

# Legal and General Assurance (Pensions Management) Limited

## Solvency and Financial Condition Report

31 DECEMBER 2017

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## SUMMARY

### THIS DOCUMENT

This Solvency and Financial Condition Report (SFCR) is a regulatory document as required by the Reporting part of the PRA Rulebook for Solvency II firms and Directive 2009/138/EC of the European Parliament Articles 51 and 256. All values are (unless otherwise stated) as at 31 December 2017.

### WHO WE ARE

We are the largest external pension fund management business in the UK, offering a range of investment products to both UK and international clients.

The Company offers clients a wide range of products and looks to expand this offering as more bespoke solutions are designed in order to satisfy client needs. The size and range of our funds provides the scale and diversity that fund managers need to offer clients a complete suite of services for defined benefit schemes to support them along their de-risking journey. Additionally, the Company continues to reposition its business toward a growing defined contribution proposition, developing its product offerings and distribution models to meet the requirements of the changing marketplace.

The majority of the Company's business relates to UK pension schemes.

Incorporated as a private limited company in March 1971, we are part of the Legal & General Investment Management (LGIM) business division and are one of the major insurance entities within the Legal & General Group (the Group).

### OUR PERFORMANCE

Our key financial performance measures for the year ending 31 December 2017, together with the corresponding measures for the previous year, were:

- IFRS Operating profit before tax £226m (2016: £205m)
- Solvency II regulatory surplus of £441m (2016: £394m)
- Solvency II coverage ratio of 268% on the regulatory basis (2016: 246%)

Our main source of income relates to management fees generated by the value of assets under management. Fee rates have seen downward pressure in an increasingly competitive marketplace. However, revenue growth driven by increased assets under management led to increased profitability.

Assets under management at the end of 2017 were £437bn (2016: £415bn), including segregated funds of £128bn (2016: £121bn) which do not appear on the Company's balance sheet.

Further details on our business and performance are provided in section A.

## OUR GOVERNANCE

### Overview

There have been no material changes to our system of governance during the year.

The Board of Legal & General Group Plc is accountable for the long-term success of the Group by setting the Group's strategic objectives and monitoring performance against those objectives. The Group and its subsidiaries operate within a clearly defined delegated authority framework. The delegated authority framework ensures that there is an appropriate level of Board contribution to and oversight of key decisions and that the day-to-day business is managed effectively.

### Understanding our risk landscape

Legal and General Assurance (Pensions Management) Limited ('PMC') is a separate legal entity within the Legal & General Group, with its own Board of directors responsible for acting independently to promote the success of the company and exercise independent judgement, as required under the Companies Act 2006.

PMC's Board is responsible for setting its strategic direction and managing the business's daily operations, albeit under the high level strategic guidance of our immediate parent company Legal & General Investment Management (Holdings) Limited ('LGIMH') and our ultimate parent company Legal & General Group Plc.

Within the LGIMH group of companies, independent oversight is given to key risks. The reporting lines for these risk management activities are separate to the investment teams and are overseen by a governance framework of senior committees and, ultimately, the LGIMH Board. Risk governance for PMC is thus largely carried out under delegated authorities, but subject to PMC Board challenge and regular monitoring.

In addition, PMC has operational and governance arrangements which are distinct from the Group's other major business units.

The products that we write, the investments that we hold to meet our obligations and the environment in which we operate give rise to a broad range of risks. Our risk management framework seeks to ensure that we are only exposed to those residual risks for which we have an appetite.

### Risk management framework

Our risk framework is designed to enable the Board to draw assurance that risks are being appropriately identified and managed in line with our risk appetite.

Our framework seeks to reinforce the parameters of acceptable risk taking, allowing business managers to make decisions that are consistent with our risk appetite.

We deploy a 'three lines of defence' risk governance model, whereby:

- business functions are responsible for risk taking within the parameters of our risk appetite and accountable for identifying, assessing and managing risks in line with our risk policies;
- risk and compliance functions led by the Chief Risk Officer provide oversight, objective challenge and guidance on risk and regulatory compliance matters;
- Group Internal Audit providing independent assurance on the effectiveness of business risk management and the overall operation of the risk framework.

Further details on our system of governance are provided in section B.

## OUR RISK PROFILE

There has been no material change in our risk profile during the year.

Our most material risk exposures are:

- Operational risks
- Market and broader economic conditions, including sector performance and reputation
- Insurance risks, i.e. lapse, expense, income

We assess on an ongoing basis the capital that we need to hold above our liabilities to meet our strategic objectives and ensure continued solvency.

Our risk-based capital model seeks to provide a quantitative assessment of our risk exposures. It forms part of the suite of tools that we use to evaluate our strategic plans and set risk appetite. The key output from our capital model is the generation of capital requirements. We calibrate our model to ensuring that we hold sufficient capital to survive our assessment of a worse case 1-in-200 year event, equivalent to a 99.5% value at risk confidence level over one year. In terms of capital requirement, operational and insurance (lapse and expense) risks are our most significant risks.

Further details on our risk profile are provided in section C.

## SOLVENCY II BALANCE SHEET

A summary of the position as at 31 December 2017 on the Solvency II basis, together with the comparative position as at 31 December 2016, is shown in the following table.

<b>Summary Solvency II Balance Sheet (£m)</b>	<b>2017</b>	<b>2016</b>
Assets held for index-linked and unit-linked contracts	308,789	294,398
Reinsurance recoverables	3	3
All other assets	650	674
<b>Total assets</b>	<b>309,442</b>	<b>295,075</b>
Bid value of policyholder unit liabilities	308,789	294,398
Other components of Solvency II technical provisions	(385)	(376)
All other liabilities	334	389
<b>Total liabilities</b>	<b>308,738</b>	<b>294,411</b>
<b>Solvency II Own Funds</b>	<b>704</b>	<b>664</b>

Our Solvency II coverage ratio as at 31 December 2017 was 268% with eligible Own Funds of £704m and Solvency Capital Requirement (SCR) of £263m.

The amount of the regulatory Minimum Capital Requirement (MCR) at that date was £118m.

We do not apply any transitional measure, matching adjustment or volatility adjustment within our Solvency II calculations.

There has been no material change in the methods or assumptions used in the valuation for solvency purposes during the year ended 31 December 2017. Assumptions have been reviewed and updated as part of our established annual review of relevant experience which takes into account one additional year's actual experience compared with the previous assumption basis. In aggregate, the updated assumption basis has produced a small increase in Own Funds compared to the previous basis.

Further details on our valuation for solvency purposes are provided in section D.

We aim to manage our capital resources to maintain financial strength and policyholder security. There has been no material change in our capital management during the year ended 31 December 2017.

PMC holds a comfortable capital surplus against its regulatory capital requirements. Our SCR is calculated using the Legal & General Group Internal Model which has received the necessary regulatory approvals.

Our Own Funds amount is entirely comprised of unrestricted basic Tier 1 items, and as such there are no ineligible own funds for the purpose of covering our capital requirements.

There have been no instances of non-compliance with the MCR or SCR at any time over the reporting period.

Further details on our capital management are provided in section E.

The appendix contains copies of Quantitative Reporting Templates as required by the PRA Rulebook.

## **DIRECTORS' CERTIFICATE**

### **Legal and General Assurance (Pensions Management) Limited**

*Financial year ended 31 December 2017*

The Directors acknowledge their responsibility for the proper preparation of the Solvency and Financial Condition Report (SFCR) in all material respects in accordance with the PRA Rules and Solvency II Regulations.

The Board is satisfied that to the best of its knowledge and belief:

(a) throughout the financial year to 31 December 2017, the firm has complied in all material respects with the requirements of the PRA rules and Solvency II Regulations as applicable to the firm; and

(b) it is reasonable to believe that in respect of the period from 31 December 2017 to the date of the publication of the SFCR, the firm has continued so to comply and that it will continue so to comply for the remainder of the financial year to 31 December 2018.

By Order of the Board



Siobhan Boylan  
*Chief Finance Officer*  
2 May 2018



## AUDITORS' REPORT AND OPINION

Report of the external independent auditors to the Directors of Legal and General Assurance (Pensions Management) 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 Solvency and Financial Condition Report

### Opinion

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

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2017, (**the Narrative Disclosures subject to audit**); and
- Company templates S.02.01.02, S.12.01.02, S.23.01.01 and S.28.01.01 (**the Templates subject to audit**).

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**relevant elements of the Solvency and Financial Condition Report**'.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the **Other Information** which comprises:

- Information contained within the relevant elements of the Solvency and Financial Condition Report set out above which are, or derives from the Solvency Capital Requirement, as identified in the Appendix to this report;
- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S05.01.02, S05.02.01 and S.25.03.21;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report (**the Responsibility Statement**).

To the extent the information subject to audit in the relevant elements of the Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Company as at 31 December 2017 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as supplemented by supervisory approvals.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) including ISA (UK) 800 and ISA (UK) 805, and applicable law.. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report* section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC's Ethical

Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Conclusions relating to going concern**

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

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

### **Emphasis of Matter - Basis of Accounting**

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

### **Other Information**

The Directors are responsible for the Other Information.

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

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

### **Responsibilities of Directors for the Solvency and Financial Condition Report**

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified and supplemented by the approvals made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed below:

- i) approval to use a full internal model

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report**

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

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

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

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

### **Other Matter**

The Company has authority to calculate its Solvency Capital Requirement using an internal model ('the Model') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

### **Report on Other Legal and Regulatory Requirements**

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

*PricewaterhouseCoopers LLP*

*PricewaterhouseCoopers LLP*

*Chartered Accountants*

London

2 May 2018

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

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

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions - non-life (excluding health) - risk margin
  - Row R0590: Technical provisions - health (similar to non-life) - risk margin
  - Row R0640: Technical provisions - health (similar to life) - risk margin
  - Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
  - Row R0720: Technical provisions - Index-linked and unit-linked - risk margin
  
- The following elements of template S.12.01.02
  - Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
  
- The following elements of template S.23.01.01
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds
  
- The following elements of Company template S.28.01.01
  - Row R0310: SCR

Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

## A. BUSINESS AND PERFORMANCE

### A.1 BUSINESS

#### A.1.1 Company details

##### A.1.1.1 Name and legal form of the undertaking

This report is prepared in respect of Legal and General Assurance (Pensions Management) Limited ('the Company', 'PMC') for the financial year ended 31 December 2017.

The Company is a limited company incorporated in England and Wales, authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and by the PRA.

Our registered office is:

One Coleman Street  
London  
EC2R 5AA

##### A.1.1.2 Supervisory authority responsible for financial supervision

The supervisory authority responsible for financial supervision of the Company is:

Prudential Regulation Authority  
20 Moorgate  
London  
EC2R 6DA

The Prudential Regulation Authority is also the supervisor of Legal & General Group Plc.

##### A.1.1.3 External auditor

The independent external auditor of the Company is:

PriceWaterhouseCoopers LLP  
7 More London Riverside  
London  
SE1 2RT

##### A.1.1.4 Qualifying holdings

The Company's issued share capital is £100,000 being 100,000 fully paid ordinary shares of £1 each.

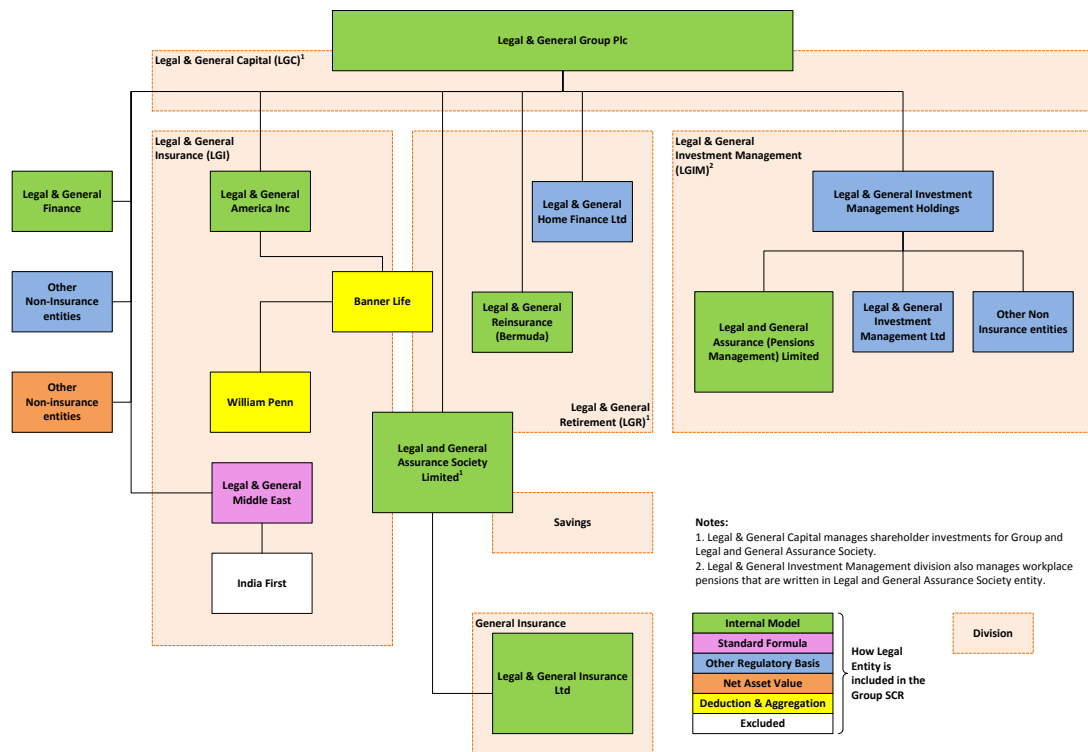
There is one class of ordinary share and all shares carry equal voting rights.

All shares and voting rights are held by the immediate parent company, Legal & General Investment Management (Holdings) Limited, which is a company incorporated in England and Wales.

The ultimate parent company is Legal & General Group Plc, which is a company incorporated in England and Wales.

### A.1.1.5 Group structure

A simplified group structure is shown below.



### A.1.1.6 Material related undertakings

There are no material related undertakings. The Company holds interests in certain related property vehicles which are held as assets within unit-linked funds. The total value of the equity shares held in such vehicles as at 31 December 2017 was £157m, which constitutes an immaterial proportion of the Company's total assets.

### A.1.2 Material lines of business

The principal business of the Company is the management of assets for pension funds.

For Solvency II reporting purposes, the Company has only the following two material defined Solvency II lines of business:

- Index-linked and unit-linked insurance
- Life reinsurance

The Life reinsurance line of business is entirely comprised of unit-linked and index-linked contracts, similar in all material respects for valuation and risk management purposes to the index-linked and unit-linked insurance line of business.

The majority of the Company's business relates to UK pension schemes.

### A.1.3 Significant events over the reporting period

No significant business or other events have occurred during 2017 that have materially impacted the Company.

## A.2 UNDERWRITING PERFORMANCE

Since the Company prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), the underwriting performance information in this section is presented on an IFRS basis. There is no prescribed definition of underwriting performance as presented in the Company's financial statements in the Solvency II regulations. We consider the IFRS operating profit to be an appropriate measure of the underwriting performance.

IFRS operating profit before tax for the 2017 financial year was £226m (2016: £205m).

Our main source of income relates to management fees generated by the value of assets under management. Fee rates have seen downward pressure in an increasingly competitive marketplace. However, revenue growth driven by increased assets under management led to increased profitability.

Assets under management at the end of 2017 were £437bn (2016: £415bn), including segregated funds of £128bn (2016: £121bn) which do not appear on the Company's balance sheet.

Information on policyholder inflows and outflows on pooled funds are presented by Solvency II line of business in QRT S.05.01 in the appendix of this report.

## A.3 INVESTMENT PERFORMANCE

The total investment return over 2017 as shown in the Company's IFRS financial statements was £29,103m (2016: £55,099m). This comprised two elements as follows.

The vast majority of assets on the Company's balance sheet are held for unit-linked and index-linked contracts and therefore the nature of the business written is such that investment returns on these assets contribute directly to the value of policyholder units. Assets are invested in line with the fund choices made by the policyholders and the returns achieved consist of dividends, interest and other income receivable, unrealised and realised gains/losses as appropriate. The investment return over 2017 on assets held for linked contracts was £29,102m (2016: £55,098m), with investment management expenses of £116m (2016: £130m).

Shareholder assets are primarily held to provide liquidity and capital security, as distinct from targeting specific investment returns. The investment return over 2017 on the shareholder assets was £0.5m (2016: £1m) and is included in the overall operating profit figure shown in section A.2 above. The investment return relates almost entirely to gains achieved on holdings of UK government bonds. A minor amount arises as interest on cash and short-term deposit holdings. The expense incurred in the investment of shareholder assets is de minimis.

All investment gains and losses are recognised in the income statement. There are no amounts recognised directly in equity.

### Investments in securitisations

The Company holds securitisations with a total market value of £811m as at 31 December 2017, all of which are held for unit-linked and index-linked contracts. This represents less than 0.3% of the total assets.

## **A.4 PERFORMANCE OF OTHER ACTIVITIES**

The nature of the segregated contracts is such that each client retains beneficial ownership of their underlying asset portfolios, and therefore the value of the assets under management is not included on our balance sheet.

Accordingly, the investment performance information provided in section A.3 above excludes segregated contracts. For consistency with the balance sheet treatment, the expenses attributable to the management of segregated contracts are shown separately within the S.05.01 QRT (see Appendix) and amounted to £45m (2016: £32m). The corresponding fee revenue amounted to £89m (2016: £84m). The revenue and expenses associated with management of the segregated contracts is included within the operating profit shown in section A.2 above.

There have been no other significant activities undertaken.

The Company has several operating leases which are rental agreements for various properties held within certain unit-linked funds as assets for unit-linked contracts. None of the leasing arrangements are individually material to the relevant funds. There are no other leasing arrangements.

## **A.5 ANY OTHER INFORMATION**

All material information regarding the business and performance of the Company has been covered in the above sections A.1 to A.4 inclusive.



## B. SYSTEM OF GOVERNANCE

### B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE

The Board of Legal & General Group Plc is accountable for the long-term success of the Group by setting the Group's strategic objectives and monitoring performance against those objectives.

Legal & General Group is managed across business lines rather than legal entities. PMC is an entity within the LGIM business division. LGIM operates within Risk & Capital Mandates set by Group. These set out the risk-taking parameters that LGIM is empowered to operate within and the nature of products and services LGIM is authorised to provide.

#### B.1.1 Structure of the PMC Board

PMC is a separate legal entity within the Legal & General Group, with its own Board of directors responsible for acting independently to promote the success of the Company and exercise independent judgement. PMC's operational and governance arrangements are distinct from the Group's other major businesses.

As a result of the corporate structuring and the operation of English company law, PMC's assets are legally and financially separated from the rest of Legal & General Group and from other entities within the Group.

The PMC Board, which meets quarterly, comprised the following as at 31 December 2017:

- Chairman - Mark Zinkula
- Chief Executive Officer - Sarah Aitken
- Chief Finance Officer - Siobhan Boylan
- Chief Actuary - Justin Browne
- Director - Mike Walsh
- Director - Pauline Plunkett (appointed 24/05/2017)

There is a defined schedule of matters reserved for the PMC Board, which is approved and reviewed annually. The matters reserved are:

- Strategic and Financial Control
- Board membership
- Corporate structure
- Approval of the Annual Report and Accounts
- Dividends
- Consider relevant contingent liabilities and assets on a quarterly basis
- Any other matters which, in the opinion of a Director or the Company Secretary, should be reviewed by the Board.

Those matters which are not reserved are delegated to the PMC Governance Committee (PMCGC) whose role is to exercise the responsibility of the PMC Board for ensuring that a forum for debate and decision-making is regularly convened in order that PMC's legal, regulatory and financial obligations are discharged within an appropriate governance framework. The PMCGC meets monthly or on an ad hoc basis if required.

In addition to the matters reserved, the PMC Board has a schedule of regular agenda items which includes a report from its primary delegated committee (PMCGC) and Compliance and Finance reports. The Board also notes the minutes of any delegated committees which are not incorporated into the PMCGC report. The PMC Board also receives relevant business updates from various key function holders on issues impacting PMC.

Oversight of PMC's key functions is either by way of:

- Delegation to committee; either the PMCGC or an LGIMH committee
- Direct oversight via a PMC Board member who is the key function holder

Currently, where oversight is delegated to a committee, each committee includes at least one PMC board member and/or key function holder.

## B.1.2 Key functions

### B.1.2.1 Senior Insurance Management Functions

PMC has six direct Senior Insurance Management Functions (SIMF) requirements as detailed in the following table.

Senior Insurance Manager Function		Summary responsibility
Chief Executive Officer	SIMF1	Under the immediate authority of the Board, alone or jointly with others, for carrying out the management of the conduct of the whole of the business of PMC
Chief Finance Officer	SIMF2	The management of the financial resources of PMC and reporting to the Board in relation to its financial affairs
Chief Risk Officer	SIMF4	Overall management of the risk management system
Head of Internal Audit	SIMF5	Management of the internal audit function
Chairman	SIMF9	Chairing and overseeing the performance of the Board
Chief Actuary	SIMF20	The actuarial function of PMC

In addition, under SIMF7 there are two LGIMH/Legal & General Group SIMF holders (the Group CEO and the Group CFO) who are deemed to have significant influence on the management or conduct of PMC.

### B.1.2.2 Delegation of key functions

PMC delegates three key functions to LGIM to undertake which are:

- Fund operations, including the pricing and valuation of assets, the unit pricing of pooled funds and the oversight of appointed third parties
- Distribution and customer operations, including the distribution and marketing of PMC's products and services, customer record keeping and client reporting
- Product management, incorporating product development and product maintenance including an appropriateness assessment

LGIMH undertakes and resources six key functions; Risk Management, Internal Control, Compliance, Internal Audit, Finance and IT.

PMC retains the responsibility for the above functions with the relevant business area heads being the key function holder on behalf of PMC.

### B.1.2.3 Delegation to LGIMH committees

The PMC Board delegates certain responsibilities to the following LGIMH committees:

- *Fund Manager Oversight Committee:* To ensure that the investment management activities and associated services performed by LGIM, its delegates and other fund managers are conducted in accordance with applicable regulations, the terms of the relevant governing IMA and the relevant policies and procedures;
- *Product Governance Committee:* To establish a governance structure to oversee the design and development of LGIM products; to ensure that appropriateness of pooled fund products can be evidenced and to ensure that information provided to distributors is sufficient; to oversee the review of products through the product lifecycle process;
- *Risk & Compliance Committee:* To ensure that the critical business, regulatory and operational risks are identified assessed and managed by the appropriate processes and to ensure compliance with the relevant regulatory controls; to ensure there are appropriate management structures and sub-committees in place to manage the identified risks and regulatory requirements;
- *LGIM Fees Committee:* To monitor, review and approve fee rates on behalf of LGIMH and its subsidiaries;

### B.1.2.4 Key function holder oversight

Where function oversight is not delegated to a committee, the oversight function is carried out directly by the PMC Board member who is the key function holder. The responsible individual reports and escalates any issues to the PMC Governance Committee or directly to the PMC Board as required.

Further oversight of risk management, audit and remuneration responsibilities is provided by Group Board committees, being the Group Risk Committee, Group Remuneration Committee and the Group Audit Committee.

### B.1.3 Details of any material changes

No material changes in the system of governance have taken place over the reporting period.

One PMC director was newly appointed during 2017 to replace one departing director, with the majority of the PMC Board composition unchanged over the year.

### B.1.4 Remuneration policy and practices

The remuneration policy is consistent across the Legal & General Group and is designed to reward, motivate and retain high performers in line with the risk appetite of the Group. Remuneration decisions are reviewed and approved at the Group Remuneration Committee. Details can be found in the Directors' Report on Remuneration in the Legal & General Group Plc Annual Report and Accounts.

The Company itself does not have any direct employees. Staff members supporting the Company are employed by either the parent company, Legal & General Investment Management (Holdings) Limited, or by an affiliate, Legal & General Resources Limited. The Company is recharged a portion of the costs incurred.

No fees are paid by the Company to the directors. Directors are not employees of the Company, but their services are reflected in a management charge levied by the parent on the basis of time spent on Company business by each director.

### B.1.5 Material transactions

There were no material transactions between the Company and its directors or key managers or persons exercising a significant influence on the Company during the reporting period.

Under a management agreement, the Company's shareholder supplies and makes charges for administrative and staff expenses to the Company. The amount of this recharge for 2017 is £72m (2016: £55m).

The Company declared and paid £150m in dividends to its parent company during the year.

## B.2 FIT AND PROPER REQUIREMENTS

### B.2.1 Application of Policy

Legal & General has in place a fit and proper policy, the purpose of which is to set out the procedures required by regulated firms within the Legal & General Group to assess the fitness and propriety of individuals who run these undertakings or who hold other key functions in them.

### B.2.2 Key requirements

In summary the policy requires that each regulated entity shall establish, implement and maintain documented policies and adequate procedures to ensure that all persons who are responsible for running the entity or are responsible for other key functions are at all times fit and proper.

The assessment of fitness and propriety covers the following factors:

- Honesty, integrity and reputation
- Competence and capability
- Financial soundness

#### B.2.2.1 Legal & General assessment procedures

In support of the Group policy, defined processes are in place to ensure that the fitness and propriety of applicants is carefully considered before an application to the regulators to grant approval is submitted. An assessment will also be made before a notification is made to the regulators in relation to the appointment of a Key Function Holder.

Legal & General will not support an application for approval or a notification if it is believed that the candidate fails to meet any element of the fit and proper test.

Each application will be looked at on its own merits, on a case-by-case basis, but the following principle generally applies to all applications:

- Has the candidate been open and honest with Legal & General and disclosed all relevant matters;

If the candidate has disclosed any incidents pertaining to their fitness and propriety, the following will be considered:

- The seriousness of the issue and the relevance to the specific role applied for;
- The passage of time since the incident occurred; and
- Whether the issue relates to an isolated incident or whether there is a pattern of adverse behaviour.

Fit and Proper Assessment criteria have been developed and each application will be considered against each criterion, regardless of the current approved status of individual. The criteria are:

- knowledge – does the individual have generic knowledge of the industry sector and specific knowledge of the firm;
- qualifications – does the individual have prerequisite or supporting relevant qualifications;
- skills – does the individual demonstrate the appropriate level of business and interpersonal skills;
- behaviour – does the individual demonstrate the appropriate attitudes and standards of ethical behaviour; and
- expertise – does the individual achieve positive and fair outcomes and meet performance standards expected of the post.

The assessment criteria are also relevant in assessing the continuing fitness and propriety of approved persons.

### B.2.2.2 Maintaining Fitness and Propriety

From time to time, individuals will be required to certify that there has been no change to the information provided at the point of approval and consequently, the fitness and propriety status is unchanged.

Legal & General's Group Policies and Procedures place an obligation on approved persons to notify the Group Conduct Risk and HR Director in the event of any pending or actual criminal, civil or other disciplinary charges, judgements, petitions for bankruptcy, or other actions or disciplinary measures whatsoever, against them or any entity, body or other entity with which he/she is, or has been, associated.

Should such a notification occur, Legal & General will assess the information to decide whether the individual remains fit and proper. If the assessment ultimately concludes that the individual can no longer remain as an approved person, a notification will be made to the regulators in line with the regulatory requirements.

Legal & General's performance management process is the primary mechanism for tracking ongoing competency. Legal & General will take appropriate steps to monitor an individual's financial soundness on an ongoing basis.

## **B.3 RISK MANAGEMENT SYSTEM INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT**

### **B.3.1 Risk management system**

Legal & General deploys a ‘three lines of defence’ risk governance model, whereby:

- business divisions are responsible for risk taking within the parameters of our risk appetite and accountable for identifying, assessing and managing risks in line with our risk policies and appetite;
- risk functions led by the Group Chief Risk Officer provide objective challenge and guidance on risk matters; with
- Group Internal Audit providing independent assurance on the effectiveness of business risk management and the overall operation of the risk framework.

#### **B.3.1.1 Risk appetite**

The Company’s risk appetite statement sets out our overall attitude to risk, and the ranges and limits of acceptable risk taking. The Group Risk Committee leads an annual review of the Group’s risk appetite, assessing the continued appropriateness of our key measures and tolerances relative to the risk exposures of the Group. Additionally, as part of the annual planning cycle, assessment is made of the level of risk taking proposed in the Group plan and the capacity for risk taking within the overall appetite framework.

The Company’s risk appetite is approved by the Company’s Board. The regular management information received by the Board and Group Risk Committee includes our risk appetite dashboard setting out actual positions relative to the key targets and limits set in our risk appetite.

#### **B.3.1.2 Risk taking authorities**

The parameters of acceptable risk taking defined within the risk appetite are cascaded to business managers through ‘Risk and Capital Mandates’, empowering managers to make decisions that are consistent with our appetite for risk.

Mandates articulate the product types and features that may be written; the assets classes that may be held; the target capital positions and ranges of earnings volatility within which the overall profile of risks should be managed; and tolerances for specific risk exposures. Activities that would result in a business operating outside agreed parameters require formal approval from the Board.

#### **B.3.1.3 Risk policies**

##### **Risk control**

We set formal policies for the management of our risks, either by consideration and adoption of a relevant Group policy if suitable or by approval of a PMC-specific policy. The policies specify our overall strategies for ensuring each risk type is managed in line with our risk appetite and the minimum control standards that should be applied in managing our significant risk exposures.

##### **Risk mitigation**

We deploy a range of risk management techniques to manage and mitigate risks, so as to control risk exposures in line with our risk limits. Our framework of controls includes documented policies and structured delegated authorities.

### B.3.1.4 Risk identification and assessment

#### Review process

We operate a risk identification and assessment process under which we regularly consider changes in the profile of existing and emerging risks. The assessment process evaluates the risks that are inherent in our products as well as those that are presented from changes in the environments that we operate in.

#### Own risk solvency assessment (ORSA)

Our risk identification and assessment process forms part of our broader 'own risk and solvency assessment' process, our ongoing assessment of the risks to which we are exposed and an evaluation of the sufficiency of resources to sustain the business strategy over the horizon of the planning period.

### B.3.1.5 Risk management information

Our risk management information framework is structured to report and support the review of ongoing and emerging risks and assess actual risk positions relative to the risk limits and targets that we set.

### B.3.1.6 Risk oversight

The Group Chief Risk Officer, who is independent of the business line, supports the Group Board and its Risk Committee in articulating acceptable risk taking and ensuring the effective operation of our risk and capital framework. This includes ongoing assessment of the Group's capital requirements to confirm that they meet regulatory solvency requirements.

The Group Chief Risk Officer also provides objective challenge and guidance on a range of risk matters to business managers, including the risks implicit in product developments, business transactions and new asset classes, and strategies for managing risks in line with the Group's overall risk appetite.

The Chief Risk Officer (CRO) for the LGIM division is the CRO for PMC. The divisional CRO and their team operate as an independent second line oversight function with reporting lines, systems and processes which are independent of the first line functions.

### B.3.1.7 Risk committees

The Company operates within the Group's risk management framework. The Company's Board has ultimate responsibility for ensuring that the Group's risk management framework is appropriate for the Company. The Group Board's Risk Committee, supported by the Group Chief Risk Officer, serves as the focal point for risk management activities.

Beneath the Group Risk Committee is a structure of formal risk oversight committees providing more focused review and challenge of specific risks to the Group, and reviewing the effectiveness of frameworks in place to manage those risks.

The Company's Board:

- Owns the Company's overall risk management system
- Owns the Company's risk appetite statements
- Is the ultimate owner of the Company's regulatory relationships

The Group Risk Committee ensures the effectiveness of the overall risk management system and recommends to the Group Board material changes in risk appetite.

The Executive Directors are accountable for:

- The implementation and operation of the risk management system



- Identifying, measuring, managing, monitoring and reporting risks within the business
- Ensuring all business decisions are informed by risk-based measures by reference to the agreed risk appetite statements wherever appropriate
- Ensuring appropriate risk taking and risk assurance resources are in place

The Group Chief Risk Officer (Group CRO) leads the risk management function which provides the second line of defence across the Group.

Divisional Chief Risk Officers and their teams provide a more focused review and challenge of business processes and the management of the risks implicit in each of their operating divisions. The divisional CRO sits on the relevant divisional Executive team committees and Strategic Planning meetings to ensure that appropriate risks are considered at the earliest point and ensure engagement of other risk specialists as appropriate. The Divisional CRO for LGIM has a direct reporting line to the divisional CEO, and access to the Group Risk Committee through the Group CRO.

Group Internal Audit provides the third line of defence across the Group. It provides assurance to the Group Audit Committee, Executive Directors and risk management function that the design and operation of the risk management system is appropriate for all risk types.

### B.3.2 Own risk and solvency assessment

The purposes of the Own Risk and Solvency Assessment (ORSA) are to assess our risks and to evaluate whether we have sufficient financial resources to sustain the business strategy over the plan horizon. The Group ORSA process covers each EU regulated insurer and the whole Group, including non-EU entities and non-insurance entities.

The ORSA process brings together, and is integrated with, the business-as-usual risk and capital management processes by which we identify, assess, monitor and measure our risks, review our business against risk appetite and tolerances and project the solvency position over the business planning period. The ORSA cycle is aligned with the strategic and business planning process so that the key elements can interact and inform forward-looking decision-making.

The ORSA policy was last reviewed by the Group Board (delegated to GRC) in July 2017. The updated Group policy was cascaded to the legal entities within the Group and was approved by the PMC Board in August 2017.

The Group is managed on a divisional basis. As such, ORSA (i.e. risk and capital management) responsibilities follow the Group's divisional management structure. Regular ORSA processes are aligned with the strategic and business planning process, with various Group functions coordinating and/or aggregating and divisions providing key ORSA inputs in line with the plan timetable.

Additionally we produce a solo entity-specific ORSA report for the Company which is reviewed and approved by the Company's Board on an annual basis.

The core stages to the ORSA process are as follows:

- Q1, review ORSA framework and policy along with lessons learnt and feedback from the previous ORSA cycle.
- Q2, Stress and scenario tests determined and recommended in order to provide sufficient time to model.
- Q3, projections of capital requirements (as part of the annual planning process) and capital coverage ratio on the Solvency II basis; stress and scenario testing results inform the review of the plan.
- Q4, formal ORSA reporting, including review of the plan by the CRO and production of the formal ORSA report to the Board.



Throughout the year, both the Group and the Company monitor performance against the current plan as well as monitoring risk and capital management information.

### B.3.3 Governance of the Internal Model

The Group Board is ultimately responsible for ensuring the continuous appropriateness of the design and operation of the Group's partial internal model (the Internal Model). This responsibility is discharged through the Group Risk Committee (GRC), whilst the Group Internal Model Committee (GIMC) oversees Internal Model activities.

The overall appropriateness and effectiveness of the Internal Model depends upon the effective operation of the Group's established internal control system.

First line business management are responsible for implementing adequate and effective controls over the Internal Model as well as the material risk exposures, with the ongoing application and effectiveness of these overseen by second line Group and divisional risk teams and by Group Internal Audit in the third line of defence. Material concerns are escalated to operational and senior management for resolution. The status of remediation activity is monitored by Group and divisional risk teams, with significant issues escalated to the GIMC and where necessary to the GRC. Group Internal Audit provides independent oversight of the effectiveness of the internal control system.

This approach has ensured the implementation of adequate controls to ensure the ongoing appropriateness of the design and operation of the Internal Model, and these controls are subject to effective governance and oversight.

The Group Internal Model Governance Policy sets out the governance framework in place for the Internal Model designed to mitigate model risk. This complements the Group's existing system of governance, highlighting specific requirements in respect of the Internal Model to ensure that it operates properly on a continuous basis, including ensuring that controls relating to the Internal Model are implemented in accordance with the Group Internal Control Policy and are adequate and effective at all times.

The Internal Model governance framework is outlined in the following table:

Board or Committee	Responsibilities
Group Board	Ensuring the ongoing appropriateness of the design and operation of the Internal Model. This responsibility is discharged through the GRC, subject to certain matters being reserved for its direct attention.
Legal entity boards	Ensuring the ongoing appropriateness of the design and operation of their parts of the Internal Model; discharged by use and challenge of the model in decision making; ensuring that the model's scope remains appropriate; and ensuring that appropriate validation is performed.
Group Risk Committee (GRC)	Monitoring the performance and appropriateness of the Internal Model, including ensuring that related controls are adequate, effective, and implemented in line with the Group's Group Internal Control Policy. Primarily, the GRC discharges these responsibilities through acting on the receipt of recommendations, analysis and reports from the Group CRO team and the Group Internal Model Committee (GIMC)
Group Internal Model Committee (GIMC)	Overseeing the design, development and operation of the Internal Model to ensure that it operates as expected on a continuous basis to meet the Group's regulatory and economic requirements for risk-based capital management. This includes reviewing the effectiveness of internal controls as they relate to the Internal Model through the receipt of relevant reports and management information.

### B.3.3.1 Internal Model controls

As set out in the Group Internal Control Policy first line business are responsible for operating a robust control framework and appropriate controls to manage exposures and mitigate unacceptable outcomes (per the Group's risk appetite). Business management are responsible for implementing robust controls to mitigate key risks associated with processes they are responsible for, and to ensure that these are regularly reviewed and remain fit for purpose. Day-to-day responsibility for ensuring that robust internal controls are in place and are operating effectively over Internal Model related processes is delegated to Internal Model Controllers (IMCs). IMCs provide first line management coverage of the Internal Model across all relevant legal entities and business units. Key responsibilities include ensuring compliance of their area with the requirements of the Group Internal Model Governance Policy and Group Internal Control Policy.

Oversight of the internal control system is provided by the Group Risk and divisional risk teams.

#### B.3.3.1.1 Changes over the reporting period

There have been no material changes to our internal model governance processes during the year.

#### B.3.3.1.2 Internal Model validation

The Group Validation Policy and associated standards define the Group's validation framework, and capture the requirements of the PRA Rulebook and relevant EU regulations. The framework requires an annual validation cycle for the Internal Model. This has been performed as part of the production of the Solvency Capital Requirement as at 31 December 2017. The objective is to produce a robust, proportionate and demonstrably complete approach to validation overseen by the Group Chief Risk Officer.

At least annually, the Group Enterprise Risk Director assesses which aspects of the Internal Model must be independently validated. Independent validators must demonstrate how independence is met and state any limitations on independence.

Requirements for each annual cycle are specified in the Validation Terms of Reference. Respective validators outline approach, activities, tools and aspects of the model in Validation Work Programmes. The results, conclusions and consequences including remediation are detailed in independent validation reports or validation reports. These are presented to GIMC for approval.

#### Validation activity

Validation activity for 2017 covered the whole of the Internal Model. The level of validation undertaken was consistent with the level of risk incurred. Independent validation was performed on those areas identified as most material to the Internal Model's operation and results. The outputs are validation reports, highlighting key findings, strengths, weaknesses, limitations and remediation actions.

## B.4 INTERNAL CONTROL SYSTEM

The Group internal control policy requires that each divisions internal control system shall at least include administrative and accounting procedures, an internal control framework, appropriate reporting arrangements at all levels of the undertaking and a compliance function.

The Group's internal control framework seeks to ensure that:

- An organisational structure is defined, with clarity of roles, responsibilities and reporting lines;
- Appropriate management information and reporting processes are defined;
- Frameworks for decision making (including the delegation of authority) are articulated;
- Clear segregation of duties is in place;
- Conflicts of interest are managed;

- Administrative and accounting procedures are aligned with Group requirements;
- Personnel have sufficient skills, knowledge and expertise to discharge their responsibilities (including those relating to the regulatory environment);
- Adequate and orderly records of business are maintained;
- The security of customer data and other internal records is ensured;
- Business procedures combat financial crime;
- Processes are in place to deal with policyholder claims and complaints;
- The integrity of manual and computerised business systems is ensured; and
- Processes ensure assessment of the possible impact of any changes in the legal environment.

The Group's main operating boards and the Group Audit Committee oversee the adequacy and effectiveness of the internal control framework, primarily through the receipt of assurances in support of the UK Corporate Governance Code, and reports from Group Internal Audit, external auditors, and risk teams in the second line of defence.

#### B.4.1 Solvency II Compliance function

We have defined the Solvency II Compliance function as being responsible for:

- advising the Board and its sub committees on compliance with the requirements of the Solvency II Directive and its associated laws, regulations and administrative provisions;
- advising the Board on the possible impact of any changes in the legal environment on operations of the undertaking concerned and the identification and assessment of compliance risk;
- developing and managing the Solvency II Compliance Policy, which inter alia sets out the responsibilities, competencies and reporting duties of the Solvency II compliance function; and
- establishing and operating the Solvency II Compliance Plan that details the activities the function will undertake in relation to compliance risk.

We have defined our Chief Risk Officer role as the functional head of Solvency II Compliance at the entity level, with the risk, actuarial, finance, compliance and HR functions delivering activities in support of the Solvency II Compliance function.

Our Solvency II Compliance Policy defines who will perform the governance tasks and other activities of the Solvency II compliance function, their roles and responsibilities, and the overall approach to assessing, monitoring and reporting compliance with applicable laws, regulations and administrative provisions adopted pursuant to Solvency II Directive.

Our Solvency II Compliance Plan is defined as the review activities performed by the Compliance Function to support them in advising the Board and its sub committees on compliance in relation to Solvency II matters.

### B.5 INTERNAL AUDIT FUNCTION

Group Internal Audit acts across the Group, providing a third line of defence. Group Internal Audit's responsibilities towards the Company align with its responsibilities towards the Group.

Group Internal Audit carries out:

- independent reviews and audits of the controls mitigating the key risks in all areas of the business, prioritised according to the relative risk of each assignment as determined by Group Chief Internal Auditor in conjunction with senior management;

- reviews of all major Business Change Initiatives; and
- reviews of the risk management and internal control processes

Internal control objectives considered by Group Internal Audit include:

- consistency of operations or programmes with the Group's established risk appetite, objectives and goals;
- effectiveness and efficiency of operations, and use of resources;
- compliance with policies, plans, procedures, laws and regulations;
- reliability and integrity of management and financial information processes, including the means to identify, measure, classify, and report such information; and
- safeguarding of assets

The Group Chief Internal Auditor reports functionally to the Chair of the Group Audit Committee and administratively to the Group Chief Executive.

The internal audit activity remains free from interference by anyone within Legal & General. This includes the choice of business areas to audit, procedures, frequency, timing, or the content of Group Internal Audit reports. This ensures that Group Internal Audit can maintain a necessary independent and objective perspective.

Internal auditors have no direct operational responsibility or authority over any of the activities audited. Accordingly, they will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair internal auditors' judgement.

Internal auditors will exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors will make a balanced assessment of all the relevant circumstances and will not lose their objectivity when forming judgements.

The Group Chief Internal Auditor confirms to the Group Audit Committee, at least annually, the organisational independence of internal audit activity.

## **B.6 ACTUARIAL FUNCTION**

The Actuarial Function across the Group is split along legal entity lines.

The PRA have specified that firms should appoint a Chief Actuary who should fulfil the role of Head of Actuarial Function (a role that is not required by the Directive) and hold the SIMF20 role as set out under the SIMR regime, and PMC has appointed a Chief Actuary accordingly.

The Chief Actuary presents an annual report to the PMC Board summarising the activities of the Actuarial Function during the year to:

- support compliance with the requirements on the calculation of Technical Provisions
- provide opinions on the underwriting and reinsurance arrangements
- contribute to the effectiveness of the risk management system more widely

The actuarial activities are split between those involved in delivery of actuarial analysis and reporting, and independent oversight and validation. Requirements are addressed through various activities and the membership of a number of key entity, divisional and Group Committees with risk and financial reporting responsibilities. For example, a number of reports during the year were provided to the Board on the data, models, methodologies, assumptions and results of the Solvency II Technical Provisions calculations.

## B.7 OUTSOURCING

The Group's Outsourcing and Essential Supplier Services Policy sets out the framework and minimum standards of control and governance that Legal & General expects to be applied in the management of risks associated with outsourced supplier service arrangements. The policy specifies that an activity should not be outsourced where it would materially impair the quality of the Group's system of governance; unduly increase the Group's exposure to operational risk; impair the ability of supervisory authorities to monitor the Group's compliance with its obligations; or undermine continuous and satisfactory service to the Group's policyholders. Within the LGIM division, compliance with the Group Outsourcing and Essential Supplier Services Policy is overseen by the LGIM Supplier Management Committee, which is a sub-committee of the LGIMH Risk & Compliance Committee.

The policy requires that for all outsourced arrangements a rigorous evaluation and supplier selection process is undertaken having regard for the financial stability, expertise, ability and capacity of the supplier to deliver the required service. The policy also specifies that a written contract must be in place which must include: a service level agreement; the conditions under which the arrangement may be terminated; provision for the orderly transition of services if the contract is terminated; a defined mechanism to resolve disputes arising out of or relating to the contract; appropriate contingency plans should the supplier be unable to provide the required service; and provision for the continued availability of any software upon which Legal & General is reliant. Contracts must also ensure access to the providers' premises, business management and any data relating to the outsourced activity, by Legal & General's Internal Audit, Risk and Compliance functions, its external auditors and Supervisory Authorities; and appropriate warranties that Legal & General and client data is adequately protected against unauthorised access at all times. All outsourced arrangements must be managed under the direction of a named Legal & General relationship manager.

A number of the Company's outsourcing arrangements are considered to be critical or important operational functions or activities and are monitored in line with the policy. These are:

- Citibank NA, which provides custodian services for non-UK assets
- HSBC Bank plc, which provides custodian services for UK assets

Under an Agency Agreement, Citibank NA also provides the Company with a securities lending service which operates for the benefit of certain of the Company's unit-linked funds within strictly defined parameters.

The following significant services are provided to the Company by other companies within the Legal & General Group:

- Administration services are provided by Legal & General Investment Management (Holdings) Limited ('LGIMH')
- Investment management services are provided by Legal & General Investment Management Limited, with services in respect of specific funds sub-delegated to Legal & General Investment Management America Inc. and to Legal & General Investment Management (Asia), all of which are wholly owned subsidiaries within LGIMH
- Property management services are provided by Legal & General Property Limited, a wholly owned subsidiary of LGIMH.

These services are charged to the Company on a cost recovery basis, and the outsourcing risks are assessed as if the Company performed the services directly.

## **B.8 ANY OTHER INFORMATION**

### **B.8.1 Adequacy of the system of governance**

The Group Executive Risk Committee (a sub-committee of the Group Risk Committee) undertakes an annual review of the Group's risk management framework and broader system of governance to confirm its adequacy given the nature, scale and complexity of the risks inherent in its business. The most recent review was in February 2018, where the Committee concluded that the Group's risk framework aligns with the Group's key risk exposures, and operated effectively during 2017 in identifying material risk exposures.

### **B.8.2 Any other information**

All material information regarding the system of governance has been covered in the above sections B.1 to B.8 inclusive.

## C. RISK PROFILE

Our Own Risk and Solvency Assessment (ORSA) is an ongoing analysis of our risk profile and the sufficiency of capital resources to sustain our business strategy over the plan horizon. The process, which is undertaken across the whole group, considers how the risks to which we are exposed may evolve over the planning cycle; the impacts of a range of more extreme stresses and scenarios on those risks; and the consequential impacts on our solvency position. The ORSA process is integrated into our business risk and capital management activities and aligned with the strategic planning process to inform forward-looking decision-making. As such, it is a key business management tool for the Group.

Our risk-based capital model seeks to provide a quantitative assessment of our relevant risk exposures. It forms part of the suite of tools that we use to evaluate our strategic plans and set risk appetite.

The key output from our capital model is the generation of capital requirements. We calibrate our model to a 99.5% value at risk confidence level over one year, equivalent to ensuring that we hold sufficient capital to survive our assessment of a worse case 1-in-200 year event.

There has been no material change in our risk profile during the year.

In terms of the Company's Solvency II capital requirement, operational risk and underwriting (expense, lapse) risks remain our most significant risks.

### C.1 UNDERWRITING RISK

#### C.1.1 Material risk exposures

Given the nature of our business, underwriting in this context refers to the setting of policyholder contract terms and fee rates, together with the associated taking on of lapse, expense and income risks. Underwriting risk is the exposure to loss arising from experience of these items being different to that anticipated.

On an IFRS basis, the Company's exposure to underwriting risk is immaterial.

Under Solvency II, the Own Funds amount includes a present value of projected future cashflows. Therefore, the Solvency II Own Funds are exposed to underwriting risk in so far as emerging future experience may differ from the assumptions made in calculating the present value.

Policies contain no material options or guarantees, and the Company has wide contractual rights to vary policy terms and conditions (including charges) upon suitable provision of notice to policyholders.

Pooled contracts contain an embedded annuity option whereby individual scheme members may purchase an annuity at the market rates prevailing at the time of purchase. Any such annuities would be automatically 100% reinsured under an existing reinsurance treaty. The terms of this option are therefore financially immaterial to PMC and in practice no such new annuities have been written for many years.

The nature of the PMC business means that any constraints related to underlying policyholder investments are automatically taken into account in the process of designing new funds or products.



### C.1.1.1 Persistency risk

This is the risk of loss of future profits as a result of unexpectedly high surrenders (net of new business), which exposes the Company to the risk of lower fee income from policyholder assets. The standard terms under which the Company accepts new business are such that no material new business strain arises.

### C.1.1.2 Expense and income risks

These risks relate to the impact of potential variation in the amount and/or timing of expenses incurred and in management fees and charges received, relative to the best estimate assumption.

Expense and income risks are managed through regular investigations and monitoring experience and reflecting the conclusions in product design and operating strategies.

Our main source of income relates to management fees generated by the value of assets under management. Fee rates have seen downward pressure in an increasingly competitive marketplace.

The amounts of expense incurred and income received also vary in line with the underlying mix of funds chosen by policyholders, in accordance with the various natures of the relevant funds' investment strategies.

### C.1.2 Risk concentration

The Company's business exclusively relates to the investment needs of pension schemes, covering defined benefit and defined contribution arrangements.

Some policies are reasonably large in terms of value of assets under management. However, the largest single policy represents less than 5% of total pooled funds under management.

The market is served by a relatively small number of financial advisors, and consequently there is risk concentration such that potentially similar policyholder behaviours may impact the terms the Company is able to offer, in particular where schemes may be related within industry or employment sector.

### C.1.3 Risk mitigation

Policies contain no material options or guarantees, and the Company has wide contractual rights to vary policy terms and conditions, including charges, upon suitable provision of notice to policyholders (typically four months).

Pooled policy terms and conditions also allow the Company to defer policyholder disinvestments if considered appropriate and in the interests of continuing policyholders in circumstances outside our control.

There are no guaranteed surrender values and policyholder payments equal the bid value of units disinvested. Our asset-liability matching policy requires assets to be held that are equal to the bid value of policyholder units. As such, there is no deviation between actual and expected payments.

Segregated contracts can be unilaterally terminated by the Company on provision of one month notice period to the client.

Pooled contracts contain an embedded annuity option whereby individual scheme members may purchase an annuity at the market rates prevailing at the time of purchase. Any such annuities would be automatically 100% reinsured under an existing reinsurance treaty. The terms of this option are therefore financially immaterial and in practice no such new annuities have been written for many years.



No additional financial guarantees or options, or extension in the standard notice period for changes to policy conditions, are permitted without specific approval by the PMC Governance Committee.

The LGIM Fees Committee has responsibility to approve, review and monitor the appropriateness and transparency of charges, including deviation from standard fee rates.

The LGIM Product Governance Committee has responsibility to review pricing strategies and assumptions for new initiatives prior to submission for approval by the LGIM Fees Committee.

The nature of the business means that any constraints related to underlying policyholder investments are automatically taken into account in the process of designing new funds or products.

Management controls are in place to manage lapse and expense risk, including regular monitoring of lapse experience, competitor activity, and ongoing cost income ratio, to initiate appropriate management action.

The risks associated with the very small annuity book, which are already immaterial, are further mitigated by a 100% reinsurance arrangement which is in place. As such, there is no residual longevity or other insurance risk in respect of the annuity book.

#### C.1.4 Risk sensitivity

A range of firm-wide stress scenarios are considered as part of the annual ORSA exercise. Given the nature of the business, asset and liability stresses are equal and opposite, and the only financial impact on the Solvency II basis arises from consequent fee variation and associated pressure on expenses.

The contribution, prior to diversification with other risks, towards the Company's Solvency Capital Requirement in respect of extreme (1-in-200 year event) variation in the components of underwriting risk experience is shown in form S.25.03 in the Appendix.

#### C.1.5 Prudent Person Principle (Underwriting risks)

The Company's only material line of business is unit-linked business whereby the investment risk is borne by the policyholders and the benefits provided are directly linked to the value of assets contained in internal funds divided into units.

The Company holds assets which match the nature and value of the policyholder liabilities, set as the bid value of the units. Accordingly, the assets held are invested in a manner appropriate to the liabilities and in the best interest of all policyholders.

## C.2 MARKET RISK

### C.2.1 Material risk exposures

The vast majority of assets on the Company's balance sheet are held for unit-linked and index-linked contracts and therefore the nature of the business written is such that investment returns on these assets contribute directly to the value of policyholder units. Assets are invested in line with the fund choices made by the policyholders, and the associated market and counterparty risks are borne by the policyholders.

The Company is exposed to the risk of volatility in asset management fee income due to the impact of interest rate, currency rate and market price movements on the fair value of the assets held in the linked funds, on which fees are based. There is also the risk of expense over-runs should the market depress the level of charges which could reasonably be imposed.

The Company's shareholder investments are primarily held to provide liquidity and capital security, and the assets held are subject to minimal market risk accordingly.

### C.2.2 Risk concentration

The Company provides a wide range of unit-linked funds and, subject to the fund choices made by its policyholders, assets held for unit-linked contracts are diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings, or geographical area and excessive accumulation of risk in the portfolio as a whole.

Investments in assets issued by the same issuer, or by issuers belonging to the same group, do not expose the insurance undertakings to excessive risk concentration.

A significant proportion of the Company's Own Funds are invested in holdings of UK government securities. However these are restricted to securities with short remaining duration to maturity and as such are not significantly exposed to market risk.

### C.2.3 Risk mitigation

Market risks are managed through maintaining a diversified range of funds in which customers may invest, including external funds. In addition, the Company has the contractual right to amend pooled fund policy terms on provision of suitable notice to policyholders.

#### C.2.3.1 Unit-linked and index-linked contracts

The underlying investments held in respect of unit-linked and index-linked contracts are selected in the best interest of policyholders and beneficiaries, taking into account the disclosed objectives, documentation and expectations for the relevant funds and any liquidity or other contractual constraints. Each unit-linked fund has a Fund Objectives and Guidelines document detailing the portfolio's objectives and restrictions.

The market risks relating to each fund are fully communicated to policyholders.

#### C.2.3.2 Segregated contracts

For segregated mandates, an Investment Management Agreement (IMA) is in place for each client and details the allowable nature and terms of asset transactions agreed by the relevant client.

There is no asset-liability mismatch risk, other than via the operational risk of the IMA not being suitably adhered to. As such, this risk is covered under the Operational Risk Policy.

#### C.2.3.3 Unit-linked matching

Article 132(3) of the Solvency II Directive requires that where policy benefits are directly linked to the value of units or assets contained in an internal fund, technical provisions must be held which are represented as closely as possible by those assets.

PMC's matching philosophy is to hold the appropriate assets within each unit-linked fund to the value which matches the unit-linked liabilities, determined as the bid value of the units.

As such, PMC does not expect to operate a unit box position and no deliberate mismatches are permitted.

#### C.2.3.4 Shareholder assets

The Company's policy is such that shareholder investments are primarily held to provide liquidity and capital security, as distinct from targeting specific investment returns. Accordingly market risk is kept to a minimum by requiring the shareholder assets to be concentrated towards short-dated, high-quality assets, denominated in Sterling.

## C.2.4 Risk sensitivity

Direct exposure to market risks is borne by policyholders within the relevant unit-linked funds. Under asset stress within unit-linked funds, the Company is exposed only to second order risk of lower fee income from assets under management and an associated pressure on continuing to meet expenses.

Minimal market risk is associated with the Company's directly held investments within Own Funds, which are short-dated, high-quality assets.

A range of firm-wide stress scenarios are considered as part of the annual ORSA exercise. Given the nature of the business, asset and liability stresses are equal and opposite, and the only financial impact arises from consequent fee variation.

The contribution, prior to diversification with other risks, towards the Company's Solvency Capital Requirement in respect of the components of market risk is shown in form S.25.03 in the Appendix.

## C.2.5 Prudent Person Principle (Market risks)

Investment management services provided to the Company by LGIM and other LGIMH companies operate under a strict set of controls with regards to the type and amount of assets that are allowed. These controls are exercised through mandates which list the acceptable asset classes and exposure limits.

Derivative instruments are held directly within policyholder unit-linked funds for efficient portfolio management purposes only. Derivatives are also held indirectly, for example within collective investment schemes, for investment purposes as well as efficient portfolio management. However, there is no cross-contamination of derivatives held for investment purposes in collective investment schemes with assets held directly in PMC's long-term fund and therefore there is no burn through exposure from these indirect derivative contracts to other policyholders invested in PMC's long-term fund.

The Company holds assets for unit-linked contracts which match the nature and value of the policyholder liabilities, set as the bid value of the units. Accordingly, the assets held are invested in a manner appropriate to the liabilities.

The Company invests its capital in short-dated high-quality liquid instruments, such as UK gilts, which are subject to minimal market risk.

## C.3 CREDIT RISK

### C.3.1 Material risk exposures

Credit risk is the risk that the Company is exposed to loss if another party fails to perform its financial obligations to the Company.

For unit-linked contracts, the Company matches all the liabilities with assets in the portfolio on which the unit prices are based. There is therefore no material interest, price, currency or credit risk for the Company on these contracts. Market and counterparty risks on unit-linked funds are borne by the policyholders.

The Company is directly exposed to counterparty risk relating to shareholder cash held overnight at banking counterparties. This includes the risk of counterparty default for the short period between receipt of monies in respect of client investment into, or disinvestment from, unit-linked funds and the corresponding completion of the processing of those monies into the relevant funds or by settlement

to client as applicable. The risk is not material given the short time period involved and the framework of counterparty controls and limits that operate.

The Company is exposed to the risk of default in respect of payment of fees by clients and the risk of default under the Company's reinsurance arrangements. However these risks are not considered to be material given the exposure amounts and the risk controls and mitigations that are in place.

The Company holds short-dated UK government securities and short-term deposits as capital.

### C.3.1.1 Reinsurance counterparty risk

The Company does not have any material credit risk exposure to third party or internal reinsurers. Information on the nature of the exposures is shown below for completeness.

#### C.3.1.1.1 Legal & General Group Plc shares held via reinsurance

The pooled fund business offers a wide range of investment fund types. Some UK Index funds necessarily desire to have an exposure to movements in the Legal & General Group Plc share price. In order that the Company does not itself hold shares in its own ultimate parent company (since a direct holding would breach a Companies Act requirement), the required exposure is obtained via a reinsurance arrangement with Swiss Re Europe S.A. (Swiss Re).

The underlying purpose of the reinsurance is to reduce tracking error on policyholder UK Index funds in order to facilitate closer alignment of policyholder returns to the relevant index economic constituents.

The economic effect of the reinsurance (i.e. on a look-through basis) is that the index funds are exposed to Legal & General Group Plc share price movement, as desired. Although the contractual arrangement is classified as a reinsurance treaty, it does not have the typical features of a risk mitigating contract since the purpose is not to indemnify the Company against losses. The value of the reinsurance treaty (which is directly linked to the assets held in a Swiss Re custody account) is included in the assets held for unit-linked funds and exactly matches the policyholder liability. As such there is no basis risk.

PMC has a floating rate first priority charge on specific assets held by the reinsurer to match this exposure, and the relevant assets (a portfolio of Legal & General Group Plc shares and any uninvested cash) are held for the reinsurer in a custody account with LGIM as asset manager.

In principle, PMC is exposed to the risk of reinsurer default. However, the priority charge on the relevant assets means that, in the event of such default, the value of those assets would be secured for PMC. The reinsurer's credit rating, in conjunction with the operation of the priority charge and the unit-linked nature of the liabilities, is considered to mean immaterial counterparty default risk applies. Further, the custodial relationship for the assets is managed by LGIM as asset manager and trading instructions are routed via LGIM, and as a result PMC has good ongoing visibility of the assets charged for its benefit.

#### C.3.1.1.2 Investment Only platform

The Company also has in place a number of reinsurance arrangements with external third parties relating to a minor proportion of the assets held within unit-linked funds. The underlying purpose of the arrangements is not to transfer risk in the conventional reinsurance sense but instead the various arrangements allow expansion of the available range of policyholder investment choice.

Use of such reinsurance arrangements in order to expand the available range of investment choice for policyholders has increased during 2017. Although contractually structured as reinsurance treaties, there is no underlying transfer of risk as the PMC policyholder bears the risk of reinsurer default (which is explicitly written accordingly into each legal contract between the Company and the

relevant PMC policyholders) and the Company's exposure is restricted to a second order impact via consequent reduction in fee income. At the current levels, such second order exposure is immaterial.

The nature of the arrangements means that the Company is not directly impacted by the credit standing of each reinsurer. Nevertheless, before each arrangement is entered into, the Company secures an appropriate floating charge to the value of the relevant assets in order to reduce the risk of PMC policyholders being adversely economically impacted by reinsurer default. Approval for these arrangements is governed by the existing product and fund approval framework.

#### C.3.1.1.3 Annuity reinsurance

The Company also has a reinsurance arrangement with Legal and General Assurance Society Limited in respect of a very small book of annuities in payment. The gross exposure is financially immaterial to the Company's balance sheet. The reinsurer also provides all administration services for the small number of policies concerned.

#### C.3.1.2 Banking counterparty risk

The Company is exposed to potential financial loss should banks or other issuers of financial instruments default on their obligations to us. We are also exposed to counterparty risks in respect of the providers of settlement and custody services.

Exposures to banking counterparties and the issuers of financial instruments are controlled using a framework of counterparty limits. These limits take account of the relative financial strength of the counterparty as well as other exposures that the Company may have. Limits are subject to regular review with actual exposures monitored to limits. We apply defined criteria for the ongoing monitoring of custody and settlement services and the financial strength of providers is regularly reviewed.

#### C.3.1.3 Client counterparty risk

Whilst it is possible for the fund management fees to be deducted as part of the unit price, the majority of policyholders pay fund management fees quarterly in arrears.

Although there is therefore an exposure to the risk of clients not paying the incurred and invoiced fees in a timely manner, the standard policy terms allow the Company to recoup any unpaid amounts directly from the value of assets managed for the client should this prove to be necessary.

A minority of new clients occasionally request that the Company allocates fund units in advance of the client providing monies for investment. The Company only agrees to such 'pre-funding' subject to strict limits and controls, and the timeframe involved before receipt of the client monies is typically two days. Counterparty risk is not material as the Company holds the assets purchased.

### C.3.2 Risk concentration

A significant proportion of the Company's Own Funds are invested directly or indirectly in holdings of UK government securities. However these are restricted to securities with short remaining duration to maturity and, in conjunction with the UK government's credit rating, do not expose the Company to any material credit risk or significant risk concentration.

The agreed limits for placement of overnight deposits with counterparties are set at a level to avoid material risk concentrations.

### C.3.3 Risk mitigation

The Investment Manager is assigned diversification limits to manage shareholder exposures to external counterparties. Diversification limits are subject to the Investment Manager's independent portfolio monitoring and breach reporting processes.

Counterparty risk relates primarily to overnight deposits of shareholder cash. This is monitored to ensure that counterparty placements do not exceed agreed limits and that amounts held in the current accounts are placed with other counterparties each day. The process allows a proportion of cash to be left with HSBC as custodian.

As described in section C.3.1.3 above, the Company has the right to effect payment of the relevant outstanding amount should invoiced fees remain unpaid, either by auto-surrender of policy units in accordance with the standard terms and conditions or by deduction from proceeds at the point of policy redemption.

Reinsurance counterparty risks are mitigated by the presence of the floating charges described in section C.3.1.1 above.

#### C.3.4 Risk sensitivity

The Company has no material exposure to credit risk.

#### C.3.5 Prudent Person Principle (Credit risks)

Investment management services provided to the Company by LGIM and other LGIMH companies operate under a strict set of controls with regards to the type and amount of assets that are allowed. These controls are exercised through mandates which list the acceptable asset classes and exposure limits.

Assets are properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings, or geographical area and excessive accumulation of risk in the portfolio as a whole.

Investments in assets issued by the same issuer, or by issuers belonging to the same group, do not expose the insurance undertakings to excessive risk concentration. The Company has a relatively large proportion of shareholder investments in UK gilts; however these are considered to be low risk assets.

To ensure protection of assets for unit-linked funds, for pooled business, assets are held at a separate custodian and clients are protected by the presence of a floating charge over PMC's assets and a security trustee.

Where clients have chosen to link the value of their policy to a fund provided by an external insurer, the Company secures an appropriate floating charge to the value of the relevant assets in order to reduce the risk of the clients being impacted by reinsurer default.

For segregated business, the assets are held at the client's custodian.

## C.4 LIQUIDITY RISK

### C.4.1 Risk exposure

Liquidity risk is the risk that the Company, though solvent, either does not have sufficient liquid financial resources available to meet its obligations as they fall due, or can only secure such liquid financial resources either at an excessive borrowing cost or through a sale of assets at a price significantly below the fair value of such assets in the recent past.

The cash conversion cycle within the Company is such that there is some exposure to corporate working capital strain; in particular, fee income is typically collected quarterly in arrears but expenses are payable monthly.

The investment risks associated within the unit-linked funds, including liquidity risk, are borne by the policyholders.

### C.4.2 Liquidity risk management

The Company does not seek exposure to liquidity risk as a part of its business model, but accepts that exposure to liquidity risk can arise as a consequence of the markets in which it operates, the products that it writes and through the execution of investment management strategies.

Overall, the Company maintains sufficient liquid funds for business as usual purposes. Furthermore, it seeks to ensure that exposures to liquidity risk which arise are effectively managed so that the Company continues to meet its obligations under unlikely, but plausible, extreme liquidity scenarios.

Exposure to liquidity risk is measured in terms of a liquidity coverage ratio expressed in terms of the sources of cash or liquid assets and committed facilities that need to be maintained to cover identified liquidity requirements. The identified liquidity requirements are defined as:

- **Near term:** The immediate liquidity requirements managed under normal circumstances on a daily basis. The main requirements here include working capital funding, together with known and forecast cash flows relating to less routine transactions such as dividend payments. In this everyday scenario the sources of liquidity are cash held in bank accounts and liquidity funds and known cash inflows;
- **Moderate:** This scenario is adjusted for stresses more severe than everyday requirements. The sources of liquidity are also stressed in this scenario and may be reduced because of the adverse effects of the stress scenario;
- **Extreme:** The stressed liquidity requirements in an unlikely, but plausible, extremely adverse market scenario. The sources of liquidity are also stressed in this scenario and may be reduced because of the adverse effects of the stress scenario.

In addition to other sources of liquidity, the Company has access to short-term borrowing in the form of an overdraft facility with HSBC.

A credit facility has also been established with Legal & General Finance Plc for the provision of up to £200m for use in the event that the Company does not have sufficient cash on any given business day. This facility is primarily intended to cover planned short-term spikes in the Company's liquidity requirements, and as such any loan through this facility will normally be very short term. The loan facility is also available, if required, to provide liquidity in other defined circumstances, such as around the time of the annual dividend payment, in which case the duration for loan repayment is agreed at the time of borrowing though will typically not exceed 6 months.

### C.4.3 Risk concentration

The Company's control framework defines procedures, exposure limits and minimum credit quality standards in order that no material liquidity risk concentration exists.

### C.4.4 Risk mitigation

Policyholders who invest in the Company's pooled pension funds do so by way of an insurance policy to which units are allocated in the range of pooled investment funds operated as 'PF Sections'.

The investment risks associated with the unit-linked funds, including liquidity risk, are borne by the policyholders.

As part of its existing liquidity risk management, the Company uses daily controls to monitor and manage withdrawal requests.



Where a PF Section could not meet a requested redemption from its prevailing cash level, the relevant fund manager would work with the trading team on a dealing strategy that raises the required cash sum without material disruption to the PF Section or its remaining policyholders.

Standard redemption terms are communicated with clients and vary according to the dealing frequency of the relevant fund.

No surrender penalties apply upon surrender. However, in addition to the standard redemption terms which apply as described above, the contractual policy terms include further provisions for liquidity management as follows:

- where the surrender of units in an individual PF Section is greater in value than £1m, PMC can give notice to transfer assets in specie
- when market conditions or other external factors impact the realisation of underlying investments, the Company may delay surrender payment by up to one year for all pooled funds, and by a further nine months for real estate funds.

For segregated mandates, investment objectives are agreed with each client at outset and include any liquidity requirements. The Company is not exposed to any liquidity risk in respect of the investments managed under segregated mandates.

#### C.4.5 Expected profit in future premiums

All in-force business written by the Company is treated for valuation purposes as single premium business. As such the amount of the expected profit from future premiums included on the Solvency II balance sheet is zero.

#### C.4.6 Prudent Person Principle (Liquidity risks)

Investment management services provided to the Company by LGIM and other LGIMH companies operate under a strict set of controls with regards to the type and amount of assets that are allowed. These controls are exercised through mandates which list the acceptable asset classes and exposure limits.

The Company's shareholder investments are short-dated, high-quality localised liquid assets.

Although no regulatory requirement exists for the segregation of shareholder cash and policyholder cash in transit, PMC has implemented a policy of physically separating them to strengthen policyholder protection and provide greater clarity to underpin the Company's floating charge security structure.

### C.5 OPERATIONAL RISK

#### C.5.1 Material risk exposures

Operational risk is defined as loss arising from inadequate or failed internal processes, people, systems or external events.

The Company operates within a framework of internal controls to minimise the risk of unanticipated loss from operational risk events, whilst recognising that no system of internal control can completely eliminate the risk of error and financial loss. Poor or inefficient business processing can also lead to increased cost as a whole, and operational errors with associated reputational damage and loss of assets.

The Operational Risk assessment process for the Company has two main components.



The first covers processing risks, which arise relatively frequently from the day-to-day operations of the business. Control frameworks are designed to minimise such operational losses to acceptable levels.

The second covers event risks, relating to rare events which have a low probability but may have a material financial impact should they occur and may cause reputational damage. Controls and processes are designed to prevent and detect any such event.

Operational risks are regularly reviewed, including an annual in-depth analysis and discussion at risk assessment meetings with senior management and relevant Committees.

### C.5.2 Risk concentration

Investment management services are provided by LGIM. Given the size and nature of the Company's business, the operational systems and processes utilised by LGIM represent a potential concentration of operational risk for the Company, albeit LGIM procedures remain subject to the Group's internal control framework as appropriate.

We have not identified any other material risk concentration for operational risk.

### C.5.3 Risk mitigation

The Company has a well-established and embedded risk governance model that seeks to ensure that business management is actively engaged in ensuring an appropriate control environment for managing the risks implicit in the business. The Risk function led by the Chief Risk Officer provides both expert advice and guidance on the required control environment, together with objectively challenging the way risks are being managed. The Internal Audit function, which reports to the Group Audit Committee, provides independent assurance on the adequacy and effectiveness of controls.

The Company's plans for growth will inherently increase the profile of operational risk across the business. Accordingly, as the Company grows, it continues to invest in system capabilities and operational processes to meet the expectations of customers; comply with regulatory, legal and financial reporting requirements; and mitigate the risks of loss or reputational damage from operational risk events. To deliver this, a number of strategic initiatives are being implemented.

From January 2017, a minor portion (approximately 12%) of the UK gilt investment is held in a bespoke Qualifying Investor Alternative Investment Fund managed by LGIM (Ireland) Risk Management Solutions, which can be used from time to time to hedge the potential risks to the PMC balance sheet following the occurrence of specific market-related operational risk errors. This holding is consistent with PMC's risk appetite regarding minimal market risk exposure for shareholder assets. To date, the hedging facility provided by this bespoke holding has not been required to be utilised.

The financial services sector has seen attempts by third parties to seek and exploit perceived vulnerabilities in IT systems. Potential threats include denial of service attacks, network intrusions to steal data for the furtherance of financial crime, and the electronic diversion of funds. We are focused on maintaining a robust and secure IT environment that protects customer and corporate data and minimises the potential for the perpetration of criminal acts. Processes exist to evaluate the security of systems and proactively address emerging threats.

### C.5.4 Risk sensitivity

A variety of sensitivity tests have been undertaken within the calibration of the operational risk capital requirement, including: using alternative distribution shapes for operational risk scenarios; applying different techniques to combine scenarios; and varying correlation assumptions. The sensitivity tests employed have identified no material concerns with the results of the calibration.

Triggers have been set within the regular risk reporting to monitor key categories of operational risk such that when these triggers are breached, a reassessment of capital needs will be undertaken.

The contribution, prior to diversification with other risks, towards the Company's Solvency Capital Requirement in respect of operational risk is shown in form S.25.03 in the Appendix.

### **C.5.5 Prudent Person Principle (Operational risks)**

Investment management services provided to the Company by LGIM and other LGIMH companies operate under a strict set of controls with regards to the type and amount of assets that are allowed. These controls are exercised through mandates which list the acceptable asset classes and exposure limits. The investment manager is only permitted to invest on behalf of the Company in assets and instruments whose risks it can properly identify, measure, monitor, manage, control and report.

Granular asset data for all assets held by the Company is included in regular reporting to the PRA.

The Fund Objectives and Guidelines document for each unit-linked fund details the relevant objectives and restrictions, including consideration of the requirements of COBS 21 (permitted links).

The nature of the PMC business means that any constraints related to underlying policyholder investments are automatically taken into account in the process of designing new funds or products.

## **C.6 OTHER MATERIAL RISKS**

There is also reputational contagion risk to the Company from events that may arise elsewhere within the parent Legal & General Group. Lack of confidence in the Company and the Group is mitigated by the retention within the Company of sufficient capital to avoid the need to rely on parental support in all but the most extreme circumstances and by effective ongoing capital management.

The markets in which the Company operates are highly regulated, with regulation and legislation defining the overall framework for the design, marketing and distribution of products; the acceptance and administration of business; and the prudential capital that regulated companies should hold. There continues to be a significant pipeline of globally driven regulatory change, which may affect the cost of providing insurance-based investment products or the way that investment firms do business.

Furthermore, the long-term impact on regulation of Brexit is still developing. A small proportion of the Company's business relates to EU-based clients and, without confirmation of local EU post-Brexit regulatory requirements, there remains a potential risk to effective future servicing of that business. Discussions are in progress accordingly with the relevant regulators in order to confirm an appropriate post-Brexit solution.

The Company has a framework for identifying these risks through annual reviews of divisional plan strategy, regular meetings with senior management and a quarterly legal entity and business risk assessment.

## **C.7 ANY OTHER INFORMATION**

The above sections C.1 to C.6 inclusive contain all material information regarding the risk profile of the Company.

## D. VALUATION FOR SOLVENCY PURPOSES

### D.1 ASSETS

A summary of the Company's assets on the Solvency II valuation basis is set out in the following table.

<b>Assets (£m)</b>	<b>2017</b>	<b>2016</b>
Assets (other than those held for linked contracts)	653	677
<i>Bonds</i>	231	262
<i>Collective Investment Undertakings</i>	32	0
<i>Deposits other than cash equivalents</i>	12	101
<i>Cash and cash equivalents</i>	34	92
<i>Reinsurance recoverables</i>	3	3
<i>Insurance and intermediaries receivables</i>	71	71
<i>Other (non-invested) assets</i>	270	148
Assets held for index-linked and unit-linked contracts	308,789	294,398
<b>Total assets</b>	<b>309,442</b>	<b>295,075</b>

#### D.1.1 Solvency II valuation for each material class of asset

The Solvency II Balance Sheet is prepared on a market-consistent basis, whereby assets are accounted for at market value and liabilities are assessed on a best estimate basis.

The Company values its assets in accordance with Article 75 of the Solvency II Directive and in line with the requirements of Article 10 of the Solvency II Delegated Regulation. Valuations of assets are underpinned by a system of processes and controls ensuring compliance with Article 267 of the Solvency II Delegated Regulation. Included within these processes is an assessment of valuation uncertainty and the extent to which asset valuations are appropriate in light of uncertainties that exist. This process focusses on, although is not limited to, assets that are valued using alternative valuation techniques.

There is no material uncertainty in the valuation of assets. A minority (approximately 1%) of instruments are valued using alternative valuation techniques where some inputs are not based on observable market data (unobservable inputs). All such instruments are held within unit-linked funds and the designated asset value is exactly matched by a policyholder unit liability of identical amount. Further detail on these is provided in section D.4 below.

We have concluded that our assets are valued appropriately in accordance with Article 10 of the Solvency II Delegated Regulation and appropriately reflect consideration of valuation uncertainty.

There have been no changes to the asset recognition and valuation bases used during the reporting period.

##### D.1.1.1 Bonds

Bond investments are measured at fair value using quoted market bid prices.

##### D.1.1.2 Deposits other than cash equivalents

These are short-term deposits held with highly rated banks and other financial counterparties, measured as the par amount of the deposit plus any attaching accrued interest.

### D.1.1.3 Assets held for index-linked and unit-linked contracts

Assets held for index-linked and unit-linked contracts are measured at the fair value of the underlying assets and liabilities (other than technical provisions) held within such funds.

Unit-linked assets are closely matched to the corresponding liabilities, and the value of policyholder assets held equals the bid value of the policyholder unit liability.

Where available, assets and liabilities within unit-linked funds are valued using quoted market bid prices obtained from independent sources in active markets for the identical assets and liabilities.

Derivative assets are directly held only within policyholder unit-linked funds for efficient portfolio management. When valuing derivatives as part of the unit-pricing mechanism, warrants, futures, swaps and listed options are taken at market value and currency forwards are valued using current exchange rates.

A minority of instruments within unit-linked funds are valued using unobservable inputs. Further detail on these is provided in section D.4 below.

### D.1.1.4 Reinsurance recoverables

This asset class is not financially material but is described here for completeness. The value shown in the balance sheet corresponds to the best estimate liability for a very small immediate annuity book which is included within gross technical provisions and is 100% reinsured.

The Company also has in place a number of reinsurance arrangements with external third parties relating to a minor (less than 1%) proportion of the assets held within unit-linked funds. Although contractually structured as reinsurance treaties, the underlying purpose of the arrangements is not to transfer risk in the conventional reinsurance sense but instead the various arrangements allow expansion of the available range of policyholder investment choice and facilitate exposure within certain unit-linked funds to the price of Legal & General Group Plc shares. The value of these reinsured assets is included within the total asset value held for linked contracts.

### D.1.1.5 Cash and cash equivalents

Cash and cash equivalents are valued at fair value in accordance with IFRS. The value primarily relates to cash in hand or held at call with banks.

### D.1.1.6 Insurance and intermediaries receivables

These are held at fair value in accordance with IFRS. This item primarily relates to invoiced fees due to be received from clients.

### D.1.1.7 Other assets

These are held at fair value in accordance with IFRS. This item primarily relates to fees which have accrued though not yet invoiced to clients.

## D.1.2 Material differences between IFRS and Solvency II valuation

There are no material differences in the bases, methods and main assumptions used in the asset valuation for Solvency II purposes compared to the valuation in the IFRS financial statements.

There are certain presentational differences which have zero net impact on the balance sheet position.

The main relevant presentational difference is that under Solvency II all assets held for linked contracts are consolidated and reported as a single distinct asset class, whereas in the IFRS financial statements the underlying assets and liabilities within the unit-linked funds are separated out and shown according to the nature of each particular instrument. As such the total asset value shown in

the IFRS financial statements is higher than that shown in the Solvency II balance sheet by £6bn, with a correspondingly higher value of liabilities. The main component of this difference relates to the presentational treatment of the fair value of derivative liabilities within unit-linked funds.

One further presentational difference is that short-term deposits are included in the IFRS balance sheet within Cash and cash equivalents, whereas for Solvency II these are separated out and shown under Deposits other than cash equivalents.

## D.2 TECHNICAL PROVISIONS

A summary of the Company's technical provisions split by the defined Solvency II lines of business is set out in the following table.

<b>Solvency II Technical provisions (£m)</b>	<b>Index-linked and unit-linked insurance</b>	<b>Other life insurance</b>	<b>Accepted reinsurance</b>	<b>Total 2017</b>
Best estimate liability	270,293	3	38,071	308,367
Risk margin	32	0	5	37
<b>Total Technical Provisions (gross)</b>	<b>270,325</b>	<b>3</b>	<b>38,076</b>	<b>308,404</b>

<b>Solvency II Technical provisions (£m)</b>	<b>Index-linked and unit-linked insurance</b>	<b>Other life insurance</b>	<b>Accepted reinsurance</b>	<b>Total 2016</b>
Best estimate liability	262,405	3	31,579	293,987
Risk margin	32	0	3	35
<b>Total Technical Provisions (gross)</b>	<b>262,437</b>	<b>3</b>	<b>31,582</b>	<b>294,022</b>

The line of business described as accepted reinsurance is entirely comprised of unit-linked and index-linked contracts, similar in all material respects for valuation purposes to the index-linked and unit-linked insurance line of business. Accordingly, in the following sections, 'unit-linked' refers to both of these Solvency II lines of business.

### D.2.1 Solvency II valuation basis for material lines of business

For Solvency II, technical provisions are calculated as the sum of a best estimate liability and a risk margin.

Liabilities under the unit-linked contracts are recognised as and when the units are created.

Unit-linked assets are closely matched to the corresponding liabilities, and the value of policyholder assets held equals the bid value of the policyholder unit liability.

#### D.2.1.1 Methodology

##### D.2.1.1.1 Best estimate liability

The best estimate liability for the unit-linked business is a combination of the bid value of policyholder units and a discounted value of future expected cashflows (i.e. expected fee income less expenses) over a suitable projection period using risk-free rates of return and best estimate experience assumptions.

For valuation purposes, all of our contracts are treated as single premium policies and projected cashflows assume no future premium payments accordingly.

The cash flow projection includes the following components in relation to existing contracts:

- payments to policyholders;
- expenses that will be incurred in servicing existing contractual obligations, including expenses incurred in making payments to policyholders and investment management costs; and
- charges and fees received in respect of continuing existing contracts.

The projection period differs for pooled business and segregated contracts, reflecting their inherently different contractual terms and conditions.

For the segregated business, the assets under management are excluded from the Solvency II balance sheet since these assets remain in the clients' possession. For the purposes of setting technical provisions under Solvency II rules, for segregated contracts the methodology directly reflects the Company's unilateral right to terminate the provided services upon giving one month's notice. Accordingly the present value of future projected cashflows on segregated contracts would be calculated using a one month projection period, and applying this as a reduction in balance sheet liabilities. In practice, we instead take the value to be zero. This proportionate approach gives materially the same overall result on the Solvency II basis.

#### D.2.1.1.2 Risk margin

Solvency II regulations require insurers to hold a risk margin as an additional liability within Technical Provisions. The risk margin is designed with the aim of ensuring that the overall value of a firm's technical provisions is equivalent to the amount that would be expected to be required if a third party were to take over and meet the insurance obligations of the firm.

The risk margin in relation to our business is relatively small, reflecting the nature of the business which almost entirely consists of unit-linked contracts with no material options or guarantees.

The risk margin is calculated as the present value of the cost of capital required in respect of non-hedgeable risks within the Solvency Capital Requirement over the assumed projected run-off period of the relevant business. The discount rate used to determine the present value is the relevant basic risk-free rate, and the cost of capital rate is set to 6% as prescribed in the Delegated Regulations. The calculation assumes that all risks are non-hedgeable, with the exception of market risk which is assumed to be hedgeable.

The calculation of Solvency II risk margin for the PMC unit-linked business uses an approximation rather than undertaking a precise projection of future capital requirements. The non-hedgeable components of the SCR are projected forward over future years using appropriate proxy carrier variables for each relevant risk; for example, the operational risk component is based upon the projected value of funds under management. This is appropriate since movements in fund sizes can be expected to impact transaction volumes and hence impact operational risks.

The approximation used implicitly assumes stable diversification between risks. This is appropriate given the cash flow projection period and the relative immateriality of the size of the risk margin. It would be disproportionate to model a more precise approach allowing for variation in diversification.

#### D.2.1.1.3 Matching adjustment

PMC does not apply the matching adjustment referred to in Article 77b of Directive 2009/138/EC.

#### D.2.1.1.4 Volatility adjustment

PMC does not apply the volatility adjustment referred to in Article 77d of Directive 2009/138/EC.

#### D.2.1.1.5 Transitional measures

PMC does not apply the transitional risk-free interest rate-term structure referred to in Article 308c of Directive 2009/138/EC.

PMC does not apply the transitional measure on technical provisions referred to in Article 308d of Directive 2009/138/EC.

#### D.2.1.2 Main assumptions

The cash flow projection assumptions reflect the relevant contract terms and conditions, and cover expected persistency, expenses and fee income. The assumptions are set by reference to and examination of detailed experience analysis for each item, supplemented by expert judgement where considered appropriate, for example to incorporate any anticipated deviation in emerging experience compared to the underlying historic actual experience or agreed future management actions where considered realistic and objective.

As part of the assumption setting process, any material deviation in emerging experience compared to previous estimate is considered and an appropriate adjustment to the methodology would be made in the event of any identified systematic deviation.

Expert judgement is applied when considering the accuracy, completeness and appropriateness of available data used to determine best estimate assumptions. Generally, the methodology applied to derive assumptions from the data is well established and the financial impact of any additional expert judgement used to set best estimate assumptions is relatively minor.

##### D.2.1.2.1 Economic assumptions

The overriding principle followed in setting economic assumptions is that they should reflect the economic conditions at the valuation date.

##### Risk free yield curve

The valuation interest rate is based on a risk free rate of return yield curve taking into consideration the changes in this rate over the projection period. The risk free rate used is calculated based on the methodology specified by EIOPA, which is applied to construct zero coupon base rates from the underlying swap rates.

##### Unit growth

For the cash flow projections, an assumption regarding the rate of future growth in the value of funds under management for existing contracts is required. The assumption made is that the growth rate before charges is the same as the risk free discount rate.

##### D.2.1.2.2 Non-economic assumptions

##### Expenses

The cash flow projection used to calculate the best estimate liability takes into account all relevant administrative and investment management expense, including allocated overhead expenses. The expected costs are expressed as a percentage of funds under management for the projection. This implicitly allows for expense inflation at the unit growth rate. Judgement is used to set a further assumption that expenses will increase in percentage terms reflecting additional client pressures to provide enhanced services.

##### Persistency

Actual persistency experience is reviewed annually. Large cases are adjusted for and allowed for as an addition to the regular rate. The long-term persistency assumptions are set using underlying lapse experience typically examining experience over the preceding three year period.



## Fee income

Expected fee income is expressed as a percentage of funds under management, based on the most recent actual experience. The best estimate basis includes projected allowance for continuing fee pressures on defined benefit scheme business emanating from competitor action and client demand.

### D.2.1.3 Material changes in assumptions compared to the previous reporting period

Best estimate assumptions have been reviewed and updated as part of the established annual review of relevant experience which takes into account one additional year's actual experience compared with the previous assumption basis.

In aggregate, the impact of the revised assumptions on PMC Solvency II results for 2017 was marginally, though not materially, favourable compared to the previous assumptions and increased Own Funds by approximately £25m.

### D.2.2 Level of uncertainty associated with the value of technical provisions

The technical provisions are derived largely from the bid value of units and therefore there is relatively little uncertainty associated with the amount of technical provisions. The key criterion is that the value and nature of policyholder assets held equals the value and nature of the policyholder unit liability.

The components in the technical provisions relating to discounted projected cash flows and risk margin are based on assumptions and therefore inevitably contain some uncertainty in relation to the extent to which future actual experience may differ from the best estimate assumptions. However these components amount to less than 0.2% of the total technical provisions.

A robust assumption setting process is followed in order to ensure the uncertainty is well understood. The assumptions are primarily based on actual experience data with expert judgement applied to determine their appropriateness.

A framework to assess the confidence in the methodology and assumptions has been established through the Group Audit Committee. The framework allocates a status to the confidence in the assumption and methodology, based on a mixture of qualitative and quantitative criteria. The criteria set out in the framework and the initial assessments have been challenged and validated by experienced actuaries and accountants throughout the business.

### D.2.3 Material differences between IFRS and Solvency II valuation

Given the nature of the Company's business, the main difference in the valuations of the unit-linked business under the two reporting standards is the inclusion in the Solvency II valuation of a discounted value of assumed future projected cashflows on in-force business. This is included as a deduction within Solvency II technical provisions.

As described earlier, for the Solvency II valuation insurers are required to hold a risk margin as an addition liability within technical provisions.

For IFRS, technical provisions do not include the value of projected cashflows or risk margin, and instead directly reflect the bid value of units for linked contracts. As such, no projected experience assumptions are required for IFRS purposes. Consequently for IFRS there is no uncertainty or variability created by actual experience differing from assumptions.

The defined Solvency II lines of business are not used for the Company's IFRS reporting.



The following table provides a summary of the valuation differences for the unit-linked business.

<b>Unit-linked business (£m)</b>	<b>2017</b>	<b>2016</b>
IFRS liabilities for unit-linked contracts	308,789	294,398
Difference in liability valuation basis	(425)	(414)
Risk margin	37	35
<b>SII technical provisions</b>	<b>308,401</b>	<b>294,019</b>

The impact of valuation basis differences relating to the very small (£3m) book of annuities in payment is not material.

#### D.2.4 Reinsurance recoverables

The very small book of annuities in payment is 100% reinsured to another insurer within the Legal & General Group. In addition to the risk mitigation provided by this arrangement, the reinsurer also provides all required administration and valuation services for the relevant contracts. The reinsurance arrangement has no basis risk.

As stated in section D.1.1.4 above, the amount of reinsurance recoverables is not financially material.

Given the nature of the reinsurance contracts, there are no time differences between recoveries and direct payments that would impact the calculation of amounts recoverable.

### D.3 OTHER LIABILITIES

A summary of liabilities other than technical provisions on the Solvency II valuation basis is set out in the following table.

<b>Liabilities other than Technical Provisions (£m)</b>	<b>2017</b>	<b>2016</b>
Deferred tax liabilities	71	71
Insurance & intermediaries payables	134	235
Payables (trade, not insurance)	3	2
Any other liabilities, not elsewhere shown	126	81
<b>Total Other liabilities</b>	<b>334</b>	<b>389</b>

#### D.3.1 Solvency II valuation for each material class of other liabilities

There have been no changes made to the relevant recognition and valuation bases used or on estimations during the reporting period.

##### D.3.1.1 Deferred tax liabilities

An additional deferred tax liability is held on the Solvency II balance sheet. This reflects assumed tax payable on the present value of the assumed projected future cashflows on the Solvency II basis, adjusted appropriately for the Solvency II balance sheet risk margin. Since the value of projected future profits and the risk margin are not applicable to the IFRS financial statements, the amount of the calculated deferred tax appears directly as a difference between the two valuations. At the valuation date, the Company did not have any deferred tax liability on the IFRS basis.

##### D.3.1.2 Insurance & intermediaries payables

These are recognised and valued in accordance with IFRS. The balance primarily relates to payments in transit to clients, representing the bid value of units disinvested.

### D.3.1.3 Any other liabilities

These are recognised and valued in accordance with IFRS, and primarily relate to intra-group balances.

### D.3.2 Material differences between IFRS and Solvency II valuation

Other than the difference of £71m described above relating to deferred tax liabilities, there are no material differences in the bases, methods and main assumptions used for the valuation of other liabilities for Solvency II purposes compared to the valuation in the IFRS financial statements.

As described in section D.1.2 above, there are certain presentational differences which have zero net impact on the balance sheet position.

The main relevant presentational difference is that under Solvency II all assets held for linked contracts are consolidated and reported as a single distinct asset class, whereas in the IFRS financial statements the underlying assets and liabilities within the unit-linked funds are separated out and shown according to the nature of each particular instrument. As such the total value of liabilities shown in the IFRS financial statements is higher than that shown in the Solvency II balance sheet by £6bn, with a correspondingly higher value of assets. The main component of this difference relates to the presentational treatment of the fair value of derivative liabilities within unit-linked funds.

## D.4 ALTERNATIVE METHODS FOR VALUATION

A minority (approximately 1%) of instruments are valued using unobservable market inputs. All such instruments are held within unit-linked funds and the designated asset value is exactly matched by a policyholder unit liability of identical amount.

In certain circumstances, the fair values of financial instruments are measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. Illiquid market conditions have resulted in inactive markets for certain of the Company's financial instruments. As a result, there is generally no or limited observable market data for these assets and liabilities. Fair value estimates for financial instruments deemed to be in an illiquid market are based on judgement regarding current economic conditions, liquidity discounts, currency, credit and interest rate risks, loss experience and other factors. These fair values are estimates and involve considerable uncertainty and variability as a result of the inputs selected and may differ significantly from the values that would have been used had a ready market existed. As a result, such calculated fair value estimates may not be realisable in an immediate sale or settlement of the instrument. In addition, changes in the underlying assumptions used in the fair value measurement technique could significantly affect these fair values estimates.

Fair values are subject to a control framework designed to ensure that input variables and outputs are assessed independent of the risk taker. These inputs and outputs, including appropriate comparison against previous experience where relevant, are reviewed and approved by a valuation committee.

The following table shows the financial instruments valued using unobservable market inputs at the balance sheet date.

<b>Assets valued using alternative techniques (£m)</b>	<b>Solvency II</b>
Unquoted investments in property vehicles	157
Suspended securities	1
Unquoted securities	472
Investment property	3,358
<b>Total (all unit-linked)</b>	<b>3,988</b>

Unquoted investments in property vehicles and direct holdings in investment property are valued by independent valuers on the basis of open market value as defined in the appraisal and valuation manual of the Royal Institute of Chartered Surveyors. Valuation techniques may include discounted cash flow calculations using net current rent, and estimated and terminal values. They may also include yield methodology calculations using market rental values capitalised with a market capitalisation rate. Both of these are then further validated against actual market transactions to produce a final valuation.

The valuation of all the above instruments for Solvency II purposes is identical to the valuation in the IFRS financial statements.

## **D.5 ANY OTHER INFORMATION**

The above sections D.1 to D.4 inclusive contain all material information regarding the valuation of assets and liabilities for solvency purposes.

## E. CAPITAL MANAGEMENT

### E.1 OWN FUNDS

#### E.1.1 Objectives, policies and processes for managing Own Funds

There have been no material changes to the objectives, policies, and processes employed to manage the Company's own Funds.

The Company aims to manage its capital resources to maintain financial strength and policyholder security. Capital is managed such that the total available Own Funds exceeds a Solvency Capital Requirement (SCR) calculated in accordance with Solvency II regulations.

The SCR is set such that the Company remains solvent following a 1-in-200 year stress event (i.e. a 99.5% confidence level over a one year period). Our capital management policy is to hold an additional buffer above the calculated regulatory SCR such that the solvency coverage ratio exceeds 196%. Since PMC does not have a published credit rating from an external credit assessment institution, the coverage ratio influences the level of capital which our insurance clients are themselves required to hold in respect of the value of assets they have invested with us. A coverage ratio at this level corresponds to the lowest risk of default for the purposes of their capital calculations under the EU Directive. This is the same level of default risk assigned for capital calculations under the EU Directive for individual entities with a published credit rating of AA or better.

The PMC Governance Committee monitors the solvency capital position at least quarterly, enabling any appropriate actions to be identified as and when necessary to ensure compliance with the capital management policy. We aim to maintain a broadly stable solvency ratio, and the implied post-dividend coverage ratio on the Solvency II basis is one of the key metrics considered by the PMC Board when recommending our annual dividend payment to our parent holding company.

Assets held to cover the SCR are localised in the UK or Ireland, and are invested directly or indirectly in short-dated Sterling-denominated liquid instruments, such as UK gilts, so as to ensure appropriate security, quality, and liquidity of those assets.

The capital coverage of Own Funds is projected over a five-year planning horizon through the annual ORSA and builds on the overall Strategic plan and divisional Business plan. Performance against plan is monitored on a regular basis, and is used to inform the dividend recommendation.

#### E.1.2 Structure, amount, and quality of basic Own Funds

All of the Company's Own Funds are unrestricted Tier 1 basic Own Funds and there are no ancillary Own Funds. As such, there are no ineligible Own Funds for the purpose of covering the SCR and MCR. This was also the case at the end of the previous financial reporting period.

The eligible amount of Solvency II Own Funds to cover the SCR and MCR as at 31 December 2017 was £704m (2016: £664m). This corresponded to a solvency capital coverage ratio of 268% (2016: 246%).

The balance sheet figures are dominated by the value of unit-linked assets and corresponding matching bid value of policyholder unit liabilities, which are equal. Therefore movements in Own Funds are largely driven by the emerging retained profits from the unit-linked book and changes in the discounted present value of assumed future cashflows.

None of the Company's Own Funds are subject to transitional arrangements and there are no ancillary items.

No deductions are applied to Own Funds and there are no material restrictions affecting their availability or transferability.

### E.1.3 Differences between IFRS equity and SII Own Funds

The following table shows a high level reconciliation between the equity as shown in the Company's financial statements and the excess of assets over liabilities as calculated for Solvency II purposes.

<b>Summary reconciliation (£m)</b>	<b>2017</b>	<b>2016</b>
Share capital	0.1	0.1
Retained earnings	387	356
<b>IFRS equity</b>	<b>387</b>	<b>356</b>
Difference in liability valuation basis	425	414
Risk margin	(37)	(35)
Deferred tax	(71)	(71)
<b>Solvency II Own Funds</b>	<b>704</b>	<b>664</b>

The difference between the amount of Solvency II Own Funds compared with IFRS equity is a result of the additional liability components (additions and deductions) on the balance sheet which are specific to Solvency II and therefore not included in the IFRS liabilities. As at 31 December 2017, these comprise:

- A liability valuation basis difference of £425m, which represents a discounted value of assumed future projected pre-tax cashflows from existing business, as described in section D.2 above. This increases Solvency II Own Funds. For presentation purposes in the Solvency II balance sheet, this value is shown as a deduction within the technical provisions rather than as an asset.
- Risk margin of £37m, which reduces Own Funds
- A deferred tax liability of £71m, which reduces Own Funds. This primarily relates to assumed tax on the future projected cashflows.

In aggregate, these result in lower Solvency II liabilities by £317m compared with IFRS liabilities and therefore a higher value of Own Funds for Solvency II by the same amount.

### E.1.4 Reconciliation reserve

The Company's Own Funds equal the total value of assets less liabilities under Solvency II, and are comprised of a small amount (£0.1m) of paid-in share capital, plus a reconciliation reserve. The reconciliation reserve equals retained earnings plus the Solvency II adjustments as described in section E.1.3 above.

### E.1.5 Significant changes in Own Funds

During the reporting year, the Company declared and paid interim dividends totalling £150m to its parent company. This amount represented a proportion of operating profits arising during the year.

## E.2 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT

### E.2.1 Solvency Capital Requirement (SCR)

The SCR at 31 December 2017 was £263m (2016: £270m), calculated using the internal model approved by the PRA. The Standard Formula is not used and no capital add-on applies. The SCR calculated using the internal model is unaudited.

The following table shows the SCR split by risk categories:

<b>SCR by risk category (£m)</b>	<b>2017</b>	<b>2016</b>
Operational risk	172	167
Life underwriting risk	297	269
Market risk	101	101
Diversification between risk categories	(228)	(202)
Tax and other adjustments	(79)	(65)
<b>Total SCR</b>	<b>263</b>	<b>270</b>

The change in the amount of the total SCR over the year is not material.

Further underlying detail can be found in form S.25.03 which is included in the appendix.

### E.2.2 Minimum Capital Requirement (MCR)

The MCR at 31 December 2017 was £118m (2016: £122m).

The size and nature of the Company's business means that the MCR is defined by Article 248 of the Delegated Acts to be 45% of the calculated SCR, and therefore changes to the total SCR lead directly to proportional changes to the MCR.

The change in the amount of the MCR over the year is not material.

Further underlying detail can be found in form S.28.01 which is included in the appendix.

## E.3 USE OF THE DURATION-BASED EQUITY RISK SUB-MODULE IN THE CALCULATION OF THE SOLVENCY CAPITAL REQUIREMENT

The duration-based equity risk sub-module is not used in the calculation of the Company's SCR.

## E.4 DIFFERENCES BETWEEN THE STANDARD FORMULA AND ANY INTERNAL MODEL USED

### E.4.1 Internal Model

Legal & General Group Plc has chosen to adopt an Internal Model approach to calculate the SCR for all of the material insurance companies in the Group. The model has received the required regulatory approvals and the Company accordingly uses the Internal Model to determine its SCR.

### E.4.1.1 Use of the Internal Model

The Internal Model plays a central role in the measurement of risks, as the model translates identified risk exposures into risk-based capital requirements.

The output from the Internal Model is a key component of various activities as follows:

- Risk management, including experience monitoring of key risks using the internal model risk distribution for the relevant risk and the associated impact on SCR.
- Capital management, for example to monitor performance against the target capital coverage ratio.
- Business planning. For example, the projected business plan over the next five years includes corresponding projections of the capital requirement using the internal model SCR output. The model output is also used to inform dividend decisions and expectations over the projected period.
- Public reporting and disclosure, such as this Solvency and Financial Condition Report.
- Supervisory reporting under the Solvency II regime.

Effective management information using the Internal Model output informs and supports decision-making and risk assessment responsibilities.

### E.4.1.2 Scope of the Internal Model

In order that the Internal Model is a good fit to the business, the modelling approach reflects the nature, scale and complexity of the risks inherent in those business activities. The Internal Model covers all of the Company's material and quantifiable risk exposures.

The Internal Model provides a full probability distribution of capital outcomes for each material risk type within each category.

The model covers existing business and one year's expected new business.

Given the nature of the Company's business, there is no need to define more granular level business units within the model, as PMC is a mono-line company (i.e. operating in one specific financial area) focusing on the fund administration and management of unit-linked pension policies.

### E.4.1.3 Methods used in the Internal Model

PMC determines best estimate assumptions for future lapses, expenses and income. Experience investigations are conducted at least annually in order to ensure that the best estimate assumptions are compared to, and reflect where appropriate, the underlying actual experience.

The Solvency II liability value is calculated using a model which projects cash flows from the existing funds under management, allowing for the best estimate lapses, expenses and income. The resulting projected cashflows are discounted using the risk-free discount rate to give the present value of the assumed future expected cashflows arising from the existing business on the Solvency II liability valuation basis.

A probability distribution is determined for each relevant risk, with an associated correlation structure. Together, these specify possible outcomes over one year and the probability of those outcomes occurring.

The cashflow projection model is run on 5,000 scenarios drawn from the risk distributions, in conjunction with a formula fit algorithm, in order to derive an appropriate formula to represent the discounted cashflow value on the Solvency II basis.

The derived formula is then loaded into the Internal Model's primary calculation engine which runs 500,000 scenarios randomly sampled across all risk drivers. The simulations are constructed in such a way that each risk driver follows a predefined distribution and that the relationship between any two risk drivers follows a predefined correlation assumption. The simulations can be looked at as a sample generated from a multidimensional distribution. The multidimensional distribution is built from the risk driver distributions and a copula function which represents the dependency structure between the risks. The results of these runs are then ranked in order to determine the solvency capital requirement at the biting scenario corresponding to a 99.5<sup>th</sup> percentile. Final capital requirements are determined using a smoothing process, whereby rather than taking the 99.5<sup>th</sup> percentile capital requirement as the 2,500<sup>th</sup> worst outcome out of 500,000 scenarios, a weighted average of a number of simulations around the 99.5<sup>th</sup> percentile is used. This average incorporates the 1,250 scenarios immediately above the 99.5<sup>th</sup> percentile point and the 1,250 scenarios immediately below it, i.e. the average of all scenarios between the points corresponding to the 99.25<sup>th</sup> percentile and the 99.75<sup>th</sup> percentile.

Since the impact of market risks on PMC is second order only, stresses on policyholder funds are derived using summarised or proxy data rather than the actual individual asset data. For example, a model point group may be assessed with representative summary bond and equity assets such as a 40% bond / 60% equity portfolio.

For shareholder assets, each asset is considered individually using its specific relevant data.

#### E.4.2 Main differences compared to the standard formula approach

In line with Article 101(3) of the Solvency II Directive, the SCR calculated using the Internal Model corresponds to the value-at-risk of the Company's basic Own Funds subject to a confidence level of 99.5% over a one-year period. This calibration standard is the same as for the Standard Formula. However, the detailed calculations differ in their sophistication and the extent to which they have been tailored to the Company's own risk profile.

Standard Formula is not the Company's regulatory basis for calculating its SCR. The Internal Model has received the appropriate regulatory approval.

The main differences are as follows:

- *Life expenses and income risks* - The Internal Model includes an additional risk (which is not covered by the Standard Formula) in respect of variation in projected fee income compared to best estimate expectations. In addition, expense risk within the Internal Model is calibrated higher (i.e. more severe) than the Standard Formula.
- *Life lapse risk* - The Internal Model allows for potential variation in lapse experience to occur from both regular and mass lapses concurrently, whereas the Standard Formula takes the higher of the two stress results. In the Internal Model, the lapse risk stress is calibrated lower than the Standard Formula stress, reflecting the scale and nature of the Company's business.
- *Operational risk* – The Internal Model takes the 99.5<sup>th</sup> percentile of a combined loss distribution for operational risk losses over one year. The Standard Formula adopts a factor-based approach.
- *Aggregation and diversification* - The Internal Model aggregates the risks using a Monte Carlo simulation approach and a t-copula. The diversification approach implicit in the Standard Formula is based upon correlations at a single stress point using a sum of squares approach.



- *Counterparty default risk* – Where the Company utilises reinsurance arrangements to expand the range of investment fund choices available to its policyholders, the Internal Model allows more appropriately for the fact that the underlying counterparty risk is borne by the policyholders invested in the relevant unit-linked fund and not by the Company. The Standard Formula overstates the risk to the Company relating to reinsurance of unit-linked fund assets.
- *Market risk* – Group-wide calibrations for market risk are used by the Internal Model and these differ from the corresponding Standard Formula calibrations. However, given the unit-linked nature of the Company's business, market risks are primarily borne by policyholders and the differences in market risk calibrations do not materially impact the overall SCR for the Company.

### E.4.3 Internal Model data

In order to calculate our Solvency Capital Requirement our Internal Model is provided with data about our assets, liabilities and the risks associated with each of these.

In order to assess the risks associated with our assets and liabilities we use a wide range of economic, market and insurance data and operational risk experience. Our material risks are primarily assessed using internal historical experience and any relevant external data and forecasts. In the calibration of mass lapse risk and of operational risk, since actual data of relevant extreme events is very scarce, the available data is supplemented by the judgement of experts with relevant knowledge, experience and understanding of the risks inherent in the business.

Data are used to assess:

- The likelihood and scale of individual risks; and
- How these risks are correlated, i.e. the extent to which a change in one risk is likely to coincide with change in another risk.

Our Solvency II data governance instils best practice in managing data risk and improving data quality to add robustness to model processes and outputs. The Solvency II Data Management Policy sets out the Group's requirements for managing data risk on data used to develop, populate, operate and validate the Internal Model. The data management control framework provides the conditions for business areas to ensure that all internal model data are recorded and that associated data risks and quality are managed effectively. The framework includes regular assessments of data quality and controls effectiveness.

The appropriateness of all internal and external data is considered and justified by the experts in each area of risk; these justifications are independently validated.

## E.5 NON-COMPLIANCE WITH THE MINIMUM CAPITAL REQUIREMENT AND NON-COMPLIANCE WITH THE SOLVENCY CAPITAL REQUIREMENT

The Company has held capital exceeding regulatory requirements throughout the reporting period and continues so to do.

There have been no instances of non-compliance with the MCR or SCR at any time over the reporting period.

## E.6 ANY OTHER INFORMATION

All material information regarding the capital management of the Company has been covered in the above sections E.1 to E.5 inclusive.

## APPENDIX – QUANTITATIVE REPORTING TEMPLATES (QRTS)

All values in these templates are shown in £'000s.

### S.02.01.02 BALANCE SHEET

	Solvency II value	
	C0010	
<b>Assets</b>		
Intangible assets	<b>R0030</b>	
Deferred tax assets	<b>R0040</b>	
Pension benefit surplus	<b>R0050</b>	
Property, plant & equipment held for own use	<b>R0060</b>	
Investments (other than assets held for index-linked and unit-linked contracts)	<b>R0070</b>	274,082
Property (other than for own use)	<b>R0080</b>	
Holdings in related undertakings, including participations	<b>R0090</b>	
Equities	<b>R0100</b>	
Equities - listed	<b>R0110</b>	
Equities - unlisted	<b>R0120</b>	
Bonds	<b>R0130</b>	230,740
Government Bonds	<b>R0140</b>	230,740
Corporate Bonds	<b>R0150</b>	
Structured notes	<b>R0160</b>	
Collateralised securities	<b>R0170</b>	
Collective Investments Undertakings	<b>R0180</b>	31,842
Derivatives	<b>R0190</b>	
Deposits other than cash equivalents	<b>R0200</b>	11,500
Other investments	<b>R0210</b>	
Assets held for index-linked and unit-linked contracts	<b>R0220</b>	308,788,693
Loans and mortgages	<b>R0230</b>	
Loans on policies	<b>R0240</b>	
Loans and mortgages to individuals	<b>R0250</b>	
Other loans and mortgages	<b>R0260</b>	
Reinsurance recoverables from:	<b>R0270</b>	2,623
Non-life and health similar to non-life	<b>R0280</b>	
Non-life excluding health	<b>R0290</b>	
Health similar to non-life	<b>R0300</b>	
Life and health similar to life, excluding health and index-linked and unit-linked	<b>R0310</b>	2,623
Health similar to life	<b>R0320</b>	
Life excluding health and index-linked and unit-linked	<b>R0330</b>	2,623
Life index-linked and unit-linked	<b>R0340</b>	
Deposits to cedants	<b>R0350</b>	
Insurance and intermediaries receivables	<b>R0360</b>	71,324
Reinsurance receivables	<b>R0370</b>	
Receivables (trade, not insurance)	<b>R0380</b>	
Own shares (held directly)	<b>R0390</b>	
Amounts due in respect of own fund items or initial fund called up but not yet paid in	<b>R0400</b>	
Cash and cash equivalents	<b>R0410</b>	34,300
Any other assets, not elsewhere shown	<b>R0420</b>	270,441
<b>Total assets</b>	<b>R0500</b>	309,441,463

	<b>Solvency II value</b>	
	<b>C0010</b>	
<b>Liabilities</b>	<b>R0510</b>	
Technical provisions – non-life	<b>R0520</b>	
Technical provisions – non-life (excluding health)	<b>R0530</b>	
Technical provisions calculated as a whole	<b>R0540</b>	
Best Estimate	<b>R0550</b>	
Risk margin	<b>R0560</b>	
Technical provisions - health (similar to non-life)	<b>R0570</b>	
Technical provisions calculated as a whole	<b>R0580</b>	
Best Estimate	<b>R0590</b>	
Risk margin	<b>R0600</b>	2,623
Technical provisions - life (excluding index-linked and unit-linked)	<b>R0610</b>	
Technical provisions - health (similar to life)	<b>R0620</b>	
Technical provisions calculated as a whole	<b>R0630</b>	
Best Estimate	<b>R0640</b>	
Risk margin	<b>R0650</b>	2,623
Technical provisions – life (excluding health and index-linked and unit-linked)	<b>R0660</b>	
Technical provisions calculated as a whole	<b>R0670</b>	2,623
Best Estimate	<b>R0680</b>	
Risk margin	<b>R0690</b>	308,400,846
Technical provisions – index-linked and unit-linked	<b>R0700</b>	
Technical provisions calculated as a whole	<b>R0710</b>	308,363,929
Best Estimate	<b>R0720</b>	36,917
Risk margin	<b>R0740</b>	
Contingent liabilities	<b>R0750</b>	
Provisions other than technical provisions	<b>R0760</b>	
Pension benefit obligations	<b>R0770</b>	
Deposits from reinsurers	<b>R0780</b>	70,843
Deferred tax liabilities	<b>R0790</b>	
Derivatives	<b>R0800</b>	
Debts owed to credit institutions	<b>R0810</b>	
Financial liabilities other than debts owed to credit institutions	<b>R0820</b>	134,112
Insurance & intermediaries payables	<b>R0830</b>	
Reinsurance payables	<b>R0840</b>	2,574
Payables (trade, not insurance)	<b>R0850</b>	
Subordinated liabilities	<b>R0860</b>	
Subordinated liabilities not in Basic Own Funds	<b>R0870</b>	
Subordinated liabilities in Basic Own Funds	<b>R0880</b>	126,472
Any other liabilities, not elsewhere shown	<b>R0900</b>	308,737,470
<b>Total liabilities</b>	<b>R1000</b>	703,994
<b>Excess of assets over liabilities</b>		

## S.05.01.02 PREMIUMS, CLAIMS AND EXPENSES BY LINE OF BUSINESS

	Line of Business for: <b>life insurance obligations</b>						Life reinsurance obligations		Total
	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life-reinsurance	
	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
<b>Premiums written</b>									
Gross	R1410		31,298,674					8,344,275	39,642,949
Reinsurers' share	R1420								
Net	R1500		31,298,674					8,344,275	39,642,949
<b>Premiums earned</b>									
Gross	R1510		31,298,674					8,344,275	39,642,949
Reinsurers' share	R1520								
Net	R1600		31,298,674					8,344,275	39,642,949
<b>Claims incurred</b>									
Gross	R1610		48,940,168	481				5,282,990	54,223,638
Reinsurers' share	R1620			481					481
Net	R1700		48,940,168	0				5,282,990	54,223,157
<b>Changes in other technical provisions</b>									
Gross	R1710								
Reinsurers' share	R1720								
Net	R1800								
<b>Expenses incurred</b>	R1900		183,463	0				25,489	208,953
<b>Other expenses</b>	R2500								45,153
<b>Total expenses</b>	R2600								254,105

Note: Since the home country (UK) represents more than 90% of the total business written, the S.05.02.01 QRT showing a detailed split of other countries is not required to be reported.

## S.12.01.02 LIFE AND HEALTH SLT TECHNICAL PROVISIONS

**Technical provisions calculated as a whole**  
 Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole

**Technical provisions calculated as a sum of BE and RM Best Estimate**  
**Gross Best Estimate**  
 Total recoverables from reinsurance/SPV and Finite Re before the adjustment for expected losses due to counterparty default  
 Recoverables from reinsurance (except SPV and Finite Re) before adjustment for expected losses  
 Recoverables from SPV before adjustment for expected losses  
 Recoverables from Finite Re before adjustment for expected losses  
 Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default

**Best estimate minus recoverables from reinsurance/SPV and Finite Re**

**Risk Margin**  
**Amount of the transitional on Technical Provisions**  
 Technical Provisions calculated as a whole  
 Best estimate  
 Risk margin

**Technical provisions - total**

	Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other
		C0020	C0030	Contracts without options and guarantees C0040	Contracts with options or guarantees C0050	C0060	Contracts without options and guarantees C0070	
<b>R0010</b>								
<b>R0020</b>								
<b>R0030</b>			269,375,238	917,794		2,623		
<b>R0040</b>						2,623		
<b>R0050</b>						2,623		
<b>R0060</b>								
<b>R0070</b>								
<b>R0080</b>						2,623		
<b>R0090</b>			269,375,238	917,794		0		
<b>R0100</b>		32,353			0			
<b>R0110</b>								
<b>R0120</b>								
<b>R0130</b>								
<b>R0200</b>		270,325,385			2,623			

**Technical provisions calculated as a whole**  
 Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole

**Technical provisions calculated as a sum of BE and RM Best Estimate**  
**Gross Best Estimate**  
 Total recoverables from reinsurance/SPV and Finite Re before the adjustment for expected losses due to counterparty default  
 Recoverables from reinsurance (except SPV and Finite Re) before adjustment for expected losses  
 Recoverables from SPV before adjustment for expected losses  
 Recoverables from Finite Re before adjustment for expected losses  
 Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default

**Best estimate minus recoverables from reinsurance/SPV and Finite Re**

**Risk Margin**  
**Amount of the transitional on Technical Provisions**  
 Technical Provisions calculated as a whole  
 Best estimate  
 Risk margin

**Technical provisions - total**

	Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance				Annuities stemming from non-life accepted insurance contracts and relating to insurance obligation other than health insurance obligations	Total (Life other than health insurance, incl. Unit-Linked)	Total (Health similar to life insurance)
		Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance				
	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0210
<b>R0010</b>								
<b>R0020</b>								
<b>R0030</b>		38,070,897		38,070,897			308,366,552	
<b>R0040</b>							2,623	
<b>R0050</b>							2,623	
<b>R0060</b>								
<b>R0070</b>								
<b>R0080</b>							2,623	
<b>R0090</b>		38,070,897					308,363,929	
<b>R0100</b>		4,564		4,564			36,917	
<b>R0110</b>								
<b>R0120</b>								
<b>R0130</b>								
<b>R0200</b>		38,075,461					308,403,469	

## S.23.01.01 OWN FUNDS

### Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35

Ordinary share capital (gross of own shares)  
 Share premium account related to ordinary share capital  
 Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings  
 Subordinated mutual member accounts  
 Surplus funds  
 Preference shares  
 Share premium account related to preference shares  
 Reconciliation reserve  
 Subordinated liabilities  
 An amount equal to the value of net deferred tax assets  
 Other own fund items approved by the supervisory authority as basic own funds not specified above

### Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds

Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds

### Deductions

Deductions for participations in financial and credit institutions

### Total basic own funds after deductions

### Ancillary own funds

Unpaid and uncalled ordinary share capital callable on demand  
 Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand  
 Unpaid and uncalled preference shares callable on demand  
 A legally binding commitment to subscribe and pay for subordinated liabilities on demand  
 Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC  
 Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC  
 Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC  
 Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC  
 Other ancillary own funds

### Total ancillary own funds

### Available and eligible own funds

Total available own funds to meet the SCR  
 Total available own funds to meet the MCR  
 Total eligible own funds to meet the SCR  
 Total eligible own funds to meet the MCR

### SCR

### MCR

### Ratio of Eligible own funds to SCR

### Ratio of Eligible own funds to MCR

### Reconciliation reserve

Excess of assets over liabilities  
 Own shares (held directly and indirectly)  
 Foreseeable dividends, distributions and charges  
 Other basic own fund items  
 Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

### Reconciliation reserve

### Expected profits

Expected profits included in future premiums (EPIFP) - Life business  
 Expected profits included in future premiums (EPIFP) - Non- life business

### Total Expected profits included in future premiums (EPIFP)

Total	Tier 1 - unrestricted	Tier 1 - restricted	Tier 2	Tier 3
C0010	C0020	C0030	C0040	C0050

R0010	100	100		
R0030				
R0040				
R0050				
R0070				
R0090				
R0110				
R0130	703,894	703,894		
R0140				
R0160				
R0180				

R0220				
R0230				
R0290	703,994	703,994		

R0300				
R0310				
R0320				
R0330				
R0340				
R0350				
R0360				
R0370				
R0390				

Total	Tier 1 - unrestricted	Tier 1 - restricted	Tier 2	Tier 3
C0010	C0020	C0030	C0040	C0050

R0400				
R0500	703,994	703,994		
R0510	703,994	703,994		
R0540	703,994	703,994		
R0550	703,994	703,994		
R0580	262,700			
R0600	118,215			
R0620	267.98%			
R0640	595.52%			

### C0060

R0700	703,994	
R0710		
R0720		
R0730	100	
R0740		
R0760	703,894	
R0770		
R0780		
R0790		

## S.25.03.21 SOLVENCY CAPITAL REQUIREMENT

Solvency Capital Requirement - for undertakings on Full Internal Models

Unique number of component	Components description	Calculation of the Solvency Capital Requirement
<b>C0010</b>	<b>C0020</b>	<b>C0030</b>
70100I	Operational risk	171,600
30600I	Expense risk	201,400
30400I	Mass lapse risk	161,600
30900I	Income risk	125,300
10400I	Equity risk	92,000
30500I	Regular lapse risk	30,400
10600I	Property risk	13,500
10300I	Interest rate risk	2,400
10700I	Spread risk	2,700
11000I	Other market risk	-500
19900I	Diversification within market risk	-9,200
39900I	Diversification within life underwriting risk	-221,400
80400I	Future profits from life new business	-20,800
80300I	Loss-absorbing capacity of deferred tax	-58,700

### Calculation of Solvency Capital Requirement

Total undiversified components	<b>R0110</b>	<b>C0100</b>	490,300
Diversification	<b>R0060</b>		-227,600
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC (transitional)	<b>R0160</b>		
<b>Solvency capital requirement excluding capital add-on</b>	<b>R0200</b>		262,700
Capital add-ons already set	<b>R0210</b>		
<b>Solvency capital requirement</b>	<b>R0220</b>		<b>262,700</b>
<b>Other information on SCR</b>			
Amount/estimate of the overall loss-absorbing capacity of technical provisions	<b>R0300</b>		
Amount/estimate of the overall loss-absorbing capacity of deferred taxes	<b>R0310</b>		-58,700
Total amount of Notional Solvency Capital Requirements for remaining part	<b>R0410</b>		
Total amount of Notional Solvency Capital Requirement for ring fenced funds	<b>R0420</b>		
Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	<b>R0430</b>		
Diversification effects due to RFF nSCR aggregation for article 304	<b>R0440</b>		
Net future discretionary benefits	<b>R0460</b>		

## S.28.01.01 MINIMUM CAPITAL REQUIREMENT

### Linear formula component for life insurance and reinsurance obligations

MCR <sub>L</sub> Result	<b>R0200</b>	<b>C0040</b>	2,158,548		
				Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
				<b>C0050</b>	<b>C0060</b>
Obligations with profit participation - guaranteed benefits	<b>R0210</b>				
Obligations with profit participation - future discretionary benefits	<b>R0220</b>				
Index-linked and unit-linked insurance obligations	<b>R0230</b>		308,363,929		
Other life (re)insurance and health (re)insurance obligations	<b>R0240</b>				
Total capital at risk for all life (re)insurance obligations	<b>R0250</b>				0

### Overall MCR calculation

Linear MCR	<b>R0300</b>	<b>C0070</b>	2,158,548
SCR	<b>R0310</b>		262,700
MCR cap	<b>R0320</b>		118,215
MCR floor	<b>R0330</b>		65,675
Combined MCR	<b>R0340</b>		118,215
Absolute floor of the MCR	<b>R0350</b>		3,251
		<b>C0070</b>	
<b>Minimum Capital Requirement</b>	<b>R0400</b>		<b>118,215</b>

Note: The defined Linear MCR formula does not provide a meaningful figure given the nature of the PMC business.