Unallocated divisible surplus	31	(17)

The Society reported an IFRS profit before tax, mutual bonus and unallocated divisible surplus transfer for the year of £62m (2016: £47m). The increase in profit was mainly attributable to the increase in dividend income from Group undertakings, which increased to £94m (2016: £44m). There were also, material impacts generated by model and basis changes during the year, including:

- £53m favourable impact related to changes in longevity assumptions.
- £42m favourable impact of the OB pensions reinsurance arrangement.
- £48m adverse impact following a change in the life IFRS reserving reporting basis to better align with Solvency II.
- £34m adverse impact of higher Equity Release prepayment rates.
- £30m adverse impact associated with expenses, including a provision for potential stranded costs arising from the Allianz transaction.

The result was also impacted by £19m adverse experience variances mainly relating to increases in equity release prepayment rates and adverse mortality experience.

For further information on the results, please refer to the Report and Accounts.

Capital position and changes in risk profile

At 31 December 2017 the LVFS Solo capital surplus on a standard formula basis was £724m (2016: £688m) with capital cover of 190% (2016: 202%), see table below for further details. The results shown below include the closed ring-fenced funds. The closed ring-fenced funds do not require capital support at the valuation date.

£m	2017	2016	Change
Own funds	1,527	1,364	163
SCR	803	676	127
Surplus capital	724	688	36
CCR	190%	202%	(12)%

The Society's risk profile and capital position was materially affected in the year by the following actions:

- Ordinary Branch (OB) Pensions Reinsurance (increase in surplus capital of £108m, before TMTP recalculation)
 - OB Pensions is a portfolio of with-profits deferred and in-payment annuities with onerous guarantees, where the majority of policies are still in their deferment phase. It attracted high levels of standard formula SCR capital due to the long-dated longevity risk and the optionality the policyholder has at retirement to take cash, rather than the annuity benefit. The risk margin associated with OB Pensions is also very material and sensitive to change in interest rates.
 - On 2 December 2017, LVFS reinsured the majority of its OB Pensions deferred and in-payment annuities with Reinsurance Group of America (RGA). The transaction took the form of a funded longevity risk transfer and resulted in a reduction in the Society's exposure to post-vesting longevity risk with LVFS retaining the pre-vesting mortality and lapse risks, in particular the risk that fewer than expected policyholders take up the cash option as opposed to the guaranteed annuity. The transaction also reduced the gilt-swap spread risk that the Society is exposed to.
 - The day one impact of the transaction was mostly due to the impact on Own funds, which included a reduction in the Risk Margin. There was also a small reduction in the Society's post-diversified SCR, mostly due to the reduction in longevity risk offset by an increase in counterparty default risk. This is before recalculating TMTP.
- Sale of stake in General Insurance business (increase in surplus capital of £179m)
 - On 28 December 2017, the Society sold a 49% stake in LVGIG Ltd (sold through its LV Capital PLC subsidiary) to Allianz. This generated proceeds of £500m for the Society, which were retained within LV Capital PLC. In addition, renewal rights on its general insurance commercial lines business were also sold to Allianz Insurance plc (sold through its general insurance subsidiaries).
 - The increase in surplus capital for LVFS is significantly lower than the £444m increase in surplus for LV= Group. This is mainly because the proceeds of the sale of the 49% stake in LVGIG are held within LV Capital PLC, a subsidiary of LVFS which, on a solo basis, attracts an equity stress within the SCR calculation.
- Following the part sale of the General Insurance business, LVCAP is now being treated as a strategic holding. This change has reduced the SCR by £207m, compared to treating it as an equity investment. The Society considers this to be appropriate given the change in circumstances. In particular, it is believed that the value of the investment is likely to be materially less volatile for the following 12 months than other equities due to its assets which comprise:
 - £569m of cash/receivables (which is not subject to market risk)
 - 51% ownership in LVGIG (over which it has a put option to dispose of this holding at a guaranteed valuation of £520m).
- TMTP recalculation and step-down (reduction in surplus capital of £451m)
 - The Society recalculated TMTP as at 31 December 2017 following the OB Pensions reinsurance transaction and to coincide with the PRA's first biennial recalculation requirement. The effect of recalculation was to significantly reduce the level of TMTP, primarily due to changes in economic conditions following the prior recalculation on 31 August 2016.
 - The Society has updated its approach to stepping-down TMTP, with the annual step-down in TMTP occurring on 31 December (previously on 1 January) and allowed for in the year-end results. Therefore, the TMTP at year-end 2017 reflects two step-downs in TMTP compared with year-end 2016.
 - The overall impact of TMTP recalculation and step-downs was to reduce TMTP from £910m to £574m, an impact of £336m. The overall reduction in surplus capital of £451m is larger as this includes the impact of the change in the mutual bonus clawback management action, where this was removed from the risk margin, increasing TMTP. The FRR test continues to result in no restriction at the date of TMTP recalculation.
- A change in methodology to the mutual bonus claw back management action reduced the amount of claw back allowed for in the Solo SCR calculation and resulted in an increase in the Solo SCR of £75m.
- Loans from LVCAP to LVFS were converted into equity which increased the LVFS Solo SCR by £96m.
- The closure of derivative positions held in respect of the gilt-spread hedge and swaption collar strategy. This reduced the interest rate risk the Society is exposed to on a post-TMTP recalculation basis, but increased it on a pre-TMTP recalculation basis.
- The Society extended its equity hedging to cover NMPTL and Teachers unit-linked exposures. This reduced the equity risk the Society is exposed to.

System of Governance

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

A Cook appointed 1 January 2017
A Parsons appointed 30 June 2017
C Ledlie appointed 1 August 2017
S Treloar resigned 28 December 2017
P W Moore resigned 29 June 2017
M Austen resigned 20 June 2017
C Keers resigned 20 June 2017

Legal and regulatory environment

The wider external environment proved to be challenging during 2017. We continued to operate under a heightened level of uncertainty with political, financial and regulatory risks being the predominant themes over the year, exacerbated by the level of uncertainty around the outcome of the Brexit negotiations.

In March 2017 the UK government reduced the Ogden discount rate from 2.5% to -0.75%, which required the whole motor insurance industry to materially increase reserves held against future lump-sum personal injury claims. In September 2017 a government review into how the discount rate is set concluded that a revised methodology should be legislated for. We have welcomed the Government's recent publication of their Civil Liability Bill which seeks to address this, with an expectation that the planned outcome is a partial reversal of the previous reduction. However, there are a number of factors influencing this potential change meaning that its impact and timing remain uncertain.

We expect the overall heightened level of uncertainty to continue throughout 2018 and will continue to operate a prudent investment philosophy with a clear focus on strong risk management.

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.

All business is underwritten in the UK.

Net earned premiums

	Society	
	2017 £m	2016 £m
Gross earned premiums		
Long-term insurance and participating investment contracts		
Single premium		
New business		
Investments and savings	420	561
Pensions and annuities	151	423
Regular premium		
New business		
Life and health protection	37	37
Existing in-force business		
Investments and savings	33	31
Pensions and annuities	9	10
Life and health protection	185	166
Gross earned premiums	835	1,228
Premiums ceded to reinsurers		
Long-term insurance premiums	(1,092)	(261)
	(1,092)	(261)
Net earned premiums	(257)	967

2017 gross earned premiums of £835m fell by 32% compared to 2016 predominantly driven by falls in the retirement business, including the cessation of enhanced annuity sales during 2016 and also reduced new business flexible guarantee bond sales. In December 2017 the Society entered into a reinsurance arrangement in respect of the OB Pensions portfolio. This has increased premiums ceded to reinsurers by £829m.

Net benefits and claims

Society	2017			2016		
	Gross £m	Reinsur- ance £m	Net £m	Gross £m	Reinsur- ance £m	Net £m
Long-term insurance and participating investment contracts						
Benefits and claims paid	866	(237)	629	857	(237)	620
Change in the provision for claims	5	-	5	2	-	2
	871	(237)	634	859	(237)	622

2017 net benefits and claims are broadly in line with 2016 at £871m.

Net change in contract liabilities

Society	2017 £m	2016 £m
Gross increase in long-term contract liabilities		
Increase in long-term insurance contract liabilities - participating	(191)	(813)
Increase in investment contract liabilities - participating	(51)	(21)
Increase in long-term insurance contract liabilities - non-participating	(117)	(417)
Increase in investment contract liabilities - non-participating	(234)	(303)
Increase in long-term linked insurance contract liabilities	(23)	(54)
	(616)	(1,608)
Mutual bonus	26	17
	(590)	(1,591)
Increase in long-term contract liabilities ceded to reinsurers		
Increase in long-term insurance contract liabilities relating to non-participating contracts	143	47
Increase in long-term insurance contract liabilities relating to participating contracts	857	-
Increase in long-term linked insurance contract liabilities	35	47
	1,035	94
(Decrease)/increase in non-participating value of in-force business	(30)	3
Net change in contract liabilities before change in economic basis	415	(1,494)
Change in economic basis	(48)	-
Net change in contract liabilities	367	(1,494)

The gross increase in long-term contract liabilities has reduced from £1,591m in 2016 to £590m in 2017 driven by the lower levels of policyholders' investment gains, lower levels of new business during 2017 and the one-off impact of the Teachers acquisition in 2016. The net change in contract liabilities was also impacted by the £933m increase in reinsurance in respect of the OB Pensions portfolio.

Other operating and administrative expenses

Society	2017 £m	2016 £m
Commission paid on acquisition of business	54	57
Amortisation and impairment of intangible assets	2	-
Depreciation on property and equipment	3	3
Loss on disposal of property and equipment	1	-
Investment management expenses and charges	15	22
Auditors' remuneration	1	2
Employee benefits expense	249	259
Management charge allocated to group undertakings	(215)	(227)
Rent, rates and other facilities expense	12	12
Marketing and advertising	9	9
Other staff costs	15	4
IT costs	36	36
Fees	31	33
Other expenses	15	10
Claims handling cost recognised in Gross benefits and claims	(6)	(5)
Net operating and administrative expenses	222	215

2017 net operating and administrative expenses are broadly in line with 2016 at £222m.

Solvency II lines of business

In addition to the above, the material Solvency II lines of business by reference to IFRS gross written premiums, a component of underwriting performance, are outlined below based on gross written premium analysed within Quantitative Reporting Template (QRT) S.05.01.02, which is annexed to this SFCR.

Life insurance

All of the Society's business is classified as life insurance. This includes participating insurance and investment business and non-participating insurance and investment business. The material life insurance Solvency II lines of business for the year ended 31 December 2017 are as follows, based on contribution to life insurance business gross written premiums:

- Insurance with-profit participation – 31%
- Index-linked and unit-linked insurance – 44%
- Other life insurance – 21%
- Health – 4%

Gross written premiums collected under non-participating investment contracts are deposit accounted rather than accounted for through the income statement under IFRS. Consequently non-participating investment business is not captured within IFRS gross written premiums within QRT S.05.01.02 'Premiums, claims and expenses by line of business'.

A.3 Investment performance

Income and expenses with respect to investment activities

Components of investment activities

Investment income is 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 previous 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 of £15m (2016: £22m) are reported in Other operating and administrative expenses. These expenses are directly attributable to investment activities.

Investment performance

The following tables summarise the investment performance, on an IFRS basis:

Investment income

Society	2017 £m	2016 £m
Income from investments at fair value through income:		
- Dividend income	109	95
- Interest income from debt and fixed interest securities	164	200
- Interest on loans secured on residential property	36	36
- Interest on loans secured on commercial property	9	7
Interest income from group undertakings	18	24
Dividend income from group undertakings	94	44
	430	406

Investment income has increased to £430m (2016: £406m), driven by the £50m increase in dividend income from group undertakings as surplus funds were dividended up from the General Insurance business prior to the Allianz transaction.

Net gains on investments

Society	2017 £m	2016 £m
Investment properties	3	-
Investments at fair value through income:		
- Debt securities	2	396
- Equity securities	419	558
- Derivatives at fair value through income	(36)	(15)
- Loans and mortgages	4	77
- Other	3	-
Investments in group undertakings	(16)	(3)
	379	1,013

Net gains on investments of £379m are driven by the gains in equity securities as markets continued to rise in 2017. The higher net gains on investments in 2016 of £1,013m reflected the impact of a more pronounced fall in yields, driving increases in the value of debt securities, and a strong increase in UK equity markets.

Investments in securitisation.

There are no investments in securitisation (2016: £8m).

A.4 Performance of other activities

The results of other activities are as follows:

Finance costs

Society	2017	2016
	£m	£m
Interest expense on subordinated liabilities	23	23
	23	23

In 2013 the Society issued £350m of Fixed Rate Reset Subordinated Notes at par. The directly related costs of £4m incurred to issue the Notes have been capitalised as part of the carrying value and are being amortised using the effective interest rate basis over the period to the first call date in 2023. The effective interest rate on the £350m liability is 6.654% resulting in a £23m finance charge for the year.

The Notes have a maturity date of 22 May 2043 but the issuer 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% (£23m) 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.

Other income

Society	2017	2016
	£m	£m
Unit linked income	0	1
Fee and commission income	19	9
Other income	3	2
	22	12

Fee and commission income has increased in the Society, following the acquisition of the Teachers business in 2016 and changes to the SIPP income cash flows between the Society and one of its subsidiaries during the year.

Leasing arrangements

Operating lease commitments

Operating lease commitments of £8m (2016: £17m) relate to leases for various properties under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

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.

The Directors of LVFS during the year were as follows:

R. A. Rowney	C. Burton
S. Treloar - resigned 28 December 2017	J. Dean
P.W. Moore - resigned 29 June 2017	D. Neave
A. Parsons - appointed 30 June 2017	D. Barral
A.Cook - appointed 1 January 2017	C. Keers - resigned 20 June 2017
M.E. Austen - resigned 20 June 2017	C. Ledlie - appointed 1 August 2017

C. Risk Profile (LVFS – Solo)

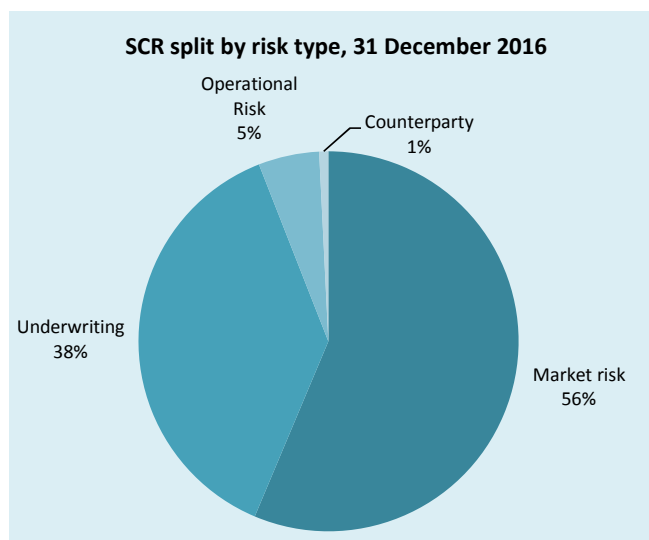
C.1 Overview

C.1.1 Overview of risk exposures

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 LVFS 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 the Group section of this report.

The chart below shows the 31 December 2017 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The results for 31 December 2016 are provided for comparison. Reference to the SCR in this and later sections is to the final post-diversified SCR including ring-fenced funds unless stated otherwise. The amount of SCR illustrated below is £1,034m (2016: £960m). This differs from the total SCR reported in section E.2 as it excludes the loss absorbing capacity of deferred tax and mutual bonus claw back management action, in order to aide comparison. The mutual bonus claw back management action results in a significant reduction in a small number of selected risks within the SCR calculation and so distorts any comparison between risks and between different year-ends where the selected risks differ.



C.1.2 Measurement of risk exposures

The Society's measurement of risk exposures has not changed materially over the reporting period.

Risk exposures are managed in a similar way for the Society as for the Group. This includes 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. In addition, 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.

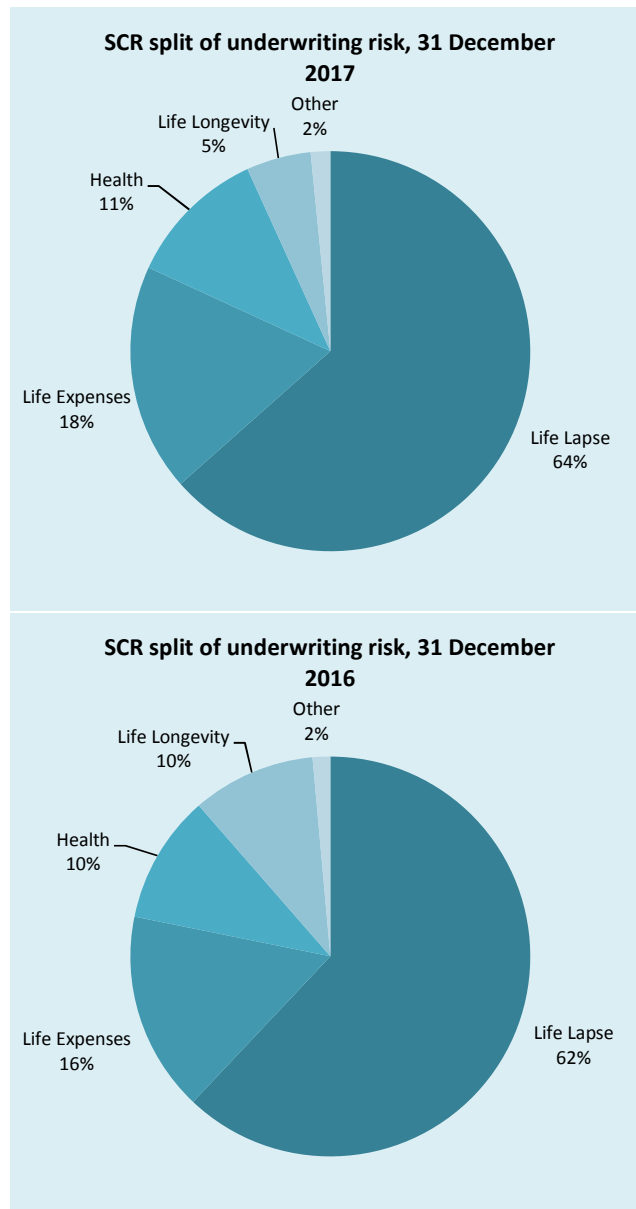
Where material, further information on risk concentrations relating to particular risks are given in sections C.2 to C.6 below.

C.2 Underwriting risk

In determining the price of its insurance products, and when reporting the financial results relating to these products, the Society makes a number of assumptions related to the future amounts and timing of payments. Underwriting risk arises from the actual outcome being different to these assumptions.

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 31 December 2017 split of underwriting risks within the Standard Formula SCR. The results for 31 December 2016 are provided for comparison. The amount of SCR illustrated below is £332m (2016: £362m). This differs from the underwriting risk capital shown in section E.2 as it excludes the mutual bonus claw back management action and fully allows for diversification within the SCR calculation, in order to aid comparison. The mutual bonus claw back management action results in a significant reduction in a small number of selected risks within the SCR calculation and so distorts any comparison between risks and between different year-ends where the selected risks differ.



Lapse risk is generally a significant risk across the life insurance industry, due to the long-term nature of life business. As a result, lapse rates on material product lines are closely monitored. Lapse risk also captures the risk associated with the take-up of policyholder options, notably the option to take a cash lump sum at retirement instead of the annuity on OB Pensions deferred annuity with-profits business. The cost of fewer policyholders taking cash at retirement has a material contribution to the lapse risk of the Society.

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. A significant amount of OB Pensions business, a with-profits deferred annuity product, was reinsured during 2017. This has reduced the amount of longevity risk the Society is exposed to. Further details are in section C.2.2 below.

All health exposure comes from protection products which 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.

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 other sources of risk.

C.2.2 Material changes over the reporting period

As mentioned above, a significant amount of OB Pensions business was reinsured during 2017. This has reduced the amount of longevity risk the Society is exposed to. LVFS retains all forms of pre/at retirement mortality and lapse risk (including risk of differing cash take-up rates), as well as expense, operational, and the longevity risk associated with expenses and higher levels of annuity than expected.

C.2.3 Risk mitigation techniques

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

C.2.4 Risk concentrations

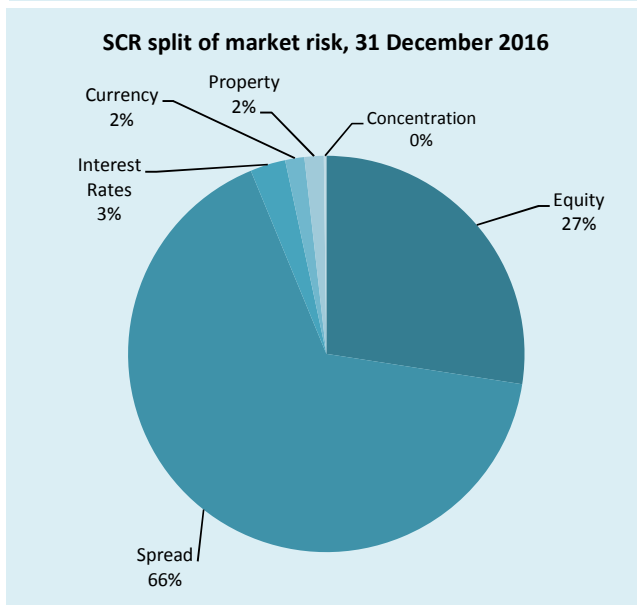
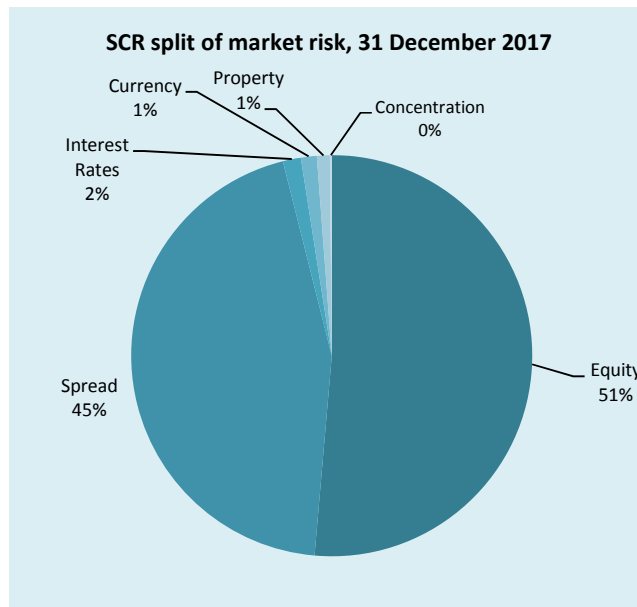
The Society has developed its insurance underwriting strategies to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome. Further details can be found in the Group section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

C.3 Market risk

Market risk arises as part of the Society’s general investment performance and product pricing. The risk to the Society arises from the performance of the investments being different from that assumed in the planning and pricing processes.

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 31 December 2017 split of market risks within the Standard Formula SCR. The results for 31 December 2016 are provided for comparison. The amount of SCR illustrated below is £652m (2016: £541m). This differs from the market risk capital shown in section E.2 as it excludes the mutual bonus claw back management action and fully allows for diversification within the SCR calculation, in order to aide comparison. The mutual bonus claw back management action results in a significant reduction in a small number of selected risks within the SCR calculation and so distorts any comparison between risks and between different year-ends where the selected risks differ.



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. For this reporting period, and following the Allianz Strategic Partnership, the Society held a significant amount of assets within the subsidiaries, resulting in the large increase in equity risk capital shown above.

Equity risk otherwise 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.

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 mortgage loans. 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.

Interest rate risk is present under all lines of business, as the level of best-estimate liabilities are calculated by discounting future cashflows.

The Society has only a limited exposure to currency (foreign exchange) risk through its investment in overseas assets.

A small amount of commercial property risk arises mainly from the with-profits business and from the Society's pension schemes. Note that residential 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 and is instead monitored using the Society's internal view of capital.

Sensitivities to key market risks are provided in section C.8.1.

C.3.2 Material changes over the reporting period

As noted previously, the Society entered a Strategic Partnership with Allianz which included the transfer of 49% of its general insurance business on 28 December 2017 in exchange for a significant amount of assets. This increased the assets held within a subsidiary of LVFS which, on a solo basis, are treated as equity within the SCR calculation.

Loans from LVCAP to LVFS were converted into equity which decreased the amount of spread risk the Society is exposed to whilst increasing the equity risk exposure.

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 of this report.

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

Credit counterparty risk arises from the holding of certain investment assets, hedging, reinsuring certain product related risks to third parties, and from normal trade credit such as brokers and premium finance. The risk to the Society is that a counterparty defaults on its obligations or fails to meet them in a timely manner.

C.4.1 Credit counterparty risk exposure

The principal risk that the Society is exposed to is the 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 mitigant then any reinsurance default could significantly impact the Society's capital position.
- The default of insurance intermediaries on money owed to the Society.

C.4.2 Risk Mitigation techniques

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

C.4.3 Material changes over the reporting period

The Society's exposure to RGA has increased as a result of the reinsurance of OB Pensions business. However, the capital associated with this is small because the arrangement is collateralised.

There were no other material changes to credit counterparty risk during 2017.

C.4.4 Risk concentrations

In order to limit its exposure to a single default, the Society 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 Society and the Society's Risk Appetite.

C.5 Liquidity risk

Liquidity risk arises from the possibility that the Society is unable to realise sufficient cash to be able, although solvent, to meet commitments to customers or third party partners when they fall due or can only secure them at excessive cost. This may arise either because of the nature of the investments held or adverse market conditions.

Liquidity risk is managed using the same techniques as used for Group, and further details are available in the Group section of this report.

The expected profit in future premiums (EPIFP) for the Society at the year end 2017 was £274m (2016: £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 the Group.

Further details can be found in the Group section of this report.

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 C.5. 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 of 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 annual submissions of the Own Risk and Solvency Assessment.

C.8 Sensitivities

This section sets out the Society's sensitivity to various economic and demographic assumptions. 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. They should only be treated as estimates which give a broad indication of the direction and magnitude of the change in surplus capital. The estimates have been calculated using a combination of analysis and expert judgement and include some approximations where these are not material to the final results.

C.8.1 Economic sensitivities

The below sensitivities have been carried out on the same basis as those in the Group section. 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.

Surplus capital at 31 Dec 2017:				
	724			
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
25% market fall in equities	(89)	(1)	(11)%	27%
100 bp fall in interest rates	(112)	64	(13)%	1,195%
100 bp rise in interest rates	91	(45)	12%	(967)%
50 bp rise in gilt swap spreads	(128)	3	(16)%	n/a
100 bp rise in credit spreads	146	(13)	19%	(50)%

C.8.2 Demographic sensitivities

The below sensitivities have been carried out on the same basis as those in the Group section. They therefore contain similar approximations and should only be treated as estimates which give a broad indication of the direction and magnitude of the impact of the sensitivity. More detail on the sensitivities and exposures are shown in the Group section of this report.

Surplus capital at 31 Dec 2017:				
	724			
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
15% increase in mortality rates (protection business only)	(8)	0	(1)%	583%
20% decrease in mortality rates (excluding protection business)	(44)	0	(5)%	255%
50% increase in lapses*	(22)	33	(3)%	10%
50% decrease in lapses*	28	(30)	4%	
50% decrease in OB Pensions cash-take-up rates at retirement	(58)	(15)	(7)%	14%

* Early retirements have been excluded from this sensitivity.

C.9 Additional information on risk profile

Further information can be found on an IFRS basis within the Report and Accounts.

D. Valuation for Solvency Purposes (LVFS - Solo)

D.1 Assets

Assets on a Solvency II basis	2017	2016
	£m	£m
Pension benefit surplus	178	134
Property, plant and equipment held for own use	7	9
Investments (other than assets held for index-linked and unit-linked funds)		
- Property (other than for own use)	3	5
- Participations	927	536
- Equities	860	871
- Bonds	4,298	5,051
- Collective Investment undertakings	3,068	2,732
- Derivatives	80	179
- Deposits other than cash equivalents	23	37
- Other Investments	3	-
Assets held for index-linked and unit linked funds	2,485	2,001
Loans and mortgages	868	884
Reinsurance recoverables	1,730	673
Insurance and intermediaries receivables	9	4
Reinsurance receivables	19	11
Receivables (trade, not insurance)	58	131
Cash and cash equivalents	71	143
Any other assets, not elsewhere shown	15	35
Total Assets	14,702	13,436

For solvency II 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.

Reconciliation between IFRS and Solvency II valuation		2017			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Intangible assets	#	10	-	(10)	-
Pension benefit surplus	1	178	-	-	178
Property, plant and equipment held for own use	#	7	-	-	7
Investments (other than assets held for index-linked and unit-linked funds)					
- Property (other than for own use)	3	3	-	-	3
- Participations	2,3	897	91	(61)	927
- Equities	3	3,698	(2,838)	-	860
- Bonds	3	3,916	382	-	4,298
- Collective Investment undertakings	3	3,391	(323)	-	3,068
- Derivatives	3	80	-	-	80
- Deposits other than cash equivalents	3	-	23	-	23
- Other Investments		3	-	-	3
Assets held for index-linked and unit linked	4	-	2,485	-	2,485
Loans and mortgages	5	867	1	-	868
Reinsurance recoverables	6	1,747	596	(613)	1,730
Insurance and intermediaries receivables	#	10	(1)	-	9
Reinsurance receivables	#	19	-	-	19
Receivables (trade, not insurance)	#	65	(7)	-	58
Cash and cash equivalents	7	424	(353)	-	71
Any other assets, not elsewhere shown	8	71	(56)	-	15
Total Assets		15,386	-	(684)	14,702

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

Supporting Notes

1. Pensions Benefit Surplus

For solvency II 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 II valuation purposes certain investments are not consolidated and are valued as participations.

Participations	£m
Shares in subsidiaries	887
Loan stock in subsidiaries	10
Investments in group undertakings - IFRS	897
Joint venture properties reclassified as participations	91
Adjusted equity method valuation differences	(61)
Participations - solvency II valuation	927

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 mapping differences between the IFRS and Solvency II hierarchies with certain assets being 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 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 31 December 2017.

	QMP £m	QMPS £m	AVM £m	AEM £m	Total £m
Bonds	2,099	2,199	-	-	4,298
Equities – Listed	818	-	-	-	818
Equities - Unlisted	-	-	42	-	42
Collective Investment Undertakings	3,001	67	-	-	3,068
Derivatives	-	80	-	-	80
Participations	-	-	-	927	927
Deposits other than cash equivalents	23	-	-	-	23
Other Investments	-	-	3	-	3
Property (other than own use)	-	-	3	-	3
Investments (other than assets held for index-linked and unit-linked funds)	5,941	2,346	48	927	9,262
Loans and mortgages (see note 5 below)	-	200	668	-	868
Total	5,941	2,546	716	927	10,130

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

5. Loans and Mortgages

For solvency II 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.

	£m
Equity release mortgages	667
Commercial mortgages	200
Total included in Financial assets at fair value through income - IFRS	867
Reclassify accrued interest on commercial mortgages from accrued interest	1
Total Loans and Mortgages - solvency II valuation	868

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 3 Investments for full definition of AVM and Section D.4). 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. Their basis is classified as Level 2 for IFRS and Quoted Market Price in active markets for similar assets (QMPS) for Solvency II. (Please see note 3 Investments for a full description of QMPS).

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 Section D.2 Technical Provisions).

7. Cash and cash equivalents

For solvency II 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.

8. Any other assets, not shown elsewhere

For solvency II 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	62
Other prepayments and accrued income	9
Prepayments and accrued income - IFRS	71
Reclassify accrued interest on bonds to investments	(56)
Total Any other assets, not elsewhere shown - solvency II valuation	15

D.2 Technical provisions

Technical provisions by line of business

Total Technical Provisions by line of business:

Line of Business	2017 £m	2016 £m
Insurance with-profits participation	5,820	5,351
Index-linked and unit-linked insurance	3,037	2,517
Other life insurance (including Health)	3,609	3,432
Total Life insurance obligations	12,466	11,300

The following table sets out the LVFS technical provisions split by Solvency II lines of business as at 31 December 2017.

Line of Business	31 December 2017 - £m			
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP)	Total Technical Provisions
Insurance with-profits participation	5,841	153	(174)	5,820
Index-linked and unit-linked insurance	3,037	42	(42)	3,037
Other life insurance (including Health)	3,831	136	(358)	3,609
Total Life insurance obligations	12,709	331	(574)	12,466

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 D.2.2.2 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 the S.22.01.21 QRT annexed to this report.

Uncertainty within the Technical Provisions

The calculation of Technical Provisions uses 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	Solvency II value £m	IFRS value £m	Difference £m
Insurance with-profits participation	5,820	6,019	(199)
Index-linked and unit-linked insurance	3,037	3,048	(11)
Other life insurance (including Health)	3,609	4,271	(662)
Total Life insurance obligations	12,466	13,338	(872)

Note: The IFRS value excludes outstanding claims, stranded costs and equity release provision of £100m.

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 in section D.2.2.2 of the Group part of this report.

The other primary differences between Solvency II and IFRS are set out below:

Discount rates: Whilst the risk-free reference curve under IFRS has been aligned to the rates prescribed by EIOPA for use under Solvency II (derived from swap rates), there are differences due to additions to the risk-free rates. Under Solvency II, the Society makes use of the VA and MA, 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, where the VA is applied, the movement in the EIOPA-curve with the VA is the primary difference between Solvency II and IFRS (other than the Risk Margin and TMTP).

Prudent margins: 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: These exist under Solvency II but not IFRS.

Description of Reinsurance Recoverables

The BEL is calculated gross without deduction of amounts recoverable from reinsurance contracts. The calculation of recoverable amounts is carried out separately for reinsurance contracts as follows:

- the value of unitised funds invested via the reinsurance arrangement with Managed Pension Funds Limited; and
- for all other business, the probability-weighted average of the discounted future cash flows allowing for contract boundaries.

The amounts recoverable are then adjusted to allow for the default risk associated with the reinsurance counterparties. The assumptions and models used were the same as those used for the BEL.

Reinsurance recoverables are 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.

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

Material changes in assumptions

Equity Release prepayment rates have been increased for terms 3 to 14 years. This corresponds to observed higher levels of prepayments compared to the previous year's assumptions.

Future mortality improvements are allowed for based on the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) 2016 projection model. Previously the 2013 CMI model was used.

Flat lapse rates that apply to the LVFS unit-linked pensions have been replaced with rates that typically vary by age. Additionally the drawdown rate has increased.

The calculation of the insurance contract liabilities is impacted by changes in unit costs. A review of the methodology has been carried out in 2017 and the revised expense assumptions have been adopted.

D.3 Other liabilities

Other liabilities on a Solvency II basis	2017	2016
	£m	£m
Provisions other than technical provisions	13	11
Deferred tax liabilities	98	73
Derivatives	187	236
Debts owed to credit institutions	62	116
Insurance and intermediaries payables	65	64
Reinsurance payables	7	2
Payables (trade, not insurance)	146	143
Subordinated liabilities	367	373
Any other liabilities, not elsewhere shown	49	3
Total Other Liabilities	994	1,021

Reconciliation between IFRS and Solvency II valuation	Note	2017			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
		£m	£m	£m	£m
Provisions other than technical provisions	#	13	-	-	13
Deferred tax liabilities	#	98	-	-	98
Derivatives	#	187	-	-	187
Debts owed to credit institutions	#	62	-	-	62
Insurance and intermediaries payables	1	15	-	50	65
Reinsurance payables	#	7	-	-	7
Payables (trade, not insurance)	2	159	-	(13)	146
Subordinated liabilities	3	348	-	19	367
Any other liabilities, not elsewhere shown	4	9	-	40	49
Total Other Liabilities		898	-	96	994

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

Supporting Notes

1. Insurance and intermediaries payables

For Solvency II valuation purposes, insurance and intermediaries payables 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 II purposes are reclassified to insurance and intermediaries payables.

Under IFRS, insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

Insurance and intermediaries payables	£m
Due to policy holders	15
Due to intermediaries	-
Total insurance and intermediaries payables - IFRS	15
Reclassification from technical provisions to insurance and intermediaries payables	50
Total insurance and intermediaries payables - solvency II 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	15	-	-	-	-	15

2. Payables (trade, not insurance)

For solvency II valuation purposes, payables (trade, not insurance) are valued consistently with IFRS and then adjusted to remove the MIB levy as part of the technical provisions calculation.

Under IFRS, trade payables are recognised when due. Payables are initially recognised at fair value and subsequently held at amortised cost.

Payables (trade, not insurance)	£m
Bank overdrafts	8
Trade payables	16
Amounts owed to group undertakings	21
Other taxes and social security costs	10
Other payables	31
Accruals and deferred income	73
Total Payables (trade, not insurance) - IFRS	159
Reclassification of payables to technical provisions	(13)
Payables (trade, not insurance) - solvency II valuation	146

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)	149	-	-	-	-	149

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 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.

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 II 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)	348
Subordinated liabilities - IFRS	348
Revaluation of subordinated debt	19
Subordinated liabilities - solvency II valuation	367

4. Any other liabilities, not elsewhere shown

For Solvency II valuation purposes, current corporation tax is valued consistently with IFRS. On the Solvency II balance sheet, the Expense reserve is included in the value of Any other liabilities, not elsewhere shown as well as the adjustment of the loan to Wealth Wizards as part of the revaluation of subsidiaries.

Under IFRS, current corporation tax is due within one year.

Any other liabilities, not elsewhere shown	£m
Current corporation tax	9
Any other liabilities, not elsewhere shown - IFRS	9
Expense reserve reclassified from technical provisions	50
Adjustment to value of Wealth Wizard intergroup loan	(10)
Total Any other liabilities, not elsewhere shown - solvency II valuation	49

D.4 Alternative methods for valuation

Information is provided for assets valued using alternative methods.

Justification for using alternative methods

The Society 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 Society 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 the table below;

		2017		
		Reasonably possible alternative assumptions		
Description	Unobservable input	Current fair value	Increase in fair value	Decrease in fair value
		£m	£m	£m
Loans secured on residential property	Discount rates +/- 50bps	667	33	(30)

For Equity release mortgages (£667m), please refer to Section D.1 Assets, Note 5 Loans and Mortgages, sub-heading Equity release mortgages for the valuation basis.

- Unlisted equity (£133m) 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 (£3m) 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 (£7m) is valued at the IFRS carrying value, based on cost less accumulated depreciation with assets written down to their recoverable amount where this is less than the carrying value. The IFRS carrying value is deemed to be materially the same as fair value.

D.5 Any other information

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

E. Capital Management (LVFS - Solo)

E.1 Own funds

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

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 £m	Tier 2 £m	Tier 3 £m	Total £m
Surplus funds	1,242	-	-	1,242
Reconciliation reserve	(82)	-	-	(82)
Subordinated liabilities	-	367	-	367
Total Basic Own Funds	1,160	367	-	1,527
Total available Own Funds to meet the SCR	1,160	367	-	1,527
Total available Own Funds to meet the MCR	1,160	367	-	1,527

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

Total available Own Funds to meet the SCR	1,160	367	-	1,527
Tier 2 capital restriction	-	-	-	-
Total eligible Own Funds to meet the SCR	1,160	367	-	1,527

Total available Own Funds to meet the MCR	1,160	367	-	1,527
Tier 2 capital restriction	-	(328)	-	(328)
Total eligible Own Funds to meet the MCR	1,160	39	-	1,199

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 which 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.

More information on the terms and conditions of Tier 2 subordinated liabilities can be found in Section D.3 Other Liabilities, note 3.

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. 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 policyholders together with the free assets of the Group. Any profit or 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 which are included as Tier 2 capital within own funds, together with the valuation methodology are given in Section D.3, note 3.

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 £803m which therefore means a maximum of £401.5m of subordinated debt is eligible to meet the SCR.

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 £201m which therefore means a maximum of £40m of subordinated debt is eligible to meet the MCR.

Changes in own funds during the reporting period

	LVFS		
	1 January 2017 £m	Movement £m	31 December 2017 £m
Eligible own funds			
Tier 1 capital	1,027	133	1,160
Tier 2 capital	373	(6)	367
Total capital	1,400	127	1,527
Made up by:			
Surplus funds	1,116	126	1,242
Reconciliation reserve	(89)	7	(82)
Subordinated liabilities	373	(6)	367
Total capital	1,400	127	1,527
Total eligible own funds to meet SCR	1,400	127	1,527

- 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 the SCR

Ancillary own funds

At 31 December 2017 there were no ancillary own funds.

Deductions from own funds

At 31 December 2017 there were no deductions from own funds.

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

LVFS is a friendly society and is incorporated under the Friendly Societies Act 1992. As a mutual insurer it is owned by its 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 31 December 2017	
	£m	£m
Analysis of Equity per the statutory financial statements		
Unallocated divisible surplus		1,050
Solvency II Adjustments (excluding reclassifications)		
<u>Assets</u>		
- Reduction in valuation of participations (Section D.1 note 2)	(61)	
- Reduction in valuation of intangibles	(10)	
- Reduction in valuation of reinsurance recoverable (Section D.1 note 6)	(613)	
		(684)
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2)		972
<u>Other liabilities</u>		
- Increase in payables	(37)	
- Increase in subordinated debt	(19)	
- Other	(40)	
		(96)
Total Equity - solvency II valuation		1,242
Restricted own fund items due to ring-fencing		(82)
Subordinated liabilities allowable as own funds items		367
Total own funds - solvency II valuation		1,527
Excess of Assets over Liabilities - solvency II valuation		
Total Assets		14,702
Total Technical Provisions		(12,466)
Total Other Liabilities		(994)
Excess of Assets over Liabilities - solvency II valuation		1,242

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 approach adopted for the 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 SCR for LVFS as at 31 December 2017 was £803m (31 December 2016: £676m). The SCR increased significantly over the period reflecting the sale proceeds of the 49% sale of the general insurance business, which have been retained within a subsidiary of the Society. As described above, on a Solo basis the value of the Society's subsidiaries are treated as equities and attract large equity stresses within the Solo SCR calculation, irrespective of the nature of their actual investment holdings.

The Minimum Capital Requirement (MCR) as at 31 December 2017 was £201m (31 December 2016: £169m).

The calculation of the MCR is laid out in the S.28.01.01 QRT annexed to this report. The MCR is calculated, as prescribed in the Solvency II regulations, involving the multiplication of prescribed factors to Technical Provisions (excluding Risk Margin) and capital at risk, subject to a floor of 25% of the SCR and a cap of 45% of the SCR. There is also an absolute floor specified as 3.7m Euros, 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 LVFS 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 the remaining part of LVFS, with no credit being taken for diversification between them. The risks allow for the mutual bonus claw back management action and so the results here are not directly comparable with those presented in section C of this report.

Risk Module (all figures in £m)	2017	2016
Market risk	640	497
Credit counterparty risk	30	22
Life underwriting risk	260	252
Health underwriting risk	89	86
Non-Life underwriting risk	-	-
Total before diversification	1,019	857
Diversification	(193)	(174)
Basic Solvency Capital Requirement	826	683
Operational risk	40	50
Loss absorbing capacity of deferred taxes	(63)	(57)
Other adjustments	-	-
Solvency Capital Requirement	803	676

Market risk has increased materially on a Solo basis. This is because the Society entered into a Strategic Partnership with Allianz which included the sale of 49% of its general insurance business on 28 December 2017. The sale proceeds are retained within a subsidiary of LVFS which, on a solo basis, is treated as equity investments within the SCR calculation.

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 A.1 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 A.1 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 A.1 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 A.1 of the Group section of this report.

f) Material lines of business and material geographic areas.

LVLC underwrites life insurance contracts within the UK.

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 a reinsurer of Protection contracts consisting of term assurances and critical illness policies for which it receives premium income.

Changes of Directors during 2017 were as follows:

A M Parsons – Appointed 30 June 2017	S R Haynes – Resigned 31 December 2017
P W Moore – Resigned 29 June 2017	J T Perks – Appointed 1 July 2017
M I Rix - Resigned 30 June 2017	

Apart from the director changes, the governance of LVLC remained stable and, the solvency position and overall strength of the business was consistent during the year.

LVLC used the Standard Formula to calculate its capital requirements throughout 2017, and this is expected to continue 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:

2017	Other life insurance	Health reinsurance	Life reinsurance	Total
	£000	£000	£000	£000
Net earned premiums	100	367	24	491
Net claims incurred including changes in other technical provisions	(108)	(288)	-	(396)
Expenses incurred (excluding investment management expenses)	(4)	-	-	(4)
Net total	(12)	79	24	91

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)	-	(1)	(35)
Net total	(1,124)	152	(55)	(1,027)

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.

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:

	2017	2016
	£000	£000
Net earned premium per the financial statements	491	564
Net total per Solvency II	491	564
Net claims incurred per the financial statements	(1,185)	(1,454)
Net change in insurance contract liabilities per the financial statements	789	(102)
Net total per Solvency II	(396)	(1,556)
Operating expenses per the financial statements	(25)	(54)
Less investment management expenses	21	19
Net total per Solvency II	(4)	(35)

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	2017 £000	2016 £000
Dividend income	3	5
Interest income	450	501
Realised and unrealised (losses)/gains	(63)	1,253
Investment expenses	(21)	(19)
Total Investment Performance	369	1,740

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

2017 Asset class £000	Dividends	Interest	Realised / Unrealised gains / losses	Total	Percentage of total	Average investment holding during 2017	Average investment return
Government bonds	-	440	(74)	366	93.8%	15,031	2.4%
Corporate bonds	-	8	11	19	4.9%	2,026	0.9%
Collective investment undertakings	3	-	-	3	0.8%	1,272	0.2%
Cash and deposits	-	2	-	2	0.5%	2,102	0.1%
Total	3	450	(63)	390			
Less investment expenses				(21)			
Net total				369			

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			

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.

The Directors of LVLC during the year were as follows:

R A Rowney	M I Rix - Resigned 30 June 2017
A M Parsons – Appointed 30 June 2017	S R Haynes – Resigned 31 December 2017
P W Moore – Resigned 29 June 2017	J T Perks – Appointed 1 July 2017

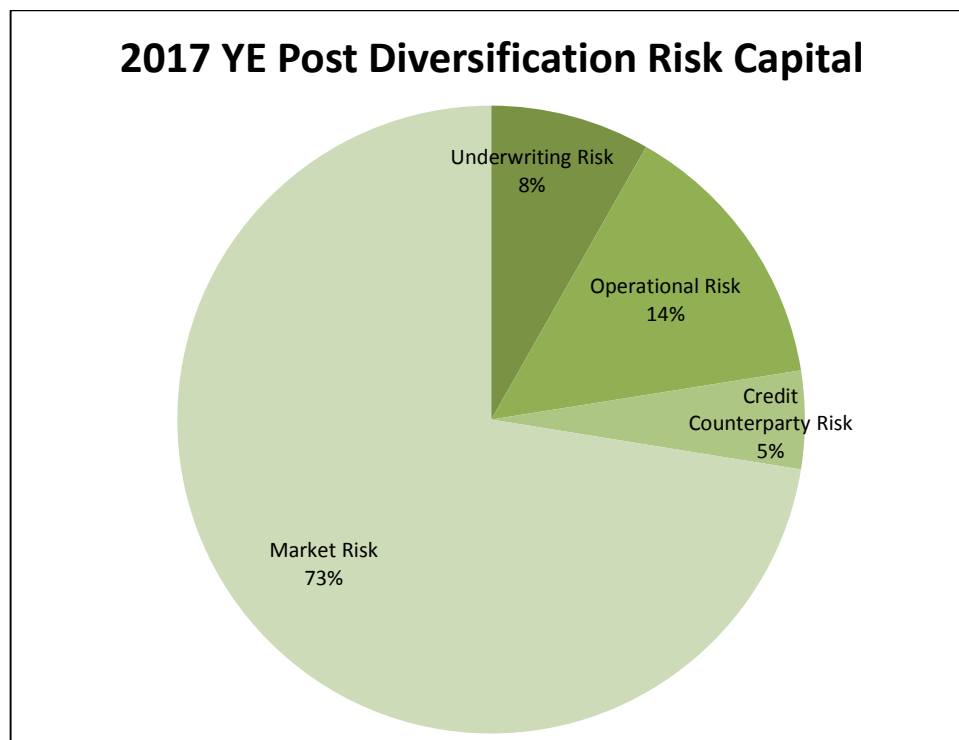
C. Risk Profile (LVLC)

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. Other risks contributing to the SCR are Underwriting, Credit Counterparty and Operational Risks, which 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 31 December 2017, the SCR falls below the Absolute Minimum Capital Requirement (AMCR) that LVLC is required to hold. This has been the case for some time and it is expected that this position is likely to continue going forward. The AMCR at 31 December 2017 was £3.25m.



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 C.1.2.

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 C.1.3.

C.1.4 Risk Concentration

There are no material concentrations of risk within LVLC. As a result, the SCR at 31 December 2017 falls below the 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

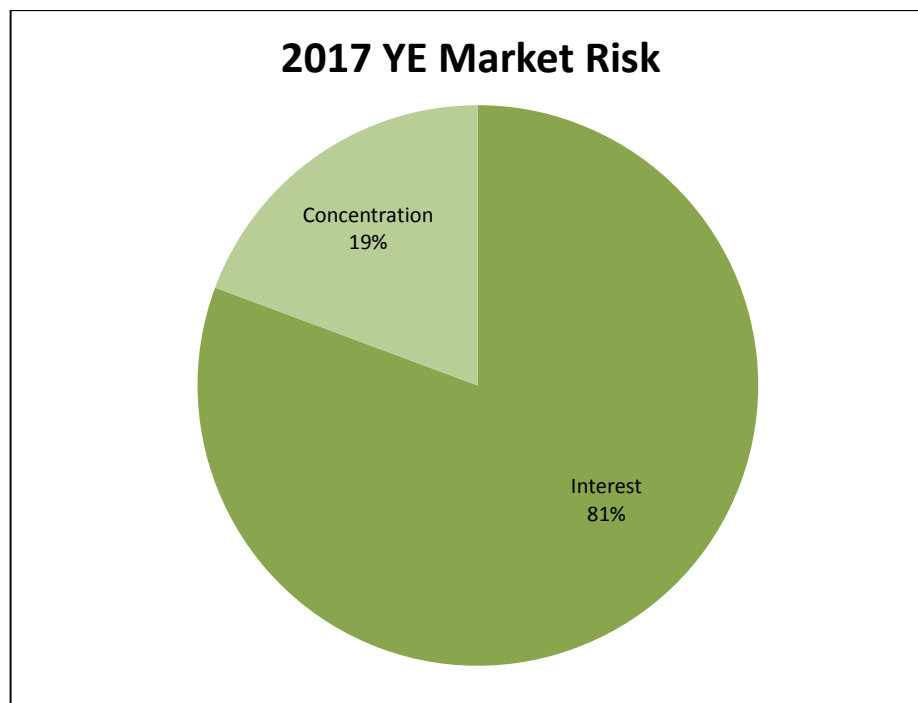
There have been no material changes in the level of underwriting risk during 2017.

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 2017.

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 in section C.4 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 2017.

C.5 Other Risks

Liquidity, Operational and other risks are managed at a Group level and are described further in sections C.5, C.6 and C.7 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 II 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. 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.

Reconciliation between IFRS and the Solvency II valuation		2017		
		IFRS	Adjustments	Solvency II
Assets	Note	£000	£000	£000
Investments (other than assets held for index-linked and unit-linked contracts)	1	15,783	3,667	19,450
Bonds		14,591	3,077	17,668
Collective Investments Undertakings		1,192	-	1,192
Deposits other than cash equivalents		-	590	590
Cash and cash equivalents	2	4,266	(3,590)	676
Loans and other receivables	#	260	-	260
Insurance receivables	#	29	-	29
Any other assets, not elsewhere shown	#	97	(77)	20
Total assets		20,435	-	20,435

#= Disclosure note not provided as solvency II 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 mapping differences between the IFRS and Solvency II hierarchies with certain assets being 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 31 December 2017:

	QMP	QMPS	AVM	AEM	Total
	£000	£000	£000	£000	£000
Government bonds	14,646	-	-	-	14,646
Corporate bonds	-	3,022	-	-	3,022
Collective Investments Undertakings	1,192	-	-	-	1,192
Deposits other than cash equivalents	590	-	-	-	590
Investments (other than assets held for index-linked and unit-linked funds)	16,428	3,022	-	-	19,450

2. Cash and cash equivalents

For solvency II 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.

Cash and cash equivalents	£000
Bank Balances	676
Short-term bank deposits	3,590
Total cash and cash equivalents - IFRS	4,266
Reclassify short-term deposits into bonds and deposits	(3,590)
Total cash and cash equivalents - solvency II valuation	676

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 31 December 2017.

Line of Business	31 December 2017 - £000		
	Best Estimate Liability (BEL)	Risk Margin (RM)	Total Solvency II Technical Provisions
Health insurance	25	2	27
Other life insurance	14,517	125	14,642
Total Life insurance obligations	14,542	127	14,669

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

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 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.

D.2.3 Uncertainty within the Technical Provisions

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.2.4 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 December 2017 - £000		
	Solvency II Value	IFRS Value	Difference
Health insurance	27	25	2
Other life insurance	14,642	14,468	174
Other – claims liabilities	-	186	(186)
Total Life insurance obligations	14,669	14,679	(10)

As at 31 December 2017, 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 rate based on gilt yields. Under Solvency II, a curve is used as prescribed by EIOPA and derived from swap rates. As at 31 December 2017, the swap rates were below gilt yields for later durations. Although the impact of this varies with the duration of different lines of business, overall the result is a decrease in Technical Provisions under Solvency II relative to IFRS.

D.3 Other liabilities

Reconciliation between IFRS and Solvency II value		2017		
		IFRS	Adjustments	Solvency II
Other Liabilities	Note	£000	£000	£000
Insurance and intermediaries payables	1	55	186	241
Payables (trade, not insurance)	#	4	-	4
Any other liabilities, not elsewhere shown	#	89	-	89
Total other liabilities		148	186	334

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

Supporting Notes

1. Insurance and intermediaries payables

For solvency II valuation purposes, insurance and intermediaries payables 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 II purposes are reclassified to insurance and intermediaries payables.

Under IFRS, Insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

Insurance and intermediaries payables	£000
Due to policy holders	55
Total insurance and intermediaries payables - IFRS	55
Reclassification from technical provisions to insurance and intermediaries payables	186
Total insurance and intermediaries - solvency II valuation	241

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

						£000
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Insurance and intermediaries payables	55	-	-	-	-	55

D.4 Alternative methods for valuation

There are no material assets or liabilities for LVLC that use alternative valuation methods.

D.5 Any other material information

All relevant information is provided in the sections above and as such, no further information is disclosed here.

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.

	Tier 1 £000	Tier 2 £000	Tier 3 £000	Total £000
Ordinary share capital	100	-	-	100
Reconciliation reserve	5,332	-	-	5,332
Total Basic Own Funds	5,432	-	-	5,432
Total available Own Funds to meet the SCR	5,432	-	-	5,432
Total available Own Funds to meet the MCR	5,432	-		5,432

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

Total available Own Funds to meet the SCR	5,432	-	-	5,432
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	5,432	-	-	5,432

Total available Own Funds to meet the MCR	5,432	-		5,432
Capital restrictions	-	-		-
Total eligible Own Funds to meet the MCR	5,432	-		5,432

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		
	1 January 2017 £000	Movement £000	31 December 2017 £000
Eligible own funds			
Tier 1 capital	5,083	349	5,432
Total capital	5,083	349	5,432
Made up by:			
Equity shares	100	-	100
Reconciliation reserve / surplus	4,983	349	5,332
Total capital	5,083	349	5,432
Total eligible own funds to meet SCR	5,083	349	5,432

- Tier 1 capital includes movements in excess of assets over liabilities.

Ancillary own funds

At 31 December 2017 there were no ancillary own funds.

Deductions from own funds

At 31 December 2017 there were no deductions from own funds.

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Retained earnings on a Solvency II basis	5,332
Total	5,332

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

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities:

	At 31 December 2017	
	£000	£000
Analysis of Equity - IFRS		
Ordinary shares, allotted and fully paid	100	
Retained Earnings	5,508	
Total Equity - IFRS		5,608
Solvency II Adjustments (excluding reclassifications)		
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2.3)		10
<u>Other liabilities</u>		
- Increase in payables (Section D.3)		(186)
Total Equity – solvency II basis		5,432
Total own funds - solvency II basis		5,432
Excess of Assets over Liabilities - solvency II basis		
Total Assets		20,435
Total Technical Provisions		(14,669)
Total Other Liabilities		(334)
Excess of Assets over Liabilities – solvency II basis		5,432

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.

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	2017	2016
Solvency Capital Requirement (SCR)	459	431
Minimum Capital Requirement (MCR)	3,251	3,332

There has been no material change in the SCR during 2017. There has been a decrease in the Absolute Minimum Capital Requirement during 2017 of £81k due to a change in the Euro/Pound exchange rate over the period.

E.2.2 SCR split by risk

The following table summarises the risk modules which contribute to the Solvency Capital Requirement for LVLC applicable under standard formula.

Year-end 2017 - all figures in £000

Category	Specific Risk	Post Diversified Capital Requirement
Credit Counterparty Risk		23
Market Risk	Interest	268
	Concentration	64
Market Risk		332
	Expenses	38
	Mortality	-
Underwriting Risk		38
Liquidity Risk		-
Operational Risk		66
SCR		459

E.2.3 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 SFCR

A. Business and Performance (LVPL)

A.1 Business

a) Name and legal form of undertaking

LV Protection Limited (LVPL) is a UK-incorporated and domiciled company limited by shares.

For the contact details of LVPL please see part a) in chapter A.1 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 A.1 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 A.1 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 A.1 of the Group section of this report.

f) Material lines of business and material geographic areas.

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.

On 31 May 2017 new business sales were suspended pending a review of market opportunities and further in-house system development.

Changes of Directors during 2017 were as follows:

A M Parsons – Appointed 30 June 2017	J T Perks – Appointed 1 July 2017
P W Moore – Resigned 29 June 2017	S R Haynes – Resigned 31 December 2017
M I Rix – Resigned 30 June 2017	

Apart from the director changes, the governance of LVPL remained stable, and the solvency position has also remained stable.

LVPL used the Standard Formula to calculate its capital requirements throughout 2017, and this is expected to continue 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 table provides further information on the income and expenses analysed by material lines of business written during the reporting period:

	2017	2016
	£000	£000
Net earned premiums	235	218
Net claims incurred including changes in other technical provisions	(310)	(211)
Expenses incurred (excluding investment management expenses)	(212)	(165)
Net total	(287)	(158)

The income and expenses in the above table 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.

During 2017 the claims performance experienced by LV Protection Limited (LVPL) worsened which increased the loss ratio.

There have been higher expenses incurred by the company in the year, resulting from prior year releases of deferred acquisition costs.

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)	2017	2016
Dividend income	9	17
Total Investment Performance	9	17

Other than a small cash balance of £10k (2016: £10k), LVPL maintains an OEIC (Institutional Sterling Liquid Fund) with Blackrock of £3,558k (2016: £3,448k). All investment income received relates to dividends paid by the OEIC.

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

2017 Asset class (£000)	Dividends	Percentage of total	Average investment holding during 2017	Average investment return
Collective investment undertakings	9	100.0%	3,503	0.3%

The average investment holding listed above is a simplified average calculated as:
(investment holding at year end 2017 + investment holding at year end 2016) ÷ 2

2016 Asset class (£000)	Dividends	Percentage of total	Average investment holding during 2016	Average investment return
Collective investment undertakings	17	100.0%	3,868	0.4%

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.

The Directors of LVPL during the year were as follows:

R A Rowney	M I Rix – Resigned 30 June 2017
A M Parsons – Appointed 30 June 2017	J T Perks – Appointed 1 July 2017
P W Moore – Resigned 29 June 2017	S R Haynes – Resigned 31 December 2017

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 1 January 2015 and was closed to new business in 2017. 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 C.1.2.

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 C.1.3.

C.1.4 Risk concentration

Whilst there is only one product written in LVPL, concentration risk is mitigated through reinsurance as described in section C.2 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 decreased over 2017. This is primarily due to low new business volumes and the ultimate closure of the entity to new business during the year.

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 C.2.3.

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 C.3.1 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.

Market risk is managed in-line with Group policies, rather than mitigated.

C.3.2 Material changes over the reporting period

There have been no material changes in market risk over the reporting period.

C.4 Credit counterparty risk

Credit Counterparty risk is described further in section C.4 of the main LVFS Group SFCR. This is not a material risk for LVPL.

C.5 Other material risks

Liquidity, operational and other risks are managed at an LVFS Group level and are described further in sections C.5, C.6 and C.7 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 II 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. 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.

Reconciliation of IFRS and Solvency II valuation		2017		
		IFRS	Adjustments	Solvency II
Assets	Note	£000	£000	£000
Deferred acquisition costs	1	527	(527)	-
Investments (other than assets held for index-linked and unit-linked contracts)	2	3,558	-	3,558
Reinsurance recoverables	3	347	(377)	(30)
Loans and Receivables	#	20	(20)	-
Insurance and intermediaries receivables	4	1,050	(1,050)	-
Cash and cash equivalents	#	10	-	10
Any other assets, not elsewhere shown	#	54	-	54
Total assets		5,566	(1,974)	3,592

#= Disclosure note not provided as solvency II 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 D.2 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 II 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 31 December 2017.

	QMP	QMPS	AVM	AEM	Total
	£000	£000	£000	£000	£000
Collective Investments Undertakings	3,558	-	-	-	3,558
Investments (other than assets held for index-linked and unit-linked funds)	3,558	-	-	-	3,558

3. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of businesses. 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 D.2 Technical provisions). Reinsurance recoverable is negative because the reinsurance premiums exceed the reinsured 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.

	£000
Reinsurers' share of provision for unearned premiums	335
Reinsurers' share of claims liabilities	12
Total Reinsurance Recoverables - IFRS	347
Best estimate liability adjustments	(377)
Total reinsurance recoverables - solvency II valuation	(30)

4. Insurance and intermediaries receivables

For solvency II 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 D.2 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	£000
Due from policyholders	1,050
Total Insurance and intermediaries receivables - IFRS	1,050
Best estimate liability adjustments	(1,050)
Total reinsurance recoverables - solvency II valuation	-

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 31 December 2017.

Line of Business	31 December 2017 - £000		
	Best Estimate Liability (BEL)	Risk Margin (RM)	Total Solvency II Technical Provisions
Other Non-Life	(573)	289	(284)
Total Non-Life insurance obligations	(573)	289	(284)

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, Matching Adjustment or Volatility Adjustment 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-linked business with allowances for different commission clawback periods.

Expenses

The expense assumption is set in line with the service agreement.

D.2.3 Uncertainly within the Technical Provisions

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.2.4 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 December 2017 - £000		
	Solvency II Value	IFRS Value	Difference
Other Non-Life	(284)	1,223	(1,507)
Total Non-Life insurance obligations	(284)	1,223	(1,507)

As at 31 December 2017, 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

Reconciliation between IFRS and Solvency II valuation		2017		
		IFRS	Adjustments	Solvency II
Other Liabilities	Note	£000	£000	£000
Reinsurance payables	1	335	(335)	-
Payables (trade, not insurance)	#	31	(20)	11
Total other liabilities		366	(355)	11

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

Supporting Notes

1. Reinsurance payables

For solvency II valuation purposes, reinsurance payables are valued consistently with IFRS.

Under IFRS, reinsurance payables are recognised when due. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Reinsurance payables	£000
Due to reinsurers	335
Total Reinsurance payables - IFRS	335
Reinsurance payables included in BEL calculations	(335)
Total Reinsurance payables - solvency II valuation	-

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

						£000
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Reinsurance payables	335	-	-	-	-	335

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.

D.5 Any other material information

All relevant information is provided in the sections above and as such, no further information is disclosed here.

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.

	Tier 1 £000	Tier 2 £000	Tier 3 £000	Total £000
Ordinary share capital	1,000	-	-	1,000
Initial funds / members' contributions	4,000	-	-	4,000
Reconciliation reserve	(1,135)	-	-	(1,135)
Total Basic Own Funds	3,865	-	-	3,865
Total available Own Funds to meet the SCR	3,865	-	-	3,865
Total available Own Funds to meet the MCR	3,865	-	-	3,865

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

Total available Own Funds to meet the SCR	3,865	-	-	3,865
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	3,865	-	-	3,865

Total available Own Funds to meet the MCR	3,865	-	-	3,865
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the MCR	3,865	-	-	3,865

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		
	1 January 2017 £000	Movement £000	31 December 2017 £000
Eligible own funds			
Tier 1 capital	3,800	65	3,865
Total capital	3,800	65	3,865
Made up by:			
Equity shares	1,000	-	1,000
Initial funds / members' contribution	4,000	-	4,000
Reconciliation reserve / surplus	(1,200)	65	(1,135)
Total capital	3,800	65	3,865
Total eligible own funds to meet SCR	3,800	65	3,865

- Tier 1 capital includes movements in excess of assets over liabilities.

Ancillary own funds

At 31 December 2017 there were no ancillary own funds.

Deductions from own funds

At 31 December 2017 there were no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Retained loss on a Solvency II basis	(1,135)
Total	(1,135)

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

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities.

	At 31 December 2017	
	£000	£000
Analysis of Equity - IFRS		
Ordinary shares, allotted and fully paid	1,000	
Capital reserves	4,000	
Retained losses	(1,023)	
Total Equity - IFRS		3,977
Solvency II Adjustments (excluding reclassifications)		
<u>Assets</u>		
- Reduction in valuation of DAC (Section D.1 note 1)	(527)	
- Reduction in valuation of reinsurance recoverable (Section D.1 note 3)	(377)	
- Reduction in valuation of insurance and intermediaries recoverable (Section D.1 note 4)	(1,050)	
		(1,954)
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2.3)		1,507
<u>Other liabilities</u>		
- Decrease in payables		335
Total Equity - solvency II basis		3,865
Total own funds - solvency II basis		3,865
Excess of Assets over Liabilities - solvency II basis		
Total Assets		3,592
Total Technical Provisions		284
Total Other Liabilities		(11)
Excess of Assets over Liabilities - solvency II basis		3,865

Differences in the asset and liability valuation methodology used for solvency II 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

E.2.1 SCR and MCR

The following table shows the amount of the SCR and MCR for LVPL:

£000	2017	2016
Solvency Capital Requirement (SCR)	887	1,175
Minimum Capital Requirement (MCR)	2,196	2,251

The SCR decreased by £288k during 2017 largely due to the closure of the entity 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 annexed to 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 LVPL the biting requirement is the absolute floor of the MCR, set equal to €2.5m Euros and converted to pounds sterling. The MCR decreased by £55k during 2017 due to the change in the Euro/Pound exchange rate.

E.2.2 SCR split by risk

The following table summarises the risk modules which contribute to the SCR for LVPL applicable under standard formula. Year-end 2017 – all figures in £000:

	Semi Diversified* Capital Requirement
Market Risk	417
Credit Counterparty Risk	4
Non-Life Underwriting Risk	668
Total before diversification	1,089
Diversification	(216)
Basic Solvency Capital Requirement	873
Operational Risk	14
Solvency Capital Requirement	887

*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 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 A.1 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 A.1 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 A.1 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 A.1 of the Group section of this report.

LVIC is a partially owned indirect subsidiary of Liverpool Victoria Friendly Society (LVFS) which owns LV Capital PLC, owner of 51% of Liverpool Victoria General Insurance Group (LVGIG), LVIC's intermediate parent holding company. The remaining 49% of LVGIG is owned by Allianz Holdings plc

For an illustration of the qualifying holdings up to LVFS please see part e) in chapter A.1 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 A.1 of the Group section of this report.

f) Material lines of business and material geographic areas.

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
- Medical expense insurance

On 28 December 2017, LVIC sold its Commercial broker lines renewal rights to Allianz Insurance plc. The Company will cease writing Commercial broker new business during 2018. For further information, please see part g) below and chapter A.1 of the Group section of this report.

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

Strategic Partnership

On 28 December 2017, LVIC sold its Commercial broker lines renewal rights for £31m to Allianz Insurance plc as part of a wider deal which saw Allianz Holdings plc acquire 49% of Liverpool Victoria General Insurance Group Limited (LVGIG), an intermediary parent holding company. LVIC will cease writing Commercial broker new business during 2018.

Solvency and Financial Condition

The capital surplus as at 31 December 2017 under the Standard Formula stood at £221m (2016: £33m) with capital cover of 156% (2016: 108%).

Business and Performance

LVIC reported a profit before tax for the year of £172m (2016: £20m loss). The 2016 result includes the impact of the Ogden discount rate change on claims reserves of £95m.

Net earned premium has improved by 4% as prices rose sharply following the Ogden discount rate increase. Net claims have fallen 12% year-on-year with favourable experience in prior accident years. Other income includes £31m representing the gain on the sale of the Commercial broker lines renewal rights to Allianz Insurance plc.

LVIC (£m)	2017	2016
Net earned premium	952	917
Net claims incurred	(628)	(713)
Expenses incurred	(292)	(289)
Net underwriting result	32	(85)
Net investment income	63	28
Other	77	37
Profit/(loss) before tax	172	(20)

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 W Moore – Resigned 29 June 2017	D Barral – Appointed 28 December 2017
M P Crane – Resigned 28 December 2017	A Cook – Appointed 28 December 2017
C Burton – Resigned 28 December 2017	J Dye – Appointed 28 December 2017
S C A Fernandes – Resigned 28 December 2017	R Hudson – Appointed 28 December 2017
K O’Keeffe – Resigned 28 December 2017	K Wenzel – Appointed 28 December 2017
A Parsons – Appointed 30 June 2017 and resigned 28 December 2017	

A.2 Underwriting performance

All business is underwritten in the UK and the following provides an analysis of the underwriting income and expenses for 2017 in addition to a comparative for 2016.

LVIC - 2017 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	Medical expense insurance	Total
Net earned premiums	494	173	184	26	23	48	4	952
Net claims incurred	(346)	(121)	(117)	(13)	(1)	(27)	(3)	(628)
Expenses incurred (excluding investment management expenses)	(141)	(50)	(75)	(12)	(3)	(10)	(1)	(292)
Underwriting result	7	2	(8)	1	19	11	-	32

Claims Ratio	70.0%	69.9%	63.6%	50.0%	4.3%	56.3%	75.0%	66.0%
Expense Ratio	28.5%	28.9%	40.8%	46.2%	13.0%	20.8%	25.0%	30.7%
Combined Ratio	98.5%	98.8%	104.3%	96.2%	17.3%	77.1%	100%	96.7%

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	Medical expense insurance	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)	(46)	(83)	(8)	(4)	(12)	-	(289)
Underwriting result	(77)	(25)	(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%	28.6%	41.5%	47.1%	17.4%	24.5%	-	31.5%
Combined Ratio	116.5%	115.5%	104.0%	105.9%	26.1%	81.6%	-	109.3%

LVIC - 2017 versus 2016 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	Medical expense insurance	Total
Net earned premiums	27	12	(16)	9	-	(1)	4	35
Net claims incurred	62	19	8	(3)	1	1	(3)	85
Expenses incurred (excluding investment management expenses)	(5)	(4)	8	(4)	1	2	(1)	(3)
Underwriting result	84	27	-	2	2	2	-	117

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

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:

	2017	2016
	£m	£m

Net earned premium per the financial statements	952	917
Net total per Solvency II	952	917

Net claims incurred per the financial statements	(667)	(753)
Less claims management costs (net of reinsurance)	39	40
Net total per Solvency II	(628)	(713)

Operating expenses per the financial statements	(255)	(251)
Add claims management costs (net of reinsurance)	(39)	(40)
Less investment management expenses	2	2
Net total per Solvency II	(292)	(289)

Market conditions have remained competitive, particularly in Motor. Following the impact of the Ogden discount rate decrease in 2017 from 2.5% to -0.75%, 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 and underwriting margins.

LVIC's underwriting result improved during 2017, delivering a combined ratio of 96.7% (2016: 109.3%). The reserves have continued to reflect the Ogden rate now in force. There has been some favourable experience in prior accident years. However, the Ogden discount rate change highlighted that its business returns were not adequately protected against unexpected shocks of this order of magnitude. Accordingly, a decision was made to increase the overall margin above the Actuarial Best Estimate of claims reserves to give improved protection in this area, by £21.3m.

During 2017, while a number of prior year large claims were settled, LVIC saw a reduction in the frequency of claims and no severe weather events, which led to an overall net claims reduction of 11.9% year on year.

LVIC has continued to maintain strong cost disciplines by controlling operating expenses and acquisition costs during the year. Investment in staff, systems, marketing and infrastructure has continued to ensure that it is well placed to deliver its profitable growth strategy.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities:

	2017	2016
	£m	£m
Dividend income	56	9
Interest income	32	32
Realised and unrealised gains/(losses)	(23)	(11)
Investment expenses	(2)	(2)
Total Investment Performance	63	28

The continued low underlying interest rate market resulted in low income returns. Dividend income increased in 2017 mainly due to dividends received from participations of £50m (2016: £nil).

The following tables summarise the undertaking's overall investment performance by relevant asset class:

2017 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2017	Average investment return
Government bonds	-	4.2	(3.5)	0.7	251.5	0.3%
Corporate bonds	-	26.3	(16.1)	10.2	902.0	1.1%
Equity	52.3	-	1.4	53.7	236.1	22.7%
Collective investment undertakings	3.8	0.1	6.6	10.5	206.5	5.1%
Collateralised securities	-	0.5	(0.4)	0.1	10.8	0.9%
Cash and deposits	-	0.1	-	0.1	38.3	0.3%
Put Options/Swaps/Futures /Forwards	-	0.5	(11.1)	(10.6)	N/A	N/A
Total	56.1	31.7	(23.1)	64.7		
Less investment expenses				(2.0)		
Net total				62.7		

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	2.1%
Corporate bonds	-	26.2	(9.3)	16.9	648.5	2.6%
Equity	2.5	-	-	2.5	216.2	1.2%
Collective investment undertakings	6.9	-	15.3	22.2	285.5	7.8%
Collateralised securities	-	0.4	(0.2)	0.2	6.0	3.3%
Cash and deposits	-	0.1	-	0.1	250.0	0.0%
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		

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:

	2017	2016
	£m	£m
Other income	77	37
Tax (charge)/credit	(22)	6
Total	55	43

Other income includes the net gain on the sale of the commercial lines renewal rights to Allianz Insurance plc on 28 December for £31m.

There is a further £32m being interest amounts charged to policyholders who pay for their general insurance on a monthly basis compared to fully paying for the insurance at the time of purchase.

Other income also includes £14m 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 deprecation 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.

B. System of Governance (LVIC)

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

The Directors of LVIC during the year were as follows:

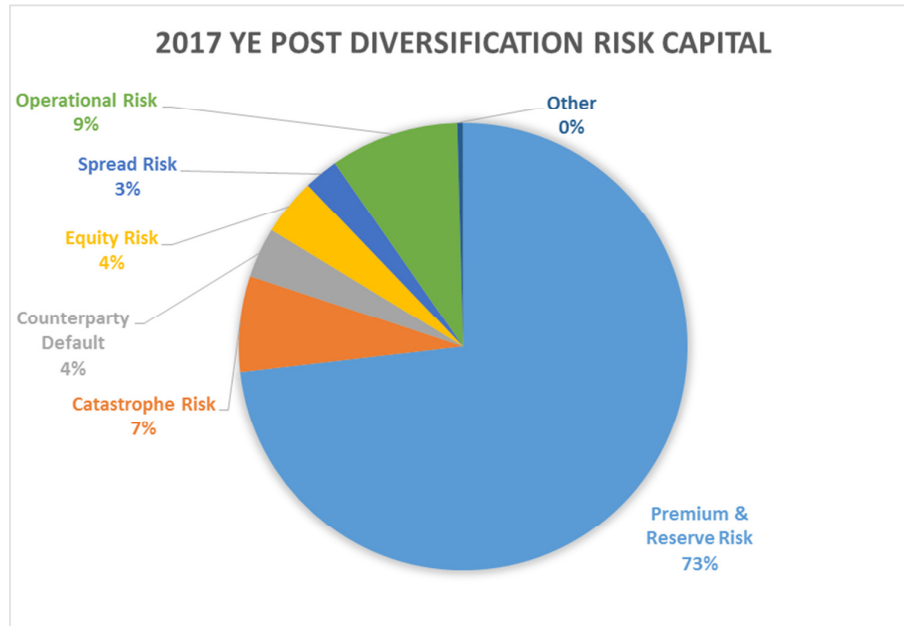
R Rowney	S C A Fernandes – Resigned 28 December 2017
S Treloar	K O’Keeffe – Resigned 28 December 2017
D Neave	D Barral – Appointed 28 December 2017
P W Moore – Resigned 29 June 2017	A Cook – Appointed 28 December 2017
M P Crane – Resigned 28 December 2017	J Dye – Appointed 28 December 2017
C Burton – Resigned 28 December 2017	R Hudson – Appointed 28 December 2017
A Parsons – Appointed 30 June 2017 and resigned 28 December 2017	K Wenzel – Appointed 28 December 2017

C. Risk Profile (LVIC)

C.1 Overview

C.1.1 Overview of risk exposures

The chart below shows the year-end 2017 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposure, 73% of the SCR, relates to Premium & Reserve Risk followed by Operational Risk with 9% and Catastrophe Risk with 7%.



The breakdown of risk exposures is broadly in line with that seen at year-end 2016, and projections based on plan figures suggest a similar risk profile over the next few years. Since the vast majority of LVIC's business is personal lines insurance the strategic partnership with Allianz, which will lead to a reduction in the volume of Commercial business, is not anticipated to have a significant impact on the risk profile.

C.1.2 Measurement of risk exposures

A group wide approach is applied in measuring risk exposures. This is described within the main LVFS Group SFCR in section C.1.2.

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 C.1.3.

C.1.4 Risk concentration

This is described within the main LVFS Group SFCR in section C.1.4.

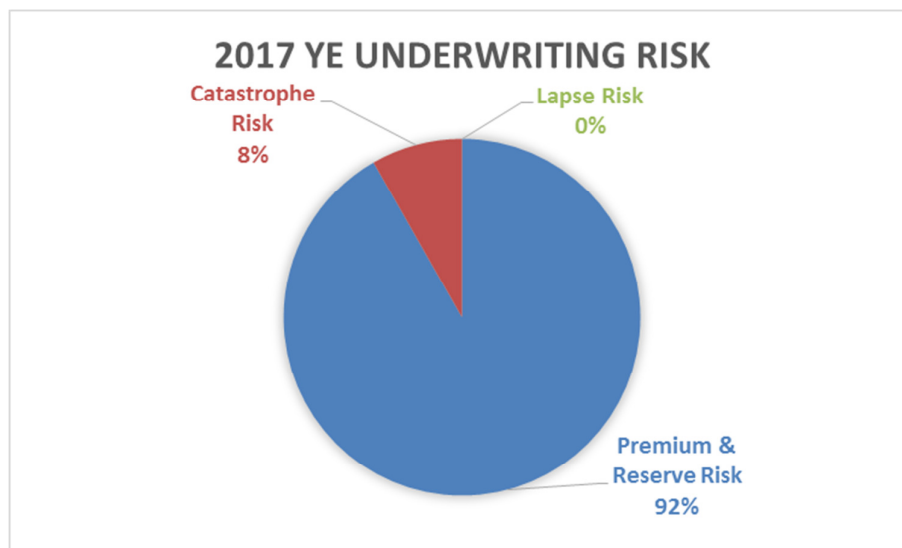
C.2 Underwriting risk

C.2.1 Underwriting risk exposure

This is described within the main LVFS Group SFCR in section C.2.1.

LVIC's Underwriting Risk is primarily driven by the uncertainty in the amount of claims and expenses it incurs from both expired and unexpired risk obligations 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 is exposed to natural catastrophe events, primarily floods 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.



C.2.2 Material changes over the reporting period

The largest underwriting risk, Premium and Reserve risk, has been stable over the year. There was a significant increase in catastrophe risk in Q3 due to the aggregation of exposures within a 200m radius; this has since been mitigated using a facultative reinsurance arrangement.

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 C.2.3 of the LVFS Group SFCR.

A range of reinsurance contracts are entered into, typically annually, across different lines of business to mitigate the losses arising from individual large losses and catastrophe events.

- Excess of loss programmes are used for motor and commercial property lines to limit the impact of individual losses. The current programme protects LVIC within Premium Risk while the historic programmes protect losses occurring within Reserve Risk.
- Catastrophe reinsurance, which covers total losses stemming from an event across personal and commercial property lines, reduces catastrophe risk.

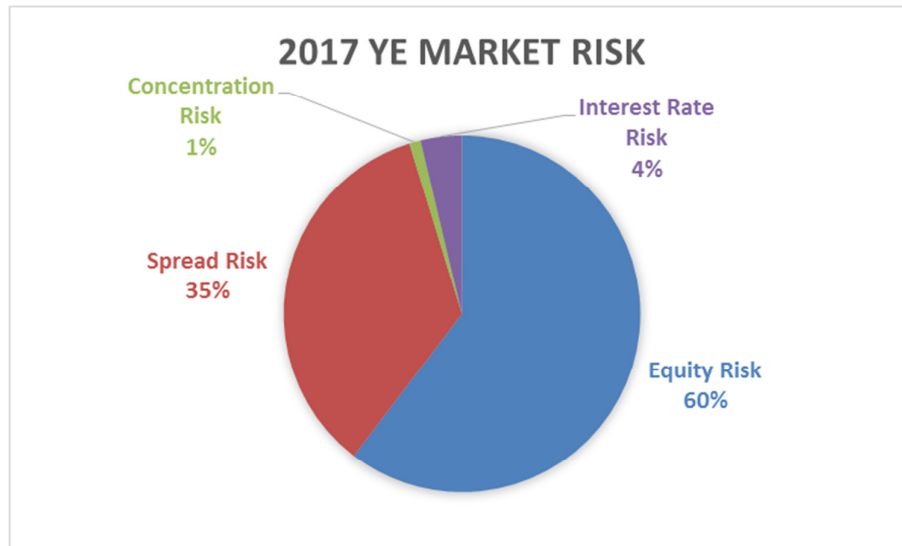
In addition, Loss Portfolio Transfer and Whole Account Quota Share programmes were entered into with a single AA-rated reinsurer at the end of 2015 in order to cede a portion of risk out of the entity. The business plan assumes that the Quota Share programme will be renewed beyond current expiry at the end of 2018 and therefore no future spike in capital requirements is expected.

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 C.3.1 of the main LVFS Group SFCR.

Within Market Risk the key exposure is to Equity Risk which comprises 60% of the SCR post-diversification. Spread Risk is the next largest exposure at 35%, with LVIC having a relatively large exposure to corporate bonds.



C.3.2 Material changes over the reporting period

Equity Risk has reduced from 74% in 2016 to 60% in 2017 due to the implementation of a new hedging strategy at the beginning of the year. There was an increase from 0% in 2016 to 4% in 2017 in interest rate risk due to the movement of interest rate swaps into the GI fund from elsewhere within the LVFS Group. While Spread Risk remained relatively constant in £ terms the overall reduction in Market Risk of approximately £17m results in Spread Risk accounting for an increased share of total Market Risk at 35% (2016: 23%).

C.3.3 Risk mitigation techniques

This is discussed in the LVFS Group SFCR, Section C.3.3.

C.3.4 Risk concentrations

This is discussed in the LVFS Group SFCR, Section C.3.4, 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 C.4.

LVIC's largest counterparty exposure is 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; this accounts for approximately 60% of the reinsurance recoverables due. Besides this arrangement LVIC's counterparty exposures are shared between a panel of reinsurers with no other single counterparty accounting for more than 10% of recoverables due.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in sections C.5, C.6 and C.7 of the LVFS Group SFCR.

The expected profit in future premiums (EPIFP) for LVIC at the year end 2017 was £20m.

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 where the impact is symmetrical.

Sensitivities		Impact	
Item	Size	£m	%
Baseline SCR		392	
Premium Risk	10% increase (rates down or loss ratios up)	14	3.6%
Premium Risk	10% decrease (rates up or loss ratios down)	-14	-3.5%
Reserve Risk	10% increase (Ogden type shock)	15	3.8%
Reserve Risk	10% decrease (Ogden type shock)	-15	-3.7%
Catastrophe Risk	(+25% increase in 1:200 gross loss)	53	13.6%
Catastrophe Risk	(+25% decrease in 1:200 gross loss)	-0	-0.0%

For Premium risk, scenarios which would increase (or decrease) this risk by 10% alone were considered. This could either be as a result of the impact of a reduction in premium rates or some change in business mix which leads to a deterioration in loss ratios.

Within Reserve risk, the impact of a shock of 10% which might emerge from an event similar to those which resulted from the Ogden discount rate change and LASPO were considered.

The catastrophe reinsurance programme is designed to absorb the Standard Formula gross 1 in 200 loss stresses. Accordingly only losses up to the retention typically contribute to LVIC's Catastrophe Risk. Increasing these losses by 25% however would exhaust some of the layers leading to an increase in net losses and hence a significant increase in the SCR. With future expected exposure reductions to Commercial business this risk element is expected to moderate through 2018. Decreasing the gross losses would have little impact as LVIC would still be liable for the same losses below the reinsurance retention. The impact of this test has increased materially since 2016 year-end as a result of a large increase in commercial exposures over the year.

D. Valuation for Solvency Purposes (LVIC)

D.1 Assets

For solvency II 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 liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

Reconciliation between IFRS and Solvency II valuation	Note	2017			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
		£m	£m	£m	£m
Goodwill	1	16	-	(16)	-
Deferred acquisition costs	2	65	-	(65)	-
Intangible assets	#	2	-	(2)	-
Deferred tax assets	3	-	-	6	6
Investments					
- Participations	4	301	-	(92)	209
- Equities	5	55	-	-	55
- Bonds	5	769	495	-	1,264
- Collective Investment Undertakings	5	144	-	-	144
- Deposits other than cash equivalents	5	158	(133)	-	25
Reinsurance recoverables	6	336	-	(15)	321
Insurance and intermediaries receivables	7	212	-	(212)	-
Reinsurance receivables	#	14	-	(14)	-
Receivables (trade, not insurance)	#	89	-	-	89
Cash and cash equivalents	8	355	(350)	-	5
Any other assets, not elsewhere shown	9	24	(12)	-	12
Total Assets		2,540	-	(410)	2,130

#= Disclosure note not provided as solvency II 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 D.2. 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 (DTA) 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 - IFRS	-
Solvency II Valuation Adjustment	6
Deferred tax assets - solvency II valuation	6

There are a number of changes that are made to the IFRS Balance Sheet in moving to a Solvency II basis 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.

The impact of these changes is that there is a decrease in the Solvency II taxable profits of £32m with a consequent £6m taxation impact. 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 corporation tax 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 £32m has been justified based on the Board approved business plans for the period 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)
2018	32	19.00%	6
Total	32		6

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
Investments in group undertakings - IFRS	301
Adjusted equity method valuation differences	(92)
Participations - solvency II valuation	209

5. Equities, Bonds, Collective Investment Undertakings and Deposits other than cash equivalents

For solvency II valuation purposes, financial assets are valued consistently with IFRS. However there are mapping differences between the IFRS and Solvency II hierarchies with certain assets being 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 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 31 December 2017.

	QMP	QMPS	AVM	AEM	Total
	£m	£m	£m	£m	£m
Holdings in related undertakings, including participations	-	-	-	209	209
Equities	54	-	1	-	55
Bonds	718	546	-	-	1,264
Collective Investments Undertakings	144	-	-	-	144
Deposits other than cash equivalents	25	-	-	-	25
Investments	941	546	1	209	1,697

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 D.2 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	14
Reinsurers' share of claims liabilities	322
Total Reinsurance recoverables - IFRS	336
Best estimate liability adjustments	(15)
Total Reinsurance recoverables – solvency II valuation	321

7. Insurance and intermediaries receivables

For solvency II 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 D.2 Technical Provisions).

Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from policyholders, 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	179
Due from agents, brokers and intermediaries	33
Total Insurance and intermediaries receivables - IFRS	212
Best estimate liability adjustments	(212)
Total Insurance and intermediaries receivable - solvency II valuation	-

8. Cash and cash equivalents

For solvency II valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short-term bank deposits which are included in investments as bonds.

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	5
Short-term bank deposits	350
Total Cash and cash equivalents - IFRS	355
Reclassify short-term deposits into bonds	(350)
Total Cash and cash equivalents - solvency II valuation	5

9. Any other assets, not elsewhere shown

For solvency II 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	12
Other prepayments and accrued income	12
Prepayments and accrued income - IFRS	24
Reclassify accrued interest on bonds to Investments	(12)
Total Any other assets, not elsewhere shown - solvency II valuation	12

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 gross technical provision recorded as at year end 2017:

LVIC Entity (£m)	Total	Motor Liability	Motor Other	Property Damage	General Liability	Legal Expenses	Assistance	Medical Expenses	Life excl Health
Gross Claims Provision	1,087	930	(38)	74	66	2	6	1	46
Gross Premium Provision	282	149	63	57	7	(3)	6	3	-
Gross Best Estimate Liability	1,369	1,079	25	131	73	(1)	12	4	46
Risk Margin	60	38	2	4	3	-	-	-	13
Gross Technical Provisions	1,429	1,117	27	135	76	(1)	12	4	59

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 Standard Actuarial Techniques for more developed accident periods, 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 known 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. Following a re-calibration exercise carried out this year, the IBNR amounts are then adjusted to allow for the explicit uplift for PPO IBNR.

For PPO claims a cashflow model is used to project cashflows for both claims that have settled on a PPO basis and those identified as having the potential to settle as a PPO in the future. This model projects both gross and reinsurance cashflows separately. The models used for PPOs are deterministic and for settled PPOs the settled amounts are known. 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 calculation of the Premium Provision requires a set of assumptions to be made. 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 Premium Provision is calculated in a single model. The model projects all relevant cashflows for each line of business and discounts these using the relevant yield curve. The Premium Provision requires cashflow projections for all items associated with in-force business, i.e. premium (net of IPT), claims and expenses (acquisition, administration and claims handling) and other ancillary income. The Premium Provision is calculated separately for each Solvency II Line of Business. The calculations are performed on an aggregated basis as opposed to an individual policy basis.

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 required by the Solvency II regulations.

No transitional adjustment, Matching Adjustment or Volatility Adjustment was applied.

Risk Margin

The risk margin is calculated using an in-house model that makes a full calculation of all future SCRs without using simplifications, as permissible by the Solvency II regulations.

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 aim to capture this uncertainty.

ENIDS

The approach used to derive the ENIDs loading has considered a combination of a mean load statistical approach for the attritional claims and a set of stresses and scenarios for large claims, PPOs and weather events. The statistical approach for attritional claims builds on a presentation at the Institute and Faculty of Actuaries 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 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 (DAC) 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 SII. 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.

As at 31 December 2017, the Solvency II value of gross technical provisions was £1,429m and the IFRS value of gross insurance contract liabilities was £1,684m.

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. The Group has entered into a quota share arrangement with effective date of 1 January 2016, covering each of the three calendar years to 31 December 2018.

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.

A re-calibration exercise was carried out this year on large claims that are yet to be reported. This has meant a number of changes in assumptions since the 2016 year-end:

- Claim frequency and severity assumptions were changed as a result of the re-calibration. This resulted in a favourable impact on the Technical Provisions net of Excess of loss reinsurance.
- In addition, reinsurance loss ratios on large claims at 2017 year-end for the Premium Provision calculation were set using the reinsurance recovery rate derived in the re-calibration and the actual 2018 reinsurance premium rates.

This exercise also involved the establishment of a PPO IBNYR allowance. Note there has been no change in the assumed Ogden discount rate between the 2016 and 2017 year-ends. The best estimate assumption remains at -0.75% p.a.

D.3 Other liabilities

Reconciliation between IFRS and Solvency II valuation	2017				
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Deferred tax liabilities	#	1	-	(1)	-
Derivatives	#	3	-	-	3
Insurance and intermediaries payables	#	4	-	(4)	-
Reinsurance payables	1	17	-	(17)	-
Payables (trade, not insurance)	2	83	-	(8)	75
Other liabilities	#	10	-	-	10
Total Other Liabilities		118	-	(30)	88

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

There are no material off-balance sheet assets or liabilities which fall into the scope of this narrative.

Supporting Notes

1. Reinsurance payables

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

Under IFRS, reinsurance payables are recognised when due. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

	£m
Due to reinsurers	17
Total Reinsurance payables - IFRS	17
Reinsurance payables included in BEL calculations	(17)
Total Reinsurance payables - solvency II valuation	-

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

	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	£m
Reinsurance payables	17	-	-	-	-	17

2. Payables (trade, not insurance)

For solvency II valuation purpose, trade payables are initially valued consistently with IFRS and then adjusted to remove the MIB levy as part of the BEL calculations.

Under IFRS, trade payables are recognised when due. Payables are initially recognised at fair value and subsequently held at amortised cost.

Payables (trade, not insurance)	£m
Amounts owed to group undertakings	12
Other taxes and social security costs	34
Other payables	7
Accruals and deferred income	30
Total Payables (trade, not insurance) - IFRS	83
Reclassification of payables included in BEL calculations	(8)
Total Payables (trade, not insurance) - solvency II valuation	75

D.4 Alternative methods for valuation

Information is provided for material assets and liabilities 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 £6m; 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 £321m; 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 £89m and Any other assets, not elsewhere shown of £12m 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 £1,429m; this has been valued under Solvency II methodologies and further information can be found in Section D.2 of this report.
- 2) Payables (trade, not insurance) £75m; 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. Further information on this calculation can be found in Section D.3 of this report.

D.5 Any other information

The bases, methods and main assumptions used at a group level for the Solvency II valuation 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 are consistent across all entities. The approach to measuring and monitoring capital for LVIC 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.

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Ordinary share capital	385	-	-	385
Initial funds / members contributions	67	-	-	67
Reconciliation reserve	155	-	-	155
Deferred tax assets	-	-	6	6
Total Basic Own Funds	607	-	6	613
Total available Own Funds to meet the SCR	607	-	6	613
Total available Own Funds to meet the MCR	607	-	6	607

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

Total available Own Funds to meet the SCR	607	-	6	613
Total eligible Own Funds to meet the SCR	607	-	6	613

Total available Own Funds to meet the MCR	607	-	6	607
Total eligible Own Funds to meet the MCR	607	-	6	607

Tier 1 consists of both Ordinary Shares of £385m (increase of £40m over 2016 YE) and Initial Funds being a capital injection of £67m (reduction of £70m from 2016 YE), 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 £6m which is valued in accordance with IFRS and has no terms and conditions attached.

A dividend of £70.1m (£0.18212 per share) was declared by the Directors during 2017 and remitted to the parent company in December 2017.

Analysis of significant changes in own funds during the reporting period

	LVIC		
	1 January 2017 £m	Movement £m	31 December 2017 £m
Eligible own funds			
Tier 1 capital	446	161	607
Tier 3 capital	14	(8)	6
Total capital	460	153	613
Made up by:			
Equity shares	345	40	385
Initial funds / members' contribution	137	(70)	67
Deferred tax	14	(8)	6
Reconciliation reserve / surplus	(36)	191	155
Total capital	460	153	613
Total eligible own funds to meet SCR	460	153	613

Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax. The increase of £161m has been driven by strong underwriting results, investment income from subsidiary companies and the sale of the commercial lines renewal rights.

- Tier 3 capital represents the deferred tax asset.
- The fall in initial funds / members' contributions is due to a dividend payment of £70.1m

Ancillary own funds

At 31 December 2017 there were no ancillary own funds.

Deductions from own funds

At 31 December 2017 there were no deductions from own funds.

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Retained earnings on a Solvency II basis	155
Total	155

LVIC has not applied loss absorbency mechanisms as at the end of 2017.

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

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities.

	£m
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	385
Capital reserve	67
Retained Earnings	285
Total Equity - IFRS	737
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of goodwill (Section D.1 note 1)	(16)
- Reduction in valuation of DAC (Section D.1 note 2)	(65)
- Reduction in valuation of intangibles	(2)
- Reduction in participations	(92)
- Reduction in valuation of reinsurance recoverable (Section D.1 note 6)	(15)
- Reduction in valuation of insurance and intermediaries recoverable (Section D.1 note 7)	(212)
- Reinsurance Receivables	(14)
- Deferred Tax Assets	6
	(410)
<u>Technical provisions</u>	
- Increase in valuation of technical provisions	256
<u>Other liabilities</u>	
- Reduction in deferred tax liabilities	1
- Reduction in payables	29
	30
Total Equity - Solvency II basis	613
Total own funds - Solvency II basis	613

Excess of Assets over Liabilities - Solvency II basis	
Total Assets	2,130
Total Technical Provisions	(1,429)
Total Other Liabilities	(88)
Excess of Assets over Liabilities - Solvency II basis	613

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

Own-fund items that are 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.

	2017	2016
LVIC SCR (£m)	392	427
LVIC MCR (£m)	173	177

The LVIC SCR decreased by £35m over the reporting period largely due to the increased profitability seen over the year and the resulting increase in the loss-absorbing capacity of deferred taxes (LACDT). Movements in the underlying risks have been largely immaterial, with impacts either offsetting or diversifying with other risks.

The Minimum Capital Requirement (MCR) as at 31 December 2017 was £173m. The calculation of the MCR is laid out in the S.28.01.01 QRT annexed to this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provisions, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. The MCR decreased 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 2017 - all figures in £m	
Market risk	72
Counterparty default risk	24
Life underwriting risk	2
Health underwriting risk	1
Non-life underwriting risk	351
Diversification	(62)
Basic solvency capital requirement	388
Operational risk	40
Loss-absorbing capacity of deferred taxes	(36)
Solvency capital requirement	392

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 A.1 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 A.1 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 A.1 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 A.1 of the Group section of this report.

Highway is a partially owned indirect subsidiary of Liverpool Victoria Friendly Society Limited (LVFS) which owns LV Capital PLC, owner of 51% of Liverpool Victoria General Insurance Group (LVGIG), Highway's intermediate parent holding company. The remaining 49% is owned by Allianz Holdings plc.

For an illustration of the qualifying holdings up to LVFS please see part e) in chapter A.1 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 A.1 of the Group section of this report.

f) Material lines of business and material geographic areas.

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

On 28 December 2017, Highway sold its Commercial broker lines renewal rights to Allianz Insurance plc. The Company will cease writing Commercial broker new business during 2018. For further information, please see part g) below and chapter A.1 of the Group section of this report.

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

Strategic Partnership

On 28 December 2017, Highway sold its Commercial broker lines renewal rights for £20.8m to Allianz Insurance plc as part of a wider deal which saw Allianz Holdings plc acquire 49% of Liverpool Victoria General Insurance Group Limited (LVGIG), an intermediary parent holding company. Highway will cease writing Commercial broker new business during 2018. As part of the same transaction, Highway acquired from Allianz Insurance plc the renewal rights to the Allianz Insurance plc personal lines business for a cost of £1m.

Solvency and Financial Condition

The capital surplus as at 31 December 2017 under the Standard Formula stood at £63m (2016: £82m) with capital cover of 143% (2016: 151%).

Business and Performance

HICO reported a profit before tax for the year of £33m (2016: £18m loss). The 2016 result includes the impact of the Ogden discount rate change on claims reserves of £44m.

Net earned premium has improved by 6% as prices rose sharply following the Ogden discount rate increase. Net claims have fallen 13% year-on-year with favourable experience in prior accident years. Other income of £21m represents the gain on the sale of the Commercial broker lines renewal rights to Allianz Insurance plc.

Highway P&L (£m)	2017	2016
Net earned premiums	288	272
Net claims incurred	(191)	(219)
Expenses incurred	(92)	(87)
Net underwriting result	5	(34)
Net investment income	7	16
Other	21	-
Profit / (loss) before tax	33	(18)
Tax	(6)	4
Profit / (loss) after tax	27	(14)

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 W Moore – Resigned 29 June 2017	D Barral – Appointed 28 December 2017
M P Crane – Resigned 28 December 2017	A Cook – Appointed 28 December 2017
C Burton – Resigned 28 December 2017	J Dye – Appointed 28 December 2017
S C A Fernandes – Resigned 28 December 2017	R Hudson – Appointed 28 December 2017
K O’Keeffe – Resigned 28 December 2017	K Wenzel – Appointed 28 December 2017
A Parsons – Appointed 30 June 2017 and resigned 28 December 2017	

A.2 Underwriting performance

All business is underwritten in the UK. The following tables provide an analysis of underwriting income and expenses.

2017	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	226	57	3	2		288
Net claims incurred	(150)	(38)	(2)	(1)		(191)
Expenses incurred (excluding investment management expenses)	(72)	(18)	(1)	(1)	-	(92)
Net total	4	1	-	-	-	5
Claims ratio	66.4%	66.7%	66.6%	50.0%		66.3%
Expense ratio	31.8%	31.6%	33.4%	50.0%		31.9%
Combined ratio	98.2%	98.2%	100.0%	100.0%		98.2%

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 investment management expenses)	(68)	(16)	(1)	(1)	(1)	(87)
Net total	(26)	(6)	-	(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%

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. Following the impact of the Ogden discount rate decrease in 2017 from 2.5% to -0.75%, 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.

Highway's underwriting result improved during 2017, delivering a combined ratio of 98.2% (2016: 112.5%). The reserves have continued to reflect the Ogden rate now in force. There has been some favourable experience in prior accident years. However, the Ogden discount rate change highlighted that its business returns were not adequately protected against unexpected shocks of this order of magnitude. Accordingly, a decision was made to increase the overall margin above the Actuarial Best Estimate of claims reserves to give improved protection in this area, by £9.5m.

During 2017, while a number of prior year large claims were settled, Highway saw a reduction in the frequency of claims and overall net claims reduced 13% year on year.

Highway has maintained strong cost disciplines by controlling operating expenses and acquisition costs during the year. Investment in staff, systems, marketing and infrastructure has continued to ensure that it is well placed to deliver its profitable growth strategy.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities:

	2017 £m	2016 £m
Dividend income	2	3
Interest income	16	16
Realised and unrealised gains/(losses)	(10)	(2)
Investment expenses	(1)	(1)
Total Investment Performance	7	16

The continued low underlying interest rate market resulted in low income returns.

Investment returns by asset class for 2017 and 2016 are detailed below:

2017 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2017	Average investment return
Government bonds	-	2.0	(1.7)	0.3	125.8	0.2%
Corporate bonds	-	13.0	(7.9)	5.1	439.5	1.2%
Equity	1.2	-	0.3	1.5	13.4	11.2%
Collective investment undertakings	1.2	-	3.7	4.9	94.2	5.2%
Collateralised securities	-	0.3	(0.2)	0.1	5.6	1.8%
Cash and deposits	-	-	-	-	35.5	0.0%
Put Options/Swaps/Futures /Forwards	-	0.3	(4.0)	(3.7)	N/A	N/A
Total	2.4	15.6	(9.8)	8.2		
Less investment expenses				(1.1)		
Net total				7.1		

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	2.1%
Corporate bonds	-	13.0	(4.2)	8.8	318.5	2.8%
Equity	-	-	-	-	-	N/A
Collective investment undertakings	3.4	-	8.5	11.9	157.5	7.6%
Collateralised securities	-	0.2	(0.1)	0.1	3.0	3.3%
Cash and deposits	-	0.1	1.1	1.2	132.5	0.9%
Put Options/Swaps/Futures/Forwards	-	-	(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		

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:

	2017	2016
	£m	£m
Other income	21.4	0.5
Subordinated debt charges	(0.4)	(0.4)
Tax (charge)/credit	(5.8)	4.0
Total	15.2	4.1

Other income predominantly represents the net gain on the sale of the commercial lines renewal rights to Allianz Insurance plc on 28 December for £20.8m. The remaining £0.6m relates to 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 of £0.4m 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, other income 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.

The Directors of Highway during the year were as follows:

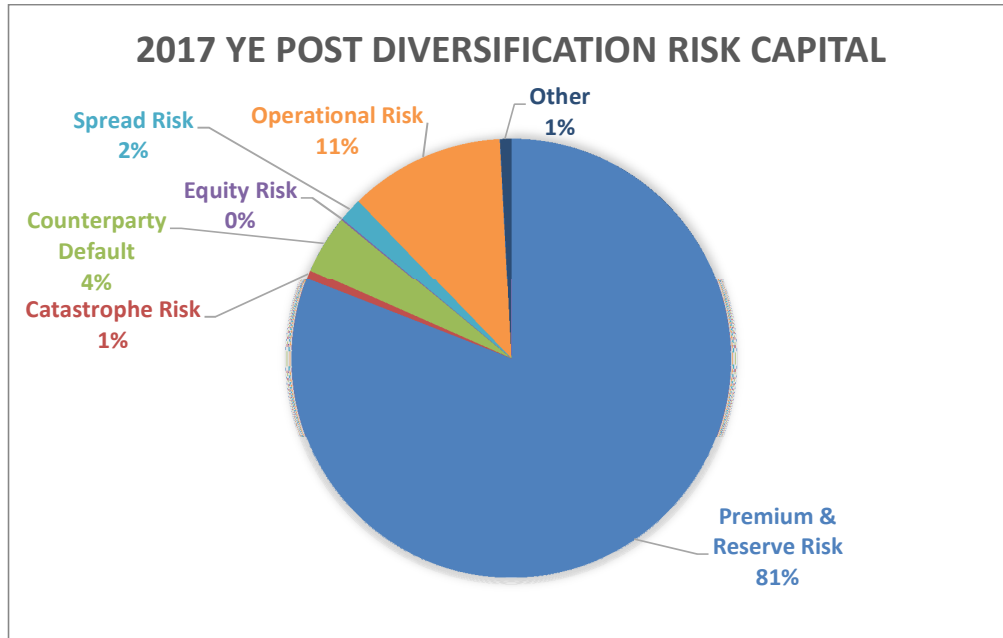
R Rowney	S C A Fernandes – Resigned 28 December 2017
S Treloar	K O’Keeffe – Resigned 28 December 2017
D Neave	D Barral – Appointed 28 December 2017
P W Moore – Resigned 29 June 2017	A Cook – Appointed 28 December 2017
M P Crane – Resigned 28 December 2017	J Dye – Appointed 28 December 2017
C Burton – Resigned 28 December 2017	R Hudson – Appointed 28 December 2017
A Parsons – Appointed 30 June 2017 and resigned 28 December 2017	K Wenzel – Appointed 28 December 2017

C. Risk Profile (Highway)

C.1. Overview

C.1.1 Overview of risk exposures

The chart below shows the year-end 2017 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposure relates to Premium & Reserve Risk with 81% followed by Operational Risk with 11%.



The breakdown of risk exposures is broadly in line with that seen at year-end 2016. The reduction in the SCR since year-end 2016 is primarily due to a reduction in Equity Risk as a result of the introduction of a new equity hedge in the early part of the year. We can see the Equity Risk proportion is now negligible. This has the impact of slightly increasing the percentage represented by other components which remain largely unchanged in £ terms. Projections based on plan figures show that no material changes in risk profile are expected over the next few years, although an increase in catastrophe risk may result from increased personal lines property exposure as part of the strategic partnership with Allianz.

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 C.1.2.

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 C.1.3.

C.1.4 Risk concentration

This is described within the main LVFS Group SFCR in section C.1.4, with no significant additional risk concentrations at the Highway entity level.

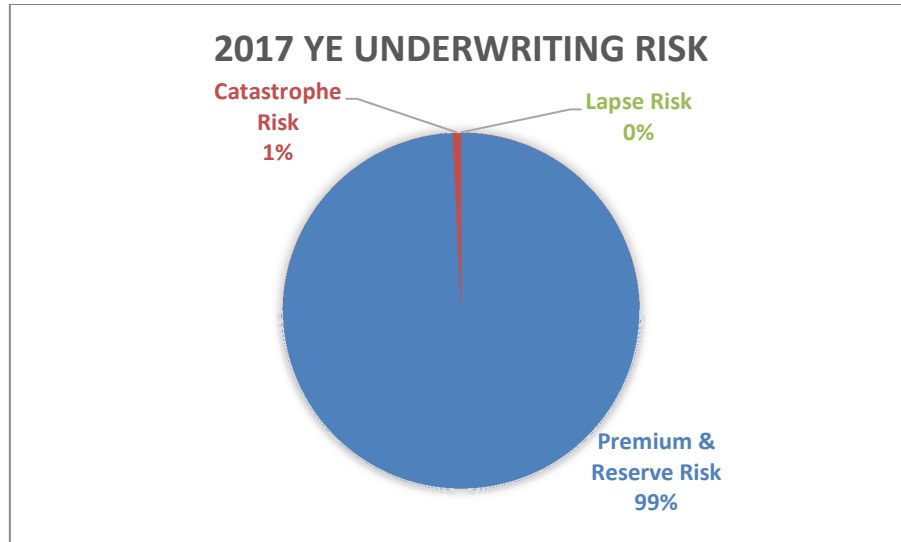
C.2 Underwriting risk

C.2.1 Underwriting risk exposure

These are described within the main LVFS Group SFCR in section C.2.1.

Highway's Underwriting Risk is dominated by the uncertainty in the amount of claims and expenses it incurs from both expired and unexpired risk obligations and in relation to the level of premiums to be written on future new business. This is captured within the Premium and Reserve 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.



As stated in section C.1.1, it is expected that Catastrophe Risk will become a more significant component of underwriting risk over the next few years. However since Highway will still be a predominantly motor writer, Premium and Reserve risk will continue to comprise most of the underwriting risk.

C.2.2 Material changes over the reporting period

There have not been any material changes 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 C.2.3 of the LVFS Group SFCR.

A range of reinsurance contracts are entered into, typically annually, across different lines of business to mitigate the losses arising from individual large losses and catastrophe events.

- Excess of loss programmes are used for motor and commercial property lines to limit the impact of individual losses. The current programme protects Highway within Premium Risk while the historic programmes protect losses occurring within Reserve Risk.
- Catastrophe reinsurance, which covers total losses stemming from an event across personal and commercial property lines, reduces catastrophe risk.

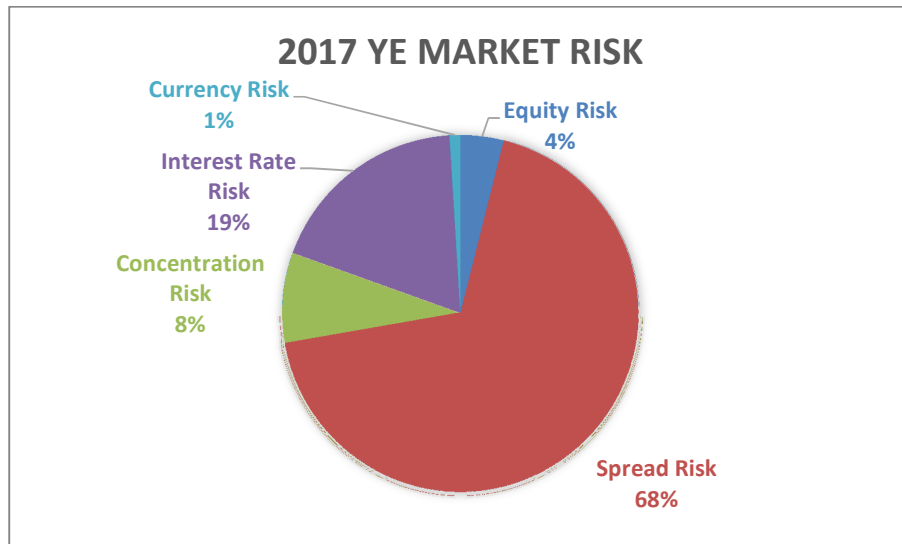
In addition, Loss Portfolio Transfer and Whole Account Quota Share programmes were entered into with a single AA-rated reinsurer at the end of 2015 in order to cede a portion of risk out of the entity. The business plan assumes that the Quota Share programme will be renewed beyond current expiry at the end of 2018 and therefore no future spike in capital requirements is expected.

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 C.3.1 of the main LVFS Group SFCR.

Within Market Risk the largest exposure is to Spread Risk which comprises 68% of the SCR post-diversification, with Highway having a relatively large exposure to corporate bonds. Interest Rate Risk is the next largest exposure at 19%.



C.3.2 Material changes over the reporting period

Equity risk reduced materially having previously been the largest individual risk (2016: 53%), due to the introduction of a new equity hedge in the early part of the year. Although Interest Rate risk increased in £ terms this was less than the reduction in Equity risk which leads to an overall reduction in Market risk. While Spread risk has remained relatively unchanged in £ terms its percentage share has shown a relatively large increase due to the total reduction in Market risk.

C.3.3 Risk mitigation techniques

This is discussed in the LVFS Group SFCR, Section C.3.3.

C.3.4 Risk concentrations

This is discussed in the LVFS Group SFCR, Section C.3.4.

C.4 Credit counterparty risk

This is discussed in the LVFS Group SFCR, Section C.4.

Highway's largest counterparty exposure is 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; this accounts for approximately 40% of the reinsurance recoverables due. Besides this arrangement Highway's counterparty exposures are shared between a panel of reinsurers with no other single counterparty accounting for more than 10% of recoverables due.

Credit counterparty risk is managed in-line with group policies, rather than mitigated.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in sections C.5, C.6 and C.7 of the LVFS Group SFCR.

The expected profit in future premiums (EPIFP) for Highway at the year end 2017 was £5m.

C.6 Sensitivities

This is discussed in the LVIC SFCR, Section C.6, with the Highway sensitivities broadly in line with those for LVIC. Note however 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 other 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.

Reconciliation between IFRS and Solvency II valuation		2017			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Deferred acquisition costs	1	30	-	(30)	-
Intangible Assets	#	1	-	(1)	-
Deferred tax assets	2	-	-	4	4
Investments (other than assets held for index-linked and unit-linked funds)					
- Equities	3	27	-	-	27
- Bonds	3	365	239	-	604
- Collective Investment undertakings	3	28	-	-	28
- Deposits other than cash equivalents	3	88	(68)	-	20
Reinsurance recoverables	4	222	-	38	260
Insurance and intermediaries receivables	5	49		(49)	-
Reinsurance receivables	#	3		(3)	-
Receivables (trade, not insurance)	#	2	-	-	2
Cash and cash equivalents	6	185	(165)	-	20
Any other assets, not elsewhere shown	7	7	(6)	-	1
Total Assets		1,007	-	(41)	966

#- Disclosure note not provided as solvency II 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.

2. Deferred tax assets

Under IFRS, deferred tax assets (DTA) 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 utilisation of future available taxable profits.

	£m
Deferred tax assets - IFRS	-
Solvency II Valuation Adjustment	4
Deferred tax assets - solvency II valuation	4

There are a number of changes that are made to the IFRS Balance Sheet in moving to a Solvency II basis 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 intangible assets, reserves, insurance recoveries and payables and the value of subordinated debt.

The impact of these changes at 31 December 2017 is a decrease in Solvency II taxable profits of £19m, with a consequent £3.6m taxation impact. 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 corporation tax 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 £19m has been justified based on the Board approved business plans over the period 2018 to 2019. The DTA established over this period is based on the announced Corporation Tax rates, as follows.

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2018	8.5	19.00%	1.6
2019	7.5	19.00%	1.4
2020	3.0	17.25%	0.6
Total	19.0		3.6

3. Equities, Bonds, Collective investment undertakings and Deposits other than cash equivalents

For solvency II valuation purposes, financial assets are valued consistently with IFRS. However there are mapping differences between the IFRS and Solvency II hierarchies within which certain assets 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 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 31 December 2017.

	QMP	QMPS	Total
	£m	£m	£m
Bonds	337	267	604
Equities	27	-	27
Collective Investments Undertakings	28	-	28
Deposits other than cash equivalents	20	-	20
Investments	412	267	679

4. 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 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	222
Total Reinsurance recoverables - IFRS	222
Best estimate liability adjustments	38
Total Reinsurance recoverables – solvency II valuation	260

5. Insurance and intermediaries receivables

For solvency II 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 D.2 Technical Provisions).

Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from 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 agents, brokers and intermediaries	49
Total Insurance and intermediaries receivables - IFRS	49
Best estimate liability adjustments	(49)
Total Insurance and intermediaries receivables – solvency II valuation	-

6. Cash and cash equivalents

For solvency II valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short-term bank deposits which are included in investments as bonds.

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	20
Short-term bank deposits	165
Total Cash and cash equivalents - IFRS	185
Reclassify short-term deposits into bonds	(165)
Total Cash and cash equivalents - solvency II valuation	20

7. Any other assets, not elsewhere shown

For solvency II 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	6
Other prepayments and accrued income	1
Prepayments and accrued income - IFRS	7
Reclassify accrued interest on bonds to Investments	(6)
Total Any other assets, not elsewhere shown - solvency II 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 gross technical provision recorded as at year end 2017:

HICO Entity (£m)	Total	Motor Liability	Motor Other	Property Damage	General Liability	Life excl Health
Gross Claims Provision	585	478	1	3	1	102
Gross Premium Provision	115	89	25	1	-	-
Gross Best Estimate Liability	700	567	26	4	1	102
Risk Margin	26	18	-	-	-	8
Gross Technical Provisions	726	585	26	4	1	110

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 Standard Actuarial Techniques for more developed accident periods, 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 known 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. Following a re-calibration exercise carried out this year, the IBNR amounts are then adjusted to allow for the explicit uplift for PPO IBNR.

For PPO claims a cashflow model is used to project cashflows for both claims that have settled on a PPO basis and those identified as having the potential to settle as a PPO in the future. This model projects both gross and reinsurance cashflows separately. The models used for PPOs are deterministic and for settled PPOs the settled amounts are known. 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 calculation of the Premium Provision requires a set of assumptions to be made. 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 Premium Provision is calculated in a single model. The model projects all relevant cashflows for each line of business and discounts these using the relevant yield curve. The Premium Provision requires cashflow projections for all items associated with in-force business, i.e. premium (net of IPT), claims and expenses (acquisition, administration and claims handling) and other ancillary income. The Premium Provision is calculated separately for each Solvency II Line of Business. The calculations are performed on an aggregated basis as opposed to an individual policy basis.

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 required by the SII regulations.

No transitional adjustment, Matching Adjustment or Volatility Adjustment was applied.

Risk Margin

The risk margin is calculated using an in-house model that makes a full calculation of all future SCRs without using simplification, as permissible by the Solvency II regulations.

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 aim to capture this uncertainty.

ENIDS

The approach used to derive the ENIDs loading has considered a combination of a mean load statistical approach for the attritional claims and a set of stresses and scenarios for large claims, PPOs and weather events. The statistical approach for attritional claims builds on a presentation at the Institute and Faculty of Actuaries 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 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 (DAC) 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 SII. 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.

As at 31 December 2017, the Solvency II value of gross technical provisions was £726m and the IFRS value of gross insurance contract liabilities was £743m.

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. The Group has entered into a quota share arrangement with effective date of 1 January 2016, covering each of the three calendar years to 31 December 2018.

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.

A re-calibration exercise was carried out this year on large claims that are yet to be reported. This has meant a number of changes in assumptions since the 2016 year-end:

- Claim frequency and severity assumptions were changed as a result of the re-calibration. This resulted in a favourable impact on the Technical Provisions net of Excess of loss reinsurance.
- In addition, reinsurance loss ratios on large claims at 2017 year-end for the Premium Provision calculation were set using the reinsurance recovery rate derived in the re-calibration and the actual 2018 reinsurance premium rates. The reinsurance recovery rate used is 52.3%. The reinsurance recovery rate has as a result increased markedly in the last year, from 27% of large claims to 52.3%, the driver of this being the Ogden rate assumption change since the previous re-calibration exercise was performed in 2015.

This exercise also involved the establishment of a PPO IBNYR allowance. Note there has been no change in the assumed Ogden discount rate between the 2016 and 2017 year-ends. The best estimate assumption remains at -0.75% p.a.

D.3 Other liabilities

Reconciliation between IFRS and Solvency II valuation		2017			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Derivatives	#	2	-	-	2
Reinsurance payables	1	6	-	(6)	-
Payables (trade, not insurance)	2	29	-	(4)	25
Subordinated liabilities	3	11	-	1	12
Any other liabilities, not elsewhere shown	#	2	-	-	2
Total Other Liabilities		50	-	(9)	41

#- Disclosure note not provided as solvency II 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. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

	£m
Due to reinsurers	6
Total Reinsurance payables - IFRS	6
Reinsurance payables included in BEL calculations	(6)
Total Reinsurance payables - solvency II 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
Reinsurance payables	6	-	-	-	-	6

2. Payables (trade, not insurance)

For solvency II valuation purpose, trade payables are initially valued consistently with IFRS and then adjusted to remove the MIB levy as part of the BEL calculations.

Under IFRS, trade payables are recognised when due. Payables are initially recognised at fair value and subsequently held at amortised cost.

	£m
Bank overdrafts	3
Amounts owed to group undertakings	5
Other taxes and social security costs	12
Other payables	3
Accruals and deferred income	6
Total Payables (trade, not insurance) - IFRS	29
Reclassification of payables included in BEL calculations	(4)
Total Payables (trade, not insurance) – solvency II valuation	25

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 II 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.

	£m
Subordinated liabilities	
Subordinated notes (€ 12m)	11
Subordinated liabilities - IFRS	11
Revaluation of subordinated debt	1
Subordinated liabilities - solvency II valuation	12

D.4 Alternative methods for valuation

Information is provided for material assets and liabilities 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 £4m; 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 £260m; 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:

- 3) Best Estimate Liability and Risk Margin £726m; this has been valued under Solvency II methodologies and further information can be found earlier in this report.
- 4) Payables (trade, not insurance) £25m; 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. 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 Solvency II valuation 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 are consistent across all entities. The approach to measuring and monitoring capital for Highway 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.

	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Ordinary share capital	75	-	-	75
Initial funds / members' contributions	75	-	-	75
Reconciliation reserve	45	-	-	45
Subordinated liabilities	-	12	-	12
An amount equal to the value of net deferred tax assets	-	-	4	4
Total Basic Own Funds	195	12	4	211
Total Basic Own Funds after deductions	195	12	4	211

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

Total available Own Funds to meet the SCR	195	12	4	211
Total eligible Own Funds to meet the SCR	195	12	4	211

Total available Own Funds to meet the MCR	195	12		207
Total eligible Own Funds to meet the MCR	195	12		207

Tier 1 consists of both Ordinary Shares of £75m and Initial Funds being a capital injection of £75m (2016: £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.

Tier 3 relates to deferred tax assets of £4m which is valued in accordance with IFRS and has no terms and conditions attached.

A dividend of £74.6m (99.47 pence per share) was declared by the Directors during 2017 and remitted to the parent company in December 2017.

Analysis of significant changes in own funds during the reporting period

	Highway		
	1 January 2017 £m	Movement £m	31 December 2017 £m
Eligible own funds			
Tier 1 capital	219	(24)	195
Tier 2 capital	12	-	12
Tier 3 capital	12	(8)	4
Total capital	243	(32)	211
Made up by:			
Equity shares	75	-	75
Initial funds / members' contribution	150	(75)	75
Subordinated liabilities	12	-	12
Deferred tax	12	(8)	4
Reconciliation reserve / surplus	(6)	51	45
Total capital	243	(32)	211
Total eligible own funds to meet SCR	243	(32)	211

- 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 £32m over the reporting period predominantly due to the payment of a £75m dividend.
- Tier 2 capital represents the subordinated debt. As the subordinated debt is a loan in Euro's, the value has increased from 2016 due to a fall in the value of sterling exchange rate.
- Tier 3 capital represents the deferred tax asset.

Ancillary own funds

At 31 December 2017 there were no ancillary own funds.

Deductions from own funds

At 31 December 2017 there were no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Retained earnings on a Solvency II basis	45
Total	45

Highway has not applied any loss absorbency mechanisms as at the end of 2017.

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

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities.

	£m
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	75
Capital reserve	75
Retained Earnings	65
Total Equity - IFRS	215
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of DAC (Section D.1)	(30)
- Increase in valuation of reinsurance recoverable (Section D.1)	38
- Reduction in valuation of insurance and intermediaries recoverable (Section D.1)	(49)
- Deferred Tax Assets	4
- Other	(4)
	(41)
<u>Technical provisions</u>	
- Increase in valuation of technical provisions	16
<u>Other liabilities</u>	
- Reduction in payables	10
- Other	(1)
	(16)
Total Equity - solvency II basis	199
Add in subordinated liabilities (Tier 2)	12
Total own funds solvency II basis	211
Excess of Assets over Liabilities solvency II basis	
Total Assets	966
Total Technical Provisions	(726)
Total Other Liabilities	(41)
Excess of Assets over Liabilities solvency II basis	199

Differences in the asset and liability valuation methodology used for solvency II 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 items that are 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 policyholders 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.

	2017	2016
Highway SCR (£m)	147	160
Highway MCR (£m)	63	62

The Highway SCR decreased by £13m over the reporting period largely due to the increased profitability seen over the year and the resulting increase in the loss-absorbing capacity of deferred taxes (LACDT). Movements in the underlying risks have been largely immaterial, with impacts either offsetting or diversifying with other risks.

The Minimum Capital Requirement (MCR) as at 31 December 2017 was £63m. The calculation of the MCR is laid out in the S.28.01.01 QRT annexed to 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 slightly in line with the small increase in Premium and Reserve risk due to growth in written premiums.

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 2017 - all figures in £m	
Market risk	17
Counterparty default risk	12
Life underwriting risk	2
Non-life underwriting risk	131
Diversification	(19)
Basic solvency capital requirement	143
Operational risk	18
Loss-absorbing capacity of deferred taxes	(14)
Solvency capital requirement	147

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 A.1 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 A.1 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 A.1 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 A.1 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 A.1 of the Group section of this report.

f) Material lines of business and material geographic areas.

TAC underwrites non-life insurance contracts within the UK.

General insurance:

TAC's principal purpose is to conduct 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 1 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 came up for renewal, policyholders were invited to renew their insurance cover with Liverpool Victoria Insurance Company Limited.

The primary sources of premium income were from the sale of Home products.

As such the following Solvency II non-life lines of business were 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 household contents and building insurance products provide insurance protection for a 12 month period so accordingly, there are no active policies in-force from 1 July 2017.

Whilst there have been changes of Director during 2017, the governance of the business remained stable and the solvency position and overall strength of the business was consistent. The changes in Directors were as follows:

A M Parsons – Appointed 30 June 2017
P W Moore – Resigned 29 June 2017
K O'Keeffe – Resigned 29 December 2017

Whilst TAC ceased writing new business after the transfer to LVFS, the organisation incurred an underwriting loss of £359k (2016: £21k). The majority of the organisation's invested assets are now in collective investment undertakings. The company has received £31k (2016: £1,022k) of investment income.

TAC used the Standard Formula to calculate its capital requirements throughout 2017, and this is expected to continue 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.

Fire and other damage to property insurance	2017	2016
	£000	£000
Net earned premiums	348	2,906
Net claims incurred	87	(1,491)
Expenses incurred (excluding investment management expenses)	(794)	(1,436)
Net total	(359)	(21)

Claims ratio	(25.0)%	51.3%
Expense ratio	228.2%	49.4%
Combined ratio	203.2%	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. Claims performance has been in line with expectations in 2017 as only its current policy holders were serviced.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period:

	2017 £000	2016 £000
Dividend income	20	167
Interest income	11	26
Net realised/unrealised gains	-	829
Net total	31	1,022

TAC had investments of £5,440,000 at 31 December 2017 (2016: £8,910,000) invested in money market collective investment undertakings.

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

2017 Asset class (£000)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Percentage of total	Average investment holding during 2017	Average investment return
Collective investment undertakings	20	-	-	20	64.5%	7,175	0.3%
Cash and deposits	-	11	-	11	35.5%	1,475	0.7%
Total	20	11	-	31			

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	-	829	996	97.5%	4,455	22.4%
Cash and deposits	-	26	-	26	2.5%	2,061	1.3%
Total	167	26	829	1,022			

A.4 Performance of other activities

Tax credits/(charges) are the only other material expense for TAC:

	2017	2016
	£000	£000
Tax credit/(charge)	36	(167)
Total	36	(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.

The Directors of TAC during the year were as follows:

R A Rowney
S Treloar
A M Parsons – Appointed 30 June 2017
P W Moore – Resigned 29 June 2017
K O’Keefe – Resigned 29 December 2017

C. Risk Profile (TAC)

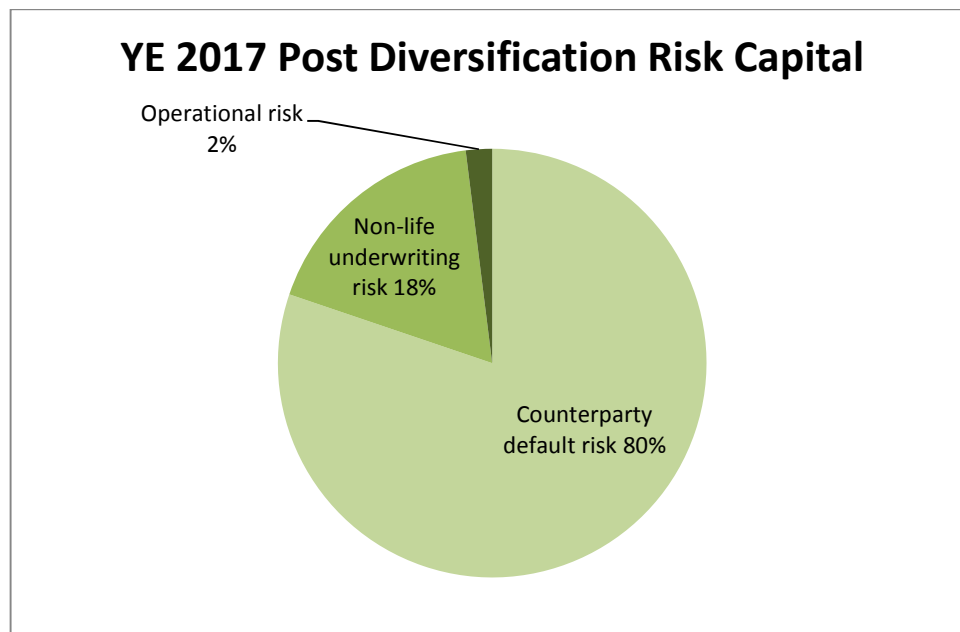
C.1 Overview

C.1.1 Overview of risk exposures

No new business has been written since June 2016 and policyholders have been able to renew their insurance with LVIC from July 2016. All policies are for 12 months so by July 2017 there were no more policies in force.

TAC is exposed to non-life reserve risk. This arises from the uncertainty of claims that are still to be settled. As the company has not been writing new business since 2016 there remains no risk from premium uncertainty or from an unknown weather event.

All risks are expected to decline in line with a fall in the investment portfolio as claims are settled and the book runs-off. TAC is exposed to some concentration risk from the collective investment holding although this is with an approved financial institution.



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 C.1.2.

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 C.1.3.

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 non-life reserve risk. This arises from the uncertainty of claims that are still to be settled. As the company has not been writing new business since 2016 there remains no risk from premium uncertainty or from an unknown weather event.

C.2.2 Material changes over the reporting period

TAC has seen a reduction in underwriting risk due to there being no premium uncertainty or exposure to weather events.

C.2.3 Risk mitigation techniques

TAC does not undertake any risk mitigation techniques. Reinsurance was in place in 2016 but was not in place in 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 C.3.1 of the main LVFS Group SFCR.

TAC is not exposed to market risk.

C.3.2 Material changes over the reporting period

TAC is in run-off. 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) 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 in section C.4 of the main LVFS Group SFCR.

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 an LVFS Group level and are described further in sections C.5, C.6 and C.7 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 II 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 liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

Reconciliation between IFRS and Solvency II valuation		2017			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£000	£000	£000	£000
Investments					
- Investment funds	1	5,440	-	-	5,440
Receivables (trade, not insurance)	#	16	-	-	16
Cash and cash equivalents	#	159	-	-	159
Any other assets, not elsewhere shown	#	87	-	-	87
Total Assets	#	5,702	-	-	5,702

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

1. Investments

All the assets of TAC are in highly liquid OEICs (which are invested in cash and cash equivalents) to match projected underwriting future liabilities.

D.2 Technical Provisions

The table below summarises the technical provision recorded as at year end 2017:

	2017		
	IFRS	Adjustments	Solvency II
	£000	£000	£000
TP; Non-Life (excluding health)			
- TP calculated as a whole	246	(246)	-
- Best Estimate	-	246	246
- Risk Margin	-	50	50
Total technical provisions	246	50	296

Overview

Due to materiality, the best estimate liability (BEL) is derived from the underlying IFRS Reserves for Solvency II valuation purposes. It comprises a calculation of a claims provision which 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.

Best Estimate Liability (BEL)

The BEL for TAC consists only of a Claims Provision as the company has no unearned premium.

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.

Risk Margin

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.:

$$\text{Risk Margin} = \text{CoC} * \sum_{t>=0} \text{SCR}_t / (1 + r_{t+1})^{\wedge(t+1)}$$

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:

$$\text{Risk Margin} = 2 * \text{CoC} * \text{SCR}_0$$

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

There are no other liabilities within TAC.

D.4 Alternative methods for valuation

There are no material assets that have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts.

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

- Best Estimate Liability and Risk Margin £296k; this has been valued under Solvency II methodologies and further information 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 Solvency II valuation 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 are consistent across all entities. The approach to measuring and monitoring capital for TAC 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.

	Tier 1 £000	Tier 2 £000	Tier 3 £000	Total £000
Ordinary share capital	-	-	-	-
Reconciliation reserve	5,406	-	-	5,406
Total Basic Own Funds	5,406	-	-	5,406
Total available Own Funds to meet the SCR	5,406	-	-	5,406
Total available Own Funds to meet the MCR	5,406	-		5,406

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

Total available Own Funds to meet the SCR	5,406	-	-	5,406
Total eligible Own Funds to meet the SCR	5,406	-	-	5,406

Total available Own Funds to meet the MCR	5,406	-		5,406
Total eligible Own Funds to meet the MCR	5,406	-		5,406

Analysis of significant changes in own funds during the reporting period

	TAC		
	1 January 2017 £000	Movement £000	31 December 2017 £000
Eligible own funds			
Tier 1 capital	10,436	(5,030)	5,406
Total capital	10,436	(5,030)	5,406
Made up by:			
Equity shares	4,000	(4,000)	-
Reconciliation reserve / surplus	6,436	(1,030)	5,406
Total capital	10,436	(5,030)	5,406
Total eligible own funds to meet SCR	10,436	(5,030)	5,406

- Tier 1 capital includes movements in excess of assets over liabilities.
- A share capital reduction during the year reduced ordinary share capital from £4,000,000 to £1
- A dividend of £5,000k was paid to LVFS, the parent undertaking in 2017.

Ancillary own funds

At 31 December 2017 there were no ancillary own funds.

Deductions from own funds

At 31 December 2017 there were no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Retained earnings on a solvency II basis	5,406
Total	5,406

TAC did not apply any loss absorbency mechanisms as at the end of 2017.

Material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency II 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	-
Retained earnings	5,456
Total Equity - IFRS	5,456
Solvency II Adjustments (excluding reclassifications)	
<i>Technical provisions</i>	
- Increase in valuation of technical provisions (Section D.2)	(50)
	(50)
Total Equity - solvency II basis	5,406
Total own funds - solvency II basis	5,406

Excess of Assets over Liabilities - solvency II basis	
Total Assets	5,702
Total Technical Provisions	(296)
Total Other Liabilities	-
Excess of Assets over Liabilities - solvency II basis	5,406

Differences in the asset and liability valuation methodology used for solvency II 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

E.2.1 SCR and MCR

The following table shows the amount of the SCR and MCR for TAC.

£000	2017	2016
SCR	421	3,605
MCR	2,196	2,251

Following the purchase of TAC in June 2016 and the renewal of all existing business into LVIC, TAC is now in run-off. The SCR has reduced due to the run-off of in-force business.

The calculation of the MCR is laid out in the S.28.01.01 QRT annexed to 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.

E.2.2 SCR split by risk

The following table summarises the risk modules which contribute to the Solvency Capital Requirement applicable under Standard Formula as at 31 December 2017:

SCR Component	£000
Counterparty default risk	372
Non-life underwriting risk	74
Diversification	(32)
Basic solvency capital requirement	414
Operational risk	7
Solvency capital requirement	421

No material simplifications have been adopted in the calculation of the SCR under Standard Formula.

E.2.3 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.