



Solvency II Single Group Solvency and Financial Condition Report

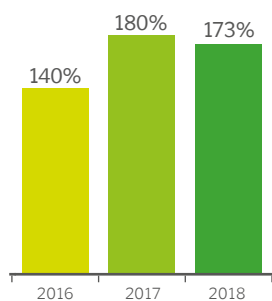
For the year ended 31 December 2018



Contents

Solvency II Capital Coverage Ratio

173%



Group Capital Surplus

£690m



Policyholders' overview	2
Executive summary	3
Company overview	8
Summary of material changes over the reporting period	19
Statements	20
Directors' approval statement	21
Independent auditors' opinion	22
LV= Group SFCR	27
A. Business and performance	28
B. Systems of governance	40
C. Risk profile	53
D. Valuation for solvency purposes	67
E. Capital management	89
Glossary	96
Appendix 1 – LV= Regulated entity SFCRs	97
LVFS solo SFCR	98
LVLC SFCR	132
LVPL SFCR	149
LVIC SFCR	167
Highway SFCR	193
TAC SFCR	218

Executive summary

Background

LV= has prepared the 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, this 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 Policyholders' Overview of Solvency is available as a stand-alone document and also makes up the introductory section of the full SFCR. The main body of the SFCR 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 the SFCR. These are the publicly available detailed forms we submit to the PRA which contain financial information prescribed by the Solvency II regulations. The values in the public QRTs represent the rounded values of those reported in the private QRTs. As a result, small rounding differences may be present in them. The SFCR and 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 2018 (the 'Report and Accounts'), a copy of which can be found at <https://lv.com/annual-report>.

Basis of preparation of the SFCR

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.

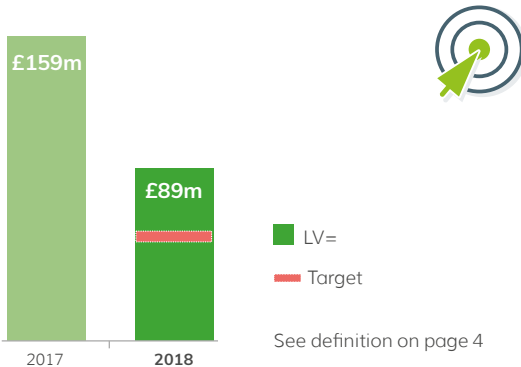
In common with many in the industry, we present two cover ratios, an 'Investor View' for analysts and investors in our subordinated debt, that excludes the ring-fenced funds entirely, and a 'Regulatory View' where the ring-fenced funds are included but their surplus is excluded from the Group's surplus.

Summarised capital performance (Investor view)

At the end of 2018 the group capital surplus on a Solvency II Standard Formula basis was £690m (2017: £698m) with a Capital Coverage Ratio (Investor view) of 173% (2017: 180%).

The key performance indicators we use to monitor our capital position are Operating capital generation and the Capital Coverage Ratio.

Operating capital generation £m



Aim

We aim to generate positive operating capital, above or in-line with our financial plan. Plan operating capital generation for 2018 was £56m.

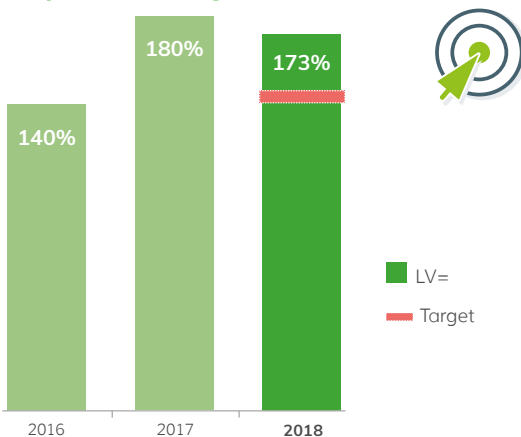
Performance

Operating capital generation includes positive contributions from both the life and general insurance trading businesses. Capital contributions are supported by rigorous cost control whilst trading performance was impacted by reduced contribution from life new business and severe weather events in general insurance. See further analysis on pages 4 and 5.

Link to directors' remuneration

Life operating capital generation contributes to the annual bonus vesting. It excludes the impact of general insurance and group items.

Capital coverage ratio (CCR) %



Aim

We aim to ensure the long-term sustainability of the group by maintaining a robust Capital Coverage Ratio (CCR). We target a CCR % above risk appetite of 140%.

Performance

The Capital Coverage Ratio is well above risk appetite. The strong capital position has enabled management to strengthen the quality of reported capital by removing the management action to potentially claw back awarded mutual bonus; this reduced the CCR by 29%. See further analysis on page 5.

Link to directors' remuneration

CCR% is derived from group eligible own funds and the solvency capital requirement. Growth in own funds contributes to the 2018-2020 LTIP scheme vesting.



Definitions

Capital surplus generation

Capital surplus 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

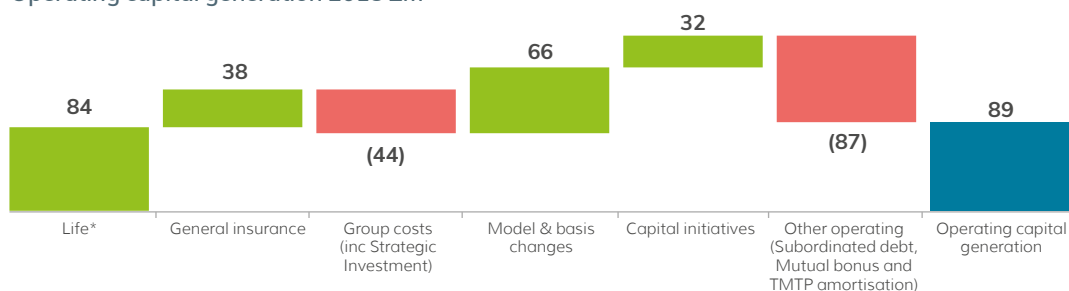
Operating capital generation is capital surplus generation adjusted to remove the effects of temporary volatility, from market movements and the static nature of Transitional Measures on Technical Provisions (TMTP), changes in defined benefit pension schemes and exceptional items.

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

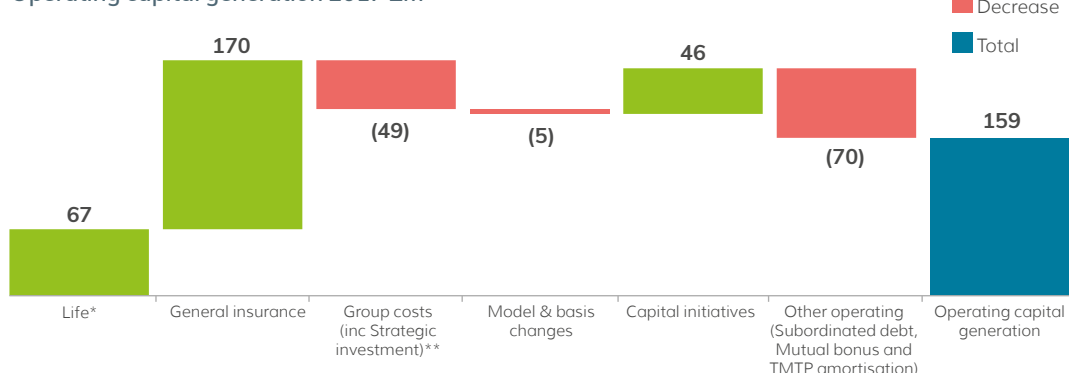
Operating capital generation

Operating capital generation of £89m (2017: £159m) includes positive contributions from both the life and general insurance trading businesses.

Operating capital generation 2018 £m



Operating capital generation 2017 £m



* 2017 results are restated to include expected investment returns above the risk free rate within life capital generation; previously this was included within economic variances. This change has been made to reflect the risk premium on assets invested by the life business. 2017 operating capital generation has been increased by £24m accordingly.

** 2017 results are restated by £2m to exclude the costs associated with creating a fitter mutual for the future. These costs are presented outside of operating capital as they are not associated with the performance of our trading businesses.

The life business generated operating capital of £84m (2017: £67m). Strong cost control offset the reduced contribution from new business written in the year. The 2017 result also included the impact of recognising a £12m provision for the costs associated with the FCA Legacy review.

Operating capital generated by the general insurance business of £38m is lower than in 2017 (£170m) reflecting our reduced equity stake of 51%, but also due to the non-recurrence of several one-off improvements in the capital position for general insurance in 2017. The result includes a £22m benefit due to our reserving assumption for the Ogden discount rate moving to 0% following the Civil Liability Bill receiving Royal assent.

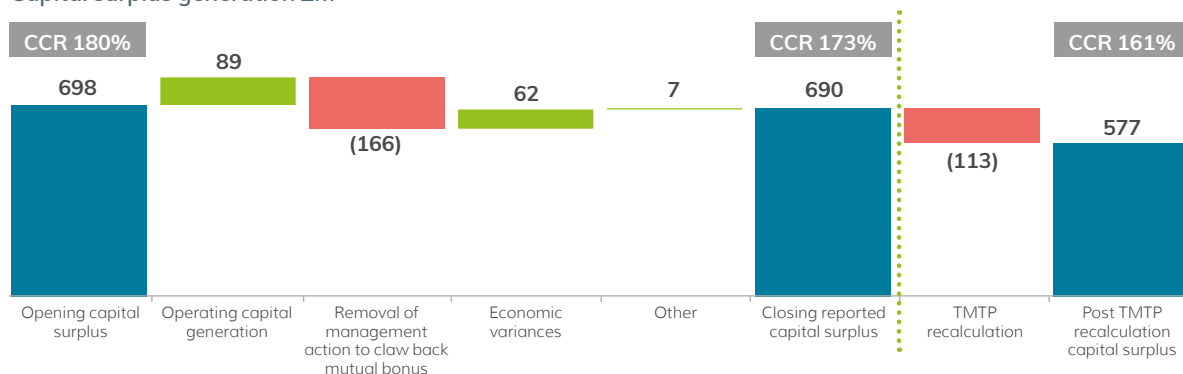
Positive model and basis changes and capital initiatives contribute £98m (2017: £41m) to capital generation. These include modelling improvements for our pensions business to better reflect policyholder behaviour post pension freedoms, favourable impacts due to updated longevity assumptions and also investment management contract renegotiations which strengthened our capital position. This offsets £131m (2017: £119m) of group costs, strategic investment, debt interest, mutual bonus and TMTP amortisation which are also included in the group operating capital position.

Capital surplus generation

At the end of 2018 the group capital surplus was £690m (2017: £698m) with a Capital Coverage Ratio (CCR) of 173% (2017: 180%) which was well within risk appetite. The strong capital position has enabled management to improve the quality of reported capital by removing the benefit associated with management's ability to claw back previously awarded mutual bonus in times of stress; this reduced the overall capital surplus by £166m. The capital surplus has been favourably impacted by market movements.

The closing capital surplus includes the positive benefit of £490m from TMTP. If a TMTP recalculation was performed, this would reduce the surplus by £113m, resulting in a CCR of 161% at the 2018 year end.

Capital surplus generation £m



Capital performance

At the end of 2018 the group capital surplus on a Solvency II Standard Formula basis was £690m (2017: £698m) with a capital coverage ratio of 173% (2017: 180%). This includes the removal of the management action to potentially claw back mutual bonus.

Definitions

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 group capital surplus table shows the estimated eligible own funds, Solvency Capital Requirement 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.

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).

Solvency II

Since the implementation of Solvency II, 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 from 2016.

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

Group capital surplus

£m	2018	2017
Eligible own funds		
Tier 1	1,244	1,178
Tier 2	372	379
Tier 3	24	10
Total eligible own funds	1,640	1,567
Solvency capital requirement	950	869
Surplus	690	698
Capital Coverage Ratio (CCR)	173%	180%

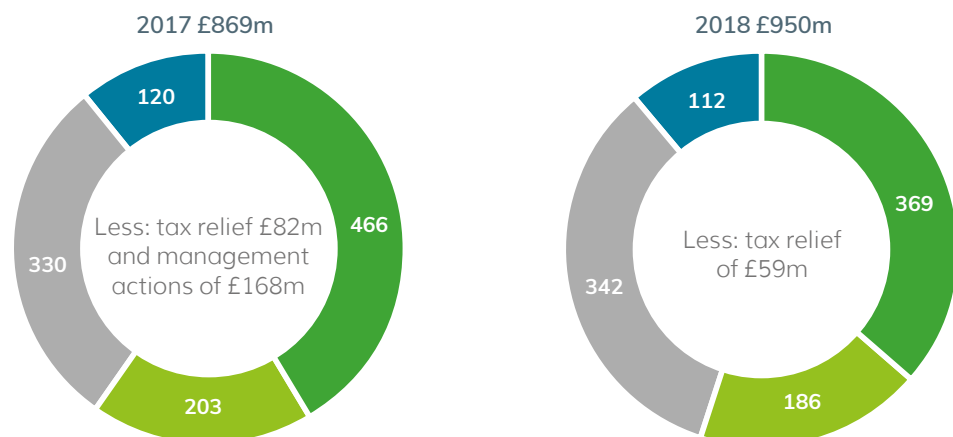
In order to report our Capital Coverage Ratio on a standard 'Investor view' basis, the eligible own funds and Solvency capital requirement exclude amounts attributable to the Royal National Pension Fund for Nurses (RNPFN) and Teachers ring-fenced funds. Including these funds, to provide a 'Regulatory view', would not change the capital surplus shown above as these funds do not require capital support. It would however increase capital required, and therefore dilute the reported Capital Coverage Ratio to 167%.

As the majority shareholder in the general insurance business the group retains control of the business, and as a result the capital calculation consolidates the risk profiles of the two entities and benefits from diversification between the different exposures. At the end of 2019, upon sale of a further equity stake in the general insurance business, the group's shareholding will reduce below 50%, at which point the capital calculation would no longer be based on this consolidation of the risk exposures.

Eligible own funds include the positive benefit of TMTP of £490m (2017: £528m) after the annual step down of £38m, (2017: £37m). TMTP is required to be recalculated for business and economic change at least every two years and the most recent recalculation was the industry-wide recalculation on 31 December 2017. The estimated impact of a potential TMTP recalculation on the 31 December 2018 surplus would be a reduction of £113m, resulting in a Capital Coverage Ratio of 161%.

The capital surpluses discussed here make assumptions about the out-turn of Brexit negotiations. It is possible the final outcome of the negotiations may impact the capital position.

Solvency capital requirement



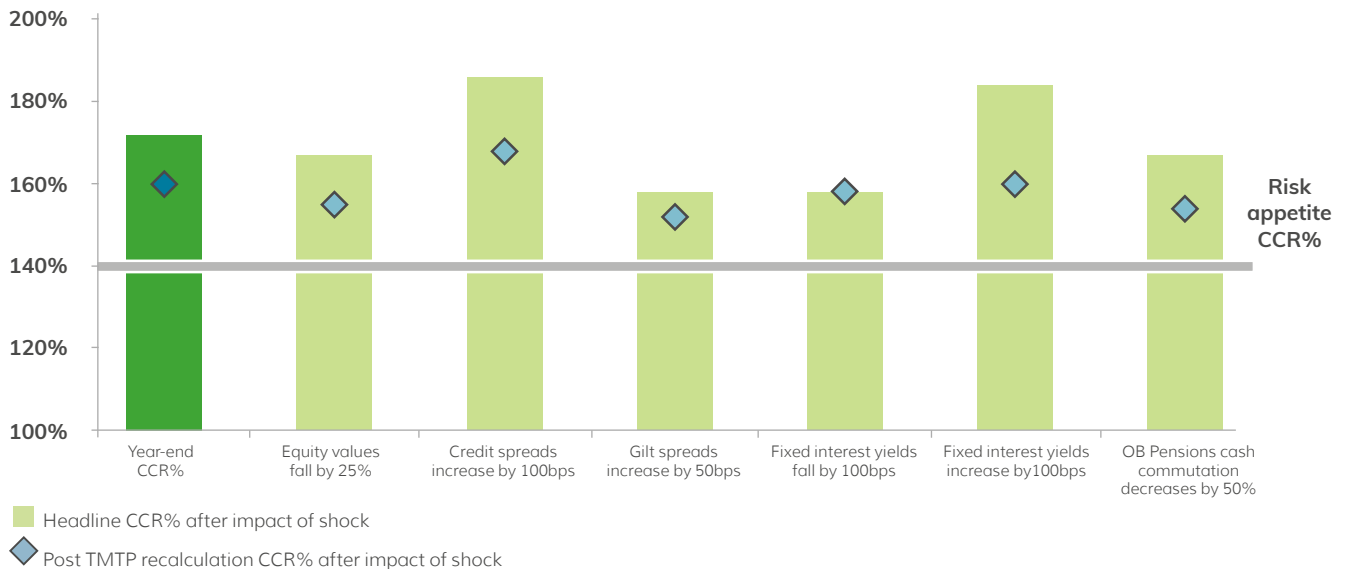
- Market risks¹
- Life insurance risk
- Operational and counterparty risk
- General insurance risk

¹ Market risks include: credit, equity, property, interest rate and other risks

Sensitivity analysis of Solvency II group capital surplus

The following table shows the sensitivity of the group's Capital Coverage Ratio to economic assumptions on a pre and post TMTP recalculation basis. 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 solvency capital requirement calculation is applicable for that sensitivity. The credit and gilt spread sensitivities represent a widening of yields on relevant asset classes in basis points (bps) relative to swap rates. The sensitivities below allow for the impact of the group's hedging strategy.

Sensitivity of Capital Coverage Ratio (CCR) % to changes in economic assumptions



173%
Solvency II Capital Coverage Ratio

The group's capital surplus position is sensitive to the above economic assumptions due to the following:

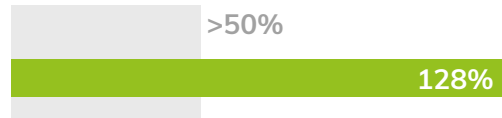
- A fall in equity values reduces the value of the group's defined benefit pension schemes, increases With-profits guarantee costs and reduces the benefit of future charges on unit-linked business, all of which are partially hedged to equity market movements. A TMTP recalculation would not reduce the impact of this sensitivity 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 by reducing the value of future liabilities. It also reduces the value of liabilities using the Volatility Adjustment. This is partially offset by a reduction in corporate bond values held to support the general insurance business lines. Following a TMTP recalculation, the benefit reduces further due to the loss of Volatility Adjustment and increased risk associated with annuity business, arising from an assumption under the previous solvency regime of increased credit defaults as spreads widen.
- 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.
- Changes to fixed interest rate yields (both swap and gilt rates) lead to changes in the group's capital surplus position prior to a TMTP recalculation 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.
- A decrease in the rate at which OB Pensions deferred annuity policyholders commute their annuities to cash increases the group's liabilities. This is because the liability to pay the annuity is higher than that to pay the cash lump-sum: this implies an annuity rate significantly more generous than that currently available in the market.

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 2018, the regulatory view SCR coverage ratio for the group was 167% (2017: 171%) and the Minimum consolidated Group SCR coverage ratio was 318% (2017: 310%). 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 128% Tier 1 capital coverage.



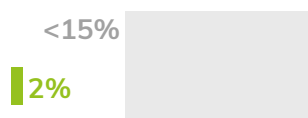
Of the Minimum consolidated Group SCR, at least 80% must be covered by Tier 1 capital. The group has complied with this and has a Tier 1 coverage ratio of 298%.



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 38% 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 2% of the SCR.



Company Overview

LVFS is the UK's largest friendly society, with more than six million policies in-force 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 changing at a faster rate than ever before, across technology and socially 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 we believe everyone deserves to live confidently and we exist to ensure everyone can do that. We believe our blueprint (see below) and our vision for the future, developed in 2018 which builds on this further, is the best way to move forward at pace to maintain and grow our business.



Our blueprint, 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:

- Deliver Green Heart experiences for our customers, IFAs, colleagues and members – to help them feel confident about life and confident in us.
- Harness the latest technologies, evolve how we operate and bring in the new talent needed to ensure that we remain relevant and competitive today and well into the future. We have termed this LV=3.0.
- Build a business that is sustainably Lean and strong so we can achieve our goals over the long term whilst continuing to grow member value.

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



We make every pound count



We make it feel special



We fight for better



We don't wait to be asked

If we do all of this our members and 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 are building an even better mutual for the future founded on a clear purpose, values, a trusted brand and innovative solutions that meet customer, member and IFA needs. We believe this 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.

Strategic priorities for the group

Green Heart experiences

- 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.
- Strengthen and reposition our brand to build on its current strength and position as a mutual for today and tomorrow with broader propositions aligned to our proposed growth strategy.

LV= 3.0

- 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.
- Develop, agree and execute the strategy to deliver accelerated growth, with new proposition launches to establish the proof points for this strategy. Define a transformation plan with strong change delivery focus at the heart.

Lean and strong

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

Building a mutual for today and tomorrow

Underpinning these priorities is the work underway to create a 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, AgFe and Aberdeen Standard Investments. 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.

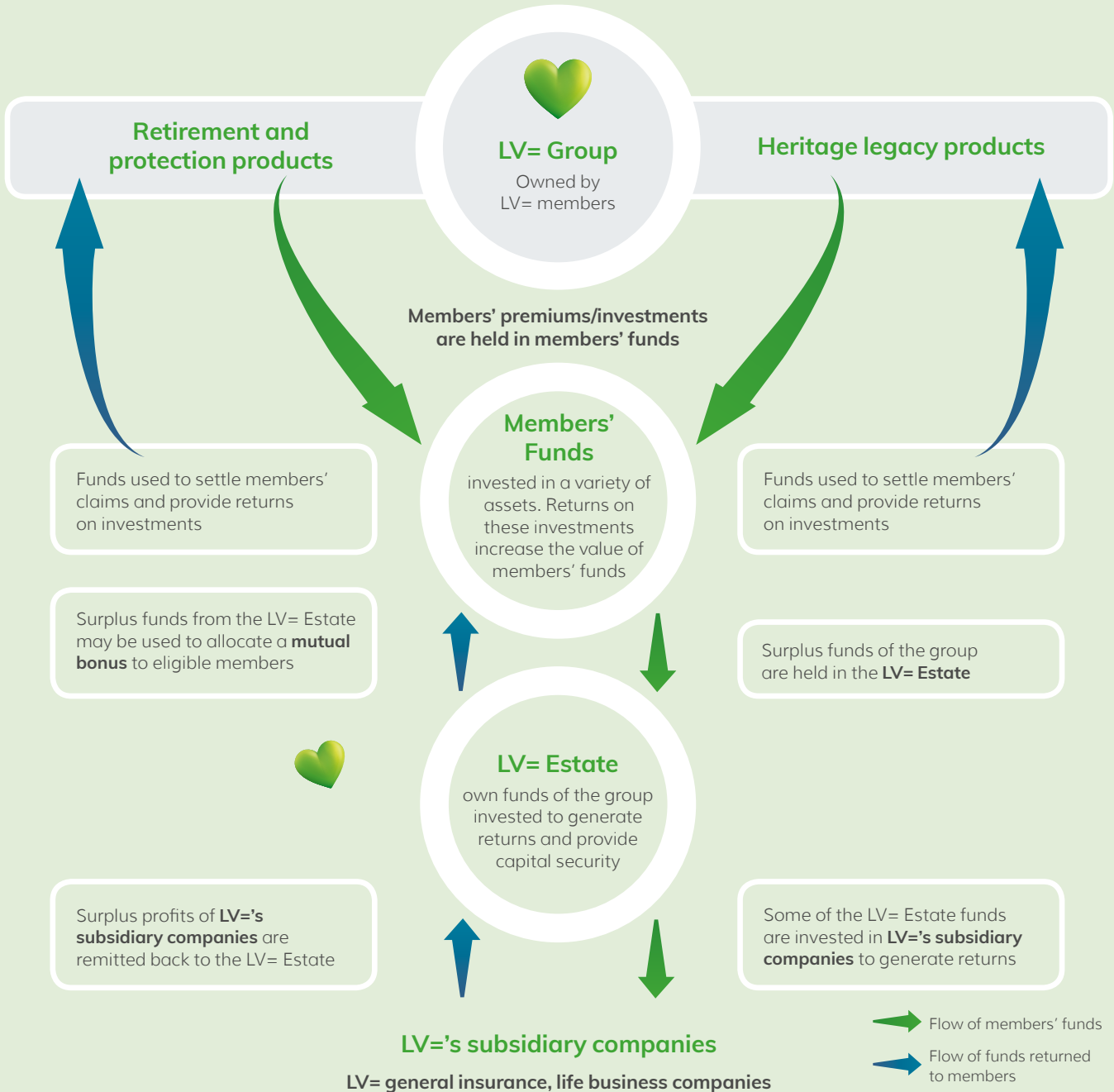
When the financial performance and financial and capital strength of the LV= group allows, surplus funds from the LV= Estate may be used to allocate a **mutual bonus** to eligible members.

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, 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= receives 51% of any future distributed profits, until such time as there is a further sale of this investment.

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



Our financial performance

Operating profit

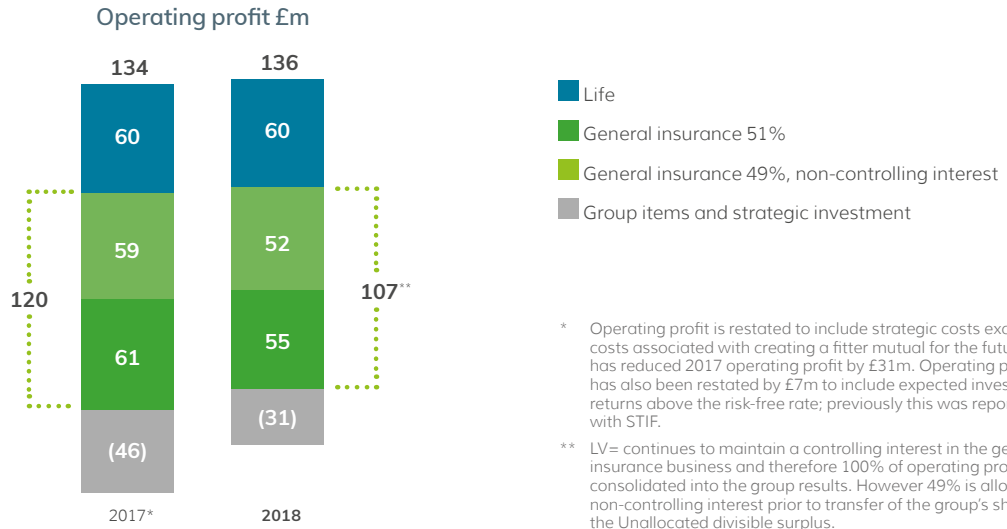
Operating profit at £136m (2017: £134m) includes £60m from life and £107m from general insurance, partially offset by group items and strategic investment of £31m.

Definitions

Operating profit

Operating profit is defined as profit before tax adjusted for:

- short-term investment fluctuations (STIF)
- gain on acquisitions / disposals
- finance costs
- restructuring and non-recurring items, including the costs of creating a fitter mutual for the future and separation of the general insurance business
- amortisation or impairment of acquired intangibles.



Operating profit from life is stable year-on-year with the reduced new business contribution offset by rigorous cost control and an improved performance in heritage which in 2017 was impacted by the legacy review provision.

Operating profit from the general insurance business of £107m (2017: £120m) includes an underwriting result of £99m (2017: £102m) and investment returns of £8m (2017: £18m). The reduction in underwriting result is primarily due to adverse current year claims experience, offset by favourable prior-year run-off of £106m (2017: £46m).

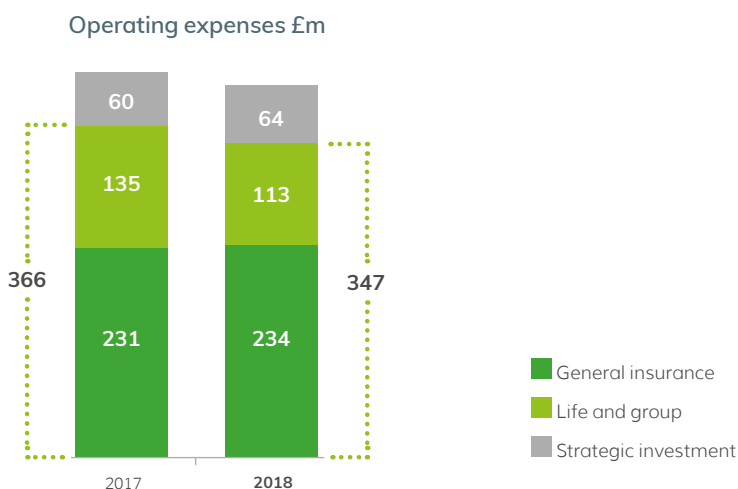
Group items and strategic investment have reduced by £15m demonstrating improved cost control.



IFRS result analysis

Expenses

Cost control remains a key priority and this is demonstrated by the continued reduction in operating expenses year-on-year of £19m.



Definitions

Operating expenses

Operating expenses are management expenses (which excludes commission) before deduction for amounts ceded to reinsurers. These are adjusted to exclude one-off costs associated with the Allianz transaction, creating a fitter mutual for the future and GMP pension equalisation adjustment.

Prior periods are restated by £5m to exclude costs associated with creating a fitter mutual for the future and amortisation of acquired intangibles. This aligns the definition of operating expenses to represent items included with operating profit.

Treatment of policyholders tax

LV= pays tax on behalf of its policyholders when they make gains on their investments.

The tax paid is deducted from the policyholders' asset share. Policyholder tax is reported in Income tax expense with the deduction from policyholders' asset share credited to Short-term investment fluctuations and related items.

Profit/(loss) before tax (PBT)

Our measure of PBT is defined as International Financial Reporting Standards (IFRS) profit before tax, mutual bonus allocated, and transfer to unallocated divisible surplus and includes the PBT from both continuing and discontinuing businesses.

Life and group costs have reduced by over 16% reflecting a continued strong focus on cost efficiencies throughout the year driving savings in staff and bonus costs, marketing spend, contractual costs and project spend. This discipline will continue through 2019 as we drive further efficiencies in the life business ahead of the exit from the agreement to provide central services to the general insurance business.

General insurance costs have remained broadly flat year-on-year with £12m of expense savings embedded into the agreement to provide central services offset by an increase in advertising and promotional spend to support the rollout of Pioneer, with additional products (Multi-car and Home), and additional investment in pricing and digital areas.

Increased strategic investment spend has been incurred as we continue to invest for the future, and includes amortisation of the re-platforming programme in general insurance.

Profit before tax

Profit before tax of £20m (2017: £122m) includes the positive impacts from operating profit of £136m (2017: £134m) and recognition of a £17m derivative asset regarding the option to sell the group's remaining equity stake in the general insurance business. Short-term investment fluctuations (STIF) are negative at £66m (2017: positive £30m) and include £37m (2017: £6m positive) relating to the impact of unmatched market movements in the value of investments driven by adverse impacts of widening corporate bond spreads causing losses on annuities. STIF also includes £29m (2017: £24m positive) relating to tax credits on policyholders' asset shares.

Costs impacting PBT include the costs associated with restructuring of the group of £34m (2017: £19m), financing costs including interest on subordinated debt of £24m (2017: £24m) and £9m (2017: £3m) of other items. Cost associated with restructuring the group of £34m (2017: £19m) include costs associated with the separation of the general insurance business of £25m (2017: £17m) and £9m (2017: £2m) invested in creating a fitter mutual for the future. Other items of £9m (2017: £3m) include £6m expense incurred from Guaranteed Minimum Pension (GMP) equalisation in our staff pension scheme and amortisation of acquired intangibles.

The 2017 result was also impacted by £52m profit on the sale of the commercial business renewal rights to Allianz and £48m increase in life reserves due to the change in economic basis for long-term insurance liabilities.

Tax

The total tax credit of £14m (2017: £50m charge) includes £29m related to tax credits on losses on policyholder asset shares. The corresponding debit is reported within short-term investment fluctuations. Profits in the general insurance business generated a tax charge of £17m. Our tax policy is published on our website LV.com.

IFRS Surplus (UDS)

Unallocated divisible surplus (UDS) has decreased by £62m in the year, which includes PBT adjusted for movements in other comprehensive income relating to revaluations of the staff pension schemes (£29m reduction, 2017: £19m increase) and revaluation of investments classified as available for sale (£10m reduction, 2017: £nil). Other items impacting the movement in UDS are a deduction of £31m relating to the non-controlling interest share of income (2017: £2m share of loss), mutual bonus allocated to members' policies of £26m (2017: £26m) and a £14m income tax credit (2017: £50m charge).

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 '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 of an independent non-executive chairman, six independent non-executive directors and three executive directors who collectively possess an appropriate balance of expertise in the financial services industry, in particular life insurance, investments, risk and governance.

As members of a unitary board, non-executive directors should meet without the executive members present to scrutinise and hold to account the performance of management and individual executive directors against agreed performance objectives.

Changes to board composition

There have been a number of changes to the board membership and committee composition during the year:

The board welcomed Alison Hutchinson, Luke Savage and Tanya Lawler as non-executive directors during the year. The new members bring a broad breadth of knowledge and diverse experience and expertise to the board.

James Dean resigned on 31 March after six years on the board. Caroline Burton stepped down at the Society's AGM on 7 June after a seven year tenure.

Alison Hutchinson took over as Remuneration Committee chair and Colin Ledlie replaced Caroline Burton as the chair of the Investment Committee from 7 June. Luke Savage became Audit Committee chair from 1 April upon James Dean's resignation and brings highly relevant financial experience to the role.

David Barral took on the responsibilities as senior independent director from 1 April and provides a sounding board for the chair and serves as an intermediary for the other directors and members. The senior independent director with the non-executive directors should meet without the chair present at least annually to appraise the chair's performance, and on other occasions as necessary.

Wayne Snow joined the board as an executive director on 2 July and as the Society's chief risk officer.



The Board

The board are responsible for our strategic success and represent the interests of members and customers.

We have a strong, experienced and diverse board with a good balance of skills.

Back row

(left to right)

Andy Parsons
Wayne Snow

Luke Savage

David Barral

Alison
Hutchinson

Colin Ledlie

Front row

(left to right)

Richard Rowney

Tanya Lawler

Alan Cook

David Neave

Board committees

A full description of the responsibilities and a summary of duties and the activities undertaken during the year can be found on pages 59 to 69 of the Report and Accounts.

The terms of reference for the board committees are reviewed each year and published on our website. They can be viewed at LV.com/boarddocs

Board – chair Alan Cook

Establish values, culture and ethics, appointment and removal of directors. Financial and strategic matters, mergers, acquisitions and disposals. Monitor board committees.

Audit Committee – chair Luke Savage

Review internal control, financial reporting process and output. Review internal and external auditor effectiveness.

Investment Committee – chair Colin Ledlie

Oversee investment strategy, align business and risk strategy. Monitor performance of external fund managers.

Risk Committee – chair David Barral

Monitor risk governance and framework, group's economic capital model and systems of governance. Focus on risk exposure. Embed risk culture.

With-profits Committee – chair Graham Berville

Compliance with the Principles and Practices of Financial Management. Protect the interests of the With-profits policyholders.

Remuneration Committee – chair Alison Hutchinson

Determine executive pay policy, monitor LTIP schemes, recommend annual bonus rates.

Corporate Governance and Nomination Committee – chair Alan Cook

Monitor balance of board's skills and experience. Shortlist and recommend candidates for appointments. Reviews the selection process.

RNPFN supervisory board – chair Peter Nowell

Protect the interests of the RNPFN policyholders, monitor compliance with policies.

Our Risk Management

Overall board responsibilities

The LV= board are responsible for determining the risks which the group faces and ensuring that they are appropriately controlled. These include the risks to the business model and future performance, those which threaten the solvency and/or liquidity of the group and those which could have a detrimental impact upon our members, customers or other stakeholders.

The board discharge this responsibility through the implementation of a robust risk management framework (LV=RM) which includes the setting of a proportionate risk strategy, risk appetite and clear risk mandate and organisational design. The Risk Committee, on behalf of the board, regularly monitor the operation and effectiveness of the LV=RM Framework to ensure that it continues to drive a suitably robust risk culture within LV=.

Risk management framework

The LV= RM Framework comprises a systematic set of processes, tools and behaviours which collectively are used to assess risks that could impact the delivery of the group's business strategy, and ensure that these are considered and dealt with effectively, consistently and on a timely basis.

The LV=RM Framework is owned by the LV= chief risk officer on behalf of the board and has been developed through 2018 in order to support high quality risk decision making, protect member value, ensure good customer outcomes and inspire confidence in the group for all of its stakeholders. These enhancements form part of a strategy of continuous improvement of the group's risk management capability, and will continue throughout 2019 as the group strives to drive a strong risk culture that ensures the business is managed in line with the board's risk appetite.

The risk universe, risk strategy and the eight key elements of the LV= RM framework are summarised on pages 35 to 37 of the Report and Accounts.



Key risks and uncertainties

Within its overarching risk universe, the group has identified eight high-level categories which represent the most material areas of financial and non-financial risk exposure faced by the organisation. The board's overall attitude to each of these exposures is described within its risk strategy.

However, at any point in time the group will also likely face a series of specific risks which reflect the prevailing risk and control environment and are influenced by a variety of internal and external factors. Over the past year, the top risks faced by the group are summarised within the table below. The LV= RM Framework ensures that these risks are monitored and regularly reported as the internal and external environment evolves over time, allowing for management actions to be adapted as appropriate.

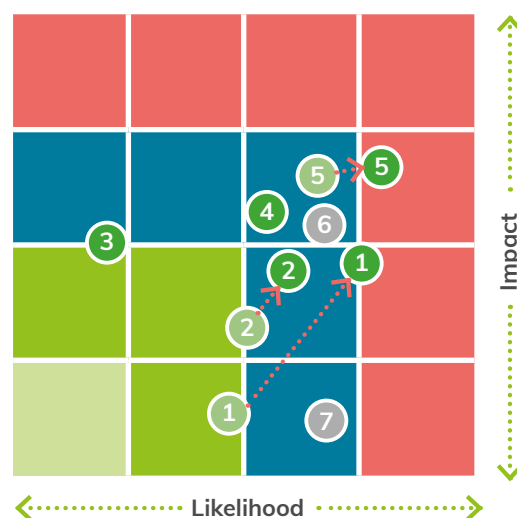
Key risks	Potential impact	Mitigation	Change from last year
<p>1</p> <p>Political, economic and regulatory uncertainty</p> <p>The risk of failure to achieve the group business plan due to material and prolonged uncertainty within the political economic and regulatory landscape.</p>	<p>The full impact of the political and economic uncertainties in the UK has been difficult to gauge during 2018 due to the continued lack of clarity around Brexit. This has been particularly relevant for the general insurance business.</p> <p>However, no immediate change is expected in the UK regulatory framework in the short term, or any significant legislative changes in the life and pensions market due to the current political situation.</p>	<p>The potential impact of Brexit on both operational capability and the financial position of the group has been a specific area of focus for the board throughout 2018, and will continue to be through 2019. Brexit planning will consider both the immediate period following the UK's exit from the EU, and the longer-term implications on LV='s business model. Stress testing of the life and general insurance businesses has concluded that the group remains robust under a wide range of severe scenarios.</p>	<p>The heightened level of risk is attributable to the close proximity and likelihood of the UK leaving the EU with no deal in place. </p> <p>Uncertainty over the nature of the UK exit from the EU has led to economic volatility in investment markets.</p>
<p>2</p> <p>Conduct risk</p> <p>The risk that conduct risk controls are ineffective resulting in negative customer outcomes.</p>	<p>The complexity and long-term nature of life and pensions products means that as customer needs change over time, there is the potential that products do not perform as customers would expect and that the products no longer deliver appropriate customer outcomes.</p>	<p>LV= has in place a product governance framework which ensures each new product or changes to products are subject to review. In addition, regular product reviews are undertaken which ensure existing products perform as customers would expect and continue to deliver appropriate customer outcomes.</p>	<p>Increases in regulatory expectations and the increased levels of activity by claims management companies, has caused this risk exposure to increase. </p>
<p>3</p> <p>Corporate bond spread</p> <p>The risk that there is a change in the market value of LV='s corporate bond holdings.</p>	<p>Corporate bonds are held to back the LVFS Pension Scheme (plus general insurance and annuity liabilities). As bond values fluctuate in the open market, any unmatched movement in the associated liabilities would expose the group to an unforeseen profit or loss.</p>	<p>Regular monitoring of the group's exposure takes place at the Asset and Liability Committee and through specific, active monitoring undertaken by the group's asset manager. Management actions are regularly reviewed and executed in order to address any specific exposures. LV= makes use of a matching adjustment allowance in its regulatory reporting to mitigate against the impact of economic volatility on assets held to match long-term liabilities.</p>	<p>This risk exposure remains unchanged from last year. </p>
<p>4</p> <p>Cyber security</p> <p>The risk that LV= does not have a sufficiently robust strategy and control infrastructure in place to protect itself against, or to recover from, a cyber event.</p>	<p>The high-level of threat from the external environment continued during 2018. High profile data loss incidents such as those affecting Facebook and British Airways demonstrate the serious impact such events can have.</p>	<p>LV= operates a comprehensive cyber risk strategy which is designed to ensure that the group continues to identify, assess and respond to the ever changing threat of a cyber attack.</p>	<p>Further development of the group's cyber risk strategy, embedding of controls targeted at data privacy and enhanced mechanisms for monitoring and reporting mean that although the external environment generates a heightened risk, the residual impact of this risk remains stable. </p>

Key risks	Potential impact	Mitigation	Change from last year
<p>5 Delivery risk The risk that the quality, timing and / or cost of delivering business as usual objectives or key strategic initiatives is impacted adversely due to the loss of key staff, or poorly executed change activity.</p>	<p>The series of strategic initiatives, including the delivery of the second phase of the transaction with Allianz and the move to a fitter mutual for the future, have created pressure upon people, processes and IT systems which could have a detrimental impact on business delivery to customers and other external stakeholders.</p>	<p>The board has established a structure of executive sponsorship and strong programme governance, challenge and escalation for all of the key initiatives undertaken across the group. This is delivered through the centralised Transformation Directorate and is subject to board oversight at both LVFS board and LVGIG board level.</p>	<p>Despite having a strong control environment in place, the high levels of complexity and the interrelated nature of projects in the strategic portfolio mean that the residual risk has increased slightly from last year. </p>

LV= top risk assessment

The residual risk assessment for the LV= top risks, including movements during the year, is illustrated as shown:

- 1** Political, economic and regulatory uncertainty
 - 2** Conduct risk
 - 3** Corporate bond spread
 - 4** Cyber security
 - 5** Delivery risk
 - 6** General Data Protection Regulation (merged into risk 2)
 - 7** UK health and social provision (closed)
-  Movement since YE 2017



Emerging risks

As well as monitoring near-term risks, the Risk Committee also considers potential risks, threats and opportunities which may impact the group at some point in the future. This process takes place formally twice per year (with more frequent assessments taking place as and when required) and captures emerging risks such as those key risks described below:

Key emerging risks	Description
Change in UK Government	A new Government introduces a radical new agenda in public policy (e.g. changes in employment law, growing unionisation, increases in the minimum wage, employee representation on boards etc).
New market entrants/ disruption from digital	New players enter the market, most likely in the general insurance or protection sectors.
New regulation	Regulators introduce new regulation (e.g. in the pension transfer market or more onerous capital standards), or raise the bar in terms of the standards expected for compliance.
Renewal pricing review	Depending upon the outcome of its market study (following a super-complaint to the Competition and Markets Authority), there is a risk that the FCA will impose an industry-wide cap on general insurance renewal premiums for home and motor insurance products.

In addition, the Risk Committee is cognisant of certain global risks such as climate change which have the potential to pose specific risks to both life and general insurance companies. In general insurance, climate change is likely to manifest itself in increased claims volatility and catastrophe claims from weather related events, and can lead to incorrect pricing and reserving of general insurance risks. In the life insurance business, whilst prolonged climate change will, in the long term, impact both longevity and mortality experience, a move to a lower carbon use economy may have an impact on the value of the assets held by LV= and the associated future investment decisions that the group chooses to make.

LV= will need to respond effectively to the impacts of both physical and investment risks arising from climate change in order to avoid an adverse impact on business strategy. This risk will therefore continue to be an area of focus for LV= and is managed through the LV= RM Framework both as an emerging risk and through the careful management of the volatility in the risks which LV= manages.

Summary of material changes over the reporting period

Removal of management action to claw back mutual bonus

The main material change which had a significant impact on the group's capital position was the removal of the management action to claw back mutual bonus. This reduced the overall capital surplus by £166m.

The Society has a legal right to claw back previously allocated mutual bonus, which has not yet been paid to policyholders, if its Solvency position is under threat. In previous years, the calculation of the Solvency Capital Requirement has included a significant reduction due to the allowable management action to claw back mutual bonus.

While mutual bonus claw back is legally allowable, the Society currently has no intention of carrying out this potential management action.

The strength of the Society's capital position following the sale of a 49% stake in the general insurance business and the fact that the management action to claw back mutual bonus is very unlikely to be exercised has enabled management to improve the quality of reported capital by removing the benefit associated with management's ability to claw back previously allocated mutual bonus in times of stress from the 2018 capital calculation.

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 year ended 31 December 2018

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 24 May 2019 and signed on its behalf by:



.....
A M Parsons
Group Finance Director

24 May 2019

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 2018:

- 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 2018, (**the Narrative Disclosures subject to audit**);
- 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**); and
- 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; and
- 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 2018 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

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.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, are not clear, and it is difficult to evaluate all of the potential implications on the Company's trade, customers, suppliers and the wider economy.

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.

Note that 'Summary' refers to 'Policyholder Summary' and 'the Responsibility Statement' refers to 'Statement of director's responsibilities' as per the SFCR.

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 Board of Directors of the Company in accordance with 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 or to any other party 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 that reads "Andrew Hill" followed by the initials "UP".

PricewaterhouseCoopers LLP

Chartered Accountants

London

24 May 2019

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: 12 Endeavour Square
London
E20 1JN
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 2018 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 Benefits Limited *	Financial intermediary	70%
Wealth Wizards Advisers Limited *	Financial intermediary	70%

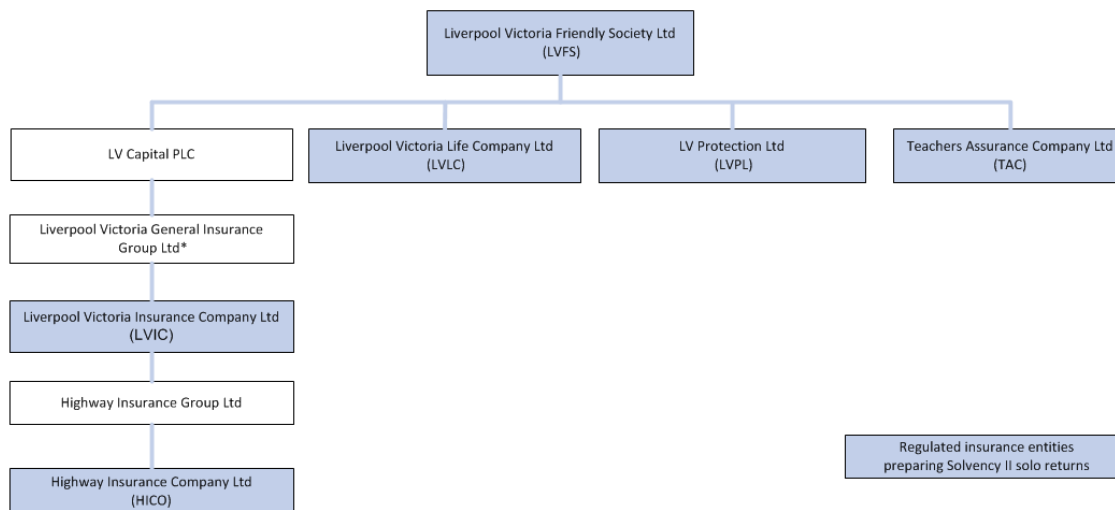
* Denotes indirect holdings

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.

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 and Home insurance products. Motor insurance products include Private Car, Specialist Car, Fleet, Motorcycle and Commercial Vehicles. The Group also underwrites Road Rescue, Pet and Travel Insurance. During 2018, the Group ceased writing Commercial broker new 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 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)	2018	2017
Life	60	60
General Insurance	107	120
Group items and strategic investment	(31)	(46)
Operating profit	136	134
Short-term investment fluctuations and related items*	(66)	30
Finance costs	(24)	(24)
Costs associated with creating a fitter mutual for the future	(9)	(2)
Impact of general insurance transaction	(8)	35
Guaranteed minimum pension equalisation	(6)	-
Change in long-term contract liabilities economic basis	-	(48)
Amortisation of acquired intangibles	(3)	(3)
Profit before tax**	20	122
Mutual bonus	(26)	(26)
Income tax credit/(expense)	14	(50)
Non-controlling interest	(31)	2
Pension scheme actuarial (loss)/gain, net of tax	(29)	19
Net loss on available for sale financial assets, net of tax	(10)	-
Sale of stake in general insurance business taken directly to UDS	-	124
Transfer (from)/to Unallocated divisible surplus (UDS)	(62)	191

* Short-term investment fluctuations represent the difference between the long-term average return expected from assets and the actual investment return achieved on these assets in the current period. These are presented outside of operating profit for the life business in order to exclude the impact of temporary volatility. This includes the impact of tax charge deducted from policy asset shares and the RNPFN fund.

** Our measure of PBT is defined as International Financial Reporting Standards (IFRS) profit before tax, mutual bonus allocated, and transfer to unallocated divisible surplus and includes the PBT from both continuing and discontinuing businesses.

Operating profit

Operating profit at £136m (2017: £134m), includes £60m (2017: £60m) from Life and £107m (2017: £120m) from General Insurance, partially offset by Group items and strategic investment of £31m (2017: £46m).

Operating profit from Life is stable year-on-year with the reduced new business contribution offset by rigorous cost control and an improved performance in Heritage which in 2017 was impacted by the legacy review provision. Operating profit from the General Insurance business of £107m (2017: £120m) includes an underwriting result of £99m (2017: £102m) and investment returns of £8m (2017: £18m). The reduction in underwriting result is primarily due to adverse current year claims experience, offset by favourable prior-year run-off of £106m (2017: £46m). Group items and strategic investment have reduced by £15m demonstrating improved cost control.

Profit before tax

Profit before tax of £20m has reduced from the prior year profit before tax of £122m. The decrease in profit of £102m is mainly attributable to short-term investment fluctuations and related items (STIF) which is adverse at £66m (2017: £30m favourable). The £66m adverse impact from STIF in 2018 was driven by the adverse impact of widening corporate bond spreads causing losses on annuities of £32m, tax credits on asset share of £29m and falls in equities of £17m, partially offset by the positive impact of rising yields of £16m.

The 2017 result also included £52m profit on the sale of the commercial business renewal rights to Allianz offset by the £48m increase in life reserves due to the change in economic basis for long-term insurance liabilities.

IFRS Surplus (UDS) generation

During 2018, £62m was transferred from the Unallocated divisible surplus (UDS). In addition to the £20m profit before tax, this includes movements in other comprehensive income relating to revaluations of the staff pension schemes (£29m reduction, 2017: £19m increase) and revaluation of investments classified as available for sale (£10m reduction, 2017: £nil). Other items impacting the movement in UDS are a deduction of £31m relating to the non-controlling interest share of income (2017: £2m share of loss), mutual bonus allocated to members' policies of £26m (2017: £26m) and a £14m income tax credit (2017: £50m charge).

For further information on the results, please refer to the Group Finance Director's review on pages 20-29 of the Report and Accounts.

Capital position and changes in risk profile

At 31 December 2018 the Group capital surplus on a standard formula basis was £690m (2017: £698m) with capital cover of 167% (2017: 171%), 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	2018	2017	Change
Own funds	1,726	1,676	50
SCR	1,036	978	58
Surplus capital	690	698	-8
CCR	167%	171%	-4%

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

- **One-off impact from removal of the mutual bonus clawback management action (decrease in surplus capital of £166m, before Transitional Measures on Technical Provisions (TMTP) recalculation).**
 - The removal of the mutual bonus clawback management action from the SCR calculation, enabled by the strength of the Group's solvency position at the beginning of the year. This has resulted in a £166m reduction to surplus capital and increased the exposure to adverse asset share performance.
- **One-off impact from Model and Basis Changes (increase in surplus capital of £66m, before TMTP recalculation).**
 - Unit-linked pensions – a significant change to the modelling and assumptions was made to better reflect product features and post pensions freedoms customer behaviour. As a result, the business significantly shortened in duration, reducing interest risk exposure due to a reduction in the capitalised value of expenses. This reduced the exposure to interest rate risk and expense risk. Also, equity exposure fell due to lower returns triggering faster fund depletion and therefore lapsing.
 - Ordinary Branch (OB) Pensions - the reduction in policyholder cash take-up and paid-up rates has strengthened reserves and reduced the exposure to lower rates relative to recent experience.
 - Equity Release - the increase in loan prepayment rates has reduced the exposure to higher rates relative to recent experience.
- **Economic impacts over 2018 (increase in surplus capital of £52m, before TMTP recalculation).**
 - Interest rate exposure across the life business continues to be managed on a post-TMTP recalculation basis. This gives rise to interest rate exposure and gilt spread exposure on a pre-TMTP basis, leading to an increase in surplus when rates rise and TMTP is not recalculated, as has occurred over 2018.
 - Interest rate exposure (post-recalculation of TMTP) has reduced over the year, partly due to an increase in duration on the Pension Scheme IAS19 accounting liabilities following the triennial review of member data.
 - Negative equity returns and derivatives held across the Life business and the Pension Schemes have led to lower market exposure.

Key elements of the Group’s capital management strategy during the year were as follows:

- Interest rate exposure across the Life business continues to be managed on a post-TMTP recalculation basis. This gives rise to interest rate exposure and gilt spread exposure on a pre-TMTP basis, leading to an increase in surplus when rates rise and TMTP is not recalculated, as has occurred over 2018.
- In the GI business, interest rate exposure of the capital surplus is managed with consideration to the IFRS volatility.
- The Society has exposure to equity markets via annual management charges. This is managed through a combination of hedging and internal arrangements.

For further information on TMTP, please refer to section D.2.2.2.

System of Governance

There have been no significant changes in the Group’s system of governance during the year.

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

J Dean – Resigned 31 March 2018	Non-Executive director
C Burton – Resigned 7 June 2018	Non-Executive director
A Hutchinson – Appointed 1 January 2018	Non-Executive director
L Savage – Appointed 1 February 2018	Non-Executive director
A W Snow – Appointed 2 July 2018	Executive director
T Lawler – Appointed 1 September 2018	Non-Executive director

Legal and regulatory environment

The full impact of the political and economic uncertainties in the UK has been difficult to gauge during 2018 due to the continued lack of clarity around Brexit. This has been particularly relevant for the general insurance business where future claims costs associated with motor vehicle repairs could be materially impacted by foreign currency exchange rate fluctuations.

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 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. On 20 December 2018, the Civil Liability Bill received Royal Assent and is thus the Civil Liability Act, with a revised Ogden Discount Rate expected to be announced in the summer of 2019. Whilst the revised rate is not yet known the Group anticipates an increase from the current legislative rate of -0.75%, with the best estimate reserves being held at the equivalent of a 0% Ogden Discount Rate.

The overall heightened level of uncertainty is expected to continue throughout 2019 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.

	Life and Group (Continuing operations) £m	General insurance (Discontinued operations) £m	Total £m
Year ended 31 December 2018			
Gross earned premiums	788	1,610	2,398
Premiums ceded to reinsurers	(246)	(383)	(629)
Net earned premiums	542	1,227	1,769
Investment and other income	(258)	85	(173)
Total segmental income	284	1,312	1,596
Gross benefits and claims	(904)	(1,033)	(1,937)
Claims ceded to reinsurers	238	175	413
Net benefits and claims	(666)	(858)	(1,524)
Net change in contract liabilities	540	-	540
Other expenses	(248)	(344)	(592)
Total segmental expenses	(374)	(1,202)	(1,576)
(Loss)/profit before tax, mutual bonus and UDS transfer	(90)	110	20

	Life and Group (Continuing operations) £m	General insurance (Discontinued operations) £m	Total £m
Year ended 31 December 2017			
Gross earned premiums	835	1,604	2,439
Premiums ceded to reinsurers	(1,092)	(363)	(1,455)
Net earned premiums	(257)	1,241	984
Investment and other income	750	121	871
Total segmental income	493	1,362	1,855
Gross benefits and claims	(872)	(1,155)	(2,027)
Claims ceded to reinsurers	237	298	535
Net benefits and claims	(635)	(857)	(1,492)
Net change in contract liabilities	367	-	367
Other expenses	(267)	(341)	(608)
Total segmental expenses	(535)	(1,198)	(1,733)
(Loss)/profit before tax, mutual bonus and UDS transfer	(42)	164	122

All material lines of business are underwritten in the UK.

Net earned premiums

Group	2018 £m	2017 £m
Gross earned premiums		
Long-term insurance and participating investment contracts		
Single premium		
New business		
Investments and savings	354	420
Pensions and annuities	170	151
Regular premium		
New business		
Life and health protection	33	37
Existing in-force business		
Investments and savings	28	33
Pensions and annuities	8	9
Life and health protection	195	185
General insurance contracts		
Motor	1,152	1,081
Commercial	184	283
Household	148	143
Other	97	89
Change in unearned premiums provision	29	8
Gross earned premiums	2,398	2,439
Premiums ceded to reinsurers		
Long-term insurance premiums	(246)	(1,092)
General insurance business	(384)	(361)
Change in unearned premiums provision	1	(2)
	(629)	(1,455)
Net earned premiums	1,769	984

2018 gross earned premiums of £2,398m fell by 2% compared to 2017. The reduction in Investment and savings new business premiums relates to a fall in Flexible Guarantee Bond volumes due to reduced marketing and promotions while the Group took steps to redesign its proposition. The General Insurance business saw an increase in Motor premiums as a result of high renewal retention and significant new business sales following the launch of Multi-car. This was offset by a decrease in premiums from our discontinued Commercial lines business. In December 2017 the Group entered into a reinsurance arrangement in respect of the OB Pension portfolio, which led to a one-off increase in premiums ceded to reinsurers of £829m.

Net benefits and claims

Group	2018			2017		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Long-term insurance and participating investment contracts						
Benefits and claims paid	896	(232)	664	868	(237)	631
Change in the provision for claims	8	-	8	4	-	4
Fair value adjustment to reinsurance receivables	-	(6)	(6)	-	-	-
General insurance contracts						
Claims paid	1,083	(243)	840	1,010	(227)	783
Claims handling costs	64	-	64	65	-	65
Change in the provision for claims	(114)	68	(46)	80	(71)	9
	1,937	(413)	1,524	2,027	(535)	1,492

2018 net benefits and claims from long-term insurance and participating investment contracts and from general insurance contracts are broadly in line with 2017.

Net change in contract liabilities

Group	2018 £m	2017 £m
Gross decrease/(increase) in long-term contract liabilities		
Decrease/(increase) in long-term insurance contract liabilities - participating	187	(191)
Decrease/(increase) in investment contract liabilities - participating	55	(51)
Decrease/(increase) in long-term insurance contract liabilities - non-participating	102	(117)
Decrease/(increase) in investment contract liabilities - non-participating	135	(234)
Decrease/(increase) in long-term linked insurance contract liabilities	34	(23)
	513	(616)
Mutual bonus	26	26
	539	(590)
(Decrease)/increase in long-term contract liabilities ceded to reinsurers		
Increase in long-term insurance contract liabilities relating to non-participating contracts	51	143
(Decrease)/increase in long-term insurance contract liabilities relating to participating contracts	(36)	857
(Decrease)/increase in long-term linked insurance contract liabilities	(24)	35
	(9)	1,035
Increase/(decrease) in non-participating value of in-force business	10	(30)
Net change in contract liabilities before change in economic basis	540	415
Change in economic basis	-	(48)
Net change in contract liabilities	540	367

The gross decrease in long-term contract liabilities for 2018 was £539m (2017: £590m increase). This reduction is driven by the lower levels of policyholders' investment gains, following adverse movements in the UK and overseas stock markets and interest rate changes adversely affecting gilts and bonds values. The net change in contract liabilities was also impacted in 2017 by a one-off £933m increase in reinsurance in respect of the OB Pension portfolio.

Other operating and administrative expenses

Group	2018 £m	2017 £m
Commission paid on acquisition of business	183	201
Movement in deferred acquisition costs	9	7
Amortisation and impairment of intangible assets	20	13
Depreciation on property and equipment	5	7
(Gain)/loss on disposal of property and equipment	(3)	1
Investment management expenses and charges	12	17
Auditors' remuneration	2	2
Employee benefits expense	256	255
Internal staff costs capitalised as attributable costs of IT assets	(4)	(16)
Rent, rates and other facilities expense	18	20
Marketing and advertising	30	27
Other staff costs	40	48
IT costs	44	40
Fees	83	85
Other expenses	13	18
Claims handling cost recognised in Gross benefits and claims	(67)	(69)
Gross operating and administrative expenses	641	656
Expenses recoverable from reinsurers	(73)	(72)
Net operating and administrative expenses	568	584

2018 net operating and administrative expenses have reduced by 3% during the year to £568m (2017: £584m), reflecting ongoing cost control measures.

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 the 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 44% (2017: 48%) of total gross written premiums. The material life insurance Solvency II lines of business for the year ended 31 December are as follows, based on contribution to life insurance business gross written premiums:

Life insurance	2018	2017
Insurance with-profit participation	31%	31%
Index-linked and unit-linked insurance	37%	44%
Other life insurance	27%	21%
Health	5%	4%

Gross written premiums collected under non-participating investment contracts are deposit accounted rather than accounted for through the income statement under IFRS.

Non-life insurance

The Group's general insurance business represents 56% (2017: 52%) of total gross written premiums. The material non-life insurance Solvency II lines of business for the year ended 31 December are as follows, based on contribution to non-life insurance business gross written premiums:

Non-life insurance	2018	2017
Motor vehicle liability insurance	58%	58%
Other motor insurance	21%	19%
Fire and other damage to property insurance	13%	15%
Assistance	4%	4%
General liability insurance	2%	2%
Legal expenses insurance	2%	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 and interest on loans secured on residential and commercial property. Dividends are recorded on the date on which the shares are declared ex-dividend.

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 £12m (2017: £17m) 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	2018 £m	2017 £m
Income from investments at fair value through income:		
- Dividend income	118	117
- Interest income from debt and fixed interest securities	183	210
- Interest on loans secured on residential property	34	36
- Interest on loans secured on commercial property	8	9
Other	10	2
	353	374

Investment income has reduced to £353m (2017: £374m), driven by the £17m decrease in interest income from debt and fixed interest securities during the year.

Net (losses)/gains on investments

Group	2018 £m	2017 £m
Investment properties	1	3
Investments at fair value through income:		
- Debt securities	(193)	(28)
- Equity securities	(440)	430
- Derivatives at fair value through income	12	(52)
- Loans and mortgages	(6)	4
- Other	(3)	3
	(629)	360

Net losses on investments of £629m are driven by the falls in equity securities of £440m as markets fell in 2018. In addition, there were losses of £193m on debt securities, driven by an increase in yields during the year.

b) Information about any investments in securitisation

There are no material investments in securitisation (2017: £nil).

A.4 Performance of other activities

The results of other activities are as follows:

Finance costs

Group	2018 £m	2017 £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	2018 £m	2017 £m
Interest income	27	32
Fee and commission income	47	37
Other income	29	16
	103	85

Other income is made up of interest income which 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; fee and commission income from the pensions, equity release and retirement advice businesses; and other income which includes profit commission relating to the general insurance quota share arrangement.

In addition to the above, in 2017, there was a £52m gain on sale of commercial business renewal rights.

Leasing arrangements

Finance lease commitments

Finance lease commitments with a present value of £19m (2017: £19m) relate to a property with a remaining lease term of 22 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 £7m (2017: £14m) 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 (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 and 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

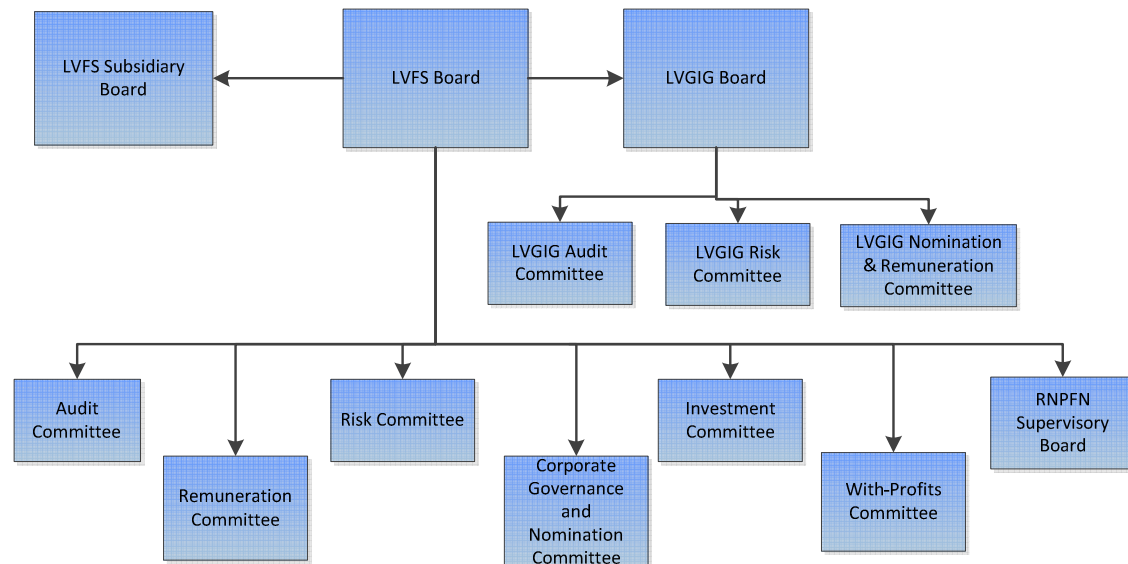
Governance structure

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, six independent non-executive directors and three 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 Board either reserve decision making powers to themselves, or delegate these powers to a Board approved sub-committee or to the Group or LVGIG Chief Executive Officer. A full description of the LVFS Board's role and responsibilities is set out in the Board section of the 2018 Annual Report and Accounts.

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



During the period up to completion of the strategic partnership transaction with Allianz on 31 December 2019, the LVFS Board and the Chief Risk Officer retain overall responsibility for the management of risk within the General Insurance business.

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 throughout the business.

Within its Systems of Governance, the LVFS Board has adopted a Three Lines of Defence model with key oversight functions being Risk, Compliance, Financial Crime, 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.

The scope, authority and responsibility for each of the Three Lines of Defence is set out in a Board-approved Risk Mandate, which is included as part of the Risk Strategy. The Mandate, in conjunction with the Risk Operating Model, confirms how each function achieves independence and how potential conflicts of interest are managed. The following table summarises the key roles and responsibilities for each function:

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

Remuneration

The Group has a Remuneration Committee consisting of three non-executive directors of the Society. 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 the Society's strategy, promote the long-term sustainable success of the Society and seeks to align remuneration with performance. Variable remuneration, with the amount paid linked to performance forms an important part of the remuneration package for all employees. All employees are eligible to participate in the Group annual bonus, with the total pool to be shared amongst all employees calculated based upon Group performance. Group performance for the purposes of determining the annual bonus pool is assessed based upon the Group balanced scorecard with a mix of financial and non-financial performance conditions.

Each person's bonus amount is then determined based on their individual performance. For more senior employees, a proportion of any bonus award may be deferred and paid out in a later year, ensuring that the Group's executives remain focused on both the short-term and long-term health of the Society.

Senior employees also participate in the Group Long-Term Incentive Plan (LTIP). The final value of an LTIP award is determined based upon long-term performance conditions measured over a three year period. The LTIP therefore incentivises senior employees and rewards them for delivering the strategic priorities and strong business performance over the long term.

The 2018 Group balanced scorecard, used to measure performance and determine the size of the bonus pool, was structured as follows:

- 50% on financial measures (each with equal weightings):
 - Life operating capital surplus
 - General insurance dividend flow
 - Economic value of new business (EVNB)
- 50% on non-financial measures:
 - Strategy and change (20%)
 - Customer, member and brand (10%)
 - Risk and compliance (10%)
 - Leadership and diversity (10%)

During 2018 the group made good progress on capital generation and maintaining a strong capital position, and in the first year of the strategic partnership with Allianz the general insurance business has performed as expected. Generating profitable new business, measured by EVNB, has been more challenging. Performance against the customer, member and brand measure has been strong, whilst we recognise that further work could have been done against the strategy and change, leadership and diversity, and risk and compliance targets during 2018. The targets across all measures were set at very stretching levels which is reflected in the final outturn.

In addition to performance against the group balanced scorecard, individual performance targets for each of the executive directors are used to determine their individual bonus amounts. The 2018 outcomes for each of the executive directors range from 38% of maximum to 51% of maximum.

The 2016-18 LTIP awards were subject to stretching performance conditions related to growth in Average Adjusted Group Profit Before Tax (AAGPBT), and awards held by current and former executive directors had a further performance condition based on Relative Investment Performance (RIP), which had a 25% weighting. The threshold target has not been met under either performance condition and therefore the 2016-18 LTIP will lapse in full.

To improve the remuneration policy and practices, a number of refinements have been made for 2019 to further align remuneration policies and practices with the Group's business strategy and member interests. Whilst the general structures remain appropriate and aligned to market practice, changes have been made to the detail of how the policy is structured and will operate.

For the 2019-21 LTIP awards, the committee is proposing to make lower target awards of 120% of salary for the chief executive officer and 101% (rounded) of salary for the group finance director and 100% of salary for the chief risk officer, taking into account the reduced complexity of the business following the strategic partnership with Allianz.

The LTIP will continue to be based on a mixture of financial measures (75% weighting) and strategic goals (25% weighting) as set out below:

- 75% weighting: Financial measures, based around growth in own funds, return on capital supporting new business and total life operational expenses.
- 25% weighting: Strategic goals, based around developing a sustainable, vibrant business with a diverse and talented workforce, with measures based upon customer satisfaction, employee engagement and gender.
- An underpin related to risk whereby no vesting will occur if appropriate levels of risk management have not been achieved.

For 2019, Return on Capital Supporting New Business has replaced Economic Value of New Business (EVNB) as a measure as we believe it is clearer to express this measure as a target return on the capital rather than a £ amount. For 2019 LTIP awards onwards there will be a two-year holding period following the end of the performance period for executive directors, taking into account the provisions of the new UK Corporate Governance Code.

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 73 to 85 of the 2018 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 Managers and Certification 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 are responsible for determining the risks which the Group faces and ensuring that they are appropriately controlled. These include the risks to the business model and future performance, those which threaten the solvency and/or liquidity of the group and those which could have a detrimental impact upon our members, customers or other stakeholders.

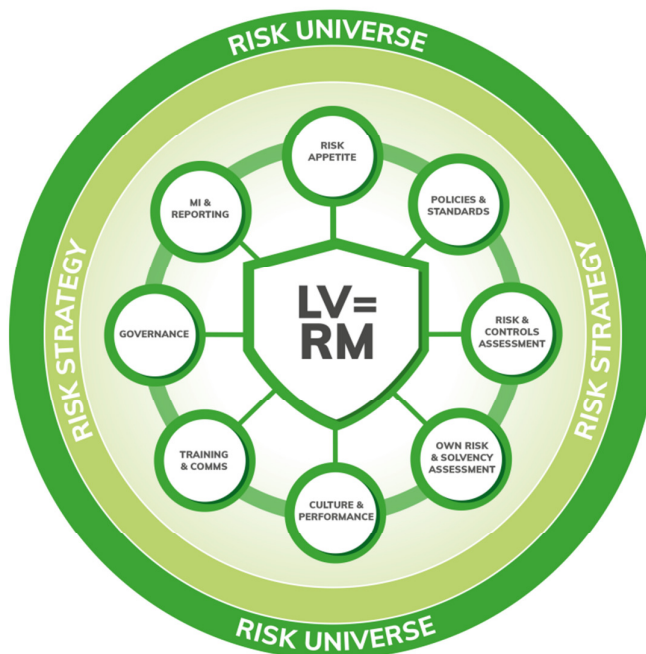
The Board discharge this responsibility through the implementation of a robust risk management framework (LV=RM) which includes the setting of a proportionate risk strategy, risk appetite and clear risk mandate and organisational design. The Risk Committee, on behalf of the Board, regularly monitor the operation and effectiveness of the LV=RM Framework to ensure that it continues to drive a suitably robust risk culture within LV=.

Risk Management Framework

The LV= RM Framework comprises a systematic set of processes, tools and behaviours which collectively are used to assess risks that could impact the delivery of the Group's business strategy, and ensure that these are considered and dealt with effectively, consistently and on a timely basis.

The LV=RM Framework is owned by the LV= chief risk officer on behalf of the Board and has been developed through 2018 in order to support high quality risk decision making, generate member value, ensure good customer outcomes and inspire confidence in the Group for all of its stakeholders. These enhancements form part of a strategy of continuous improvement of the Group's risk management capability, and will continue throughout 2019 as the Group strives to drive a strong risk culture that ensures the business is managed in line with the Board's risk appetite.

The risk universe, risk strategy and the eight key elements of the LV= RM framework are summarised below and on pages 46 to 48, and are represented by the following diagram.



Risk strategy

As an insurance provider in a complex and highly regulated market, LV= is exposed to a wide range of risks from its past, present and future activity. The risk strategy is aligned with the LV= business strategy and ensures that an effective approach to risk management is in place, in line with its business and financial goals. This risk strategy seeks:

- To inform the Board in setting a robust risk appetite which ensures that the business model and strategy are designed and executed in a controlled manner to safeguard member value.
- To drive a strong risk culture that ensures the business is managed in line with the Board's risk appetite.

The risk strategy and associated LV= RM Framework is reviewed on at least an annual basis as part of the broader LV= strategic planning process and based upon changes in both the internal and external environment.

Risk universe

As a consequence of writing insurance business, LV= is exposed to financial, operational, conduct and strategic risk. LV='s profitability and growth is dependent upon the proactive management of these risks. These risks need to be considered as LV= continues to structure and run the Group as a modern mutual in accordance with its stated values. In order to ensure that all of these key risks are fully considered, LV= has put in place a detailed risk hierarchy which breaks down the high level risk categories into a series of more detailed risks.

The high-level risk categories which LV= is exposed to are:

Financial risks:

- Life insurance risk
- General insurance risk
- Financial markets risk
- Credit counterparty risk
- Liquidity risk

Non-financial risks:

- Strategic risk
- Conduct risk
- Operational risk

Clear executive accountabilities for managing each of these key risks have been articulated and agreed at the Risk Committee.

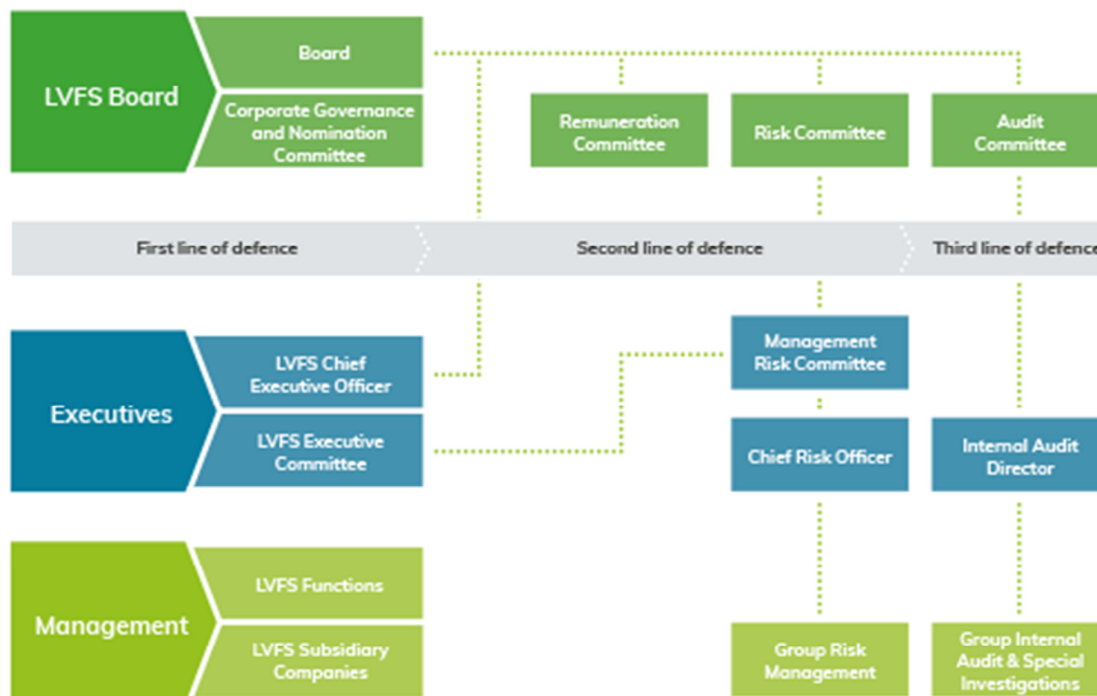
Risk governance

LV= operates a three lines of defence model as part of its day-to-day operations, as prescribed within a board-approved risk mandate. The Board delegates much of its oversight of risk matters to the Risk Committee, which together with the (executive) Management Risk Committee, the chief risk officer and the risk management teams, ensures that the group is operating in line with the requirements of the LV=RM Framework.

The roles and responsibilities across the three lines of defence model are included within the risk strategy and are summarised as follows:

- **First line of defence:** led by the chief executive who is supported by the Executive Committee and the senior leadership team. The executive teams are required to identify, assess, manage and report on the risk profile on a current and forward looking basis. Sound risk management tools, practices and knowledge facilitate informed business decision making in accordance with the LV=RM Framework, and in particular LV='s risk appetite.
- **Second line of defence:** led by the chief risk officer who is supported by the group risk management team and other risk management professionals across the organisation. Group risk management develops and directs the implementation of the LV=RM Framework, monitors, reviews and challenges first line compliance with this framework and escalates material breaches to the Board.
- **Third line of defence:** led by the internal audit director who is supported by the group internal audit team and the Audit Committee. Group internal audit provides independent and objective assurance to the Audit Committee and to executive management on the effectiveness of the systems of risk management and internal controls across the Group.

These roles and responsibilities align to the risk governance structure as follows:



Risk appetite

The Board has established a series of quantitative and qualitative risk appetite statements which cover five broad dimensions:

- Overall attitude to risk
- Financial
- Conduct
- Operational and transformation
- Regulatory and stakeholder engagement

Each of these appetite statements provides direction to senior management regarding their priorities in the execution of the risk strategy and where appropriate, are underpinned by a suite of more granular supporting measures, limits and triggers. These risk appetite statements are reviewed at least annually and are embedded within the operation of the LV=RM Framework. Clear governance exists in respect of ownership, oversight and the treatment of risks which are considered to be outside of risk appetite. Operation of the risk appetite methodology is evidenced through the provision of clear and timely management information which delivers insight to senior management and helps to drive robust and well informed risk-based decision making.

Risk policies and standards

A suite of Board-approved risk policies (plus associated supporting policies and standards) is in place which documents both the Board's requirements, as well as senior management's approach to meeting those requirements. Policy owners are aligned to LV's high level risk categories and have individual accountability for delivering ongoing effective risk management in accordance with the overall direction set by the Board.

The second line risk management function maintains the integrity and consistency of the policy suite on behalf of the Board and ongoing policy compliance is considered through regular risk and control self-assessment and through annual risk and controls attestation.

Risk and control assessment

The Group undertakes a quarterly assessment of its key risks and controls to determine whether the risk and control environment is appropriately defined and operating in line with expectations. There is a Group-wide process for the identification, escalation and remediation of risk events and control failures. In addition, independent risk-based

assurance reviews are undertaken on a regular basis by both the second and third lines in order to confirm that the overarching LV=RM Framework processes are working effectively.

Own risk and solvency assessment (ORSA)

The ORSA is a fundamental part of the Group's capital management processes under the LV=RM Framework. The ORSA consists of processes that are designed to ensure those risks mitigated by holding capital are appropriately assessed, the capital requirements are understood on a forward looking basis and that this insight is used to inform decision making. The solvency position of the business is driven by the standard formula basis under the Solvency II regime.

On an annual basis, an ORSA report is presented to the Board which consolidates the findings from these processes, which include business planning, stress testing and scenario analysis, including reverse stress testing and regular monitoring of the Group solvency position.

The 2018 ORSA report, produced in June, included the outcome of stress tests on the current balance sheet which included the demonstration that the current capital held would be sufficient to withstand a stress of significantly over the 1-in-100 level before the regulatory capital surplus would be exhausted. This is before allowance for management actions to aid recovery, such as exercising the Put option to sell the residual stake in the general insurance business.

On a forward looking basis, scenario analysis was completed as part of the business planning process. This demonstrated that the Capital Coverage Ratio remained comfortably in excess of the risk appetite level in a severe but plausible Brexit led economic downturn scenario. The impact on solvency from further adverse regulatory, operational and more extreme financial events (such as a large reinsurer default) was also assessed.

Culture and performance

The establishment of the LV= RM Framework has been designed to ensure the embedding of a strong, behavioural-based risk culture across the entire Group. This is driven by a distinct tone from the top and its application forms part of the Group's performance management regime. The operation of the LV=RM Framework is assessed on an annual basis and forms part of the inputs to the Executive Performance Plan. Risk performance features as part of an overall balanced scorecard and on an individual basis via a risk adjusted remuneration process, which is overseen by the Remuneration Committee.

Training and communication

A programme of training and communication is in place to ensure that the components of the LV=RM Framework are understood and applied consistently across the group. This training and communication is targeted at all levels within the organisation to ensure that everyone has an appropriate level of understanding of the framework requirements which are applicable to them. The programme includes Board and senior executive training and extends through to components which are used in the induction of new colleagues joining LV=.

Risk management information and reporting

Regular, relevant and timely risk reporting is in place across all three lines of defence to demonstrate the operation of the LV=RM Framework. As part of the development of this management information, the Risk Committee has helped to define the report structure and content in order to ensure that the material provided to them contains information which is sufficient and appropriate for them to exercise their oversight responsibilities.

Risk management effectiveness

The Group conducts an annual risk attestation process in which all senior executives attest to the effectiveness of the control environment operating in their areas. The outputs from this process are used to inform the declarations within the Annual Report, in accordance with the UK Corporate Governance Code requirements.

Additionally, the Group conducts an annual risk maturity and culture assessment to gauge the effectiveness of the embedding of the LV=RM Framework and to test how the risk culture of the Group is evolving over time. The outputs from this assessment are used to determine areas for further development under LV='s programme of continuous improvement.

B.4 Internal control system

Internal control encompasses all those systems and processes 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 LV= Risk Management Framework 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 'three 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:

- Director of Compliance reports to the Chief Risk Officer and whose primary responsibilities relate to advising on conduct risk compliance and oversight of non-prudential regulatory change. 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.
- The Group Compliance team reports to the Director of Compliance and is responsible for designing and facilitating the implementation of the Regulatory Risk Management 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 Chief Risk Officer who is accountable for ensuring maintenance of the policy content as well as supporting policies, processes and procedures.

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

- Establish a robust compliance system to identify and assess the impact of new requirements or changes to requirements in the legal environment.
- Advise the Board, senior management and other personnel regarding changes to the legal environment, as appropriate.

In addition, Group Compliance 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, to feed the Group Risk annual plan for review and approval by the Management Risk Committee and 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

Internal Audit

Internal Audit (IA) takes authority from the LVFS and LVGIG Audit Committees through the Committees' approval of IA's Charter and Annual Plan. The Internal Audit Director will assess whether this Charter is appropriate and in alignment with IA objectives on an annual basis. The Internal Audit Director will communicate the results of this assessment to the Audit Committees and seek approval of the Charter each year.

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

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

IA 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 second edition September 2017) and of other relevant professional bodies. It meets the requirements of the FCA, PRA and other regulatory authorities in those areas upon which its work impacts.

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

Independence and Objectivity

IA's role is to provide independent and objective assurance to the Audit Committees and Executive Management on the effectiveness of systems of risk management and internal controls across LVFS and its subsidiaries, in order to mitigate key business risks and to assess the sustainability of the organisation; to assist the Audit Committees in meeting statutory and regulatory reporting responsibilities and in meeting Corporate Governance best practice; and to support operational management by providing best practice advice on risk and control.

IA reports independently to the Audit Committees on its work. The Internal Audit Director has a direct reporting line to the Chair of the LVFS Audit Committee and LVFS Chief Executive, and also has unrestricted access to the Chair of the LVFS and LVGIG Audit Committees. The Chair of the LVFS Audit Committee and the LVFS Chief Executive approve jointly IA resources and budgets.

In order to carry out IA's mission effectively, the Internal Audit Director and the IA department will have unrestricted access to LVFS and LVGIG records, including Board level information, personnel and premises to the degree necessary and relevant to discharge the Internal Audit Director's duties.

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 and reinsurance policies and arrangements applied.

The methodology and assumptions to use for the calculation of the Life Insurance technical provisions are proposed by the Actuarial Analysis and Reporting teams who also perform the calculation. These teams sit within the Group Finance Function, reporting to the Group Finance Director, independently of the Chief Risk Officer. The proposed methodology and assumptions are reviewed by the Life Chief Actuary, as are the technical provisions themselves. The methodology, assumptions and results, along with the independent Actuarial Function reviews, 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 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 and 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

Material intra-group outsourcing arrangements

Currently there are no material intra-group outsourcing arrangements.

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 table below shows the 31 December 2018 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The results for 31 December 2017 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 £1,095m (2017: £1,228m). This differs from the total SCR reported in section E.2 as it excludes the loss absorbing capacity of deferred tax and the 2017 figure excludes the mutual bonus claw back management action, 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 different year-ends where it is or is not applied. The mutual bonus clawback management action was removed from the SCR during 2018; see section C2.2 for further details.

SCR split by risk type, for the year ended 31 December	2018	2017	Change
Underwriting risk	54%	50%	4%
Market risk	35%	40%	(5)%
Operational risk	9%	8%	1%
Counterparty risk	2%	2%	0%
Total	100%	100%	

The proportion of the high level risk categories shown within the SCR have not materially changed from 2017. The Group sold 49% of its general insurance business on 28 December 2017 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. This is consistent in the 2018 and 2017 presentation above.

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 a quarterly 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 table below shows the 31 December 2018 split of underwriting risks within the SCR. The results for 31 December 2017 are provided for comparison. The amount of SCR illustrated below is £596m (2017: £616m). This differs from the underwriting risk capital shown in section E.2 as it excludes the mutual bonus claw back management action from the 2017 figures 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 different year-ends where it is and is not applied. The mutual bonus clawback management action was removed from the SCR during 2018; see section C.2 for further details.

SCR split of underwriting risk, for the year ended 31 December	2018	2017	Change
Non-life premium and reserving	54%	50%	4%
Life lapse	27%	30%	(3)%
Life expenses	7%	8%	(1)%
Health	5%	5%	0%
Non-life catastrophe	3%	3%	0%
Life longevity	3%	3%	0%
Other	1%	1%	0%
Total	100%	100%	

The proportion of non-life risks has not changed materially over the reporting period with non-life premium and reserving risk continuing 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. The Group sold 49% of its general insurance business in 2017 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).

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 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.

Life expense risk affects all business lines and covers the possibility of higher than expected expenses, for example due to higher than expected inflation.

Almost all of the 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. 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

As mentioned above, the mutual bonus claw back management action has been removed from the SCR calculation during the reporting period. The mutual bonus clawback management action reduces allocations of mutual bonus in extreme circumstances. The management action has been removed given the strength of solvency for LVFS and on the grounds it would not be realistically exercised in a post 1-in-200 stressed scenario. This resulted in a £168m increase in the SCR, equal to the value of the management action as at year-end 2017.

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 and the 2017 Ogden discount rate change, which led to a significant increase to the amount provisioned for certain personal injury claims. On 20 December 2018, the Civil Liability Bill received Royal Assent and is thus the Civil Liability Act, with a revised Ogden discount rate expected to be announced in the summer of 2019. 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 2018 split of market risks within the Standard Formula SCR. The results for 31 December 2017 are provided for comparison. The amount of SCR illustrated below is £380m (2017: £486m). This differs from the market risk capital shown in section E.2 as it excludes the mutual bonus claw back management action from the 2017 figures 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 different year-ends where it is and is not applied. The mutual bonus clawback management action was removed from the SCR during 2018; see section C2.2 for further details.

SCR split of market risk, for the year ended 31 December	2018	2017	Change
Spread	73%	63%	10%
Equity	17%	30%	(13)%
Interest rates	7%	4%	3%
Currency	2%	2%	0%
Property	1%	1%	0%
Concentration	0%	0%	0%
Total	100%	100%	

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 directly stressed 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

Equity risk capital has significantly reduced over the year, primarily due to model and methodology changes on the unit linked pensions business and equity losses on the pension scheme. Spread risk capital has fallen over the year, largely due to run off of the business; however it now makes up a larger proportion of the market risk exposure due to the large fall in equity risk capital.

As mentioned above, the mutual bonus claw back management action has been removed from the SCR calculation during the reporting period, see section C2.2 for further details.

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 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	A number of strategies are employed by the Group to manage interest rate risk. Interest rate swaps are used to improve asset liability matching across the Group, including that arising from the SCR and risk margin associated with the general insurance subsidiaries. A cash flow swap is used by the matching adjustment portfolio to facilitate strong cash flow matching on annuity business. Transitional measures on technical provisions (“TMTP”) is utilised by LVFS and used to manage interest rate risk to the Solvency II balance sheet.
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

A reinsurance arrangement was written in 2017 with RGA to transfer longevity risk arising on OB Pensions. The level of assumed recoveries above the collateral posted by RGA has reduced over 2018 leading to an increase in counterparty default risk capital. This led to an increase in counterparty default risk capital of £4m.

The asset management company for certain unit linked funds for Pensions business changed from State Street to Vanguard over 2018. Due to a difference in classification between the two companies, the allowance for counterparty default risk, previously held against State Street, could be released and was not applicable to Vanguard. This led to a decrease in counterparty default risk capital of £3m.

There were no other material changes to credit counterparty risk during 2018.

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 which 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 2018.

The Group is not exposed to concentrations of liquidity risk.

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, economic and regulatory uncertainty The risk of failure to achieve the Group business plan due to material and prolonged uncertainty within the political economic and regulatory landscape.</p>	<p>Potential impact The full impact of the political and economic uncertainties in the UK has been difficult to gauge during 2018 due to the continued lack of clarity around Brexit. This has been particularly relevant for the general insurance business. However, no immediate change is expected in the UK regulatory framework in the short term, or any significant legislative changes in the life and pensions market due to the current political distractions.</p> <p>Mitigation The potential impact of Brexit on both operational capability and the financial position of the Group has been a specific area of focus for the board throughout 2018, and will continue to be through 2019. Brexit planning considers both the immediate period following the UK's exit from the EU, and the longer-term implications on LV's business model. Stress testing of the life and general insurance businesses has concluded that the Group remains robust under a wide range of severe scenarios.</p> <p>Changes from last year It is Group's view that there is currently a heightened level of risk attributable to the close proximity and likelihood of the UK leaving the EU with no deal in place. Uncertainty over the nature of the UK exit from the EU has led to economic volatility in investment markets.</p>
<p>Conduct risk The risk that conduct risk controls are ineffective resulting in negative customer outcomes.</p>	<p>Potential impact The complexity and long-term nature of life and pensions products means that as customer needs change over time, there is the potential that products do not perform as customers would expect and that the products no longer deliver appropriate customer outcomes.</p> <p>Mitigation LV= has in place a robust product governance framework which ensures each new product or changes to products are subject to rigorous review. In addition, regular product reviews are undertaken which ensure existing products perform as customers would expect and continue to deliver appropriate customer outcomes.</p> <p>Changes from last year Increases in regulatory expectations and the increased levels of activity by claims management companies, has caused this risk exposure to increase.</p>
<p>Cyber security The risk that LV= does not have a sufficiently robust strategy and control infrastructure in place to protect itself against, or to recover from, a cyber event.</p>	<p>Potential impact The high-level of threat from the external environment continued during 2018. High profile data loss incidents such as those affecting Facebook and British Airways demonstrate the serious impact such events can have.</p> <p>Mitigation LV= operates a comprehensive cyber risk strategy which is designed to ensure that the Group continues to identify, assess and respond to the ever changing threat of a cyber-attack.</p>

	<p>Changes from last year Further development of the Group’s cyber risk strategy, embedding of controls targeted at data privacy and enhanced mechanisms for monitoring and reporting mean that although the external environment generates a heightened risk, the residual impact of this risk remains stable.</p>
<p>Delivery risk The risk that the quality, timing and / or cost of delivering business as usual objectives or key strategic initiatives is impacted adversely due to the loss of key staff, or poorly executed change activity.</p>	<p>Potential impact The series of strategic initiatives, including the delivery of the second phase of the transaction with Allianz and the move to a fitter mutual for the future, have created pressure upon people, processes and IT systems which could have a detrimental impact on business delivery to customers and other external stakeholders.</p> <p>Mitigation The Board has established a structure of executive sponsorship and strong programme governance, challenge and escalation for all of the key initiatives undertaken across the Group. This is delivered through the centralised Transformation Directorate and is subject to Board oversight at LVFS Board level.</p> <p>Changes from last year Despite having a strong control environment in place, the high levels of complexity and the interrelated nature of projects in the strategic portfolio mean that the residual risk has increased slightly from last year.</p>

In the table above Conduct Risk has been identified as one of the firm’s most material risks. Whilst from a risk categorisation perspective LV= treats Conduct Risk as a separate Level 1 risk with its own key categories of risk, it is included in the operational risk scenarios work used to assess the capital requirements.

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

- Internal Crime
- External Crime
- People
- Product and Sales
- New Customers and Trust
- After Sale
- Business Continuity
- IT
- Third Parties
- Business Processes

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.

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 Emerging and other material risks

As well as monitoring near-term risks, the Risk Committee also considers potential risks, threats and opportunities which may impact the Group at some point in the future. This process takes place formally twice per year (with more frequent assessments taking place as and when required) and captures emerging risks such as those key risks described below:

Key emerging risks	Description
Change in UK Government	A new Government introduces a radical new agenda in public policy (e.g. changes in employment law, growing unionisation, increases in the minimum wage, employee representation on boards etc).
New market entrants /disruption from digital	New players enter the market, most likely in the general insurance or protection sectors.
New regulation	Regulators introduce new regulation (e.g. in the pension transfer market or more onerous capital standards), or raise the bar in terms of the standards expected for compliance.

In addition, the Risk Committee is cognisant of certain global risks such as climate change which have the potential to pose specific risks to both life and general insurance companies. In general insurance, climate change is likely to manifest itself in increased claims volatility and catastrophe claims from weather related events, and can lead to incorrect pricing and reserving of general insurance risks. In the life insurance business, whilst prolonged climate change will, in the long term, impact both longevity and mortality experience, a move to a lower carbon use economy may have an impact on the value of the assets held by LV= and the associated future investment decisions that the Group chooses to make.

LV= will need to respond effectively to the impacts of both physical and investment risks arising from climate change in order to avoid an adverse impact on business strategy. This risk will therefore continue to be an area of focus for LV= and is managed through the LV= RM Framework both as an emerging risk and through the careful management of the volatility in the risks which LV= manages.

Capital requirements focus on known and quantifiable material risks. 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 risk-free interest rates.
- An immediate 100 bps increase in all risk-free 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 impact some of the sensitivities shown, although a recalculation of the TMTP would in itself reduce the currently stated surplus.

The regulations require that TMTP is recalculated every two years. Given its strong capital position the Group utilises the recalculation of TMTP as part of its hedging strategy, since TMTP recalculation removes a large amount of the interest rate, credit spread and gilt swap sensitivity shown below. The group monitors the impact of change in market conditions regularly between recalculations. Equity exposure within the insurance business is largely managed using a portfolio of derivatives with additional exposure arising from the defined benefit pension schemes.

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 2018: £690m				
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
25% market fall in equities	(47)	(5)	(5)%	73%
100 bp fall in interest rates	(89)	99	(8)%	333%
100 bp rise in interest rates	69	(54)	7%	(258)%
50 bp rise in gilt swap spreads	(131)	(0)	(13)%	n/a
100 bp rise in credit spreads	120	(13)	12%	(43)%

The equity sensitivity reduces the value of the Group's assets, including those in the defined benefit pension schemes. It also increases the guarantee costs associated with the 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 rise in interest rate sensitivity as a percentage of the post-diversified interest rate SCR is negative despite the rise in interest rates being the biting stress in the SF SCR calculation. This is because the sensitivities include a stress to the Risk Margin and SCR which both fall under a rise in interest rates scenario. The benefit from the fall in Risk Margin and SCR more than offsets the cost on assets less liabilities. A more granular split of the interest rate sensitivities is used to manage the Group's interest rate exposure.

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.
- 20% decrease to mortality rates.
- 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.

The sensitivities make an approximate allowance for TMTP recalculation by not including a change in Risk Margin which is generally hedged by changes in TMTP when recalculated. They also assume 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. The sensitivities should only be treated as estimates which give a broad indication of the direction and magnitude of the impact of the sensitivity.

The group has entered into a number of reinsurance arrangements, the benefits of which are included within the results below.

Surplus capital at 31 Dec 2018:		£690m		
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
15% increase in mortality rates (affected business only)	(7)	0	(1)%	737%
20% decrease in mortality rates (affected business only)	(41)	0	(4)%	274%
50% increase in lapses	(20)	21	(2)%	12%
50% decrease in lapses	40	(14)	4%	12%*
50% decrease in OB Pension cash-take-up rates at retirement	(59)	(11)	(6)%	

* Relates to combined impact on individual risk.

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 this sensitivity on surplus is higher than the SCR capital held in respect of longevity 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. The increase in Best Estimate Liability (BEL) is partially offset by a reduction in SCR as more of the risk has been crystallised in the base position, there is less residual exposure under stress.

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	2018	2017
Assets	£m	£m
Deferred tax assets	24	10
Pension benefit surplus	199	178
Property, plant and equipment held for own use	36	40
Investments (other than assets held for index-linked and unit-linked contracts):		
Property (other than for own use)	-	3
Holdings in related undertakings, including participations	91	99
Equities	834	941
Bonds	5,997	6,182
Collective Investments Undertakings	3,468	3,768
Derivatives	83	81
Deposits other than cash equivalents	80	69
Other Investments	-	3
Assets held for index-linked and unit-linked contracts	2,969	2,485
Loans and mortgages	871	868
Reinsurance recoverables	1,710	2,312
Insurance and intermediaries receivables	9	10
Reinsurance receivables	31	19
Loans and Receivables (not insurance)	66	44
Cash and cash equivalents	174	101
Any other assets, not elsewhere shown	46	45
Total assets	16,688	17,258

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 value		2018				
		IFRS Continuing	IFRS Discontinued	Presentational adjustments *	Solvency II Valuation adjustment	Solvency II
Assets	Note	£m	£m	£m	£m	£m
Goodwill	1	34	186	-	(220)	-
Deferred acquisition costs	2	-	86	-	(86)	-
Intangible assets	1	13	85	-	(98)	-
Deferred tax assets	3	-	2	(2)	24	24
Pension benefit surplus	4	199	-	-	-	199
Property, plant and equipment held for own use	#	29	5	-	2	36
Investments (other than assets held for index-linked and unit-linked contracts):						
Holdings in related undertakings, including participations	5,6	-	-	78	13	91
Equities	6	6,974	428	(6,568)	-	834
Bonds	6	3,695	1,303	999	-	5,997
Collective Investments Undertakings		-	-	3,482	(14)	3,468
Derivatives	6,7	65	18	-	-	83
Deposits other than cash equivalents	6	-	-	80	-	80
Assets held for index-linked and unit-linked contracts	8	-	-	2,969	-	2,969
Loans and mortgages	9	869	-	2	-	871
Reinsurance recoverables	10	1,738	490	52	(570)	1,710
Insurance and intermediaries receivables	11	41	265	(70)	(227)	9
Reinsurance receivables	#	-	-	70	(39)	31
Loans and Receivables (not insurance)	12	407	129	(470)	-	66
Cash and cash equivalents	13	412	319	(554)	(3)	174
Any other assets, not elsewhere shown	14	82	51	(80)	(7)	46
Total assets		14,558	3,367	(12)	(1,225)	16,688

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

* = Included within Presentational adjustments are £12m relating to the elimination of IFRS intercompany balances between the IFRS continuing and discontinued businesses.

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 the 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 discontinued	2
Presentational adjustment	(2)
Solvency II valuation adjustment	24
Deferred tax assets - Solvency II valuation	24

There are a number of changes that are made to the LVIC, Highway and LV Insurance Management Limited (LVIM) IFRS Balance Sheets 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.

At 31 December 2018 there were total Solvency II taxable losses of LVIC, Highway and LVIM of £142m with a consequent £24m taxation impact. The recoverability of the deferred tax asset due to losses arising from a move to Solvency II has been justified based on future profits per the Board approved business plans for LVIC, Highway and LVIM. 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)
2019	72	19.0%	13
2020	40	17.5%	6
2021	30	17.0%	5
Total	142		24

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.

For further information regarding the admissibility of the asset please refer to the Significant accounting judgements section on page 171 of the Report and Accounts.

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	78
Adjusted equity method valuation differences	13
Participations - Solvency II valuation	91

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 classified as either fair value through income or available for sale (AFS).

Available for sale investments include listed and unlisted debt securities and are investments intended to be held for an indefinite period of time, that may be sold in response to liquidity or changes in interest rates, exchange rates or market movements.

AFS investments are initially recognised at fair value plus directly related transaction costs. They are subsequently carried at fair value. Impairment losses and exchange differences resulting from translating the amortised cost of foreign currency monetary AFS financial assets are recognised in the Statement of Comprehensive Income, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS financial assets are reported in a separate component of shareholders' equity (AFS reserve) until disposal. When securities classified as AFS are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the Statement of Comprehensive Income as 'net realised gains and losses'

Fair value through income has two sub categories:

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

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

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 2018.

	QMP £m	QMPS £m	AVM £m	AEM £m	Total £m
Holdings in related undertakings	-	-	78	13	91
Equities	801	-	33	-	834
Bonds	3,054	2,943	-	-	5,997
Collective Investment Undertakings	3,405	63	-	-	3,468
Derivatives	1	82	-	-	83
Deposits other than cash equivalents	80	-	-	-	80
Investments (other than assets held for index-linked and unit-linked funds)	7,341	3,088	111	13	10,553
Loans and mortgages (see note 9 below)	-	223	648	-	871
Total	7,341	3,311	759	13	11,424

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	83	(190)	(107)

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	648
Commercial mortgages	221
Total included in Financial assets at fair value through income – IFRS continuing	869
Presentational adjustment for accrued interest	2
Total Loans and Mortgages - Solvency II valuation	871

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 receivables – IFRS (continuing plus discontinued)	306
Presentational adjustment to reinsurance receivables	(70)
Solvency II valuation adjustments	(227)
Total Insurance and intermediaries - Solvency II valuation	9

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	250
Secured notes	200
Investment receivables	55
Other receivables	22
Amounts due from discontinued operations	5
Cash Collateral pledged	4
Loans and Receivables (not insurance) – IFRS (continuing plus discontinued)	536
Presentational adjustment – elimination of IFRS amount due from discontinued operations	(5)
Presentational adjustment to Investments and unit linked assets	(465)
Total Loans and Receivables (not insurance) - Solvency II valuation	66

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 interest 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 interest balances are all due within one year. These are valued at fair value based on amounts receivable on demand.

	£m
Prepayments and accrued interest – IFRS continuing plus discontinued	128
Corporation tax asset – IFRS continuing operations	5
Total Any other assets, not elsewhere shown – IFRS (continuing plus discontinued)	133
Presentational adjustment – netting off of IFRS continuing CT asset with IFRS discontinued CT liability	(5)
Presentational adjustment – reclassify accrued interest to Investments	(75)
Solvency II regulated subs valuation adjustment	(7)
Total Any other assets, not elsewhere shown - Solvency II valuation	46

D.2 Technical provisions

D.2.1 Technical provisions by line of business

Total Technical Provisions by line of business:

Line of Business	2018 £m	2017 £m
Motor vehicle liability	1,575	1,703
Other motor insurance	101	52
Fire and property damage	157	138
General liability insurance	61	78
Other Non-Life insurance	13	15
Total Non-Life insurance obligations	1,907	1,986
Insurance with-profits participation	5,604	5,821
Index-linked and unit-linked insurance	2,949	3,037
Other life insurance (including Health)	3,431	3,624
PPOs not health	165	168
Total Life insurance obligations	12,149	12,650
Total Group Technical Provisions	14,056	14,636

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 2018.

Line of Business	31 December 2018 - £m			
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP) Unaudited	Total Technical Provisions
Motor vehicle liability	1,520	55	-	1,575
Other motor insurance	99	2	-	101
Fire and property damage	153	4	-	157
General liability insurance	59	2	-	61
Other Non-Life insurance	12	1	-	13
Total Non-Life insurance obligations	1,843	64	-	1,907
Insurance with-profits participation	5,633	133	(162)	5,604
Index-linked and unit-linked insurance	2,962	26	(39)	2,949
Other life insurance (including Health)	3,634	129	(332)	3,431
PPOs not health	159	6	-	165
Total Life insurance obligations	12,388	294	(533)	12,149
Total Group Technical Provisions	14,231	358	(533)	14,056

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 methodology employed across all large claims allows for the best estimate Ogden Discount Rate of 0% following Royal Assent of the Civil Liability Bill.

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, weather events and Brexit. 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 133bps.

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, Unit Linked Pensions and the business acquired from Teachers Provident Society).

The VA prescribed by EIOPA was 27bps 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 reduces step-wise 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.

The step down in TMTP as at 31 December 2017 reduced the Group surplus by £37m. The step down as at 31 December 2018 reduced the Group surplus by £41m.

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	14,056	533	54	242
Basic own funds	1,726	(494)	(54)	(243)
Eligible own funds to meet Solvency Capital Requirement	1,726	(494)	(54)	(243)
Solvency Capital Requirement	1,036	1	7	36

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 2018 is shown in the tables below.

LVFS

Product	Base Percentage	Mortality Tables
Enhanced Annuities	95%	RMV00 CMI_2017 1.5% LT/RFV00 CMI_2017 1.25% LT with enhancements
Standard Annuities	95%	RMV00 CMI_2017 1.5% LT/RFV00 CMI_2017 1.25% LT
Annuities (Ex-Teachers)	65% M/95% F	RMV00 CMI_2017 1.5% LT/RFV00 CMI_2017 1.25% LT
Deferred Annuities (Pre-vesting)	130%	AMC00 CMI_2017 1.5% LT/AFC00 CMI_2017 1.25% LT
Deferred Annuities (Post-vesting)	115% M/121% F	RMV00 CMI_2017 1.5% LT/RFV00 CMI_2017 1.25% LT
Term Assurances (FPP)	88.40%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2017 1.50%(male)/1.25%(female) LT
Term Assurances (LVLI)	85.50%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2017 1.50%(male)/1.25%(female) LT
Term Assurances (LVFS)	85.95%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2017 1.50%(male)/1.25%(female) LT
IB Endowment/Whole of Life Assurance	80% tapered to 100% at later ages	ELT16
Whole of Life Assurances (50+)	100%*	AMC00/AFC00 adjusted CMI_2017 1.50%(male)/1.25%(female) LT
Whole of Life Assurances (Lifetime+)	100.8%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2017 1.50%(male)/1.25%(female) LT

* 106.7% for ASDA 50+

RNPFN Fund

Product	Base Percentage	Mortality Tables
Annuities in Payment	See right	80% IML00/89% 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.

Mortality Improvements

Future mortality improvements are allowed for using the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) 2017 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.

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, separate persistency rates apply for surrender (including external transfers, early retirements, full encashments and partial encashments) and 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:

Life business

- 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 impact of potential management actions. Although the management actions are focused on protecting the capital position, some of the actions impact the calculation of the Technical Provisions. In particular, the management actions of reducing the with-profits equity backing ratio and removing the smoothing of benefits for some Flexible Guarantee policies would impact policyholder benefits. The secondary impact on policyholder behaviour (primarily lapses) as a result of these management actions would also add to the uncertainty associated with the Technical Provisions.

Non-Life business

- The greatest areas of uncertainty pertinent to the Non-Life business is the future level of the Ogden Discount Rate (ODR) and the risk of a No Deal Brexit.
- The impact of a No Deal Brexit has been assessed via the addition of a specific ENID. This ENID has been derived via a stress and scenario approach. The impact of the scenarios has been netted down for the likelihood of a No Deal Brexit and the proportion of the liabilities that are expected to run off before such an event occurs.
- As at the 2018 year end, the IFRS Actuarial Best Estimate (ABE) and SII Technical Provisions ingest an Ogden Discount Rate (ODR) of 0% following Royal Assent of the Civil Liability Bill. This has changed since the 2017 year-end when an ODR of -0.75% was used.
- 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.
- 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	1,907	2,186	(279)
Insurance with-profits participation	5,604	5,699	(95)
Index-linked and unit-linked insurance	2,949	2,966	(17)
Other life insurance (including Health)	3,431	4,263	(832)
PPOs not health	165	97	68
Total Life insurance obligations	12,149	13,025	(876)
Total Group Technical Provisions	14,056	15,211	(1,155)

Note: The IFRS value excludes outstanding claims and stranded costs of £91m.

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 follows:

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 un-incepted 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 business enters into a number of reinsurance contracts. This includes an excess of loss arrangement to cover liability-related exposure with a retention set in line with risk appetite and catastrophe cover in order to limit the Group's exposure to such events.

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. Quota share arrangements have also been implemented with an effective date of 1 January 2016, covering each of the calendar years to 31 December 2019.

At present, there are no special purpose 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 assumptions are updated throughout the year in line with changes in the IFRS ABE.

The most material assumption change was the change in the assumed Ogden Discount Rate from -0.75% to 0% following Royal Assent of the Civil Liability Bill. This resulted in a favourable impact on the Technical Provisions.

Less materially, the annual large loss recalibration exercise was carried out during 2018 Q4 on large claims that are yet to be reported. The large claim frequency assumption was reduced as a result of the re-calibration. This resulted in a favourable impact on the Technical Provisions.

The expense assumptions used in the Premium Provision are updated in line with the reforecasting of the business plan throughout the year.

The loss ratio assumptions used in the Premium Provision are updated quarterly in line with the loss ratios for expired business.

The ENID loads used in both the Claims and Premium Provision are updated annually. This update involves a refresh of the mean load statistical approach for attritional claims and a refresh of the stresses and scenarios used for large claims, PPOs and weather events. In addition a new scenario considering a No Deal Brexit was added this year.

All of the above mentioned assumption updates were approved by the LVGIG Reserving Committee and the downstream governance process.

Life business

Equity Release prepayment rates have been expanded to vary by age to better reflect policyholder behaviour.

Mortality rates on whole of life products have been strengthened in line with experience.

Future mortality improvement rates have been updated from the 2016 to the 2017 version of the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) projection model.

Cash commutation rates on OB Pensions, where deferred pensioners can choose cash rather than a regular pension (on guaranteed terms), have generally been reduced to reflect expected future experience following pension freedom legislation.

Lapse and guarantee cancellation rates on Flexible Guarantee policies have been updated to anticipate policyholder reactions to changes in investment market conditions.

The granularity of assumptions for policyholder behaviour on unit-linked pension policies has been increased, including changes to rates of lapse, transition to drawdown, tax free cash and drawdown encashment.

The calculation of the insurance contract liabilities is impacted by changes in unit costs. Revised expense assumptions have been adopted following the derivation of updated unit costs in 2018. In addition, expense inflation assumptions that varied across different business lines have been aligned so that the same underlying expense inflation assumptions are used across all business lines to reflect how costs are managed at an aggregate level.

D.3 Other liabilities

Other liabilities on a Solvency II basis	2018	2017
	£m	£m
Provisions other than technical provisions	16	20
Pension benefit obligation	2	-
Deferred tax liabilities	75	96
Derivatives	190	193
Debts owed to credit institutions	59	62
Insurance and intermediaries payables	79	64
Reinsurance payables	9	8
Payables (trade, not insurance)	268	256
Subordinated liabilities	372	379
Any other liabilities, not elsewhere shown	38	70
Total Other Liabilities	1,108	1,148

Reconciliation between IFRS and Solvency II valuation		2018				
		IFRS Continuing	IFRS Discontinued	Presentational adjustment *	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m	£m
Provisions other than technical provisions	#	8	8	-	-	16
Pension benefit obligation	#	2	-	-	-	2
Deferred tax liabilities	1	78	-	(2)	(1)	75
Derivatives	#	190	-	-	-	190
Debts owed to credit institutions	2	59	-	-	-	59
Insurance and intermediaries payables	3	28	28	(35)	58	79
Reinsurance payables	4	-	-	35	(26)	9
Payables (trade, not insurance)	5	146	176	(5)	(49)	268
Subordinated liabilities	6	348	11	-	13	372
Any other liabilities, not elsewhere shown	7	-	10	(5)	33	38
Total Other Liabilities		859	233	(12)	28	1,108

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

* = Included within Presentational adjustments are £12m relating to the elimination of IFRS intercompany balances between the IFRS continuing and discontinued businesses.

Supporting Notes

1. Deferred tax liability

IFRS Deferred Tax Liabilities (DTL) at 31 December 2018 are £76m (£78m less £2m relating to the IFRS deferred tax asset for the discontinued operations) and relate to timing differences recognised on unrealised gains and the pension scheme. Solvency II Deferred Tax Liabilities are £75m. 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	-	1	7	51	-	59

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
Insurance receivables – IFRS continuing	28
Insurance receivables – IFRS discontinued	28
Total insurance and intermediaries payables – IFRS (continuing plus discontinued)	56
Presentational adjustment to transfer Reinsurance payables	(35)
Reclassification from technical provisions to insurance and intermediaries payables	58
Total insurance and intermediaries – Solvency II valuation	79

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	56	-	-	-	-	56

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
Total reinsurance payables – IFRS (continuing plus discontinued)	-
Due to reinsurers (presentational adjustment from Insurance receivables)	35
Reinsurance payables reclassified to technical provisions	(26)
Total reinsurance payables - Solvency II valuation	9

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	29
Trade payables	12
Other taxes and social security costs	52
Other creditors	62
Amounts due to continuing business	5
Finance lease liabilities	19
Accruals	143
Payables (trade, not insurance) – IFRS (continuing plus discontinued)	322
Presentational adjustments – elimination of IFRS amount due to continuing operations	(5)
Solvency II valuation adjustments	(49)
Payables (trade, not insurance) - Solvency II valuation	268

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)	247	2	3	21	-	273

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)	11
Subordinated liabilities – IFRS (continuing plus discontinued)	359
Solvency II valuation adjustments	13
Subordinated liabilities - Solvency II valuation	372

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 – IFRS discontinued	10
Presentational adjustment – netting off of IFRS continuing CT asset with IFRS discontinued CT liability	(5)
Any other liabilities, not shown elsewhere – IFRS (continuing plus discontinued)	5
Expense reserve reclassified from technical provisions	33
Total Any other liabilities, not elsewhere shown - Solvency II valuation	38

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.

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

- 1) Equity release mortgages are the only financial instrument the Group has which are 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:

Description	Unobservable input	2018		
		Reasonably possible alternative assumptions		
		Current fair value £m	Increase in fair value £m	Decrease in fair value £m
Loans secured on residential property	Discount rates +/- 50bps	648	28	(26)

For Equity release mortgages (£648m), please refer to Section D.1 Assets Note 9 Loans and Mortgages, sub-heading Equity release mortgages for the valuation basis.

- 2) Holdings in related undertakings (£78m) being joint venture properties reclassified as participations. The Society measures its interest in the joint venture at fair value in accordance with IAS 28, using the adjusted net asset method using unobservable external prices factoring in distributions or calls since the latest valuations.
- 3) Unlisted equity (£33m) 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.
- 4) Property, plant and equipment (£36m) 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 £2m as part of the Solvency II valuation.
- 5) 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.
- 6) 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.

- 7) 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	1,253	-	-	1,253
Reconciliation reserve	(99)	-	-	(99)
Subordinated liabilities	-	372	-	372
Deferred tax assets	-	-	24	24
Minority interests	176	-	-	176
Total Basic Own Funds	1,330	372	24	1,726
Total Basic Own Funds after deductions	1,330	372	24	1,726

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 2018 £m	Movement £m	31 December 2018 £m
Eligible own funds			
Tier 1 capital	1,287	43	1,330
Tier 2 capital	379	(7)	372
Tier 3 capital	10	14	24
Total capital	1,676	50	1,726
Made up of:			
Surplus funds	1,236	17	1,253
Deferred tax	10	14	24
Reconciliation reserve	(92)	(7)	(99)
Subordinated liabilities	379	(7)	372
Minority interests	143	33	176
Total capital	1,676	50	1,726
Total eligible own funds to meet SCR	1,676	50	1,726

- 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	1,330	372	24	1,726
Total eligible Own Funds to meet the Group SCR	1,330	372	24	1,726

Total available Own Funds to meet minimum Group SCR	1,330	372		1,702
Capital restrictions	-	(283)		(283)
Total eligible Own Funds to meet the minimum Group SCR	1,330	89		1,419

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.

	2018	2017
	£m	£m
IFRS Unallocated divisible surplus	1,127	1,189
Deduct deferred acquisition costs, goodwill and other intangible assets and liabilities	(404)	(410)
Add subordinated debt treated as available capital	372	379
Insurance contract valuation differences	359	305
Difference in non-controlling interest calculations	309	279
Deferred tax adjustments	24	10
Other	15	6
Less net eligible own funds relating to ring-fenced funds	(162)	(192)
Eligible own funds to meet SCR (excluding ring-fenced funds)	1,640	1,566
RNPFN – eligible own funds	114	125
Restriction of own funds in respect of RNPFN	(39)	(34)
Teachers – eligible own funds	48	67
Restriction of own funds in respect of Teachers	(37)	(48)
Total Basic own funds (excluding ring-fenced fund surplus)	1,726	1,676

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 2018 was £1,036m (31 December 2017: £978m). 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 2018 was £446m (2017: £444m).

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 for 2017 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. During 2018 the mutual bonus clawback management action was removed from the SCR calculation.

Risk Module (all figures in £m)	2018	2017
Market risk	484	487
Credit counterparty risk	45	51
Life underwriting risk	377	227
Health underwriting risk	89	90
Non-Life underwriting risk	470	478
Total before diversification	1,465	1,333
Diversification	(463)	(371)
Basic Solvency Capital Requirement	1,002	962
Operational risk	93	98
Loss absorbing capacity of deferred taxes	(59)	(82)
Non-insurance regulated entities	-	-
Solvency Capital Requirement	1,036	978

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 increased over the period. This was driven by the removal of the mutual bonus claw back management action; see section C2.2 for further details.

The loss absorbing capacity of deferred taxes has reduced over the year largely arising from GI business and the pension scheme.

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 regulations.

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

- life business written directly by the Society, which diversifies within itself; 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
TAC	Teachers Assurance Company Ltd
SBU	Strategic Business Unit
SSU	Strategic Support Unit
ExCo	The executive management committee of the Group established by the CEO

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
ENID	Events not in data
ESG	Economic Scenario Generator
GAR	Guaranteed Annuity Rate
GI	General Insurance
IFRS	International Financial Reporting Standards
LASPO	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 (ODR)	The discount rate is used to calculate lump sum settlements of bodily injury claims, including loss of earnings and ongoing medical care.
ORSA	Own Risk and Solvency Assessment
PRA	Prudential Regulation Authority
PWC	PricewaterhouseCoopers, LLP
PPO's	Permanent Payment Orders
QRTs	Quantitative Reporting Templates
RFF	Ring-Fenced Fund
RNPFN	Royal National Pension Fund for Nurses
SCR	Solvency Capital Requirement
SF	Standard Formula
SFCR	Solvency and Financial Condition Report
SII Directive	Refers to Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) unless another Directive is specified
TA Fund	Teachers Assurance Fund
TMTTP	Transitional Measures on Technical Provisions
TPS	Teachers Provident Society (a RFF)
UK	United Kingdom
VA	Volatility Adjustment

Appendix 1

LV= Regulated Entity SFCRs

LVFS Solo SFCR.....	98
LVLC SFCR.....	132
LVPL SFCR.....	149
LVIC SFCR.....	167
HIGHWAY SFCR.....	193
TAC SFCR.....	218

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 details of the supervisory authority responsible for financial supervision.

Firm's reference number: 110035

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

For the contact details of the PRA and the FCA 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)	2018	2017
Gross earned premium	787	835
Premiums ceded to reinsurers	(246)	(1,092)
Net earned premiums	541	(257)
Investment income	363	430
Net (losses)/gains on investments	(612)	379
Other income	24	22
Total income	316	574
Net benefits and claims	(665)	(634)
Net change in contract liabilities	539	415
Change in economic basis	-	(48)
Finance costs	(23)	(23)
Net operating and administrative expenses	(196)	(222)
Total benefits, claims and expenses	(345)	(512)
(Loss)/profit before tax, mutual bonus and UDS transfer	(29)	62
Mutual bonus	(26)	(26)
Income tax credit/(expense)	31	(24)
Pension scheme actuarial (loss)/gain net of tax	(27)	19
Transfer (from)/to the Unallocated divisible surplus	(51)	31

The Society reported an IFRS loss before tax, mutual bonus and unallocated divisible surplus transfer for the year of £29m (2017: £62m profit). Whilst contribution from new business has reduced year-on-year to £14m (2017: £36m), this was offset by improved cost control. Model and basis changes have remained relatively flat at £24m (2017: £26m).

The decrease in profit of £91m is mainly attributable to short-term investment fluctuations and related items (STIF) which is adverse at £66m (2017: £30m favourable). The £66m adverse impact from STIF in 2018 was driven by the adverse impact of widening corporate bond spreads causing losses on annuities of £32m, tax credits on asset share of £29m and falls in equities of £17m, partially offset by the positive impact of rising yields of £16m.

Other offsetting material items impacting the year-on-year results were:

- Income received by the Society from Group undertakings reduced by £45m year-on-year to £67m (2017: £112m).
- In 2017, the Society reported a £48m adverse impact following a change in its life IFRS reserving reporting basis to better align with Solvency II. This was a one-off impact which was not repeated in 2018.

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

Capital position and changes in risk profile

At 31 December 2018 the LVFS Solo capital surplus on a standard formula basis was £704m (2017: £724m) with capital cover of 184% (2017: 190%), 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	2018	2017	Change
Own funds	1,543	1,527	16
SCR	839	803	36
Surplus capital	704	724	-20
CCR	184%	190%	-6%

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

- **One-off impact from removal of the mutual bonus clawback management action.**
 - The removal of the mutual bonus clawback management action from the SCR calculation, enabled by the strength of the Society's solvency position at the beginning of the year. This has resulted in a £172m reduction to surplus capital and increased the exposure to adverse asset share performance.
- **One-off impact from Model and Basis Changes.**
 - Unit-linked pensions – a significant change to the modelling and assumptions was made to better reflect product features and post pensions freedoms customer behaviour, described further in the 'Valuation for solvency purposes' section. As a result, the business significantly shortened in duration, reducing interest risk exposure due to a reduction in the capitalised value of expenses. This reduced the exposure to interest rate risk and expense risk. Also, equity exposure fell due to lower returns triggering faster fund depletion and therefore lapsing.
 - Ordinary Branch (OB) Pensions - the reduction in policyholder cash take-up and paid-up rates has strengthened reserves and reduced the exposure to lower rates relative to recent experience.
 - Equity Release - the increase in loan prepayment rates has reduced the exposure to higher rates relative to recent experience.
- **Economic impacts over 2018.**
 - Interest rate exposure (post-recalculation of TMTP) has reduced over the year, partly due to an increase in duration on the Pension Scheme IAS19 accounting liabilities following the triennial review of member data.
 - Negative equity returns and derivatives held across the Life business and the Pension Schemes have led to lower market exposure.

Key elements of the Society's capital management strategy during the year were as follows:

- Interest rate exposure across the Life business continues to be managed on a post-TMTP recalculation basis. This gives rise to interest rate exposure and gilt spread exposure on a pre-TMTP basis, leading to an increase in surplus when rates rise and TMTP is not recalculated, as has occurred over 2018.
- The Society has exposure to equity markets via annual management charges. This is managed through a combination of hedging and internal arrangements.

System of Governance

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

J Dean – Resigned 31 March 2018
C Burton – Resigned 7 June 2018
A Hutchinson – Appointed 1 January 2018
L Savage – Appointed 1 February 2018
A W Snow – Appointed 2 July 2018
T Lawler – Appointed 1 September 2018

Legal and regulatory environment

The full impact of the political and economic uncertainties in the UK has been difficult to gauge during 2018 due to the continued lack of clarity around Brexit. This has been particularly relevant for the general insurance business.

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. LVFS have welcomed the Government's 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. On 20 December 2018, the Civil Liability Bill received Royal Assent and is thus the Civil Liability Act, with a revised Ogden Discount Rate expected to be announced in the summer of 2019. Whilst the revised rate is not yet known the Group anticipates an increase from the current legislative rate of -0.75%, with the best estimate reserves being held at the equivalent of a 0% Ogden Discount Rate.

The overall heightened level of uncertainty is expected to continue throughout 2019 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.

All business is underwritten in the UK.

Net earned premiums

	Society	
	2018 £m	2017 £m
Gross earned premiums		
Long-term insurance and participating investment contracts		
Single premium		
New business		
Investments and savings	354	420
Pensions and annuities	170	151
Regular premium		
New business		
Life and health protection	33	37
Existing in-force business		
Investments and savings	28	33
Pensions and annuities	8	9
Life and health protection	194	185
Gross earned premiums	787	835
Premiums ceded to reinsurers		
Long-term insurance premiums	(246)	(1,092)
	(246)	(1,092)
Net earned premiums	541	(257)

2018 gross earned premiums of £787m fell by 6% compared to 2017. The reduction in Investment and savings new business premiums relates to a fall in Flexible Guarantee Bond volumes due to reduced marketing and promotions while the Society took steps to redesign its proposition. In December 2017 the Society entered into a reinsurance arrangement in respect of the OB Pension portfolio, which led to a one-off increase in premiums ceded to reinsurers of £829m.

Net benefits and claims

Society	2018			2017		
	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	895	(232)	663	866	(237)	629
Change in the provision for claims	8	-	8	5	-	5
Fair value adjustment to reinsurance receivables	-	(6)	(6)	-	-	-
	903	(238)	665	871	(237)	634

2018 net benefits and claims are broadly in line with 2017, at £903m.

Net change in contract liabilities

Society	2018 £m	2017 £m
Gross decrease/(increase) in long-term contract liabilities		
Decrease/(increase) in long-term insurance contract liabilities - participating	187	(191)
Decrease/(increase) in investment contract liabilities - participating	55	(51)
Decrease/(increase) in long-term insurance contract liabilities - non-participating	101	(117)
Decrease/(increase) in investment contract liabilities - non-participating	135	(234)
Decrease/(increase) in long-term linked insurance contract liabilities	34	(23)
	512	(616)
Mutual bonus	26	26
	538	(590)
Decrease/(increase) in long-term contract liabilities ceded to reinsurers		
Increase in long-term insurance contract liabilities relating to non-participating contracts	51	143
Decrease/(increase) in long-term insurance contract liabilities relating to participating contracts	(36)	857
Decrease/(increase) in long-term linked insurance contract liabilities	(24)	35
	(9)	1,035
Increase/(decrease) in non-participating value of in-force business	10	(30)
Net change in contract liabilities before change in economic basis	539	415
Change in economic basis	-	(48)
Net change in contract liabilities	539	367

The gross decrease in long-term contract liabilities for 2018 was £538m (2017: £590m increase). This reduction is driven by the lower levels of policyholders' investment gains, following adverse movements in the UK and overseas stock markets and interest rate changes adversely affecting gilts and bonds values. The net change in contract liabilities was also impacted in 2017 by a one-off £933m increase in reinsurance in respect of the OB Pension portfolio.

Other operating and administrative expenses

Society	2018 £m	2017 £m
Commission paid on acquisition of business	50	54
Amortisation and impairment of intangible assets	3	2
Depreciation on property and equipment	2	3
Loss on disposal of property and equipment	-	1
Investment management expenses and charges	10	15
Auditors' remuneration	1	1
Employee benefits expense*	101	249
Management charge allocated to group undertakings	(58)	(215)
Rent, rates and other facilities expense	9	12
Marketing and advertising	7	9
Other staff costs	20	15
IT costs	25	36
Fees	27	31
Other expenses	3	15
Claims handling cost recognised in Gross benefits and claims	(4)	(6)
Net operating and administrative expenses	196	222

*On 29 December 2017, 3717 employees (excluding contractors and temporary staff) from the Society transferred to Liverpool Victoria General Insurance Group Limited (LVGIG) under a TUPE arrangement.

2018 net operating and administrative expenses have reduced by 12% during the year to £196m (2017: £222m), reflecting ongoing cost control measures.

Solvency II lines of business

For details of the material Solvency II lines of business for the Society, please see chapter A.2 of the Group section of this report, entitled Solvency II lines of business, Life insurance on page 37.

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 and interest on loans secured on residential and commercial property. Dividends are recorded on the date on which the shares are declared ex-dividend.

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 £10m (2017: £15m) 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	2018	2017
	£m	£m
Income from investments at fair value through income:		
- Dividend income	113	109
- Interest income from debt and fixed interest securities	141	164
- Interest on loans secured on residential property	34	36
- Interest on loans secured on commercial property	8	9
Interest income from group undertakings	-	18
Dividend income from group undertakings	67	94
	363	430

Investment income has decreased to £363m (2017: £430m), driven by the £23m decrease in interest income from debt and fixed interest securities and the £45m decrease in income received by the Society from Group undertakings, which included the cessation of receipt of internal subordinated debt interest, following a conversion of internal subordinated debt to share capital during 2017.

Net (losses)/gains on investments

Society	2018	2017
	£m	£m
Investment properties	1	3
Investments at fair value through income:		
- Debt securities	(160)	2
- Equity securities	(432)	419
- Derivatives at fair value through income	(5)	(36)
- Loans and mortgages	(6)	4
- Other	(3)	3
Investments in group undertakings	(7)	(16)
	(612)	379

Net losses on investments of £612m are driven by the falls in equity securities of £432m as markets fell in 2018. In addition, there were losses of £160m on debt securities, driven by an increase in yields during the year.

Investments in securitisation.

There are no material investments in securitisation (2017: £nil).

A.4 Performance of other activities

The results of other activities are as follows:

Finance costs

Society	2018	2017
	£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	2018	2017
	£m	£m
Fee and commission income	24	22
	24	22

Other income is made up of fee and commission income and is broadly in line with 2017 at £24m.

Leasing arrangements

Operating lease commitments

Operating lease commitments of £7m (2017: £8m) 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:

A. Cook	J. Dean – Resigned 31 March 2018
R. Rowney	C. Burton – Resigned 7 June 2018
D. Neave	A. Hutchinson – Appointed 1 January 2018
D. Barral	L. Savage – Appointed 1 February 2018
A. Parsons	W. Snow – Appointed 2 July 2018
C. Ledlie	T. Lawler – Appointed 1 September 2018

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, LV= offers a range of Life and Health insurance products. These cater to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location.

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

The table below shows the 31 December 2018 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The results for 31 December 2017 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 £886m (2017: £1,034m). This differs from the total SCR reported in section E.2 as it excludes the loss absorbing capacity of deferred tax and the 2017 figure excludes the mutual bonus claw back management action, 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 different year-ends where it is or is not applied. The mutual bonus clawback management action was removed from the SCR during 2018 see section C2.2 for further details.

SCR split by risk type, for the year ended 31 December	2018	2017	Change
Market risk	60%	63%	(3)%
Underwriting risk	35%	32%	3%
Operational risk	4%	4%	0%
Counterparty risk	1%	1%	0%
Total	100%	100%	

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.

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 table below shows the 31 December 2018 split of underwriting risks within the Standard Formula SCR. The results for 31 December 2017 are provided for comparison. The amount of SCR illustrated below is £310m (2017: £332m). This differs from the underwriting risk capital shown in section E.2 as it excludes the mutual bonus claw back management action from the 2017 figures 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 different year-ends where it is and is not applied.

SCR split of underwriting risk, for the year ended 31 December	2018	2017	Change
Life lapse	62%	64%	(2)%
Life expenses	18%	18%	0%
Health	13%	11%	2%
Life longevity	5%	5%	0%
Other	2%	2%	0%
Total	100%	100%	

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.

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, the mutual bonus claw back management action has been removed from the SCR calculation during the reporting period. The mutual bonus clawback management action reduces allocations of mutual bonus in extreme circumstances. The management action has been removed given the strength of solvency for LVFS and on the grounds it would not be realistically exercised in a post 1-in-200 stressed scenario. This resulted in a £172m increase in the SCR, equal to the value of the management action as at year-end 2017.

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 table below shows the 31 December 2018 split of market risks within the Standard Formula SCR. The results for 31 December 2017 are provided for comparison. The amount of SCR illustrated below is £527m (2017: £652m). This differs from the market risk capital shown in section E.2 as it excludes the mutual bonus claw back management action from the 2017 figures 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 different year-ends where it is and is not applied. The mutual bonus clawback management action was removed from the SCR during 2018 see section C2.2 for further details.

SCR split of market risk, for the year ended 31 December	2018	2017	Change
Spread	50%	45%	5%
Equity	44%	51%	(7)%
Interest rates	3%	2%	1%
Currency	2%	1%	1%
Property	1%	1%	0%
Concentration	0%	0%	0%
Total	100%	100%	

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 a significant proportion of the Society's assets comprised the value of its subsidiaries, resulting in the large amount of equity risk capital shown above. Approximately 60% of the Society's equity capital derives from equity holdings in its subsidiaries.

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 directly stressed 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

Equity risk capital has significantly reduced over the year, primarily due to model and methodology changes on the unit linked pensions business and equity losses on the pension scheme. Spread risk capital has fallen over the year, largely due to run off of the business; however it now makes up a larger proportion of the market risk exposure due to the large fall in equity risk capital.

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

A reinsurance arrangement was written in 2017 with RGA to transfer longevity risk arising on OB Pensions. The level of assumed recoveries above the collateral posted by RGA has reduced over 2018 leading to an increase in counterparty default risk capital. The asset management company for certain unit linked funds for Pensions business changed from State Street to Vanguard over 2018. Due to a difference in classification between the two companies, the allowance for

counterparty default risk, previously held against State Street, could be released and was not applicable to Vanguard. This led to an increase in counterparty default risk capital of £3m.

There were no other material changes to credit counterparty risk during 2018.

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.

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 Emerging and 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.

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

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 2018:		£704m		
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
25% market fall in equities	(47)	(5)	(6)%	20%
100 bp fall in interest rates	(89)	72	(10)%	590%
100 bp rise in interest rates	69	(54)	9%	(459)%
50 bp rise in gilt swap spreads	(131)	(0)	(16)%	n/a
100 bp rise in credit spreads	120	(13)	15%	(45)%

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 2018:		£704m		
Sensitivities	Change in Surplus (£m)	Change in SCR (£m)	Change in CCR (%)	% of individual risk post-diversified SCR
15% increase in mortality rates (affected business only) *	(7)	0	(1)%	548%
20% decrease in mortality rates (affected business only) *	(41)	0	(5)%	245%
50% increase in lapses**	(26)	27	(3)%	14%
50% decrease in lapses**	44	(18)	5%	6%***
50% decrease in OB Pensions cash-take-up rates at retirement	(56)	(14)	(7)%	

* Affected business is defined in line with Solvency II standard formula.

** Early retirements have been excluded from this sensitivity.

*** Relates to combined impact on individual risk.

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	2018	2017
	£m	£m
Pension benefit surplus	199	178
Property, plant and equipment held for own use	9	7
Investments (other than assets held for index-linked and unit-linked funds)		
- Property (other than for own use)	-	3
- Participations	896	927
- Equities	757	860
- Bonds	3,990	4,298
- Collective Investment undertakings	2,942	3,068
- Derivatives	65	80
- Deposits other than cash equivalents	38	23
- Other Investments	-	3
Assets held for index-linked and unit linked funds	2,969	2,485
Loans and mortgages	871	868
Reinsurance recoverables	1,175	1,730
Insurance and intermediaries receivables	9	9
Reinsurance receivables	31	19
Receivables (trade, not insurance)	72	58
Cash and cash equivalents	97	71
Any other assets, not elsewhere shown	15	15
Total Assets	14,135	14,702

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		2018			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Intangible assets	#	8	-	(8)	-
Pension benefit surplus	1	199	-	-	199
Property, plant and equipment held for own use	#	9	-	-	9
Investments (other than assets held for index-linked and unit-linked funds)					
- Participations	2,3	896	78	(78)	896
- Equities	3	6,784	(6,027)	-	757
- Bonds	3	3,681	309	-	3,990
- Collective Investment undertakings	3	-	2,942	-	2,942
- Derivatives	3	65	-	-	65
- Deposits other than cash equivalents	3	-	38	-	38
Assets held for index-linked and unit linked funds	4	-	2969	-	2,969
Loans and mortgages	5	869	2	-	871
Reinsurance recoverables	6	1,738	51	(614)	1,175
Insurance and intermediaries receivables	#	40	(31)	-	9
Reinsurance receivables	#	-	31	-	31
Receivables (trade, not insurance)	#	84	(12)	-	72
Cash and cash equivalents	7	392	(295)	-	97
Any other assets, not elsewhere shown	8	75	(60)	-	15
Total Assets		14,840	(5)	(700)	14,135

= 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	881
Loan stock in subsidiaries	15
Investments in group undertakings - IFRS	896
Joint venture properties reclassified as participations	78
Adjusted equity method valuation differences	(78)
Participations - Solvency II valuation	896

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 2018.

	QMP £m	QMPS £m	AVM £m	AEM £m	Total £m
Participations	-	-	78	818	896
Equities	724	-	33	-	757
Bonds	1,951	2,039	-	-	3,990
Collective Investment Undertakings	2,879	63	-	-	2,942
Derivatives	1	64	-	-	65
Deposits other than cash equivalents	38	-	-	-	38
Investments (other than assets held for index-linked and unit-linked funds)	5,593	2,166	111	818	8,688
Loans and mortgages (see note 5 below)	-	223	648	-	871
Total	5,593	2,389	759	818	9,559

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	648
Commercial mortgages	221
Total included in Financial assets at fair value through income - IFRS	869
Reclassify accrued interest on commercial mortgages from accrued interest	2
Total Loans and Mortgages - Solvency II valuation	871

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 a full definition of AVM and Section D.4 for more information). 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 interest 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
Prepayments and accrued interest – IFRS	70
Corporation tax - IFRS	5
Any other assets, not elsewhere shown - IFRS	75
Presentational adjustment for corporation tax	(5)
Reclassify accrued interest to investments	(55)
Total Any other assets, not elsewhere shown - Solvency II valuation	15

D.2 Technical provisions

D.2.1 Technical provisions by line of business

Total Technical Provisions by line of business:

Line of Business	2018 £m	2017 £m
Insurance with-profits participation	5,604	5,820
Index-linked and unit-linked insurance	2,949	3,037
Other life insurance (including Health)	3,418	3,609
Total Life insurance obligations	11,971	12,466

The following table sets out the LVFS technical provisions split by Solvency II lines of business as at 31 December 2018.

Line of Business	31 December 2018 - £m			
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP) Unaudited	Total Technical Provisions
Insurance with-profits participation	5,633	133	(162)	5,604
Index-linked and unit-linked insurance	2,962	26	(39)	2,949
Other life insurance (including Health)	3,620	130	(332)	3,418
Total Life insurance obligations	12,215	289	(533)	11,971

D.2.2 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, 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	11,971	533	54	242
Basic own funds	1,543	(494)	(54)	(242)
Eligible own funds to meet Solvency Capital Requirement	1,543	(494)	(54)	(242)
Solvency Capital Requirement	839	1	8	59

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.

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	Solvency II value £m	IFRS value £m	Difference £m
Insurance with-profits participation	5,604	5,699	(95)
Index-linked and unit-linked insurance	2,949	2,966	(17)
Other life insurance (including Health)	3,418	4,249	(831)
Total Life insurance obligations	11,971	12,914	(943)

Note: The IFRS value excludes outstanding claims and stranded costs of £91m.

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 is 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 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

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.

D.2.3.2 Material changes in assumptions

Equity Release prepayment rates have been expanded to vary by age to better reflect policyholder behaviour.

Mortality rates on whole of life products have been strengthened in line with experience.

Future mortality improvement rates have been updated from the 2016 to the 2017 version of the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) projection model.

Cash commutation rates on OB Pensions, where deferred pensioners can choose cash rather than a regular pension (on guaranteed terms), have generally been reduced to reflect expected future experience following pension freedom legislation.

Lapse and guarantee cancellation rates on Flexible Guarantee policies have been updated to anticipate policyholder reactions to changes in investment market conditions.

The granularity of assumptions for policyholder behaviour on unit-linked pension policies has been increased, including changes to rates of lapse, transition to drawdown, tax free cash and drawdown encashment.

The calculation of the insurance contract liabilities is impacted by changes in unit costs. Revised expense assumptions have been adopted following the derivation of updated unit costs in 2018. In addition, expense inflation assumptions that varied across different business lines have been aligned so that the same underlying expense inflation assumptions are used across all business lines to reflect how costs are managed at an aggregate level.

D.3 Other liabilities

Other liabilities on a Solvency II basis	2018	2017
	£m	£m
Provisions other than technical provisions	7	13
Deferred tax liabilities	78	98
Derivatives	190	187
Debts owed to credit institutions	59	62
Insurance and intermediaries payables	77	65
Reinsurance payables	9	7
Payables (trade, not insurance)	112	146
Subordinated liabilities	360	367
Any other liabilities, not elsewhere shown	13	49
Total Other Liabilities	905	994

Reconciliation between IFRS and Solvency II valuation	Note	2018			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
		£m	£m	£m	£m
Provisions other than technical provisions	#	7	-	-	7
Deferred tax liabilities	#	78	-	-	78
Derivatives	#	190	-	-	190
Debts owed to credit institutions	#	59	-	-	59
Insurance and intermediaries payables	1	28	(9)	58	77
Reinsurance payables	#	-	9	-	9
Payables (trade, not insurance)	2	126	-	(14)	112
Subordinated liabilities	3	348	-	12	360
Any other liabilities, not elsewhere shown	#	-	(5)	18	13
Total Other Liabilities		836	(5)	74	905

#= 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
Insurance payables - IFRS	28
Presentational adjustment to transfer Reinsurance payables	(9)
Reclassification from technical provisions to insurance and intermediaries payables	58
Total insurance and intermediaries payables - Solvency II valuation	77

The IFRS liabilities recognised above are all due within one year.

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 accrued interest on the subordinated debt, as this is classified within the Solvency II fair value of subordinated debts – see note 3.

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	11
Trade payables	5
Amounts owed to group undertakings	6
Other taxes and social security costs	7
Other creditors	36
Accruals	61
Total Payables (trade, not insurance) - IFRS	126
Remove subordinated debt interest accrual	(14)
Payables (trade, not insurance) - Solvency II valuation	112

The IFRS liabilities recognised above are all due within one year.

3. Subordinated liabilities

Details of the subordinated liabilities have been set out in section D.3, supporting note 6 of the LV= Group SFCR.

Subordinated liabilities	£m
Subordinated notes (GBP 350m)	348
Subordinated liabilities - IFRS	348
Revaluation of subordinated debt to fair value	12
Subordinated liabilities - Solvency II valuation	360

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;

		2018		
		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	648	28	(26)

For Equity release mortgages (£648m), please refer to Section D.1 Assets, Note 5 Loans and Mortgages, sub-heading Equity release mortgages for the valuation basis.

- Holdings in related undertakings (£78m) being joint venture properties reclassified as participations. The Society measures its interest in the joint venture at fair value in accordance with IAS 28, using the adjusted net asset method using unobservable external prices factoring in distributions or calls since the latest valuations.
- Unlisted equity (£33m) 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, plant and equipment (£9m) 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	1,259	-	-	1,259
Reconciliation reserve	(76)	-	-	(76)
Subordinated liabilities	-	360	-	360
Total Basic Own Funds	1,183	360	-	1,543
Total available Own Funds to meet the SCR	1,183	360	-	1,543
Total available Own Funds to meet the MCR	1,183	360		1,543

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

Total available Own Funds to meet the SCR	1,183	360	-	1,543
Tier 2 capital restriction	-	-	-	-
Total eligible Own Funds to meet the SCR	1,183	360	-	1,543

Total available Own Funds to meet the MCR	1,183	360		1,543
Tier 2 capital restriction	-	(318)		(318)
Total eligible Own Funds to meet the MCR	1,183	42		1,225

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. The current value of the subordinated debt is £360m

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 the LV= Group SFCR Section D.3, note 6.

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 £839m which therefore means a maximum of £419.5m 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 £210m which therefore means a maximum of £42m of subordinated debt is eligible to meet the MCR.

Changes in own funds during the reporting period

	LVFS		
	1 January 2018 £m	Movement £m	31 December 2018 £m
Eligible own funds			
Tier 1 capital	1,160	23	1,183
Tier 2 capital	367	(7)	360
Total capital	1,527	16	1,543
Made up of:			
Surplus funds	1,242	17	1,259
Reconciliation reserve	(82)	6	(76)
Subordinated liabilities	367	(7)	360
Total capital	1,527	16	1,543
Total eligible own funds to meet SCR	1,527	16	1,543

- 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 2018 there were no ancillary own funds.

Deductions from own funds

At 31 December 2018 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 2018	
	£m	£m
Analysis of Equity per the statutory financial statements		
Unallocated divisible surplus		999
Solvency II Adjustments (excluding reclassifications)		
<u>Assets</u>		
- Reduction in valuation of participations (Section D.1 note 2)	(78)	
- Reduction in valuation of intangibles	(8)	
- Reduction in valuation of linked assets	(51)	
- Reduction in valuation of reinsurance recoverable (Section D.1 note 6)	(563)	
		(700)
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2)		1,034
<u>Other liabilities</u>		
- Increase in payables	(44)	
- Increase in subordinated debt	(12)	
- Other	(18)	
		(74)
Total Equity - Solvency II valuation		1,259
Restricted own fund items due to ring-fencing		(76)
Subordinated liabilities allowable as own funds items		360
Total own funds - Solvency II valuation		1,543
Excess of Assets over Liabilities - Solvency II valuation		
Total Assets		14,135
Total Technical Provisions		(11,971)
Total Other Liabilities		(905)
Excess of Assets over Liabilities - Solvency II valuation		1,259

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 2018 was £839m (31 December 2017: £803m). The increase in SCR over the period was driven by the removal of the mutual bonus clawback management action from the SCR calculation offset by favourable movements from model and basis changes and short term investment fluctuations.

The Minimum Capital Requirement (MCR) as at 31 December 2018 was £210m (31 December 2017: £201m).

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 for 2017 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. During 2018 the mutual bonus clawback management action was removed from the SCR calculation.

Risk Module (all figures in £m)	2018	2017
Market risk	592	640
Credit counterparty risk	34	30
Life underwriting risk	376	260
Health underwriting risk	89	89
Total before diversification	1,091	1,019
Diversification	(242)	(193)
Basic Solvency Capital Requirement	849	826
Operational risk	37	40
Loss absorbing capacity of deferred taxes	(47)	(63)
Solvency Capital Requirement	839	803

Life underwriting risk SCR has materially increased over the period. This was driven by the removal of the mutual bonus claw back management action.

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 details of the supervisory authority responsible for financial supervision.

Firm's reference number: 110423

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

For the contact details of the PRA and the FCA 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 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.

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 2018 were as follows:

R A Rowney – Resigned 1 July 2018
A W Snow – Appointed 1 July 2018

J T Perks resigned on 25 February 2019.

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 2018, 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:

2018	Other life insurance	Health reinsurance	Life reinsurance	Total
	£000	£000	£000	£000
Net earned premiums	73	356	12	441
Net claims incurred including changes in other technical provisions	205	(278)	-	(73)
Expenses incurred (excluding investment management expenses)	(50)	-	-	(50)
Net total	228	78	12	318

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

The underlying result has improved during the year, driven by a reduction in net benefits and claims

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:

	2018	2017
	£000	£000
Net earned premium per the financial statements	441	491
Net total per Solvency II	441	491
Net claims incurred per the financial statements	(974)	(1,185)
Net change in insurance contract liabilities per the financial statements	901	789
Net total per Solvency II	(73)	(396)
Operating expenses per the financial statements	(69)	(25)
Less investment management expenses	19	21
Net total per Solvency II	(50)	(4)

A.3 Investment performance

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

Investment income

LVLC	2018 £000	2017 £000
Income from investments at fair value through income		
- Dividend income	3	3
- Interest income	462	449
Interest on loans and receivables	2	1
Investment income	467	453

Net losses on investments

LVLC	2018 £000	2017 £000
Loss on investments at fair value through income		
- Debt securities	(301)	(63)
Loss on investments	(301)	(63)

Losses on investments reflect market movements.

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:

A M Parsons
J T Perks
R A Rowney – Resigned 1 July 2018
A W Snow – Appointed 1 July 2018

J T Perks resigned on 25 February 2019.

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 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 2018, 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 2018 was £3.29m.

Post Diversification Risk Capital, for the year ended 31 December 2018	2018	2017	Change
Market risk	83%	73%	10%
Operational risk	14%	14%	0%
Underwriting risk	0%	8%	-8%
Credit Counterparty risk	3%	5%	-2%
Total	100%	100%	

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 2018 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:

- Mortality Risk – the risk that individuals die sooner than anticipated compared to under the best estimate assumptions, potentially causing an increase in liabilities.

This risk is managed through ongoing monitoring. Mortality risk is assessed but under current economic conditions it is zero.

C.2.2 Material changes over the reporting period

The underwriting risk over the period has reduced to zero. Expense risk has been totally removed within LVLC in accordance with the fixed-cost expense agreement between LVLC and LVFS.

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.

SCR split of market risk, for the year ended 31 December	2018	2017	Change
Interest rate risk	79%	81%	-2%
Concentration risk	21%	19%	2%
Total	100%	100%	

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 2018.

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 2018.

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		2018		
		IFRS	Adjustments	Solvency II
Assets	Note	£000	£000	£000
Investments (other than assets held for index-linked and unit-linked contracts)	1	15,254	3,682	18,936
Bonds		14,282	3,080	17,362
Collective Investments Undertakings		972	-	972
Deposits other than cash equivalents		-	602	602
Cash and cash equivalents	2	4,731	(3,602)	1,129
Insurance receivables	#	30	-	30
Any other assets, not elsewhere shown	#	137	(80)	57
Total assets		20,152	-	20,152

#= 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 2018:

	QMP	QMPS	AVM	AEM	Total
	£000	£000	£000	£000	£000
Government bonds	14,343	-	-	-	14,343
Corporate bonds	3,003	16	-	-	3,019
Collective Investments Undertakings	972	-	-	-	972
Deposits other than cash equivalents	602	-	-	-	602
Investments (other than assets held for index-linked and unit-linked funds)	18,920	16	-	-	18,936

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	1,129
Short-term bank deposits	3,602
Total cash and cash equivalents - IFRS	4,731
Reclassify short-term deposits into bonds and deposits	(3,602)
Total cash and cash equivalents - Solvency II valuation	1,129

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 2018.

Line of Business	31 December 2018 - £000		
	Best Estimate Liability (BEL)	Risk Margin (RM)	Total Solvency II Technical Provisions
Health insurance	26	0	26
Other life insurance	13,521	48	13,569
Total Life insurance obligations	13,547	48	13,595

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).

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

Expenses are fixed at £2 per month per policy in accordance with the fixed-cost agreement between LVLC and LVFS.

Investment Expenses

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

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 2018 - £000		
	Solvency II Value	IFRS Value	Difference
Health insurance	26	26	0
Other life insurance	13,569	13,566	3
Other – claims liabilities	-	220	(220)
Total Life insurance obligations	13,595	13,812	(217)

As at 31 December 2018, 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.

D.3 Other liabilities

Reconciliation between IFRS and Solvency II value		2018		
		IFRS	Adjustments	Solvency II
Other Liabilities	Note	£000	£000	£000
Insurance and intermediaries payables	1	37	220	257
Payables (trade, not insurance)	#	230	-	230
Any other liabilities, not elsewhere shown	#	31	-	31
Total other liabilities		298	220	518

#= 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	37
Total insurance and intermediaries payables - IFRS	37
Reclassification from technical provisions to insurance and intermediaries payables	220
Total insurance and intermediaries - Solvency II valuation	257

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	37	-	-	-	-	37

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 are 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	5,939	-	-	5,939
Total Basic Own Funds	6,039	-	-	6,039
Total available Own Funds to meet the SCR	6,039	-	-	6,039
Total available Own Funds to meet the MCR	6,039	-		6,039

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

Total available Own Funds to meet the SCR	6,039	-	-	6,039
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	6,039	-	-	6,039

Total available Own Funds to meet the MCR	6,039	-		6,039
Capital restrictions	-	-		-
Total eligible Own Funds to meet the MCR	6,039	-		6,039

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 2018 £000	Movement £000	31 December 2018 £000
Eligible own funds			
Tier 1 capital	5,432	607	6,039
Total capital	5,432	607	6,039
Made up of:			
Equity shares	100	-	100
Reconciliation reserve / surplus	5,332	607	5,939
Total capital	5,432	607	6,039
Total eligible own funds to meet SCR	5,432	607	6,039

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

Ancillary own funds

At 31 December 2018 there were no ancillary own funds.

Deductions from own funds

At 31 December 2018 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	5,939
Total	5,939

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 2018	
	£000	£000
Analysis of Equity - IFRS		
Ordinary shares, allotted and fully paid	100	
Retained Earnings	5,942	
Total Equity - IFRS		6,042
Solvency II Adjustments (excluding reclassifications)		
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2.4)		217
<u>Other liabilities</u>		
- Increase in payables (Section D.3)		(220)
Total Equity – Solvency II basis		6,039
Total own funds - Solvency II basis		6,039
Excess of Assets over Liabilities - Solvency II basis		
Total Assets		20,152
Total Technical Provisions		(13,595)
Total Other Liabilities		(518)
Excess of Assets over Liabilities – Solvency II basis		6,039

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	2018	2017
Solvency Capital Requirement (SCR)	419	459
Minimum Capital Requirement (MCR)	3,288	3,251

There has been no material change in the SCR during 2018. There has been a small increase in the Absolute Minimum Capital Requirement during 2018 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 2018 - all figures in £000

Category	Specific Risk	Post Diversified Capital Requirement
Credit Counterparty Risk		11
	Interest	276
	Concentration	71
Market Risk		347
	Mortality	-
Underwriting Risk		-
Liquidity Risk		-
Operational Risk		61
SCR		419

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 details of the supervisory authority responsible for financial supervision.

Firm's reference number: 611223

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

For the contact details of the PRA and the FCA 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 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.

LVPL underwrites non-life insurance contracts within the UK.

LVPL's main purpose is to underwrite unemployment insurance as part of a combined policy offered by LVFS.

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

- Miscellaneous financial loss insurance

The Company closed to new business sales in 2017 and continues to service existing policyholders.

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

Changes of Directors during 2018 were as follows:

R A Rowney – resigned 1 July 2018
A W Snow – appointed 1 July 2018

J T Perks resigned on 25 February 2019.

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 2018, 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:

	2018	2017
	£000	£000
Net earned premiums	247	235
Net claims incurred including changes in other technical provisions	(61)	(310)
Expenses incurred (excluding investment management expenses)	(47)	(212)
Net total	139	(287)

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 2018 LV Protection Limited (LVPL) experienced a reduced loss ratio due to a combination of improved claims experience and a one off credit to acquisition expenses reflecting amounts due from LVFS in relation to commission costs for certain historic cancelled policies.

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)	2018	2017
Income from investments and cash and cash equivalents		
- Dividend income	21	9
Total Investment Performance	21	9

Other than a small cash balance of £10k (2017: £10k), LVPL maintains an OEIC (Institutional Sterling Liquid Fund) with Blackrock of £3,827k (2017: £3,558k). All investment income received relates to dividends paid by the OEIC.

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:

A M Parsons
J T Perks
R A Rowney – resigned 1 July 2018
A W Snow – appointed 1 July 2018

J T Perks resigned on 25 February 2019.

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 and catastrophe 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 2018. This is primarily due to the declining volume of in-force business following the closure of the entity to new business in 2017.

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 £0.4m.

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		2018		
		IFRS	Adjustments	Solvency II
Assets	Note	£000	£000	£000
Deferred acquisition costs	1	294	(294)	-
Investments (other than assets held for index-linked and unit-linked contracts)	2	3,827	-	3,827
Reinsurance recoverables	3	286	(286)	-
Loans and Receivables	#	34	-	34
Insurance and intermediaries receivables	4	867	(867)	-
Cash and cash equivalents	#	10	-	10
Total assets		5,318	(1,447)	3,871

#= 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 2018.

	QMP	QMPS	AVM	AEM	Total
	£000	£000	£000	£000	£000
Collective Investments Undertakings	3,827	-	-	-	3,827
Investments (other than assets held for index-linked and unit-linked funds)	3,827	-	-	-	3,827

3. 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.

	£000
Reinsurers' share of provision for unearned premiums	280
Reinsurers' share of claims liabilities	6
Total Reinsurance Recoverables - IFRS	286
Best estimate liability adjustments	(286)
Total reinsurance recoverables - Solvency II valuation	-

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	867
Total Insurance and intermediaries receivables - IFRS	867
Best estimate liability adjustments	(867)
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 2018.

Line of Business	31 December 2018 - £000		
	Best Estimate Liability (BEL)	Risk Margin (RM)	Total Solvency II Technical Provisions
Other Non-Life	(405)	249	(156)
Total Non-Life insurance obligations	(405)	249	(156)

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. The inflation assumption only applies to premiums and benefits on index-linked policies.

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 accordance with the fixed cost agreement between LVPL and LVFS.

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 2018 - £000		
	Solvency II Value	IFRS Value	Difference
Other Non-Life	(156)	893	1,049
Total Non-Life insurance obligations	(156)	893	1,049

As at 31 December 2018, 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		2018		
		IFRS	Adjustments	Solvency II
Other Liabilities	Note	£000	£000	£000
Reinsurance payables	1	280	(280)	-
Payables (trade, not insurance)	#	7	-	7
Current tax liability	#	31	-	31
Total other liabilities		318	(280)	38

#= 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 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	£000
Due to reinsurers	280
Total Reinsurance payables - IFRS	280
Reinsurance payables reclassified to technical provisions	(280)
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	280	-	-	-	-	280

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 are 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
Reconciliation reserve	2,989	-	-	2,989
Total Basic Own Funds	3,989	-	-	3,989
Total available Own Funds to meet the SCR	3,989	-	-	3,989
Total available Own Funds to meet the MCR	3,989	-	-	3,989

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

Total available Own Funds to meet the SCR	3,989	-	-	3,989
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	3,989	-	-	3,989

Total available Own Funds to meet the MCR	3,989	-	-	3,989
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the MCR	3,989	-	-	3,989

The basic Own Funds structure for LVPL is a combination of ordinary share capital and the reconciliation reserve which are both classified as Tier 1.

The capital reserve of £4m in LVPL has been classified as reconciliation reserve (Tier 1). 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 2018 £000	Movement £000	31 December 2018 £000
Eligible own funds			
Tier 1 capital	3,865	124	3,989
Total capital	3,865	124	3,989
Made up of:			
Equity shares	1,000	-	1,000
Reconciliation reserve / surplus	2,865	124	2,989
Total capital	3,865	124	3,989
Total eligible own funds to meet SCR	3,865	124	3,989

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

Ancillary own funds

At 31 December 2018 there were no ancillary own funds.

Deductions from own funds

At 31 December 2018 there were no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Capital reserve	4,000
Retained loss on a Solvency II basis	(1,011)
Total	2,989

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 2018	
	£000	£000
Analysis of Equity - IFRS		
Ordinary shares, allotted and fully paid	1,000	
Capital reserves	4,000	
Retained losses	(893)	
Total Equity - IFRS		4,107
Solvency II Adjustments (excluding reclassifications)		
<u>Assets</u>		
- Reduction in valuation of DAC (Section D.1 note 1)	(294)	
- Reduction in valuation of reinsurance recoverable (Section D.1 note 3)	(286)	
- Reduction in valuation of insurance and intermediaries recoverable (Section D.1 note 4)	(867)	
		(1,447)
<u>Technical provisions</u>		
- Decrease in valuation of technical provisions (Section D.2.4)		1,049
<u>Other liabilities</u>		
- Decrease in payables		280
Total Equity - Solvency II basis		3,989
Total own funds - Solvency II basis		3,989
Excess of Assets over Liabilities - Solvency II basis		
Total Assets		3,871
Total Technical Provisions		156
Total Other Liabilities		(38)
Excess of Assets over Liabilities - Solvency II basis		3,989

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	2018	2017
Solvency Capital Requirement (SCR)	828	887
Minimum Capital Requirement (MCR)	2,222	2,196

The SCR decreased by £59k during 2018 largely due to the decrease in the volume of business in-force following 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 increased by £26k during 2018 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 2018 – all figures in £000:

Category	Specific Risk	Post Diversified Capital Requirement
Credit Counterparty Risk		3
	Interest	1
	Spread	2
	Concentration	322
Market Risk		325
	Premium and Reserve	398
	Lapse	51
	Catastrophe	41
Non-Life Underwriting Risk		490
Liquidity Risk		-
Operational Risk		10
SCR		828

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 details of the supervisory authority responsible for financial supervision.

Firm's reference number: 202965

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

For the contact details of the PRA and the FCA 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 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.

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 ceased 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

Following on from the sale of its Commercial broker lines renewal rights to Allianz Insurance plc, (28 December 2017), LVIC ceased to write Commercial broker new business during 2018. This was 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.

Solvency and Financial Condition

The capital surplus as at 31 December 2018 under the Standard Formula stood at £234m (2017: £221m) with capital cover of 162% (2017: 156%).

Business and Performance

LVIC reported a profit before tax for the year of £85m (2017: £172m) including the discontinued commercial lines of business, which generated a loss of £18m (2017: £25m profit).

Net earned premium has fallen by 3.5% mainly driven by the transfer of the commercial lines of business to Allianz Insurance plc. Net claims have fallen 2.5% assisted by favourable experience in prior accident years.

LVIC P&L (£m)	2018	2017
Net earned premium	919	952
Net claims incurred	(612)	(628)
Expenses incurred	(282)	(292)
Net underwriting result	25	32
Net investment income	6	63
Other	54	77
Profit before tax	85	172
Tax	(14)	(22)
Profit after tax	71	150
Other comprehensive Income	(8)	-
Tax on Other Comprehensive Income	1	-
Total comprehensive income	64	150

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:

B Smith – Appointed 01 November 2018

A.2 Underwriting performance

All business is underwritten in the UK and the following provides an analysis of the underwriting income and expenses for 2018 in addition to a comparative for 2017.

LVIC - 2018 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	475	187	154	25	23	50	5	919
Net claims incurred	(313)	(124)	(128)	(17)	(2)	(25)	(3)	(612)
Expenses incurred (excluding investment management expenses)	(140)	(55)	(61)	(12)	(3)	(10)	(1)	(282)
Underwriting result	22	8	(35)	(4)	18	15	1	25

Claims Ratio	65.9%	66.3%	83.1%	68.0%	8.7%	50.0%	60.0%	66.6%
Expense Ratio	29.4%	29.4%	39.6%	48.0%	13.0%	20.0%	20.0%	30.6%
Combined Ratio	95.3%	95.7%	122.7%	116.0%	21.2%	70.0%	80.0%	97.3%

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 - 2018 versus 2017 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	(19)	14	(30)	(1)	-	2	1	(33)
Net claims incurred	33	(3)	(11)	(4)	(1)	2	-	16
Expenses incurred (excluding investment management expenses)	1	(5)	14	-	-	-	-	10
Underwriting result	15	6	(27)	(5)	(1)	4	1	(7)

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 which was also affected by relatively high claims inflation. The Civil Liability Act received Royal Assent in December 2018 which will result in a new Ogden rate in 2019 with the best estimate reflecting an assumed future rate of 0% compared to the -0.75% previously held. LVIC's underwriting result deteriorated during 2018, delivering a combined ratio of 97.3% (2017: 96.7%). This was due to a severe weather event experienced in March, with the "Beast from the East" impacting mainly our Home customers but also our Motor customers followed by a significant increase in subsidence frequency, due to the warm summer weather. These two events had an impact on the current accident year, which performed adversely against expectation. The impact of these was mitigated by favourable prior year experience, predominantly from medium and large personal injury claims due to both favourable claim settlements, which had been reserved in line with the -0.75% Ogden Discount Rate and further reductions in case estimates on open claims.

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:

	2018	2017
	£m	£m
Dividend income	12	56
Interest income	33	32
Realised and unrealised losses	(37)	(23)
Investment expenses	(2)	(2)
Total Investment Performance	6	63

The continued low underlying interest rate market resulted in low income returns. Dividend income decreased in 2018 mainly due to dividends received from participations of £8m (2017: £50m) being lower.

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

2018 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2018	Average investment return
Government bonds	-	5.4	(7.5)	(2.1)	282.8	(0.7)%
Corporate bonds	-	26.0	(22.6)	3.4	901.8	0.4%
Equity	10.3	-	(6.3)	4.0	277.0	1.4%
Collective investment undertakings	1.6	-	-	1.6	149.9	1.1%
Cash and deposits	-	0.1	-	0.1	46.8	0.2%
Put Options/Swaps/Futures /Forwards	-	0.8	(0.1)	0.7	N/A	N/A
Total	11.9	32.3	(36.5)	7.7		
Less investment expenses				(2.2)		
Net total				5.5		

Liverpool Victoria Friendly Society Limited – Single Group SFCR (LVIC Solo)
Year Ended 31 December 2018

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		

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:

	2018	2017
	£m	£m
Other income	54	77
Tax charge	(14)	(22)
Total	40	55

Other Income includes £27m (2017: £32m) of 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 £12m (2017: £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.

Other Income for 2017 saw a net gain on the sale of the commercial lines renewal rights to Allianz Insurance plc on 28 December of £31m.

The tax charge is calculated based on the IFRS profits and losses reflecting the underwriting performance, investment performance and tax deductible movements on intangible assets. In addition deferred tax is recognised on timing differences relating to capital allowances in excess of depreciation and any tax losses carried forward. A deferred tax liability in relation to Intangible Assets exists where the IFRS accounts value is greater than the tax written down value. Offset against this deferred tax liability is the deferred tax asset relating to capital allowances in excess of depreciation. Deferred tax assets and liabilities can be offset where there is a legal right of offset when the taxes involved are levied by the same taxation authority, as is the case here.

Where a tax loss arises, 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:

D Barral	R Rowney
A Cook	S Treloar
J Dye	K Wenzel
R Hudson	B Smith – Appointed 01 November 2018
D Neave	

C. Risk Profile (LVIC)

C.1 Overview

C.1.1 Overview of risk exposures

The chart below shows the year-end 2018 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposure, 74% of the SCR, relates to Premium and Reserve Risk followed by Operational Risk with 9% and Catastrophe Risk with 6%. The equity risk includes the holding (and associated risk) of the Highway Insurance Company (HICO) subsidiary.

Post diversification risk capital	2018	2017	Change
Premium and Reserve risk	74%	73%	1%
Operational risk	9%	9%	0%
Catastrophe risk	6%	7%	-1%
Equity risk	5%	4%	1%
Counterparty Default risk	3%	4%	-1%
Spread risk	3%	3%	0%
Total	100%	100%	

The breakdown of risk exposures is broadly in line with that seen at year-end 2017. There have been no material changes that impact the allocation of capital down to risk.

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 business which is exposed to natural catastrophe events, primarily floods and windstorms. The risk of catastrophe losses is heavily mitigated by the use of a Catastrophe Excess of Loss reinsurance programme.

Lapse Risk is modelled explicitly within the Standard Formula and is the risk that profitable policies lapse over the one-year time horizon. Lapse risk is immaterial at less than 0.01%

Underwriting risk	2018	2017	Change
Premium and Reserve risk	93%	92%	1%
Catastrophe risk	7%	8%	-1%
Total	100%	100%	

C.2.2 Material changes over the reporting period

All risks within underwriting risk have remained stable over the year. Previously, Lapse risk was not allocated based on materiality – the approach this year, which includes an allocation to Lapse Risk, shows the small materiality of the risk.

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 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 property lines, reduces catastrophe risk.

In addition, LV= entered into a Loss Portfolio Transfer and Whole Account Quota Share programme at the end of 2015. The Quota Share programme was renewed at the end of 2018 at a similar level of cover, keeping the capital benefit stable.

C.3 Market risk

C.3.1 Market risk exposure

This is described within the main LVFS Group SFCR in section C.3.1.

Within Market Risk the key exposure is to Equity Risk which comprises 65% of the SCR post-diversification. This is due to the strategic equity holding of the Highway Insurance Company (HICO) subsidiary which dominates the risk. Spread Risk is the next largest exposure at 30%, with LVIC having a relatively large exposure to corporate bonds.

Market risk	2018	2017	Change
Equity risk	65%	60%	5%
Spread risk	30%	35%	-5%
Interest Rate risk	5%	4%	1%
Concentration risk	0%	1%	-1%
Total	100%	100%	

C.3.2 Material changes over the reporting period

The largest movement is within equity risk, where the HICO own funds have increased over the year, pushing up its contribution to overall market risk. As a result, the contribution of spread risk has reduced.

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 the initial 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

These risks are described further in the LVFS Group SFCR, Section C.5, C.6 and C.7.

C.6 Sensitivities

As Premium, Reserve and Catastrophe risk are the most material insurance risks within the Standard Formula, we show sensitivities for these. The table below shows the impact on the SCR of both increases and decreases.

Sensitivities		Impact on SCR	
Item	Size	£m	%
Baseline SCR		380	
Premium Risk	10% increase to next year premium	14	3.6%
Premium Risk	10% decrease to next year premium	-5	-1.3%
Reserve Risk	10% increase to overall claim provision	15	3.9%
Reserve Risk	10% decrease to overall claim provision	-15	-3.9%
Catastrophe Risk	10% increase to the 1-in-200 gross loss	13	3.4%
Catastrophe Risk	10% decrease to the 1-in-200 gross loss	-0	-0.0%

For premium risk, an increase (or decrease) to the next year of premium was considered. This could be caused as a result of the impact of a change in anticipated premium rates or volumes. The impact is not symmetrical; the impact of reduction in premium is reduced as a result of the standard formula methodology, which looks at the higher of the coming year and previous year's premium.

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 impact here is symmetrical, as anticipated.

The catastrophe reinsurance programme is designed to absorb the Standard Formula gross 1 in 200 loss stresses. A further increase to the gross losses of 10% would exhaust some of the mid-layers resulting in a material increase to the SCR. However, this is considered unlikely given that the main contributors to Catastrophe Risk are in run-off. The reduction in catastrophe risk is not material, given that the losses are already heavily mitigated by the reinsurance programme.

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		2018			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Goodwill	1	16	-	(16)	-
Deferred acquisition costs	2	56	-	(56)	-
Intangible assets	#	1	-	(1)	-
Deferred tax assets	3	-	-	6	6
Investments					
- Participations	4	332	-	(93)	239
- Equities	5	52	-	-	52
- Bonds	5	898	231	-	1,129
- Collective Investment Undertakings	5	156	-	-	156
- Deposits other than cash equivalents	5	89	(66)	-	23
Reinsurance recoverables	6	299	-	4	303
Insurance and intermediaries receivables	7	190	-	(190)	-
Reinsurance receivables	8	30	-	(30)	-
Receivables (trade, not insurance)	#	106	-	-	106
Cash and cash equivalents	9	193	(151)	-	42
Any other assets, not elsewhere shown	10	28	(14)	-	14
Total Assets		2,446	-	(376)	2,070

#= 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, technical provisions, reinsurance recoveries and trade payables.

As at 31 December 2018 there were total Solvency II taxable losses of £39m with a consequent £6m taxation impact. The recoverability of the deferred tax asset due to the losses arising from a move to Solvency II has been justified based on future profits per the 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 profit projections utilised ensure that profits cannot be inadvertently counted twice. The reversal of the risk margin is not included in the profit projections.

Recoverability of the deferred tax asset arising from the total taxable loss of £39m has been justified based on the Board approved business plans for the period to 2019. The DTA established over this period is based on the announced Corporation Tax rate, as follows.

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2019	39	19.00%	6
Total	39		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	332
Investments in group undertakings - IFRS	332
Adjusted equity method valuation differences	(93)
Participations - Solvency II valuation	239

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 classified as either fair value through income or available for sale (AFS).

Available for sale investments include listed and unlisted debt securities and are investments intended to be held for an indefinite period of time, that may be sold in response to liquidity or changes in interest rates, exchange rates or market movements.

AFS investments are initially recognised at fair value plus directly related transaction costs. They are subsequently carried at fair value. Impairment losses and exchange differences resulting from translating the amortised cost of foreign currency monetary AFS financial assets are recognised in the Statement of Comprehensive Income, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS financial assets are reported in a separate component of shareholders' equity (AFS reserve) until disposal. When securities classified as AFS are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the Statement of Comprehensive Income as 'net realised gains and losses'

Fair value through income has two sub categories:

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

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

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 2018.

	QMP	QMPS	AVM	AEM	Total
	£m	£m	£m	£m	£m
Holdings in related undertakings, including participations	-	-	-	239	239
Equities	51	-	1	-	52
Bonds	507	622	-	-	1,129
Collective Investments Undertakings	156	-	-	-	156
Deposits other than cash equivalents	23	-	-	-	23
Investments	737	622	1	239	1,599

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	15
Reinsurers' share of claims liabilities	284
Total Reinsurance recoverables – IFRS	299
Best estimate liability adjustments	4
Total Reinsurance recoverables – Solvency II valuation	303

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	171
Due from agents, brokers and intermediaries	19
Total Insurance and intermediaries receivables - IFRS	190
Best estimate liability adjustments	(190)
Total Insurance and intermediaries receivables - Solvency II valuation	-

8. Reinsurance receivables

For Solvency II valuation purposes, reinsurance receivables are included within the Best Estimate Liability (BEL) calculations.

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

	£m
Due from reinsurers	30
Total Reinsurance receivables - IFRS	30
Reinsurance payables included in BEL calculations	(30)
Total Reinsurance payables - Solvency II valuation	-

9. 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	42
Short-term bank deposits	151
Total Cash and cash equivalents - IFRS	193
Reclassify short-term deposits into bonds	(151)
Total Cash and cash equivalents - Solvency II valuation	42

10. 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	14
Other prepayments and accrued income	14
Prepayments and accrued income - IFRS	28
Reclassify accrued interest on bonds to Investments	(14)
Total Any other assets, not elsewhere shown - Solvency II valuation	14

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 2018:

LVIC Entity (£m)	Total	Motor Liability	Motor Other	Property Damage	General Liability	Legal Expenses	Assistance	Medical Expenses	Life excl Health
Gross Claims Provision	1,014	852	(38)	98	53	2	2	1	44
Gross Premium Provision	293	147	89	46	4	(3)	8	2	-
Gross Best Estimate Liability	1,307	999	51	144	57	(1)	10	3	44
Risk Margin	47	37	1	4	2	-	-	-	3
Gross Technical Provisions	1,354	1,036	52	148	59	(1)	10	3	47

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 can be 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. 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 settlement structure is 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 methodology employed across all large claims allows for the best estimate Ogden Discount Rate following Royal Assent of the Civil Liability Bill.

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 Actuarial Best Estimate (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.

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.

Events not in Data allowance (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, weather events and Brexit. 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 2018, the Solvency II value of gross technical provisions was £1,354m and the IFRS value of gross insurance contract liabilities was £1,569m.

Recoverables from reinsurance contracts and special purpose vehicles

The business enters into a number of reinsurance contracts. This includes an excess of loss arrangement to cover liability-related exposure with a retention set in line with risk appetite and catastrophe cover in order to limit the Company's exposure to such events.

At the 2015 year-end the Company entered into a General Insurance portfolio-wide Loss Portfolio Transfer arrangement for accident years 2015 and prior inclusive. Quota share arrangements have also been implemented with effective date of 1 January 2016, covering each of the calendar years to 31 December 2019.

At present, there are no special purpose vehicles in place for 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.

D.3 Other liabilities

Reconciliation between IFRS and Solvency II valuation	2018				
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Insurance and intermediaries payables	#	1	-	-	1
Reinsurance payables	1	18	-	(18)	-
Payables (trade, not insurance)	2	113	-	(20)	93
Other liabilities	#	8	-	-	8
Total Other Liabilities		140	-	(38)	102

#- 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 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.

	£m
Due to reinsurers	18
Total Reinsurance payables - IFRS	18
Reinsurance payables reclassified to technical provisions	(18)
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	18	-	-	-	-	18

2. Payables (trade, not insurance)

For Solvency II valuation purposes, trade payables are initially valued consistently with IFRS and then adjusted to remove the Motor Insurance Bureau (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.

	£m
Payables (trade, not insurance)	
Amounts owed to group undertakings	24
Other taxes and social security costs	31
Other payables	36
Accruals and deferred income	22
Total Payables (trade, not insurance) - IFRS	113
Reclassification of payables to technical provisions	(20)
Total Payables (trade, not insurance) - Solvency II valuation	93

D.4 Alternative methods for valuation

Information is provided for material assets and liabilities valued using alternative methods.

Justification for using alternative methods

The Company 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 Company 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 of £303m; 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 £106m and Any other assets, not elsewhere shown of £14m 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 £1,354m; 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) £93m; 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
Reconciliation reserve	223	-	-	223
Deferred tax assets	-	-	6	6
Total Basic Own Funds	608	-	6	614

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

Total available Own Funds to meet the SCR	608	-	6	614
Total eligible Own Funds to meet the SCR	608	-	6	614

Total available Own Funds to meet the MCR	608	-	6	608
Total eligible Own Funds to meet the MCR	608	-	6	608

Tier 1 consists of Ordinary Shares of £385m (2017: £385m) and the reconciliation reserve, including capital reserves of £3m (2017: £67m), which carries no requirement for LVIC to repay.

Tier 3 relates to deferred tax assets of £6m.

A dividend of £64.5m (£0.1675 per share) (2017: £70.1m (£0.18212 per share)) was declared by the Directors during 2018 and remitted to the parent company in June 2018.

Analysis of significant changes in own funds during the reporting period

	LVIC		
	1 January 2018 £m	Movement £m	31 December 2018 £m
Eligible own funds			
Tier 1 capital	607	1	608
Tier 3 capital	6	-	6
Total capital	613	1	614
Made up of:			
Equity shares	385	-	385
Deferred tax	6	-	6
Reconciliation reserve / surplus	222	1	223
Total capital	613	1	614
Total eligible own funds to meet SCR	613	1	614

Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax. The increase of £1m arose whereby the profits of £65m were offset by the obligatory dividend payment of £64m to the parent companies based on IFRS completion accounts.

Tier 3 capital represents the deferred tax asset.

Ancillary own funds

At 31 December 2018 there were no ancillary own funds.

Deductions from own funds

At 31 December 2018 there were no deductions from own funds.

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Capital reserve	3
Retained earnings on a Solvency II basis	220
Total	223

LVIC has not applied loss absorbency mechanisms as at the end of 2018.

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	3
Available for Sale Reserves	(7)
Retained Earnings	356
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)	(56)
- Reduction in valuation of intangibles	(1)
- Reduction in participations	(93)
- Increase in valuation of reinsurance recoverables (Section D.1 note 6)	4
- Reduction in valuation of insurance and intermediaries recoverables (Section D.1 note 7)	(190)
- Reinsurance Receivables	(30)
- Deferred Tax Assets	6
	(376)
<u>Technical provisions</u>	
- Increase in valuation of technical provisions	215
<u>Other liabilities</u>	
- Reduction in payables	38
	(123)
Total Equity - Solvency II basis	614
Total own funds - Solvency II basis	614
Excess of Assets over Liabilities - Solvency II basis	
Total Assets	2,070
Total Technical Provisions	(1,354)
Total Other Liabilities	(102)
Excess of Assets over Liabilities - Solvency II basis	614

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.

	2018	2017
LVIC SCR (£m)	380	392
LVIC MCR (£m)	163	173

The LVIC SCR decreased by £12m over the reporting period, driven by the reduction in claims provision over that period.

The Minimum Capital Requirement (MCR) as at 31 December 2018 was £163m. 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.

LVIC £m	2018	2017
Market risk	77	72
Counterparty default risk	23	24
Life underwriting risk	2	2
Health underwriting risk	1	1
Non-life underwriting risk	334	351
Diversification	(64)	(62)
Basic solvency capital requirement	373	388
Operational risk	38	40
Loss-absorbing capacity of deferred taxes	(31)	(36)
Solvency capital requirement	380	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 details of the supervisory authority responsible for financial supervision.

Firm's reference number: 202972

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

For the contact details of the PRA and the FCA 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.

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 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.

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 ceased 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

Following on from the sale of its Commercial broker lines renewal rights to Allianz Insurance plc, (28 December 2017), Highway ceased to write Commercial broker new business during 2018. This was 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.

As part of the same transaction, Highway acquired from Allianz Insurance plc the renewal rights to the Allianz Insurance plc personal lines business.

Solvency and Financial Condition

The capital surplus as at 31 December 2018 under the Standard Formula stood at £72m (2017: £64m) with capital cover of 143% (2017: 143%).

Business and Performance

HICO reported a profit before tax for the year of £5m (2017: £33m profit) including the discontinued commercial lines of business, which generated a loss before tax of £15m (2017: £17m profit).

Net earned premium has increased by 7% mainly driven by the transfer of the personal lines business from Allianz Insurance plc.

Highway P&L (£m)	2018	2017
Net earned premiums	309	288
Net claims incurred	(211)	(191)
Expenses incurred	(94)	(92)
Net underwriting result	4	5
Net investment income	(2)	7
Other	3	21
Profit before tax	5	33
Tax	(1)	(6)
Profit after tax	4	27
Other comprehensive Income	(4)	-
Tax on Other Comprehensive Income	1	-
Total comprehensive income	1	27

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:

B Smith – Appointed 01 November 2018

A.2 Underwriting performance

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

2018	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	233	64	11	1		309
Net claims incurred	(159)	(44)	(7)	(1)		(211)
Expenses incurred (excluding investment management expenses)	(71)	(19)	(4)	-	-	(94)
Underwriting result	3	1	-	-	-	4
Claims ratio	68.2%	68.8%	63.6%	100.0%		68.3%
Expense ratio	30.4%	29.7%	36.4%	-		30.4%
Combined ratio	98.7%	98.4%	100.0%	100.0%		98.7%

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)
Underwriting result	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%

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 which was also affected by relatively high claims inflation. The Civil Liability Act received Royal Assent in December 2018 which will result in a new Ogden rate in 2019 with the best estimate reflecting an assumed future rate of 0% compared to the -0.75% previously held. Highway's underwriting result fell slightly during 2018, delivering a combined ratio of 98.7% (2017: 98.2%). The Company experienced a severe weather event at the start of 2018, together with higher than expected vehicle repair costs over the course of the year, although these were offset by favourable claims experience in prior years.

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:

	2018	2017
	£m	£m
Dividend income	1	2
Interest income	15	16
Realised and unrealised losses	(17)	(10)
Investment expenses	(1)	(1)
Total Investment Performance	(2)	7

The continued low underlying interest rate market resulted in low income returns.
Investment returns by asset class for 2018 and 2017 are detailed below:

2018 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / (losses)	Total	Average investment holding during 2018	Average investment return
Government bonds	-	2.4	(3.7)	(1.3)	117.2	(1.1)%
Corporate bonds	-	12.6	(10.8)	1.8	434.3	0.4%
Equity	1.1	-	(2.7)	(1.6)	25.9	(6.2)%
Collective investment undertakings	0.2	-	0.2	0.4	94.7	0.4%
Cash and deposits	-	-	0.1	0.1	41.3	0.2%
Put options/Swaps/Futures/ Forwards	-	0.3	(0.1)	0.2	N/A	N/A
Total	1.3	15.3	(17.0)	(0.4)		
Less investment expenses				(1.1)		
Net total				(1.5)		

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		

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:

	2018	2017
	£m	£m
Other income	3.9	21.4
Subordinated debt charge	(0.4)	(0.4)
Other expenses	(0.2)	(0.0)
Tax charge	(0.1)	(5.8)
Total Other	3.2	15.2

Other income is predominantly made up of £3.4m relating 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.

Other Income for 2017 saw a net gain on the sale of the commercial lines renewal rights to Allianz Insurance plc on 28 December of £20.8m.

Highway issued subordinated debt of Eur12m in December 2004 and this has an original maturity date of November 2034. Accordingly, the 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	J Dye
S Treloar	R Hudson
D Neave	K Wenzel
D Barral	B Smith – Appointed 1 November 2018
A Cook	

C. Risk Profile (Highway)

C.1 Overview

C.1.1 Overview of risk exposures

The chart below shows the year-end 2018 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposure, 82% of the SCR, relates to Premium and Reserve Risk followed by Operational Risk with 11%.

Post diversification risk capital	2018	2017	Change
Premium and Reserve risk	82%	81%	1%
Operational risk	11%	11%	0%
Counterparty Default risk	3%	4%	-1%
Spread risk	3%	2%	1%
Catastrophe risk	1%	1%	0%
Other	0%	1%	-1%
Total	100%	100%	

The breakdown of risk exposures is broadly in line with that seen at year-end 2017. There have been no material changes that impact the allocation of capital down to risk. 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 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.

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.

Underwriting risk	2018	2017	Change
Premium and Reserve risk	99%	99%	0%
Catastrophe risk	1%	1%	0%
Lapse Risk	0%	0%	0%
Total	100%	100%	

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

All risks within underwriting risk have remained stable over the year.

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 lines to limit the impact of individual losses. The current programme protects HICO within Premium Risk while the historic programmes protect losses occurring within Reserve Risk.
- Catastrophe reinsurance, which covers total losses stemming from an event across property lines, reduces catastrophe risk.

In addition, LV= entered into a Loss Portfolio Transfer and Whole Account Quota Share programme at the end of 2015. The Quota Share programme was renewed at the end of 2018 at a similar level of cover, keeping the capital benefit stable.

C.3 Market risk

C.3.1 Market risk exposure

This is described within the main LVFS Group SFCR in section C.3.1.

Within Market Risk the key exposure is to Spread Risk which comprises 84% of the SCR post-diversification. Interest rate is the other large risk for HICO with 16% of the diversified Market Risk.

Market risk	2018	2017	Change
Spread risk	84%	68%	16%
Interest Rate risk	16%	19%	-3%
Concentration risk	0%	8%	-8%
Equity risk	0%	4%	-4%
Currency Risk	0%	1%	-1%
Total	100%	100%	

C.3.2 Material changes over the reporting period

The main change over the year is the reduction in equity risk (due to the effectiveness of the hedge in place) and concentration risk (where the sale of Cash Repos has reduced exposure in this area).

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 HICO entity level.

C.4 Credit counterparty risk

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

HICO's largest counterparty exposure is to a single AA-rated reinsurer following the initial 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 HICO'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.

C.6 Sensitivities

As Premium, Reserve and Catastrophe risk are the most material insurance risks within the Standard Formula, we show sensitivities for these. The table below shows the impact on the SCR of both increases and decreases.

Sensitivities		Impact on SCR	
Item	Size	£m	%
Baseline SCR		167	
Premium Risk	10% increase to next year premium	6	3.6%
Premium Risk	10% decrease to next year premium	-5	-3.0%
Reserve Risk	10% increase to overall claim provision	7	4.2%
Reserve Risk	10% decrease to overall claim provision	-7	-4.2%
Catastrophe Risk	25% increase to the 1-in-200 gross loss	0	0.0%
Catastrophe Risk	25% decrease to the 1-in-200 gross loss	0	-0.0%

For premium risk, an increase (or decrease) to the next year of premium was considered. This could be caused as a result of the impact of a change in anticipated premium rates or volumes. The impact is not symmetrical; the impact of reduction in premium is reduced as a result of the standard formula methodology, which looks at the higher of the coming year and previous year's premium.

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 impact here is symmetrical, as anticipated.

The catastrophe reinsurance programme is designed to absorb the Standard Formula gross 1 in 200 loss stresses. This, along with the small materiality of Catastrophe risk for HICO, results in a small amount of sensitivity.

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		2018			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Deferred acquisition costs	1	29	-	(29)	-
Intangible Assets	#	1	-	(1)	-
Deferred tax assets	2	1	-	4	5
Investments (other than assets held for index-linked and unit-linked funds)					
- Equities	3	25	-	-	25
- Bonds	3	365	145	-	510
- Collective Investment undertakings	3	162	-	-	162
- Deposits other than cash equivalents	3	54	(34)	-	20
Reinsurance recoverables	4	191	-	38	229
Insurance and intermediaries receivables	5	36	-	(36)	-
Reinsurance receivables	#	9	-	(9)	-
Receivables (trade, not insurance)	#	9	-	-	9
Cash and cash equivalents	6	127	(105)	-	22
Any other assets, not elsewhere shown	7	8	(6)	-	2
Total Assets		1,017	-	(33)	984

#- 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	1
Solvency II Valuation Adjustment	4
Deferred tax assets - Solvency II valuation	5

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 deferred acquisition costs, technical provisions, reinsurance recoveries, trade payables and subordinated debt.

As at 31 December 2018 there were total Solvency II taxable losses of £24m, with a consequent £5m taxation impact. The recoverability of the deferred tax asset due to the losses arising from a move to Solvency II has been justified based on future profits per the 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 profit projections utilised ensure that profits cannot be inadvertently counted twice. The reversal of the risk margin is not included in the profit projections.

Recoverability of the deferred tax asset (DTA) arising from the total taxable loss of £24m has been justified based on the Board approved business plans over the period 2019 to 2020. The DTA established over this period is based on the announced Corporation Tax rates, as follows.

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2019	13	19.00%	3
2020	11	17.50%	2
Total	24		5

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 classified as either fair value through income or available for sale.

Available for sale investments include listed and unlisted debt securities and are investments intended to be held for an indefinite period of time, that may be sold in response to liquidity or changes in interest rates, exchange rates or market movements.

AFS investments are initially recognised at fair value plus directly related transaction costs. They are subsequently carried at fair value. Impairment losses and exchange differences resulting from translating the amortised cost of foreign currency monetary AFS financial assets are recognised in the Statement of Comprehensive Income, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS financial assets are reported in a separate component of shareholders' equity (AFS reserve) until disposal. When securities classified as AFS are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the Statement of Comprehensive Income as 'net realised gains and losses'.

Fair value through income has two sub categories:

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

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

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 2018.

	QMP	QMPS	Total
	£m	£m	£m
Bonds	228	282	510
Equities	25	-	25
Collective Investments Undertakings	162	-	162
Deposits other than cash equivalents	20	-	20
Investments	435	282	717

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 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 claims liabilities	191
Total Reinsurance recoverables - IFRS	191
Best estimate liability adjustments	38
Total Reinsurance recoverables – Solvency II valuation	229

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	36
Total Insurance and intermediaries receivables - IFRS	36
Best estimate liability adjustments	(36)
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	22
Short-term bank deposits	105
Total Cash and cash equivalents - IFRS	127
Reclassify short-term deposits into bonds	(105)
Total Cash and cash equivalents - Solvency II valuation	22

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	2
Prepayments and accrued income - IFRS	8
Reclassify accrued interest on bonds to Investments	(6)
Total Any other assets, not elsewhere shown - Solvency II valuation	2

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 2018:

HICO Entity (£m)	Total	Motor Liability	Motor Other	Property Damage	General Liability	Life excl Health
Gross Claims Provision	561	441	1	4	1	114
Gross Premium Provision	128	80	44	4	-	-
Gross Best Estimate Liability	689	521	45	8	1	114
Risk Margin	23	18	1	-	-	4
Gross Technical Provisions	712	539	46	8	1	118

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 methodology employed across all large claims allows for the best estimate Ogden Discount Rate following Royal Assent of the Civil Liability Bill.

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 Actuarial Best Estimate (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 simplification, as permissible by the Solvency II regulations.

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.

Events not in Data allowance (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, weather events and Brexit. 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 2018, the Solvency II value of gross technical provisions was £712m and the IFRS value of gross insurance contract liabilities was £715m.

Recoverables from reinsurance contracts and special purpose vehicles

The business enters into a number of reinsurance contracts. This includes an excess of loss arrangement to cover liability-related exposure with a retention set in line with risk appetite and catastrophe cover in order to limit the Company's exposure to such events.

At the 2015 year-end the Company also entered into a General Insurance portfolio-wide Loss Portfolio Transfer arrangement for accident years 2015 and prior inclusive. Quota share arrangements have also been implemented with an effective date of 1 January 2016, covering each of the calendar years to 31 December 2019.

At present, there are no special purpose vehicles in place for the Company'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.

D.3 Other liabilities

Reconciliation between IFRS and Solvency II valuation	2018				
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£m	£m	£m	£m
Reinsurance payables	1	8	-	(8)	-
Payables (trade, not insurance)	2	37	-	(4)	33
Subordinated liabilities	3	11	-	1	12
Total Other Liabilities		56	-	(11)	45

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	8
Total Reinsurance payables - IFRS	8
Reinsurance payables included in BEL calculations	(8)
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	Total
Reinsurance payables	8	-	-	-	-	8

2. Payables (trade, not insurance)

For Solvency II valuation purposes, 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	6
Amounts owed to group undertakings	6
Other taxes and social security costs	10
Other payables	8
Accruals and deferred income	7
Total Payables (trade, not insurance) - IFRS	37
Reclassification of payables included in BEL calculations	(4)
Total Payables (trade, not insurance) – Solvency II valuation	33

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.

Subordinated liabilities	£m
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 Company 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 Company 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 £5m; 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 of £229m; this has been valued using the cash flow projection method, in a consistent manner with the calculation of the Best Estimate Liabilities (BEL) 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 £712m; this has been valued under Solvency II methodologies and further information can be found earlier in this report.
- 4) Payables (trade, not insurance) £33m; 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 £m	Tier 2 £m	Tier 3 £m	Total £m
Ordinary share capital	75	-	-	75
Reconciliation reserve	147	-	-	147
Subordinated liabilities	-	12	-	12
Deferred tax assets specified above	-	-	5	5
Total Basic Own Funds	222	12	5	239
Total Basic Own Funds after deductions	222	12	5	239

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

Total available Own Funds to meet the SCR	222	12	5	239
Total eligible Own Funds to meet the SCR	222	12	5	239

Total available Own Funds to meet the MCR	222	12		234
Total eligible Own Funds to meet the MCR	222	12		234

Tier 1 consists of Ordinary Shares of £75m and the reconciliation reserve, including a capital reserve of £106m (2017: £75m), which carries no requirement for Highway to repay.

Tier 2 consists of subordinated debt issued by Highway for EUR 12m.

Tier 3 relates to deferred tax assets of £5m.

Analysis of significant changes in own funds during the reporting period

	Highway		
	1 January 2018 £m	Movement £m	31 December 2018 £m
Eligible own funds			
Tier 1 capital	195	27	222
Tier 2 capital	12	-	12
Tier 3 capital	4	1	5
Total capital	211	28	239
Made up of:			
Equity shares	75	-	75
Subordinated liabilities	12	-	12
Deferred tax	4	1	5
Reconciliation reserve / surplus	120	27	147
Total capital	211	28	239
Total eligible own funds to meet SCR	211	28	239

- Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax. This has increased by £27m over the reporting period predominantly due to a capital injection of £31m.
- Tier 2 capital represents the subordinated debt.
- Tier 3 capital represents the deferred tax asset.

Ancillary own funds

At 31 December 2018 there were no ancillary own funds.

Deductions from own funds

At 31 December 2018 there were no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Capital reserve	106
Retained earnings on a Solvency II basis	41
Total	147

Highway has not applied any loss absorbency mechanisms as at the end of 2018.

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	106
Available for sale reserve	(3)
Retained Earnings	68
Total Equity - IFRS	246
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of DAC (Section D.1)	(29)
- Increase in valuation of reinsurance recoverables (Section D.1)	38
- Reduction in valuation of reinsurance receivables (Section D.1)	(9)
- Reduction in valuation of insurance and intermediaries recoverables (Section D.1)	(36)
- Deferred Tax Assets	4
- Other	(1)
	(33)
<u>Technical provisions</u>	
- Reduction in valuation of technical provisions	3
<u>Other liabilities</u>	
- Reduction in payables	4
- Reduction in reinsurance payables	8
- Other	(1)
	14
Total Change due to Solvency II adjustments	(19)
Total Equity - Solvency II basis	227
Add in subordinated liabilities (Tier 2)	12
Total own funds Solvency II basis	239
Excess of Assets over Liabilities Solvency II basis	
Total Assets	984
Total Technical Provisions	(712)
Total Other Liabilities	(45)
Excess of Assets over Liabilities Solvency II basis	227

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.

	2018	2017
Highway SCR (£m)	167	147
Highway MCR (£m)	64	63

The HICO SCR increased by £20m over the reporting period, driven by increase in business planned to be written.

The Minimum Capital Requirement (MCR) as at 31 December 2018 was £64m. 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 remained stable over the period.

E.2.2 Basis of calculation

HICO 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. HICO 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.

HICO £m	2018	2017
Market risk	15	17
Counterparty default risk	10	12
Life underwriting risk	2	2
Non-life underwriting risk	140	131
Diversification	(17)	(19)
Basic solvency capital requirement	150	143
Operational risk	18	18
Loss-absorbing capacity of deferred taxes	(1)	(14)
Solvency capital requirement	167	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 details of the supervisory authority responsible for financial supervision.

Firm's reference number: 202569

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

For the contact details of the PRA and the FCA 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 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.

TAC underwrites non-life insurance contracts within the UK.

General insurance:

TAC's principal purpose was to conduct general insurance business. At the start of July 2016 TAC ceased writing new business. TAC continues to administer any claims that occur on those policies underwritten prior to this date.

There was no premium income in 2018. The primary sources of premium income in 2017 were from the monthly instalment payments 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 2018, 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
R A Rowney
S Treloar - Resigned 24 January 2018 Reappointed 14 February 2019

Whilst TAC ceased writing new business after the transfer to LVFS, the organisation made an underwriting profit in 2018 of £9k (2017: loss £359k). The majority of the organisation's invested assets are now in collective investment undertakings. The Company has received £29k (2017: £31k) of investment income.

TAC used the Standard Formula to calculate its capital requirements throughout 2018, 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	2018	2017
	£000	£000
Net earned premiums	-	348
Net claims incurred	(3)	87
Expenses credit/(incurred) (excluding investment management expenses)	12	(794)
Net total	9	(359)

Claims ratio	-	(25.0)%
Expense ratio	-	228.2%
Combined ratio	-	203.2%

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 as only old claims were being administered.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period:

	2018 £000	2017 £000
Dividend income	28	20
Interest income	1	11
Net realised/unrealised gains		-
Net total	29	31

TAC had investments of £267,000 at 31 December 2018 (2017: £5,440,000) invested in money market collective investment undertakings.

A.4 Performance of other activities

Tax (charges)/ credits are the only other material expense for TAC:

	2018 £000	2017 £000
Tax (charge)/credit	(32)	36
Total	(32)	36

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:

A M Parsons
R A Rowney
S Treloar - Resigned 24 January 2018 Reappointed 14 February 2019

C. Risk Profile (TAC)

C.1 Overview

C.1.1 Overview of risk exposures

No new business has been written since June 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.

Post Diversification Risk Capital, for the year ended 31 December	2018	2017	Change
Counterparty default risk	96%	80%	+16%
Non-life underwriting risk	3%	18%	-15%
Operational risk	1%	2%	-1%
Total	100%	100%	

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 not since.

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		2018			
		IFRS	Presentational adjustment	Solvency II valuation adjustment	Solvency II
	Note	£000	£000	£000	£000
Investments					
- Investment funds	1	267	-	-	267
Receivables (trade, not insurance)	#	130	-	-	130
Cash and cash equivalents	#	5,149	-	-	5,149
Any other assets, not elsewhere shown	#	2	-	-	2
Total Assets		5,548	-	-	5,548

#- 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 2018:

	2018		
	IFRS	Adjustments	Solvency II
	£000	£000	£000
TP; Non-Life (excluding health)			
- TP calculated as a whole	50	(50)	-
- Best Estimate	-	50	50
- Risk Margin	-	42	42
Total technical provisions	50	42	92

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 derives 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.:

$$\text{Risk Margin} = \text{CoC} * \sum_{t=0}^{\infty} \text{SCR}_t / (1 + r_{t+1})^{(t+1)}$$

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 is a current tax liability of £32,000 (2017: £nil) in 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 £92k; 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	5,424	-	-	5,424
Total Basic Own Funds	5,424	-	-	5,424
Total available Own Funds to meet the SCR	5,424	-	-	5,424
Total available Own Funds to meet the MCR	5,424	-	-	5,424

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

Total available Own Funds to meet the SCR	5,424	-	-	5,424
Total eligible Own Funds to meet the SCR	5,424	-	-	5,424
Total available Own Funds to meet the MCR	5,424	-	-	5,424
Total eligible Own Funds to meet the MCR	5,424	-	-	5,424

Analysis of significant changes in own funds during the reporting period

	TAC		
	1 January 2018 £000	Movement £000	31 December 2018 £000
Eligible own funds			
Tier 1 capital	5,406	18	5,424
Total capital	5,406	18	5,424
Made up of:			
Equity shares	-	-	-
Reconciliation reserve / surplus	5,406	18	5,424
Total capital	5,406	18	5,424
Total eligible own funds to meet SCR	5,406	18	5,424

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

Ancillary own funds

At 31 December 2018 there were no ancillary own funds.

Deductions from own funds

At 31 December 2018 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	5,424
Total	5,424

TAC did not apply any loss absorbency mechanisms as at the end of 2018.

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	5,466
Total Equity - IFRS	5,466
Solvency II Adjustments (excluding reclassifications)	
<i>Technical provisions</i>	
- Increase in valuation of technical provisions (Section D.2)	(42)
	(42)
Total Equity - Solvency II basis	5,424
Total own funds - Solvency II basis	5,424

Excess of Assets over Liabilities - Solvency II basis	
Total Assets	5,548
Total Technical Provisions	(92)
Total Other Liabilities	(32)
Excess of Assets over Liabilities - Solvency II basis	5,424

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	2018	2017
SCR	361	421
MCR	2,222	2,196

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 2018:

SCR Component	£000
Counterparty default risk	352
Non-life underwriting risk	10
Diversification	(5)
Basic solvency capital requirement	357
Operational risk	4
Solvency capital requirement	361

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.