PHOENIX GROUP

SOLVENCY AND FINANCIAL CONDITION REPORT

Abbey Life Assurance Company Limited
For the year ending 31 December 2016

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SUMMARY

INTRODUCTION AND BACKGROUND

Abbey Life Assurance Company Limited ('ALAC' or 'the Company') is an insurance undertaking and a private company limited by shares, incorporated, registered and domiciled in the United Kingdom. The principal activity of the Company is the transaction of life insurance and pension business and with the exception of vesting pension annuity business closed to new business in 2000. The Company retained its regulatory permissions to write new business, and in 2010, the Company commenced offering de-risking products to corporate clients.

Prior to 30 December 2016, the Company was a subsidiary of Deutsche Holdings No.4 Limited and part of the Deutsche Bank A.G. Group. On 30 December 2016, the Company was acquired by Phoenix Group.

The Company is a subsidiary of Phoenix Life Holdings Limited ('PLHL'), which is the highest European Economic Area ('EEA') insurance holding company of Phoenix Group. The ultimate parent undertaking is Phoenix Group Holdings ('PGH') which is registered in the Cayman Islands and has its principal place of business in Jersey, therefore outside of the EEA. Reference to 'Phoenix' or 'Phoenix Group' in this report means PGH and all its subsidiary undertakings. References to 'Group' mean PLHL and all its subsidiary undertakings of which ALAC is a part of. Reference to the 'Life Companies' means ALAC, Phoenix Life Limited ('PLL'), Phoenix Life Assurance Limited ('PLAL') and AXA Wealth Limited ('AWL'). A simplified Group structure chart is presented in section A.1.2.2.

The Company is authorised by the Prudential Regulation Authority ('PRA') and is regulated by the Financial Conduct Authority ('FCA') and PRA.

Following the implementation of Solvency II on 1 January 2016, this is the Company's first Solvency and Financial Condition Report ('SFCR') in accordance with the PRA rules and Solvency II Regulations. The SFCR and the accompanying Quantitative Reporting Templates ('QRTs') provide detailed information of the Company's business and performance, governance, risk profile and capital position.

BASIS OF PREPARATION

The QRTs and the disclosures in the SFCR have been prepared in accordance with all applicable PRA rules and Solvency II regulations, here in after referred to as 'the regulations'.

Some sections of the SFCR require information based on the recognition and measurement principles applicable under the relevant Generally Accepted Accounting Principles ('GAAP') as presented in the financial statements. The Company's financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS') issued by the International Accounting Standards Board ('IASB') and which have been adopted for use by the European Union ('EU').

The SFCR is presented in sterling (£) rounded to the nearest thousands.

The SFCR excludes disclosures required by the regulations which are not applicable to the Company; these include, but are not limited to:

- information on non-life business as the Company only has life business;
- information on Solvency II insurance Special Purpose Vehicles ('SPVs');
- information on the Volatility Adjustment, transitional measures on risk-free interest rates and Transitional Measures on Technical Provisions as the Company has not applied these measures;
- information on significant branches within the meaning of the regulations; and
- Internal Model QRTs and related disclosures as the Company's Solvency Capital Requirement ('SCR') at 31 December 2016 was calculated on a Standard Formula basis.

As permitted by the regulations, comparison of information reported in the previous reporting period has not been presented in the SFCR for the year ended 31 December 2016. Comparatives will be presented for the first time in the SFCR for the year ending 31 December 2017.

SUMMARY
Continued

2016 KEY PERFORMANCE INDICATORS

The Company's 2016 key performance indicators are set out below.

	31 December 2016 (actual)
Solvency II surplus	£531,045k
Ratio of Eligible Own Funds to Solvency Capital Requirement	210%
Underwriting performance	£32,791k

The Company's Solvency II surplus consists wholly of unrestricted Tier 1 Own Funds less SCR calculated using the industry Standard Formula. Further details on the capital management of the Company are included in section E.

The Company's has a strong equity capital base and this is reflected in the ratio of Eligible Own Funds to SCR.

The Company's underwriting performance represents the operating profit after tax from life obligations and is based on the IFRS financial statements of the Company for the year ended 31 December 2016. Further details on the underwriting performance are included in section A.2.

STRATEGY AND BUSINESS MODEL

Phoenix Group is the largest UK consolidator of closed life insurance funds with assets under management of £76 billion and more than 6 million policyholders. Phoenix Group aims to be recognised as the 'industry solution' for the safe, innovative and profitable decommissioning of closed life funds.

Key strategic areas of focus are:

- Manage capital through effective management of risks and allocation of capital against them, with robust capital policies.
- Drive value through management actions in order to increase value or accelerate the release of capital.
- Improve customer outcomes in terms of value, service and security.

The Company has a wide range of legacy products written across different funds. The features of each policy influence whether it is the policyholder or the shareholder who is exposed to the risks and rewards of a policy. The Company operates five Solvency II lines of life insurance business based on the characteristics of the different products administered. Over 70% of the Company's Solvency II total assets of £10.6 billion belong to a single line of business, the index-linked and unit-linked insurance fund. Further details on these lines of business ('LoB') are included in section A.1.3, all of which are underwritten in the United Kingdom.

Reinsurance arrangements are in place to cover longevity exposures from corporate transactions, certain annuities in payment and some permanent health, critical illness and term assurance risks.

During the year ended 31 December 2016, the Company maintained two with-profit funds, a Matching Adjustment Portfolio and remaining part for all other life insurance obligations.

OPERATING STRUCTURE

The Company's strategic priorities are aligned to Phoenix Group's closed life fund business model and are supported by an operating structure that reduces risk, complexity and cost, improves investment performance and enhances customer service through efficient co-operation with the Company's outsourced partners.

Following its' acquisition on 30 December 2016, the Company is being integrated into Phoenix Group's life insurance business model and infrastructure.

Further details on the operating structure are included in section B.1.

GOVERNANCE

The Board is responsible for managing the overall direction and performance of the Company. It is also ultimately accountable for compliance with the Solvency II requirements. Certain matters must be referred to the boards of the parent companies in accordance with the 'Matters Reserved'.

The Board is committed to high standards of corporate governance and is supported by the appropriate Board and management committees. Further details on the governance structure are included in section B.1.

Prior to 30 December 2016, the Company was a 100% owned subsidiary of Deutsche Bank No.4 Limited and was operated as a standalone business. The management of the Company was carried out in a manner consistent with the policies of Deutsche Bank in relation to strategy, operational management, support services and risk management.

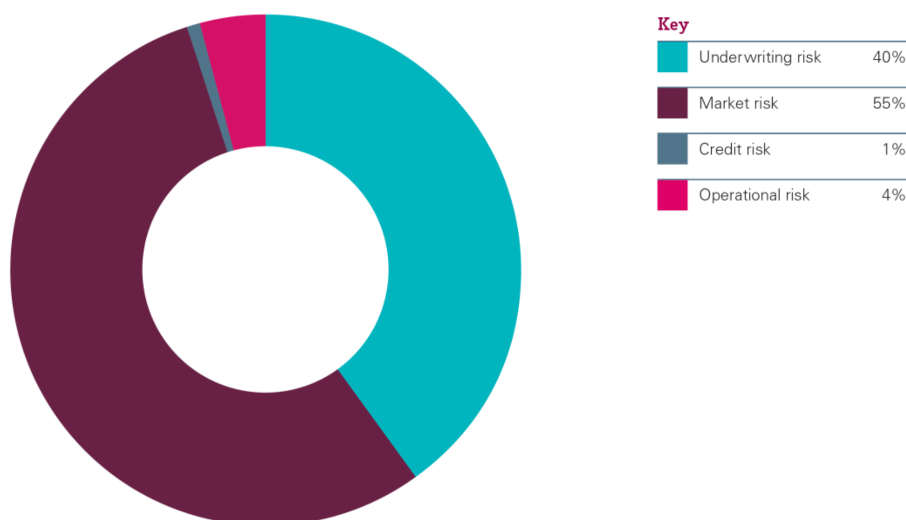
SUMMARY
Continued

RISK PROFILE

Phoenix Group, of which the Company is a part, operates a standardised Risk Management Framework ('RMF') for the identification and assessment of the risks it may be exposed to and the amount of capital that should be held in relation to those exposures. The Group defines a risk appetite framework covering the level of risk it is willing to accept in pursuit of its strategic objectives in the areas of: policyholder security and conduct, earnings volatility, liquidity and the control environment. Such risk appetite is then applied by the Company.

SOLVENCY CAPITAL REQUIREMENT BY RISK CATEGORY

The following chart shows the composition of the Standard Formula undiversified Solvency Capital Requirement as at 31 December 2016.



For the purposes of the above analysis, spread risk (which represents 41% of undiversified SCR) is categorised as market risk rather than credit risk, with the latter comprising solely of counterparty default risk.

During the year ended 31 December 2016, the following key changes to risk exposure have taken place:

- An increase in longevity risk due to the completion on 27 July 2016 of a longevity insurance transaction with the Manweb Group of the Electricity Supply Pension Scheme. This has resulted in an increase in reinsurance counterparty default risk as the majority of the longevity risk accepted has been reinsured with third parties;
- Due to the Company being closed to new business, mortality and morbidity risk continue to reduce as existing protection policies mature, expire or lapse. There is a corresponding increase in longevity risk where maturing pension policies are converted into annuities;
- On 15 November 2016 the FCA issued a Policy Statement confirming that early exit charges on personal pension schemes (including individual and group/workplace pensions) will be capped at 1% for existing policies and 0%for new policies from 31 March 2017. This may result in changes in policyholder behaviour, with lapse rates potentially increasing as the cost of transferring schemes to other providers are reduced. Even if lapse rates remain unchanged, the decrease in charges will increase the impact of lapses on profit;
- Markets have been particularly turbulent following the EU Referendum. Yields on UK government debt and swap rates have fallen markedly. Volatility is expected to remain at elevated levels until the political process and details of the negotiations are finalised;
- A tranche of shareholder funds previously managed under a discretionary mandate by Deutsche Asset Management Limited was de-risked in February 2016, with the assets being transferred to a UCITS bond fund thus reducing market risk and investment counterparty risk on these assets;
- During 2016, the Company incurred an actuarial loss of £33,267k on the Abbey Life Staff Pension Scheme (the 'Scheme') due to a significant fall in gilt yields over the year. In addition, the inflation and interest rate hedges on the Scheme were rebalanced to cover 75% of Technical Provisions. This entailed increasing inflation cover and reducing cover for interest rates; and
- The Company has experienced a number of operational risks during the year due to ongoing uncertainty over customer treatment review, regulatory compliance review, pension reforms, staff retention following Phoenix Group acquisition and outsourcers' ability to resource and deliver regulatory change.

SUMMARY
Continued

CAPITAL POSITION

Following the implementation of the Solvency II Directive from 1 January 2016, the Company's capital is managed on a Solvency II basis. The Company's Own Funds, SCR and Solvency II surplus are further explained in section E.

QUALITY OF OWN FUNDS

Eligible Own Funds represent the available capital to support the SCR of the Company under Solvency II.

As the Company's available Own Funds consists wholly of Tier 1 unrestricted Own Funds, these are not subject to any quantitative limits and the full amount can be recognised as Eligible Own Funds. Eligible Own Funds are Tier 1, and comprise of ordinary share capital, share premium, surplus funds and the reconciliation reserve.

The Company obtained the PRA's approval to apply Matching Adjustment, which allows the Company to use a higher discount rate when valuing liabilities that meet strict eligibility criteria, with the effect of increasing Own Funds and reducing the SCR. Further details are set out in section D.2.7.1, which also include the positive impact of applying Matching Adjustment on Solvency II surplus of £366,348k.

SOLVENCY CAPITAL REQUIREMENT

The Company's SCR is calculated in accordance with the Standard Formula and the position as at 31 December 2016 is presented below:

	31 December 2016 £000	Percentage of Undiversified Solvency Capital Requirement
Market risk	335,911	55
Underwriting risk	242,574	40
Operational risk	21,254	4
Credit risk	6,522	1
Undiversified Solvency Capital Requirement	**606,261**	**100**
Diversification	(110,724)	
Loss-absorbing Capacity of Deferred Taxes	(11,265)	
Solvency Capital Requirement	**484,272**	

The final amount of the Solvency Capital Requirement is still subject to supervisory assessment.

SOLVENCY II SURPLUS

Solvency II surplus is the excess of Eligible Own Funds over the SCR and is set out below:

	31 December 2016 £000
Ordinary share capital	30,500
Share premium account related to ordinary share capital	253,619
Surplus funds	47
Reconciliation reserve	731,151
Total basic Own Funds after deductions	**1,015,317**
Total available and Eligible Own Funds to meet the Solvency Capital Requirement	**1,015,317**
Solvency Capital Requirement	(484,272)
Solvency II surplus	531,045
Ratio of Eligible Own Funds to Solvency Capital Requirement	210%

SUMMARY
Continued

CAPITAL POSITION CONTINUED

SENSITIVITIES AND SCENARIO ANALYSIS

As part of the Company's internal risk management processes, the regulatory capital requirements under Solvency II are tested against a number of financial scenarios. The results of such stress testing are provided below and demonstrate the resilience of the Company's Solvency II surplus.

	Solvency II surplus £000
Base: 1 January 2017[1]	**531,045**
Following a 55bps interest rates rise	504,900
Following a 80bps interest rates fall	566,854
Following a150bps credit spread widening[2]	532,905
Following a 6% decrease in annuitant mortality rates[3]	472,699
Following a10% increase in assurance mortality rates	522,470
Following a10% change in lapse rates[4]	527,317

[1] Assumes stress occurs on 1 January 2017.

[2] Credit stress equivalent to an average 150bps spread widening across ratings, 10% of which is due to defaults/downgrades.

[3] Equivalent of 6 months increase in longevity applied to the annuity portfolio.

[4] Assumes most onerous impact of a 10% increase/decrease in lapse rates across different product groups.

FUTURE DEVELOPMENTS

During 2017, Phoenix Group is focused on the smooth transition and efficient integration of the Company into its operating platform that will deliver planned synergies whilst providing high quality of service to policyholders. This includes the Company applying to the PRA to adopt the Solvency II Internal Model risk framework which is in place across the Phoenix Group.

The Company's long-term life insurance business, with the exception of vesting pension annuities and corporate transactions, is in gradual run-off. The risk remains that the Company will be impacted by macroeconomic uncertainty or the evolving regulatory environment. The Company will continue to identify and implement new management actions to enhance and maintain a robust capital position, whilst securing future benefits for both policyholders and shareholders.

Following the completion of their thematic review of the fair treatment of long-standing customers in life insurance, the FCA commenced investigations into the Company in March 2016 in relation to the disclosure of customer exit and paid-up charges. Separately, in July 2016, the FCA instructed the Company to appoint a skilled person to oversee the annuity sales practice review. The final findings in respect of the areas under review are not yet known, and therefore uncertainty remains as to the financial impact of these investigations on the Company. A provision of £38,855k has been recognised within Solvency II Own Funds as at 31 December 2016 in respect of exposures arising from thematic review activity. This provision takes no credit for amounts that may be recoverable under the terms of an indemnity received by PLHL from Deutsche Bank, following its acquisition of the Company. The indemnity issued to the Company's parent covers exposures were they to arise on completion of the thematic review findings in respect of all regulatory fines and 80% to 90% of the costs of customer remediation. The indemnity is subject to a cap of £175 million and a maximum duration of 8 years. Following a FCA skilled person report and based on its initial findings the Company has made a provision to meet any potential future obligations.

DIRECTORS' RESPONSIBILITY STATEMENT

DIRECTORS' RESPONSIBILITY STATEMENT

ABBEY LIFE ASSURANCE COMPANY LIMITED

Approval by the Board of Directors of the Solvency and Financial Condition Report

Financial period ended 31 December 2016.

We acknowledge our responsibility for preparing the SFCR in all material respects in accordance with the PRA Rules and the Solvency II regulations.

We are satisfied that:

a) Throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA rules and Solvency II regulations as applicable to the Company; and

b) It is reasonable to believe that the Company has continued so to comply subsequently and will continue so to comply in future.

David R Cheeseman

Finance Director

For and on behalf of the Board of Directors

Date: 15 May 2017

AUDITOR'S REPORT

AUDITOR'S REPORT

Report of the external independent auditor to the Directors of Abbey Life Assurance Company Limited ('the Company') pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms

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

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of Abbey Life Assurance Company Limited as at 31 December 2016, ('the Narrative Disclosures subject to audit'); and
- Company templates S.02.01.02, S.12.01.02, S.22.01.21, S.23.01.01, S.25.01.21, 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:

- The 'Business and performance', 'System of governance' and 'Risk profile' sections of the Solvency and Financial Condition Report;
- Information relating to 1 January 2016 voluntarily disclosed by the Company in the 'Valuation for solvency purposes' and 'Capital management' sections of the Solvency and Financial Condition Report;
- Company templates S05.01.02, S05.02.01; and
- The written acknowledgement by the Directors of their responsibilities, including for the preparation of the Solvency and Financial Condition Report ('the Responsibility Statement').

Respective responsibilities of directors and auditor

As explained more fully in the Responsibility Statement, the Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been supplemented by the approval made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based.

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.

Our responsibility is to audit, and express an opinion on, the Relevant Elements of the Solvency and Financial Condition Report in accordance with applicable law and International Standards on Auditing (UK and Ireland) together with ISA (UK) 800 and ISA (UK) 805. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Relevant Elements of the Solvency and Financial Condition Report

A description of the scope of an audit is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on the Relevant Elements of the Solvency and Financial Condition Report

In our opinion, the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report of Abbey Life Assurance Company Limited as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Emphasis of Matter – Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' section 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 these matters.

Matters on which we are required to report by exception

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of Abbey Life Assurance Company Limited'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.

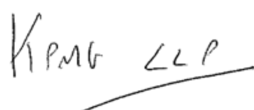
AUDITOR'S REPORT
Continued

AUDITOR'S REPORT CONTINUED

The purpose of our audit work and to whom we owe our responsibilities

This report of the external auditor is made solely to the Company's Directors, as its governing body, in accordance with the requirement in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and the terms of our engagement. We acknowledge that the Directors are required to submit the report to the PRA, to enable the PRA to verify that an auditor's report has been commissioned by the Company's Directors and issued in accordance with the requirement set out in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and to facilitate the discharge by the PRA of its regulatory functions in respect of the company, conferred on the PRA by or under the Financial Services and Markets Act 2000.

Our audit has been undertaken so that we might state to the Company's Directors those matters we are required to state to them in an auditor's report issued pursuant to Rule 4.1(2) and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company through its governing body, for our audit, for this report, or for the opinions we have formed.



KPMG LLP
15 Canada Square
Canary Wharf
London
E14 5GL

Date: 15 May 2017

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

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

Solo Standard Formula

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

- The following elements of template S.12.01.02;
  - Rows R0110 to R0130 – Amount of transitional measure on technical provisions.
- The following elements of template S.22.01.21;
  - Column C0030 – Impact of transitional measure on technical provisions.
- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

SECTION A

IN THIS SECTION

Business and performance	**10**
A.1 Business	**10**
A.2 Underwriting performance	**14**
A.3 Investment performance	**16**
A.4 Performance of other activities	**16**
A.5 Any other information	**16**

SECTION A

BUSINESS AND PERFORMANCE

A.1 BUSINESS

A.1.1 INFORMATION REGARDING THE UNDERTAKING

The Company is a private limited company limited by shares, incorporated, registered and domiciled in the United Kingdom.

The Company is authorised by the Prudential Regulatory Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA') and PRA. The PRA's and FCA's contact details are provided below:

Bank of England Prudential Regulation Authority 20 Moorgate London EC2R 6DA	Financial Conduct Authority 25 The North Colonnade London E14 5HS

The Company is an insurance undertaking of PLHL, the ultimate EEA insurance parent undertaking which has its head office in the United Kingdom. PLHL is also regulated by the PRA.

The name and contact details of the Company's external auditor is provided below:

KPMG LLP
15 Canada Square
Canary Wharf
London
E14 5GL

A.1.2 LEGAL STRUCTURE

A.1.2.1 Holders of qualifying holdings in the undertaking

The persons who were direct and indirect holders of qualifying holdings in the Company at any time during the reporting period were:

Deutsche Holdings No.4 Limited – a limited company incorporated in the United Kingdom

From 1 January 2016 to 29 December 2016, Deutsche Holdings No.4 Limited held 100% of the issued share capital of the Company and was entitled to exercise 100% of the voting power at any general meeting.

Deutsche Bank A.G. – a limited company incorporated in Germany

From 1 January 2016 to 29 December 2016, Deutsche Bank A.G. through its controlled undertakings held 100% of the issued share capital of Deutsche Holdings No.4 Limited, of which the Company is a subsidiary undertaking, and was entitled to exercise 100% of the voting power at any general meeting.

Phoenix Life Holdings Limited – a limited company incorporated in the United Kingdom

On 30 December 2016, PLHL acquired 100% of the issued share capital of the Company and from that date was entitled to exercise 100% of the voting power at any general meeting.

PGH (LCA) Limited – a limited company incorporated in the United Kingdom

PGH (LCA) Limited held 50% of the issued share capital of PLHL, of which the Company is a subsidiary undertaking effective 30 December 2016, and was entitled to exercise 50% of the voting power at any general meeting.

PGH (LCB) Limited – a limited company incorporated in the United Kingdom

PGH (LCB) Limited held 50% of the issued share capital of PLHL, of which the Company is a subsidiary undertaking effective 30 December 2016, and was entitled to exercise 50% of the voting power at any general meeting.

Phoenix Group Holdings – a limited company incorporated in the Cayman Islands

PGH held 100% of the issued share capital of PGH (LCA) Limited and PGH (LCB) Limited, which between them held 100% of the issued share capital of PLHL, of which the Company is a subsidiary undertaking effective 30 December 2016, and was entitled to exercise 100% of the voting power at any general meeting.

SECTION A
Continued

BUSINESS AND PERFORMANCE CONTINUED

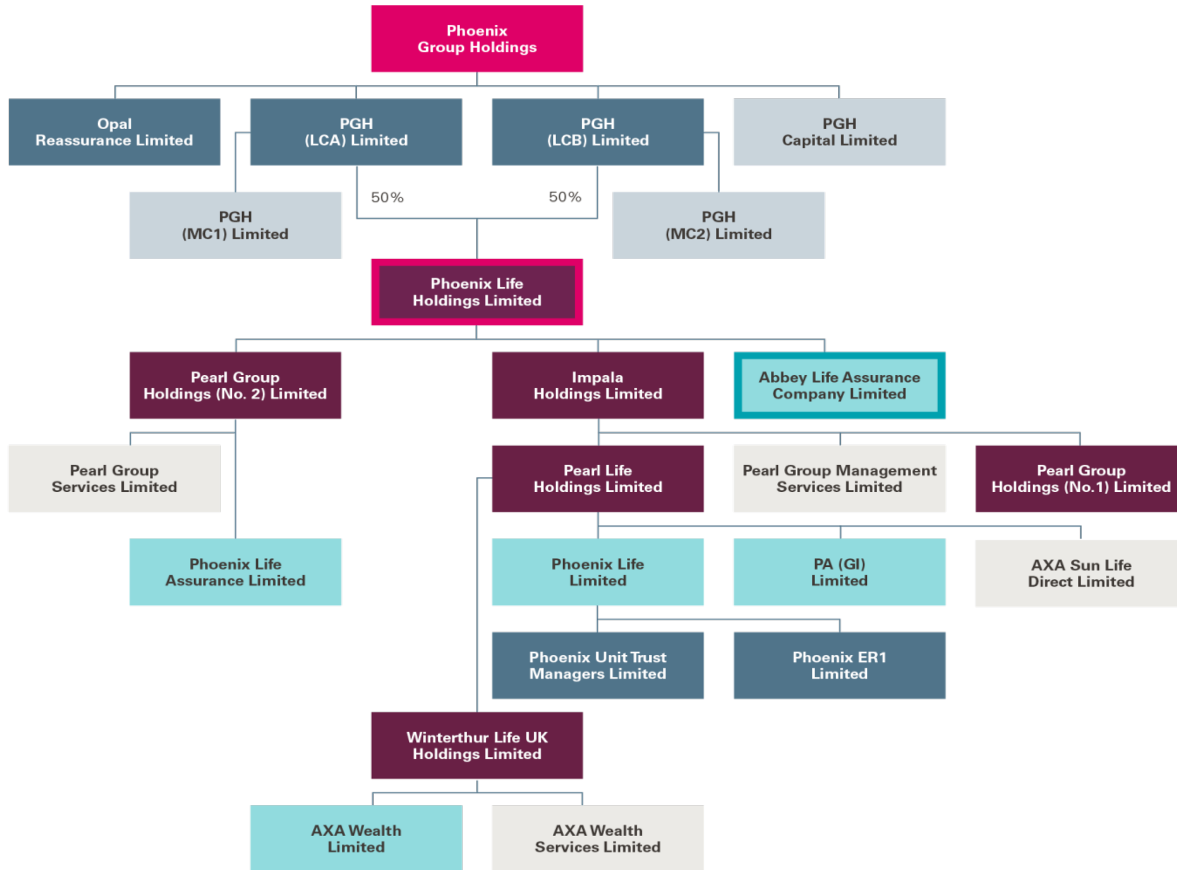
A.1 BUSINESS CONTINUED

A.1.2 LEGAL STRUCTURE CONTINUED

A.1.2.2 Group structure

The Company is a subsidiary undertaking of PLHL, the highest EEA parent undertaking, and of PGH, the ultimate parent undertaking.

A simplified structure chart as at 31 December 2016 is provided below, and shows the Company's position within the legal structure of the Phoenix Group. All shareholdings are 100% unless shown otherwise.



Key to structure

- Phoenix Life Holdings Limited – highest EEA insurance parent undertaking
- Abbey Life Assurance Company
- UK Solvency II regulated insurance companies
- PLHL Group corporate entities
- Management services
- Phoenix Group Holdings – the ultimate parent undertaking headquartered outside the EEA in Jersey
- Financial institutions
- Other companies

SECTION A
Continued

BUSINESS AND PERFORMANCE CONTINUED

A.1 BUSINESS CONTINUED

A.1.2 LEGAL STRUCTURE CONTINUED

A.1.2.3 Material related undertakings of the Company

A list of material related undertakings is provided below.

Name of related undertaking	Legal form	Type of undertaking	Country of incorporation	Proportion of ownership interest and voting rights held
Abbey Life Trust Securities Limited	Company limited by shares	Other	United Kingdom	100%
Aberdeen Capital Trust	Unit Trust with units	Collective Investment Scheme	United Kingdom	99.48%
Aberdeen Financial Equity Fund	Fund with Class A share classes	UCITS scheme	United Kingdom	85.61%
Scottish Widows International Bond Fund	Fund with Class A share classes	UCITS scheme	United Kingdom	29.91%
Scottish Widows Ethical Fund	Fund with Class X share classes	UCITS scheme	United Kingdom	23.74%

A.1.3 MATERIAL LINES OF BUSINESS AND GEOGRAPHICAL AREAS

Under Solvency II, the Company's life insurance business has been structured as follows:

Name of fund or portfolio	Ring-fenced fund, Matching Adjustment Portfolio and remaining part	Lines of Business
Abbey Life with-profit	Ring-fenced fund	Insurance with-profit participation
Hill Samuel with-profit	Ring-fenced fund	Insurance with-profit participation
Abbey Life Annuity	Matching Adjustment Portfolio	Other life insurance
Abbey Life	Remaining part	Health insurance; Index-linked and unit-linked insurance; Other life insurance; and Life reinsurance.

The Company has segmented its insurance policies into five lines of business reflecting the nature of the risks underlying these contracts. All business is underwritten in the United Kingdom.

A.1.3.1 Insurance with-profit participation

A with-profit, or participating, policy is one where the policyholder participates in the profits of the life insurance company. An insurer aims to distribute part of its profit to the with-profit policyholders in the form of bonuses. The value of such distributions is based on, among other things, the performance of the underlying pool of assets. Policy payouts are generally subject to a minimum guarantee and are 'smoothed' to lessen the impact of changes in the underlying value of the assets in the short term. With-profit products are primarily either endowments or whole of life protection contracts. Endowments may be single or regular premium policies with minimum guaranteed sums on death or maturity.

All with-profit policies are entitled to potential incremental bonuses throughout the life of the policy as well as a terminal, or final, bonus. The terminal bonus represents the policyholder's final share of the assets of the fund. Any available surplus held in a with-profit fund may only be used to meet the requirements of the fund itself or be distributed in defined proportions to the fund's policyholders and the Life Company's shareholders. For example, the traditional with-profit fund, with a 90:10 policyholder/shareholder split, entitles a Life Company's shareholder fund to a 10% share of the profits in any bonus declared.

Both of the Company's with-profit funds are 90:10 funds.

SECTION A
Continued

BUSINESS AND PERFORMANCE CONTINUED

A.1 BUSINESS CONTINUED

A.1.3 MATERIAL LINES OF BUSINESS AND GEOGRAPHICAL AREAS CONTINUED

A.1.3.2 Index-linked and unit-linked insurance

The value of unit-linked products is linked directly to the performance of the underlying assets. The policyholder typically bears all of the investment risk with unit-linked products. The benefits attributable to the policyholder are determined by reference to the investment performance of a specified pool of assets. The policyholder elects which units in a diversified open-end or closed-end fund to purchase. Unit-linked funds include personal and group pension plans and feature regular and single premium savings. They operate on a similar basis to mutual funds, with the Company charging a fee based on the value of the funds.

Customers do not legally own the underlying assets or the units themselves; they own a contract (the policy) with a right to a benefit. The value of that benefit is determined by reference to the prices of their chosen funds.

Some of the Company's unit-linked business comprises contracts with options and guarantees.

A.1.3.3 Health insurance

The Company's health insurance business comprises of individual and group income protection products, income protection riders and stand-alone critical illness protection products, and includes contracts with and without options and guarantees.

A.1.3.4 Other life insurance

This LoB includes all remaining direct underwritten business and comprises conventional non-profit products, protection policies such as life and disability policies that pay out lump sums on death or disability, group life, level and fixed escalation annuities in payment, deferred annuities and index-linked annuities.

The majority of the business included in this LoB is annuity business. Annuities generally provide a fixed specified income stream over the life of the policyholder. For these annuities, the Company is exposed to all investment and demographic risks and is generally entitled to retain 100% of the incremental investment returns from the assets backing this business.

A.1.3.5 Life reinsurance

The Company acts as a life reinsurer and has accepted business from three insurance undertakings, Santander Seguros Y Reaseguros, Compania Aseguradora, S.A. ('Spanish Reinsurance Agreement'), Santander Totta Seguros-Companhia De Seguros De Vida, S.A. ('Portuguese Reinsurance Agreement') and Zwolsche Algemeene N.V. ('Zwolsche Reinsurance Agreements').

The Spanish Reinsurance Agreement and Portuguese Reinsurance Agreement are 100% quota share reinsurance agreements for permanent disability, death or accidental death policies written in Spain and Portugal respectively.

The Zwolsche Reinsurance Agreements are 80% quota share reinsurance agreements for term assurance provided in certain life insurance policies.

A.1.4 SIGNIFICANT BUSINESS AND OTHER EVENTS

On 27 July 2016, the Company entered into a longevity insurance contract with the Manweb Group Section of the Electrical Supply Pension Scheme ('Manweb Scheme') for longevity and certain other demographic risks. Under this policy, the Company will receive a fixed fee in exchange for payments to cover benefits due to the members of the Manweb Scheme and their dependants.

The Company has reinsured 98% of these longevity and certain other demographic risks with Challenger Life Company Limited (38%) and The Canada Life Assurance Company (60%).

On 28 September 2016, Phoenix Group announced the proposed acquisition of the Company, Abbey Life Trustee Services Limited and Abbey Life Trust Securities Limited from Deutsche Holdings No.4 Limited, a wholly owned subsidiary of Deutsche Bank AG for a total consideration of £935 million in cash payable on completion. The acquisition completed on 30 December 2016.

SECTION A
Continued

BUSINESS AND PERFORMANCE CONTINUED

A.2 UNDERWRITING PERFORMANCE

A summary of the Company's performance for the year ended 31 December 2016 is presented below and in sections A.3 and A.4. The information is based on the Company's IFRS financial statements.

The Company's underwriting performance represents the operating profit after tax generated from the LoBs for life obligations.

Year ended 31 December 2016	Section reference	Health insurance £000	Insurance with-profit participation £000	Indexed-linked and unit-linked insurance £000	Other life insurance £000	Life reinsurance £000	Total £000
Net premiums written and earned		525	148	30,471	38,550	1,064	70,758
Net claims incurred		(1,036)	(5,658)	(152,091)	(153,605)	(20)	(312,410)
Net expenses incurred	A.3.1	(235)	(48)	(35,338)	(24,110)	–	(59,731)
Total of net premiums, claims and expenses		(746)	(5,558)	(156,958)	(139,165)	1,044	(301,383)
Fee income							18,552
Investment return	A.3.1						1,503,283
Change in net insurance and investment contract liabilities							(1,141,451)
Finance costs							(5,685)
Taxation attributable to policyholders							(40,525)
Underwriting performance (operating profit after tax from life obligations)							32,791
Shareholder net investment return/(deficit)	A.3.1						(5,492)
Pension benefit plan actuarial loss	A.4.1						(33,627)
IFRS loss before tax attributable to owners							**(6,328)**
Taxation attributable to owners							8,978
IFRS profit after tax attributable to owners							**2,650**

The underwriting performance of £32,791k arises from the five lines of business with premiums, claims and expenses and includes IFRS deposit accounting adjustments for investment contracts. The Company's premiums, claims and expenses excluding the IFRS deposit accounting adjustments are reported in S.05.01.02 in Appendix 1.2. The analysis of the underwriting performance is set out below:

	Note	31 December 2016 £000
Expected profit	1	61,900
New business	2	7,040
Experience variances	3	(4,149)
Assumptions	4	(32,000)
Underwriting performance		**32,791**

SECTION A
Continued

BUSINESS AND PERFORMANCE CONTINUED
A.2 UNDERWRITING PERFORMANCE CONTINUED

Note	Item	Description
1	**Expected profit**	Based on the best estimate assumptions as at 31 December 2015.
2	**New business**	On 27 July 2016, the Company entered into a longevity insurance contract with the Manweb Scheme and contributed £4,640k to underwriting performance. The balance of the new business is due to profit arising from maturing pension contracts purchasing annuities.
3	**Experience variances**	The Company's insurance contract liabilities for guaranteed annuity options are held on the balance sheet on a prudent basis. Over time, there is a natural release of these prudent margins as the underlying insurance contract matures. This offsets the costs associated with writing annuities at guaranteed rates and releases prudent margins to profits. In line with experience, the take-up rate was maintained which led to a contribution of £5,200k in underwriting performance. The Company has generated £7,280k from negative reserves on the corporate pension deals as yields have fallen. Finance costs, consisting of interest payments made to policyholders and reinsurers, have reduced underwriting performance by £4,548k. The balance of the remaining experience variances includes increases in expenses, tax and other experience variances.
4	**Assumptions**	Following a thematic review by the FCA into the fair treatment of long-standing customers in the life insurance sector, the Company has made a provision of £5,000k (£4,000k after tax) to cover the potential cost of redress plus an allowance for the operational costs of performing a redress exercise. The Company has increased the expense assumptions reflecting the increased cost of project work and implementing regulatory change. Ultimately the Company expects to make cost savings following the integration with Phoenix Group. The increase in expense assumptions has reduced underwriting performance by £14,960k. The Company has applied a 1% charge cap on over 55s from April 2017. The cost of this is £11,280k. During 2016, credit spreads narrowed slightly, but the adjustment for the risk of default or downgrade has not significantly altered, being based on two times historical default rates, so there was no absolute change to the value of the Company's credit default provision. Mortality assumptions for valuing annuity business were updated to reflect the Company's experience and continue to use mortality projections derived from the continuous mortality investigation models. The combined impact of these items has made a contribution of £2,400k to underwriting performance.

The shareholders' negative net investment return of £5,492k reflects the Company's decision to de-risk its exposure to equities by dis-investing in equities in February 2016 and investing in a UCITS bond fund.

FUTURE DEVELOPMENTS

In July 2016, the FCA instructed the Company to appoint a skilled person to oversee the annuity sales practice review. The final findings in respect of the areas under review are not yet known, and therefore uncertainty remains as to the financial impact of these investigations on the Company. Post signing of the Company financial statements it was agreed that a provision of £33,855k should be established in respect of exposures arising from this review. This provision takes no credit for amounts that may be recoverable under the terms of an indemnity received by PLHL from Deutsche Bank, following its acquisition of the Company. The indemnity issued to the Company's parent covers exposures were they to arise on completion of the thematic review findings in respect of all regulatory fines and 80% to 90% of the costs of customer remediation. The indemnity is subject to a cap of £175 million and a maximum duration of 8 years.

SECTION A
Continued

BUSINESS AND PERFORMANCE CONTINUED

A.3 INVESTMENT PERFORMANCE

A.3.1 INVESTMENT INCOME AND EXPENSES

The table below presents the actual investment income split by IFRS asset class and the component of such income. Expenses are shown in total as they all relate to investment management fees.

The actual investment return includes investment returns for the benefit of both the policyholders and shareholders.

Year ended 31 December 2016	Interest £000	Dividend £000	Rent £000	Fair value gains and losses £000	Total £000
Investment return by asset category:					
Investment properties	–	–	1,444	(25)	1,419
Investment in subsidiaries	–	15,762	–	158,172	173,934
Investment in associates	–	612	–	68,564	69,176
Shares and other variable yields	–	130,407	–	651,123	781,530
Debts and other fixed interest securities including cash and cash equivalents	164,352	–	–	297,776	462,128
Loans held at fair value	19	–	–	(1)	18
Derivative financial instruments held for trading	–	–	–	9,821	9,821
Investment return	164,371	146,781	1,444	1,185,430	1,498,026
Investment expenses	–	–	–	–	(13,825)
Net investment return after deduction of investment expenses	**164,371**	**146,781**	**1,444**	**1,185,430**	**1,484,201**

The net investment return of £1,484,201k is recognised in the income statement with £1,489,693k included in the calculation of underwriting performance and £5,492k negative net investment return attributable to owners. There are no amounts recognised directly in equity.

A.3.2 INFORMATION ON SECURITISATION

The Company has limited direct investments in securitisation vehicles within its non-index-linked and unit-linked funds. Any indirect exposures via the collective falls within the index-linked and unit-linked funds where such investments are held primarily for the benefit of the policyholders and are not deemed significant.

Investments in securitisation vehicles total £165,888k as at 31 December 2016.

A.4 PERFORMANCE OF OTHER ACTIVITIES

A.4.1 OTHER MATERIAL INCOME AND EXPENSES

Other material income and expense items are outlined below:

Year ended 31 December 2016	£000
Pension benefit plan actuarial loss – included in IFRS loss before taxation attributable to owners	**(33,267)**

The pension benefit plan actuarial loss of £33,267k is due to a significant fall in gilt yields over the year. Further information on the pension scheme is available in section D.3.4.

A.4.2 LEASING ARRANGEMENTS

The Company has no finance leases.

The Company has entered into operating leases on an investment property that it owns. Rental income of £1,444k from these operating leases is included within Net investment income in the financial statements and as Investment properties – Rent in section A.3.1. The Company has incurred direct operating expenses of £2,686k on the investment property and these are included within expenses for asset management services in the financial statements and in Investment expenses in section A.3.1.

A.5 ANY OTHER INFORMATION

There is no further material information to be disclosed regarding business and performance.

SECTION B

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SECTION B

SYSTEM OF GOVERNANCE

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE

This section provides information on the system of governance in place within the Company and any material changes that have taken place during the reporting period. Details on the structure of the Board is provided, with a description of its main role and responsibilities and those of the relevant committees, as well as a description of the main accountabilities and responsibilities of all key function holders.

The Board is collectively responsible for the management of the Company. The Board is committed to high standards of corporate governance and sets the strategy and risk appetite for the Company. Until 30 December 2016, the Company was a 100% owned subsidiary of Deutsche Holdings No. 4 Limited and was operated as a stand-alone business. The management of the Company was carried out in a manner consistent with the policies of Deutsche Bank in relation to strategy, operational management, support services and risk management.

The Company has an independent Board and a robust governance structure which looks to ensure that customers are treated fairly, risks identified and controlled, capital strategy adhered to, reserving assumptions set and updated appropriately, and balance sheet strength preserved.

From 30 December 2016, the Company has commenced transitioning to the Phoenix Group System of Governance.

B.1.1 SYSTEM OF GOVERNANCE

A clear governance structure, with documented delegated authorities and responsibilities, from the Board onwards to its specific Board committees and Management team is in place.

The objective of the Company’s governance model is to ensure that management is empowered to run the business on a day-to-day basis in accordance with the delegated authority received from the Board, whilst ensuring that Directors are able to discharge their statutory and regulatory responsibilities, and that the Board has appropriate oversight and supervision of the business.

The approach adopted is that:

1) The Board has the power to manage the Company in accordance with laws and the regulations.

2) The Board sets ‘Matters Reserved' which is a schedule of items which must go to the Board for approval. This operates as an escalation route to ensure that relevant matters are referred up through the appropriate Board structures.

3) The Board delegates authority to Board committees through terms of reference.

4) The Board delegates authority to Executive Directors and management through delegations of authority.

5) Management oversight committees support management in making decisions under delegations of authority (and are also used to review proposals before they go to the Board).

6) A system of Solvency II key functions (Actuarial, Internal Audit, Risk and Compliance) operates within the Company, reporting to both management oversight committees and Board committees accordingly. Representatives from Actuarial, Risk and Compliance attend. In addition, the Internal Audit function reports directly to the Board Audit Committee for the Company. There are also a number of other key functions that operate across the Group, including Group Finance, Treasury, Group Tax, Legal Services, Human Resources, Corporate Communications, Strategy and Corporate Development, Investor Relations and Company Secretariat.

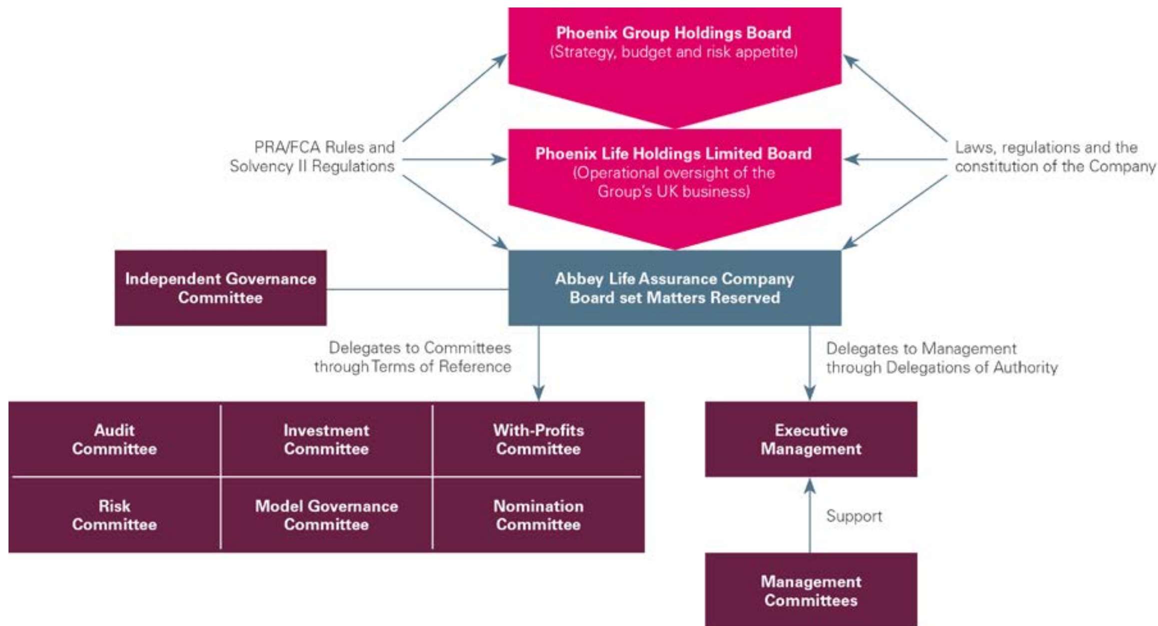
SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.2 BOARD AND COMMITTEE STRUCTURE

The chart below shows the new Company Board and delegated Committee structures following the acquisition of the Company by the Phoenix Group on 30 December 2016.



B.1.2.1 Composition and roles of the Board

The Board is made up of an independent Chairman, a senior independent Director, three other independent Non-Executive Directors, and four Executive Directors. The Chief Actuary is invited to attend all Board meetings. Those performing roles that required approval pursuant to the Senior Insurance Managers Regime have been duly approved.

The Board members following the acquisition by the Phoenix Group on 30 December 2016 are presented below:

Name	Position	Date of appointment	Date of resignation
Michael Norris Urmston	Chairman and Non-Executive Director	30 December 2016	–
Andrew Moss	Chief Executive Officer	30 December 2016	–
David Richard Cheeseman	Chief Financial Officer	30 December 2016	–
Anthony Wayne Snow	Chief Risk Officer	30 December 2016	–
David Nicholas Woollett	Director (Head of Site)	4 January 2017	–
Stephen Andrew Clarke	Chair of the Audit Committee and Non-Executive Director	30 December 2016	–
John Robert Lister	Chair of the Risk Committee and Non-Executive Director	30 December 2016	–
Diana Susan Miller	Senior Independent Director and Non-Executive Director	30 December 2016	–
Michael John Merrick	Non-Executive Director	18 April 2016	31 March 2017
Nicholas Hugh Poyntz-Wright	Non-Executive Director	30 December 2016	–

The terms of appointment for the Directors state that they are expected to attend scheduled Board meetings in person (at least six per year) and any additional Board meetings when required, and to devote appropriate preparation time ahead of each meeting.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.2 BOARD AND COMMITTEE STRUCTURE CONTINUED

B.1.2.1 Composition and roles of the Board Continued

The role of the Board is to:

- Provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enable risk to be assessed and managed;
- Set the Company's strategic aims, ensure that the necessary financial and human resources are in place for the Company to meet its objectives, and review management performance; and
- Uphold the Company's values and standards and ensure that it obligations to its shareholders, policyholders and other stakeholders are understood and met.

The Board is responsible and accountable for strategic matters (within the strategy set by the PGH Board), oversight of management and the performance of the Company's business.

B.1.2.2 Committee framework

The Board has delegated specific responsibilities to seven standing committees of the Board, which are:

- Audit Committee;
- Investment Committee;
- Independent Governance Committee;
- Model Governance Committee;
- Nominations Committee;
- Risk Committee; and
- With-Profits Committee.

With the exception of the With-profits Committee and Independent Governance Committee which are chaired by Non-Executive Members, all committees are chaired by a Non-Executive Director who also sits on the Company's Board. All committee members are appointed by the Board and both the With-profits Committee and the Independent Governance Committee, have independent members who are not Directors. Further details are provided below.

The roles and responsibilities of the committees of the Board are outlined below:

Committee	Composition	Roles, duties and responsibilities
Audit Committee	Non-Executive Chairman Non-Executive Directosr (2) Meets at least four times a year at appropriate times in the reporting cycle or more frequently as circumstances require. At least once a year, without the presence of executive management, the Committee meets separately with the external auditors, Internal Audit, the CEO, CRO and the Finance Director to discuss matters relating to its remit and any issues arising from the audit. The Committee Chairman reports formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Audit Committee are to: – Monitor the overall integrity of financial reporting. – Review the overall effectiveness of the internal control and the Internal Audit function. – Agree the nature and scope of external audit and to oversee the relationship with the external auditors. – Review the effectiveness of the Finance function and the integrity of financial reporting. – Approve the remit of the Group Internal Audit function.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED
B.1.2 BOARD AND COMMITTEE STRUCTURE CONTINUED
B.1.2.2 Committee framework Continued

Committee	Composition	Roles, duties and responsibilities
Risk Committee	Non-Executive Chairman Non-Executive Directors (4) Meets at least three times a year at appropriate times or more frequently as circumstances require. At least once a year, without the presence of Executive Management, the Committee meets the Chief Risk Officer. The Committee Chairman reports formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main role, duties and responsibilities of the Risk Committee are to: – Advise the Board on all risk matters including risk appetite and tolerance in setting the future strategy. – Maintain the Risk Management Framework and review the effectiveness of its operation, including reviewing the risk appetite framework and limits. – Approve the overall risk management strategy and principal risk policies including monitoring compliance. – Oversight of the design and execution of the stress and scenario testing framework, and also ensuring that risks to the business plan are adequately identified and assessed through stress testing and scenario analysis.
Nomination Committee	Non-Executive Chairman Senior Independent Director Executive Director Members of the Nomination Committee are appointed by the Board. The Committee Chairman shall be appointed by the Board and shall be either the Chairman of the Board or an independent Non-Executive Director. The Nomination Committee meets at least twice a year and at such other times as the Committee Chairman shall require. The Committee Chairman reports formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Nomination Committee are to: – Lead the process for appointments to the Board and ensure that the Board retains appropriate balance of skills, knowledge, experience, and diversity to support the strategic objective of the Company. – Ensure there is a formal, rigorous, and transparent approach to the appointment of Directors including maintaining an effective framework for succession planning. – Approve proposals for the appointment or removal of Directors to/from the Board of the Company. – Regularly review the structure, size and composition of the Board and make recommendations with regard to any changes that are deemed necessary. – Identify and nominate candidates to fill Board vacancies as and when they arise, and give consideration to succession planning. – Review annually the time required from Non-Executive Directors and recommend the re-appointment to the Board of any Non-Executive Director at the end of their specified term of office.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED
B.1.2 BOARD AND COMMITTEE STRUCTURE CONTINUED
B.1.2.2 Committee framework Continued

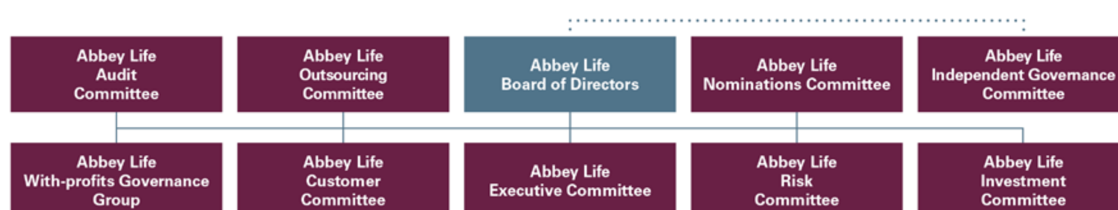
Committee	Composition	Roles, duties and responsibilities
Investment Committee	Non-Executive Chairman Non-Executive Director (2) Executive members (5) The Investment Committee meets at least four times a year or more frequently as circumstances require. Reports on the key activities of the Committee are provided to the Board and other committees of the Board as required.	The main roles, duties and responsibilities of the Investment Committee are to: – Establish and implement investment strategy and to regularly review investment and Asset Liability Management strategy whilst ensuring customers are treated fairly. – Initiate or review proposals for material changes in investment direction, and to approve such changes. – Review relative investment performance and to oversee the governance of the relationships between the Company and all investment managers, including oversight and review of fees, fee structures and Service Level Agreements. – Have oversight and review the appropriateness of investment mandates. – Liaise with the internal finance committees which have responsibility for the shareholder impact of investment matters also with the With-profits Committee which have responsibility for the policyholder impact of investment matters.
With-profit Committee	Independent Chairman Non-Executive members (2) Non-Executive Director Executive Director The Committee meets on a quarterly basis or more frequently if required (usually shortly before a scheduled Board meeting). Reports on the key activities of the Committee are provided to the Board and other committees of the Board as required.	The main, roles, duties and responsibilities of the With-profit Committee are to: – Assess, report on, and provide clear advice, independent judgement and, where appropriate, recommendations to the Board on the way in which each with-profit fund is managed and whether this is properly reflected in the Principles and Practices of Financial Management ('PPFM'). – Outline how competing or conflicting rights and interests of policyholders and, if applicable, shareholders have been addressed. – Consider all major transactions involving the Company (for example Part VII transfers, reinsurances, outsourcing) to the extent to which they impact upon with-profits policyholders. – Consider at the request of the Board all proposals for the exercise of discretion in respect of non-profit policies and the conduct and overall approach to treating customers fairly.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED
B.1.2 BOARD AND COMMITTEE STRUCTURE CONTINUED
B.1.2.2 Committee framework Continued

Committee	Composition	Roles, duties and responsibilities
Independent Governance Committee	Independent Non-Executive Chairman Non-Executive Members (2) Company representatives (2) The Committee meets at least four times a year at appropriate times or more frequently as circumstances require. The Committee Chairman reports formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Independent Governance Committee are to act in the interest of members of the contract-based workplace pension schemes operated by the Company, and assess the ongoing value for money delivered by them.
Model Governance Committee	Non-Executive Chairman Non-Executive Directors (4) Executive Directors (5)	The main roles, duties and responsibilities of the Model Governance Committee are to: – Monitor the strategic direction and overall governance of the Internal Model. – Provide assurance to the Board on the ongoing appropriateness, performance and effectiveness of the Internal Model.

B.1.3 PRE-ACQUISITION BOARD AND COMMITTEE STRUCTURE
The chart below shows the Company Board and first tier delegated Committee structures prior to the acquisition.



The Constitution of the acquired Board committees and their terms of reference were considered and, where appropriate, amended by the Board at their first meeting on 4 January 2017. The Abbey Life Executive Committee was dissolved at that time. Following a review of governance by the Head of Site, the Customer Committee and Outsourcing Committee were dissolved on 17 February 2017.

B.1.3.1 Pre-acquisition composition and roles of the Board
The Board members prior to the acquisition by the Phoenix Group on 30 December 2016 are presented below:

Name	Position	Date of appointment	Date of resignation
Christopher Guthrie Little	Chairman and Chair of Audit Committee	20 November 2007	30 December 2016
Amish Jayant Dashrath Desai	Chief Executive Officer/ Investment Executive Officer	24 February 2012	30 December 2016
Benedict Craig	Chief Financial Officer	11 February 2011	30 December 2016
Neil Charles Hardell Tointon	Director and Chief Operating Officer	1 December 2001	30 December 2016
Leslie Michael Etheridge	Senior Independent Director and Non-Executive Director	30 November 2007	30 December 2016
Michael John Merrick	Chair of Risk Committee and Non-Executive Director	18 April 2016	–
Robert Stirling	Non-Executive Director	21 December 2007	30 December 2016

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.3 PRE-ACQUISITION BOARD AND COMMITTEE STRUCTURE CONTINUED

B.1.3.1 Pre-acquisition composition and roles of the Board Continued

The roles and responsibilities of the Board up to 30 December 2016 are set out below:

Name	Roles and responsibilities
Christopher Guthrie Little	Chair of the Board, Nominations and Outsourcing committees and core responsibilities include: – Leading the development of the Company's culture; – Leading the development and monitoring effective implementation of policies and procedures for the induction, training and professional development of all members of the Board; and – Overseeing the development and implementation of the Company's remuneration policies and practices.
Amish Jayant Dashrath Desai	Chief Executive Officer, Chair of the Executive and Investment committees and core responsibilities include: – Responsibility for ensuring that the Company has complied with its obligation to ensure that every person who performs a role under the Approved Persons Regime, including Board members, is a fit and proper person and has appropriate skills to undertake the role that has been allocated to them; – Responsibility for overseeing the adoption of the Company's culture in the day-to-day management of the Company; – Responsibility for the development and maintenance of the Company's business model as approved by the Board; and – Responsibility for monitoring effective implementation of policies and procedures for the induction, training and professional development of non-Board members that are key function holders.
Benedict Craig	Chief Financial Officer with responsibilities for the production and integrity of the Company's financial information and its regulatory reporting.
Leslie Michael Etheridge	Non-Executive Director, Senior Independent Director, Whistleblowing Champion and was the Chair of the With-profits Governance Group and the Customer Committee.
Michael John Merrick	Non-Executive Director and Chair of the Risk Committee.
Robert Stirling	Notified Non-Executive Director.
Neil Charles Hardell Tointon	Executive Director with responsibilities for Operations Outsourcing and Chair of Senior Management Committee.

B.1.3.2 Pre-acquisition committee framework

The committee framework prior to the acquisition by the Phoenix Group on 30 December 2016 is presented below:

The Board delegated specific responsibilities to seven standing committees of the Board, which were:

- Executive Committee;
- Audit Committee;
- Outsourcing Committee;
- Customer Committee;
- Investment Committee;
- Risk Committee; and
- Nominations Committee.

In addition there were two other forums/committees which made up the first tier governance arrangements:

- With-profits Governance Group; and
- Independent Governance Committee.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.3 PRE-ACQUISITION BOARD AND COMMITTEE STRUCTURE CONTINUED

B.1.3.2 Pre-acquisition committee framework Continued

The roles, duties and responsibilities of the committees of the Board are outlined below:

Committee	Composition	Roles, duties and responsibilities
Executive Committee	Chief Executive Officer Chairman Chief Financial Officer Chief Operating Officer Chief Actuary Meetings were held monthly or more frequently as circumstances require. The Committee Chairman reports formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Executive Committee were to: – Manage generally the business of the Company, in accordance with the parameters set out by the Board of Directors, and with the full authority of the Board save for matters reserved specifically by the Board. – Recommend to the Board business strategies, including setting of policies. – Monitor performance and ensure that the business is managed such that it is compliant with relevant guidelines. – Ensure the Company's compliance with legal and regulatory requirements including treating customers fairly, prudential requirements and reporting obligations and to monitor the regulatory developments in each area in which the Company operates.
Audit Committee	Non-Executive Chairman Non-Executive Director Meetings were held at least twice a year at appropriate times in the reporting cycle or more frequently as circumstances required. In addition the Committee met regularly with the external auditor, without the Company management being present, to discuss the auditor's remit and any issues arising from the audit. The Committee invited other persons (for example, the External Auditor and Chief Finance Officer) when the topics being covered indicated the need to do so. At least once a year, without the presence of Executive Management, the Committee met separately with each of the external auditors and the Chief Financial Officer to discuss matters relating to its remit and any issues arising from the audit. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Audit Committee were to: – Monitor the overall integrity of financial reporting. – Monitor the effectiveness of the Company's internal quality control and risk management systems with respect to the financial reporting, without breaching its independence. – Oversee the relationship with the external auditor. – Review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement, having regard to the seniority, expertise and experience of the audit team.
Outsourcing Committee	Non-Executive Chairman Non-Executive Directors Executive Director Observer Met at least twice a year at appropriate times in the reporting cycle or more frequently as circumstances required. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main role, duties and responsibilities of the Outsourcing Committee were to oversee: – The governance arrangements for the selection of outsourced service providers and for the ongoing monitoring and control of outsourced service provider performance. – Contingency plans in the event of outsourced service provider failure. – Contractual arrangements with outsourced service providers.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED
B.1.3 PRE-ACQUISITION BOARD AND COMMITTEE STRUCTURE CONTINUED
B.1.3.2 Pre-acquisition committee framework Continued

Committee	Composition	Roles, duties and responsibilities
Customer Committee	Non-Executive Chairman Executive Directors (2) Chief Actuary Head of Legal and Compliance (Compliance Officer) Head of Customer Chief Risk Officer Meetings were held monthly or more frequently as circumstances required. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main role, duties and responsibilities of the Customer Committee were to: – Ensure that appropriate regard was given to the interests of customers in the formulation and implementation of the organisation's strategy. – Ensure that fair outcomes for the customer were adequately considered in the business plan. – Oversee the formulation and implementation of the organisation's customer strategy. – Provide oversight of the Communications Strategy, ensuring that communications were clear, fair and not misleading such that customers can make informed decisions and remain engaged. – Oversee the ongoing implementation of a positive customer culture.
Risk Committee	Non-Executive Chairman Executive Directors (2) Chief Actuary Chief Risk Officer Head of Legal and Compliance (Compliance Officer) Head of Customer Met on a monthly basis. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main role, duties and responsibilities of the Risk Committee were to: – Advise the Board on all risk matters including risk appetite and tolerance in setting the future strategy. – To maintain the Risk Management Framework and review the effectiveness of its operation, including reviewing the risk appetite framework and limits. – Approve the overall risk management strategy and principal risk policies including monitoring compliance. – Oversight of the design and execution of the stress and scenario testing framework, and also ensuring that risks to the business plan were adequately identified and assessed through stress testing and scenario analysis.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED
B.1.3 PRE-ACQUISITION BOARD AND COMMITTEE STRUCTURE CONTINUED
B.1.3.2 Pre-acquisition committee framework Continued

Committee	Composition	Roles, duties and responsibilities
Nomination Committee	Non-Executive Chairman Senior Independent Director The Nomination Committee met at least once a year and at such other times as the Committee Chairman required. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Nomination Committee were to: – Regularly review the structure, size and composition (including the skills, knowledge, experience and diversity, taking into account the legal and regulatory requirements applicable to the Company) of the Board and make recommendations to the Board with regard to any changes. – Give full consideration to succession planning for Directors and other senior executives, taking into account the challenges and opportunities facing the Company and the skills and expertise needed on the Board and within the Company. – Identify and nominate for the approval of the Board, candidates to fill Board vacancies as and when they arose. – Before any appointment were made by the Board, evaluate the balance of skills, knowledge, experience and diversity on the Board, and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. – Review the results of the Board performance evaluation process that related to the composition of the Board. – Review annually the time required from Non-Executive Directors and recommended the re-appointment to the Board of any Non-Executive Director at the end of their specified term of office.
Investment Committee	Chief Investment Officer Chairman Chief Financial Officer Chief Operating Officer Chief Actuary Independent Non-Executive Director Other Company Representatives (2) The Investment Committee met at least eight times a year or more frequently as circumstances required. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Investment Committee were to: – Monitor and challenge the performance of the investment managers against agreed standards. – Recommend changes in investment policy to the Board of Directors, noting that any changes proposed to the investment policy of the with-profits funds will also take in to account the advice of the With-profits Actuary 'WPA' and the fund's PPFM. – Agree specific changes in fund objectives. – Ensure that the Company maintained adequate controls over its investment managers. – Review proposed changes in investment strategy put forward by the investment managers.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED
B.1.3 PRE-ACQUISITION BOARD AND COMMITTEE STRUCTURE CONTINUED
B.1.3.2 Pre-acquisition committee framework Continued

Committee	Composition	Roles, duties and responsibilities
With-profit Governance Group	Non-Executive Chairman With-profits Actuary Chief Actuary Company Representative The Governance Group met four times a year or more frequently if required.	The main, roles, duties and responsibilities of the With-profit Governance Group Committee were to: – Assess, report on, and provide clear advice, independent judgement and, where appropriate, recommendations to the Board on the way in which each with-profit fund is managed and whether this is properly reflected in the PPFM. – Consider and comment as appropriate on papers to be submitted to the Board that contained recommendations in connection with the Company's with-profit business for the setting of bonus rates, surrender values, investment strategy and any significant transactions that may affect the balance of with-profits policyholders and shareholders' interests.
Independent Governance Committee	Independent Chairman Non-Executive Members (2) Company Representatives (2) The Committee met at least four times a year at appropriate times or more frequently as circumstances required. The Committee Chairman reported formally to the Board on proceedings after each meeting, on all matters within its duties and responsibilities.	The main roles, duties and responsibilities of the Independent Governance Committee were to act in the interest of members of the workplace contract-based personal pension schemes and assess the ongoing value for money delivered by them.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.4 REMUNERATION POLICY

As a company within the Phoenix Group, the principles of the Phoenix Group-wide remuneration policy apply to the Company from its date of joining the Phoenix Group in 2016.

The Group has one consistent remuneration policy for all levels of employees and this policy is made available to all staff. Therefore the same remuneration policy principles guide reward decisions for all Group employees, including Executive Directors, although remuneration packages differ to take into account appropriate factors in different areas of the business.

The Group-wide remuneration policy is overseen by the Remuneration Committee of PGH ('RemCo'). Further details on this Committee can be found on page 54 of the 2016 PGH Annual Report and Accounts and on the governance pages of the PGH website.

The policy focuses on ensuring sound and effective risk management and supports management in the operation of their business through the identification of minimum standards and key controls.

The key principles of the remuneration policy which apply across the Group are set out below.

A) **Attract, retain and motivate quality staff** – management keep remuneration practices under review to ensure that these support promotion of the long-term interests of the Group and its stakeholders, and adequately and fairly reward staff.

B) **Remuneration is positioned appropriately against external benchmarks** – remuneration is benchmarked against independent third party data at appropriate intervals.

C) **Remuneration is aligned to the long-term success of the Company** – performance-related components of remuneration are aligned to measures which reflect achievement of the Group's long-term success and strategy.

D) **Proportion of variable pay is appropriate and balanced**, and has due regard to any impact of risk. The ratio of fixed to variable remuneration will differ depending on the specific incentive schemes in operation across the business. However, the Group seeks to ensure that an appropriate balance between fixed and variable remuneration is maintained for all employees, with the fixed proportion being sufficient to allow variable pay to operate on a fully-flexible basis, including the possibility of no payments of variable remuneration in a year. For material risk-takers subject to the regulatory requirements (further details on whom are included in section B.2) there is also an appropriate balance between annual and long-term incentives, with the deferral of annual incentives into shares and all incentives including provision for the application of malus and clawback where appropriate.

E) **Independence and strong governance in decision-making processes** – as the policy is overseen by RemCo, this ensures an appropriate level of independent challenge given RemCo exclusively comprises independent Non-Executive Directors. Certain roles within control functions (Risk, Compliance, Internal Audit and Actuarial) are also subject to different variable pay arrangements which exclude any linkage to financial performance for annual incentives.

B.1.4.1 Variable remuneration plans

As the Company was a member of the Phoenix Group for only two days in 2016, no employees within the Company participated in Phoenix Annual Incentives or Long-term Incentive Plans in 2016.

For 2017 the Company's employees will join the Group-wide variable remuneration plans as described below.

Annual Incentive Plan

All permanent members of staff participate in a Group-wide Annual Incentive Plan ('AIP'). This is subject to a mixture of Corporate (financial and strategic) and Personal (individual objectives) performance measures for all staff. This represents a balanced scorecard which includes customer metrics in addition to financial and personal measures.

The quantum of and the balance between Corporate and Personal performance measures varies between different levels of staff.

The Corporate performance measures apply on a Group-wide basis to produce a 'corporate factor' in calculating AIP outcomes.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.4 REMUNERATION POLICY CONTINUED

B.1.4.1 Variable remuneration plans Continued

For 2017, the Corporate performance measures will consist of Operating Companies' Cash Generation and Customer Experience with weightings as below.

Performance Metric	Weighting of Measure
Corporate Measures for AIP in 2017	
Operating Companies' Cash Generation	71%
Customer Experience	29%

The Personal performance measures are determined by line managers in accordance with an established performance appraisal grading structure.

One-third of AIP outcomes for all material risk-takers subject to the regulatory requirements are deferred for a period of three years under the Deferred Bonus Share Scheme. For 2017's AIP, the level of deferral will increase to 40% of AIP outcomes for members of the Executive Committee.

Long-term Incentive Plan

In 2017, no employee of the Company will participate in a long-term incentive plan ('LTIP'), except for the Executive Directors of the Company.

Three of these Executive Directors are also employees of PGH and thus participate in a Group-wide LTIP for selected senior members of staff as described below.

RemCo sets performance measures for each LTIP grant. Performance measures include an appropriate mix of measures based on growth in suitable performance conditions set at the time of grant. Performance measures are subject to additional underpin requirements which permit RemCo to reduce or prevent vesting in appropriate circumstances.

The weightings of the LTIP performance measures for 2016 are summarised below. Each performance measure is assessed over the period of three financial years from 2016 to 2018.

Performance Measure	Weighting of Performance Measure
Cumulative cash generation	50%
Total Shareholder Return ('TSR')	50%
Total	100%

All 2016 LTIP awards are subject to a further underpin measure relating to debt and risk management within the Group. This 'underpin' will be extended for 2017 LTIP awards to include consideration of customer satisfaction and, in exceptional cases, personal performance.

The relative TSR measure is calculated against the constituents of the FTSE 250 (excluding Investment Trusts) with vesting commencing at median (25% of this part of the award) and full vesting at upper quintile levels, subject to an underpin regarding underlying financial performance.

The weightings for LTIP measures will be unchanged for 2017 LTIP awards.

The remaining Executive Director of the Company participates in a specific long-term plan established for 17 employees of the AXA (SunLife) business which has the potential to reward these individuals for any increase in value of that business over a period of four years. This specific plan is designed to promote appropriate retention and incentivisation of the individuals, and will normally involve deferral of amounts that may be earned.

B.1.4.2 Description of Pension Arrangements

All members of staff are invited to participate in the Group Personal Pension plan or other defined contribution pension arrangements that are open at that time. A legacy Abbey Life defined benefit pension scheme also remains open to a closed population of former Abbey Life employees. Where an individual is impacted by annual or lifetime limits on contribution levels to qualifying pension plans, the balance could be taken as a cash supplement (reduced for the impact of employers' National Insurance Contributions).

The Group does not operate any discretionary pension benefits. Death in Service benefits are provided to all staff.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE CONTINUED

B.1.4 REMUNERATION POLICY CONTINUED

B.1.4.3 Pre-acquisition remuneration policy

The Company's remuneration policy prior to 30 December 2016 is set out below:

The Company adopted the Deutsche Bank remuneration policy throughout 2016. The policy plays an integral role in the successful delivery of strategic objectives. The policy has developed remuneration principles that focus on ensuring that it is able to:

- maximise sustainable employee and firm performance;
- attract and retain staff with the required skills, knowledge and expertise;
- be simple and transparent;
- comply with regulatory requirements; and
- be aligned to shareholder interests and sustained profitability, taking into account risk and cost of capital.

The remuneration structure and policy have been evolving in order to align with the continuously changing regulatory requirements. Ensuring compliance with regulatory requirements is an overriding principle in the remuneration strategy.

Within the remuneration policy there is the term total remuneration which is made up of fixed and variable pay.

Fixed pay – is the key and primary element of compensation for the majority of employees and reflects the value of the individual role and function within the organisation. It rewards factors that an employee brings to the organisation such as skills and experience. It plays a significant role in ensuring competitiveness of the Company within the labour market, thus benchmarking provides a valuable input when determining fixed pay levels.

Variable pay – is a discretionary remuneration element that enables the Company to provide additional reward to employees for their performance and behaviours, while reflecting the Company's affordability and the financial situation. Variable pay aims to:

- Recognise that every employee contributes to success and therefore creates a clear link between corporate performance and employees'.
- Reflect individual performance, behaviours and adherence to the core values and beliefs through discretionary individual variable pay.
- Reward outstanding contribution through the discretionary recognition award.

Share options or shares – some Directors of the Company prior to 30 December 2016 were entitled to Deutsche Bank AG Group shares or payments as part of the long-term incentive scheme.

Pension – the Company sponsors a funded defined benefit pension plan and Deutsche Bank sponsors a money purchase scheme for qualifying UK employees, including Directors as applicable. Further information is available on the Abbey Life Staff Pension Scheme in section D.3.4.

Material transactions during the reporting period with shareholders, persons who exercised key influence and members of the Board – there are no material transactions to report and the Company paid no dividends during the year. None of the Directors who held office during the year had any interest in the shares of the Company.

B.1.5 KEY FUNCTIONS

Solvency II defines 'Function' within a system of governance, as an internal capacity to undertake practical tasks and to operate a system of governance which includes the Risk Management function, the Compliance function, the Internal Audit function and the Actuarial function.

The functions which operate within the Company are as follows:

- Risk Management function (see section B.3.1 for further details);
- Compliance function (see section B.4.2 for further details);
- Internal Audit function (see section B.5 for further details); and
- Actuarial function (see section B.6 for further details).

Further details on how the key functions have the necessary authority, resources and operational independence to carry out their tasks and how they report to and advise the Board of the Company are detailed in the sections which cover each function (see sections B.3, B.4, B.5 and B.6).

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.2 FIT AND PROPER REQUIREMENTS

This section provides information on the specific requirements concerning skills, knowledge and expertise applicable to the persons who effectively run the business or hold other key functions and how they are assessed to be 'fit and proper'.

B.2.1 SENIOR INSURANCE MANAGERS REGIME

Following industry consultation, the UK Regulators introduced the Senior Insurance Managers Regime ('SIMR'), applicable to all PRA and dual regulated entities (i.e. PRA and FCA) in response to the Solvency II requirements, which came into effect on 1 January 2016.

The associated regulatory requirements of this regime apply to all staff within the Group (including the Company) who are employed within a Key Function, defined as one which is essential for the successful operation of the business. Whilst all employees (with the exception of those engaged in facilities and catering activity) are subject to elements of the regime, the most significant impact is upon Senior Management, (Approved Persons and the Non-Executive Directors). In total, this equates to circa 40 roles across the Group.

The Company ensures that the associated requirements are met through the effective implementation of an Approved Person policy, and associated documentation and processes which cover the following:

- Alignment of Controlled function (i.e. the activities performed by the Approved Persons defined within a scope of responsibilities document) roles to the SIMR.
- Authorisation process for pre-approved Controlled function, notified functions (for example a Non-Executive Director in a role not requiring pre-approval) and Key function holders.
- Demonstration and maintenance of fitness and propriety.
- Application and demonstration of the applicable conduct standards across the business.
- Evidence and maintenance of competence via the Phoenix Performance Management Process.

With regards to the specific requirements concerning skills, knowledge and expertise to the initial and ongoing skills analysis, all individuals complete a relevant induction programme at appointment. As part of the recruitment process, they also have a competency assessment and agree an appropriate development plan. Once in role, relevant persons are subject to the annual performance management process in addition to the annual fit and proper process, implemented for all Approved Persons, Senior Insurance Manager Functions and Key Function Holders.

B.2.2 PROCESS FOR ASSESSING FITNESS AND PROPRIETY

The Group has a number of policies and processes established which apply to all regulated entities, and provides appropriate guidance and governance to ensure that those effectively running the Company have, and maintain, appropriate fit and proper status during their appointment. These policies and processes include the requirements to:

- Identify and maintain accurate records of all Approved Persons sufficient to meet the requirements of the FCA and PRA.
- Ensure new appointments are appropriately authorised, including skills analysis and competence assessment.
- Maintain a Group Approved Persons Framework to provide direction and guidance to the Group's Approved Persons ensuring they understand and can evidence how they meet their regulatory requirements.
- Complete periodic assessments of Approved Persons to determine their ongoing competence, including consideration of performance development rating, Disclosure and Barring Service ('DBS') check and financial self-certification.
- Maintain an effective performance management framework, ensuring that the performance of employees is effectively managed.
- Motivate and retain the right employees through appropriate reward structures.
- Deliver an appropriate organisational culture through embedding appropriate values and behaviours.
- Identify, plan and implement effective learning and development activities.
- Provide guidance, information and advice regarding the requirements, expectations and obligations of an Approved Person role.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

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

This section provides a description of the Group's risk management system including information on how the risk management functions are implemented and integrated into the organisational structure and decision-making processes of the Group.

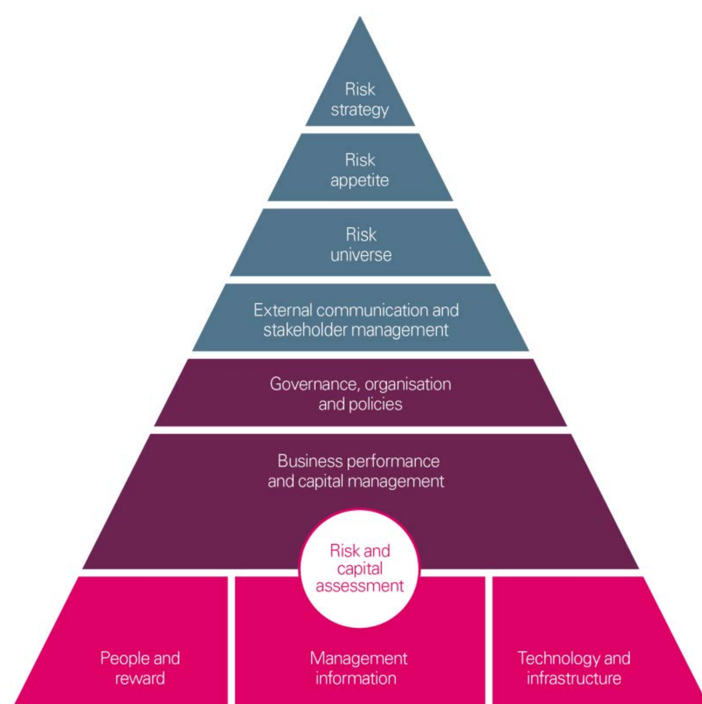
The PGH Group Board is accountable for the Group's Risk Management Framework ('RMF'), which is implemented consistently across all Group subsidiaries, including PLHL and the Life Companies. Ultimate accountability for compliance with the regulations rests with the PLHL Board, however each Life Company Board has responsibility for its own entity complying with Solvency II regulations.

B.3.1 RISK MANAGEMENT FRAMEWORK

The Group has developed a RMF which seeks to establish a coherent and interactive set of arrangements and processes to support the effective management of risk throughout the Group.

The framework has been embedded within the Group and plans for the proportionate roll-out into the Company are being developed. The roll-out of the RMF into the Company, will where relevant, take account of the Group's plans for the integration of operations into the Phoenix business model and be the focus of activity in 2017.

The Phoenix Group Risk Management Framework comprises ten components as illustrated below:



The outputs of the RMF provide assurance that all risks are being appropriately identified and managed effectively and that an independent assessment of management's approach to risk management is being performed.

Group Risk conducts an annual assessment of the Group's adherence to the RMF that provides assurance to management and the Boards that the RMF has been implemented consistently and is operating effectively across the Group.

Further details of the ten components of the RMF are below.

Risk strategy

The Group's risk strategy provides an overarching view of how risk management is incorporated consistently across all levels of the business, from decision-making to strategy implementation.

It helps the business achieve its strategic objectives by supporting a more stable, well managed business with improved customer and shareholder outcomes.

This is achieved not by risk avoidance, but through the identification and management of an acceptable level of risk (its 'risk appetite') and by ensuring that the Group is appropriately rewarded for the risks it takes.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.1 RISK MANAGEMENT FRAMEWORK CONTINUED

Risk strategy Continued

To ensure that all risks are managed effectively, the Group is committed to:

- Embedding a risk aware culture;
- Maintaining a strong system of internal controls;
- Enhancing and protecting customer and shareholder value through continuous and proactive risk management;
- Maintaining an efficient capital structure; and
- Ensuring that risk management is embedded into day-to-day management and decision-making processes.

Risk appetite

The Group's risk appetite is the level of risk the Group is willing to accept in pursuit of its strategic objectives. The statements below encapsulate the Group's risk appetite for policyholder security and conduct, earnings volatility, liquidity and the Group's control environment:

- **Capital** – The Group and each Life Company will hold sufficient capital to meet regulatory requirements in a number of asset and liability stress scenarios.
- **Cash flow** – The Group will seek to ensure that it has sufficient cash flow to meet its financial obligations and will continue to do this in a volatile business environment.
- **Shareholder value** – The Group will take action to protect shareholder value.
- **Regulation** – The Group and each Life Company will, at all times, operate a strong control environment to ensure compliance with all internal policies and applicable laws and regulations, in a commercially effective manner.
- **Conduct** – The Group has zero appetite for deliberate acts of misconduct, including omissions that result in customer detriment, reputational damage and/or pose a risk to the FCA statutory objectives.

Risk universe

A key element of effective risk management is ensuring that the business has a complete and robust understanding of the risks it faces. These risks are defined in the Group's Risk Universe.

The Risk Universe allows the Group to deploy a common risk language, allowing for meaningful comparisons to be made across the business.

There are three levels of Risk Universe categories. The highest Risk Universe category is Level 1 and includes:

- Strategic risk;
- Customer risk;
- Financial soundness risk;
- Market risk;
- Credit risk;
- Insurance risk; and
- Operational risk.

Embedded within these categories, and Customer risk in particular, are the conduct risks faced by the Group and its customers. These risks are separately monitored and reported on across the organisation to ensure that conduct risk receives appropriate emphasis and oversight.

The Group has developed a PGH Board approved risk appetite statement to manage Conduct risk. The appetite statement is supported by the assessment of all conduct-related risks faced by the Group on a quarterly basis. This regular assessment and reporting enables the Group to be forward-looking and proactive in the management of Conduct risk.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.1 RISK MANAGEMENT FRAMEWORK CONTINUED

RISK UNIVERSE CONTINUED

Section C of this SFCR contains a summary of the risk profile of the Company. The summary in section C is structured in accordance with the risk categories of the Solvency II Directive, which is different from the risk categories set out above. The following table provides a mapping between the different sets of risk categories in section B.3 and section C:

Section B – Phoenix Group Risk Universe	Section C – Risk profile	Comment
Strategic risk	Other material risks	Exposure to strategic risk is considered in section C.6.5
Customer risk	Other material risks	Exposure to customer risk is considered in section C.6.4
Financial soundness risk	Liquidity risk	Liquidity risk is a sub-category of financial soundness risk. The other material components of financial soundness risk (capital management risk and tax risk) are considered in section C.6.1
Market risk	Market risk	No difference
Credit risk	Credit risk	No difference
Insurance risk	Underwriting risk	Section C.1 underwriting risk includes all components of insurance risk (mortality risk, longevity risk, morbidity risk, expense risk, lapse risk and policyholder behaviour risk)
Operational risk	Operational risk	Not applicable
Not applicable	Other material risks	Section C.6 'Other Material Risks' considers exposure to Risk Universe categories not already covered in the other parts of section C

EXTERNAL COMMUNICATION AND STAKEHOLDER MANAGEMENT

The Group has a number of internal and external stakeholders, each of whom has an active interest in the Group's performance, including how risks are managed. Significant effort is made to ensure that the Group's stakeholders have appropriate, timely and accurate information to support them in forming the views of the Group. The Life Companies and the Group are subject to the requirements of regulators and have obligations to customers in terms of their reasonable benefit expectations and maintaining the security of the assets backing those obligations.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

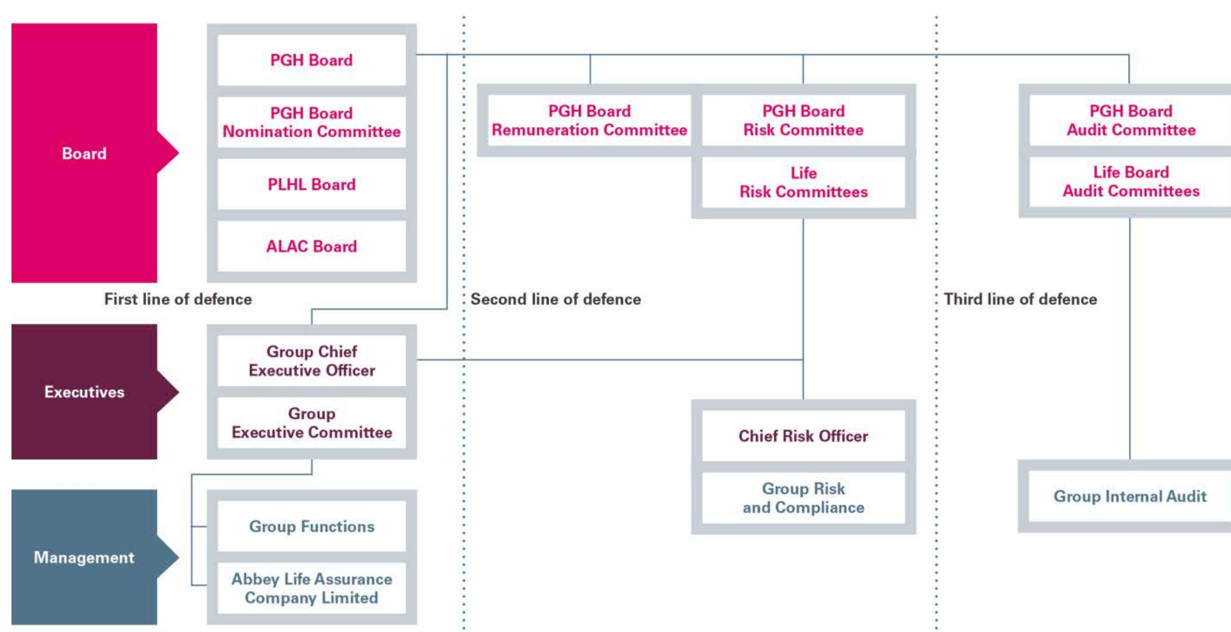
B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.1 RISK MANAGEMENT FRAMEWORK CONTINUED

GOVERNANCE

Overall responsibility for approving, establishing and embedding the RMF rests with the PGH Board. The PGH Board recognises the critical importance of having an efficient and effective RMF and appropriate oversight of its operation. There is a clear organisational structure in place with documented, delegated authorities and responsibilities from the PGH Board to the PLHL Board, Life Company Boards and the Executive Committee. Further details are included in section B.1.

The RMF is underpinned by the operation of a 'Three Lines of Defence' model with clearly defined roles and responsibilities for statutory Boards and their committees, management oversight committees, Group Risk and Group Internal Audit. This is illustrated by the diagram below:



First line: Management – Management of risk is delegated from the Board to the Group CEO, Executive Committee members and through to business managers. A series of business unit management oversight committees operate within the Group. They are responsible for implementation of the RMF and ensuring the risks associated with the business activities are identified, assessed, controlled, monitored and reported.

Second line: Risk oversight – Risk oversight is provided by the Group Risk function, the Group Board Risk Committee and the Abbey Life Risk Committee.

Third line: Independent assurance – Independent verification of the adequacy and effectiveness of the internal controls and risk management is provided by the Group Internal Audit function, which is supported by the Board Audit Committee.

ORGANISATION

The Group CRO manages the Group Risk function and has responsibility for the implementation and oversight of the Group's RMF. The Group Risk function has responsibility for oversight over financial, operational and regulatory risk. The PRA/FCA relationship team manages the relationship and interactions with the Group's primary regulators and reports to the Group CRO.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.1 RISK MANAGEMENT FRAMEWORK CONTINUED

POLICIES

The Group policy framework comprises a set of policies that support the delivery of the Group's strategy by establishing operating principles and expectations for managing the key risks to the Group's business. The policy set is mapped to the Group Risk Universe and contains the minimum control standards to which each business unit must adhere to and against which they report compliance.

The policies define:

- the individual risks the policy is intended to manage;
- the degree of risk the Group is willing to accept, which is set out in the policy risk appetite statements;
- the minimum controls required in order to manage the risk to an acceptable level; and
- the frequency of the control's operation.

Each policy is the responsibility of a member of the Executive Committee who is charged with overseeing compliance throughout the Group.

BUSINESS PERFORMANCE AND CAPITAL MANAGEMENT

The Annual Operating Plan ('AOP') is assessed to ensure that the Group operates within the stated risk appetite. Business performance is routinely monitored with consolidated reporting against performance targets.

The Group operates a Capital Management Policy where capital is allocated across risks where capital is held as a mitigant and the amount of risk capital required is reviewed regularly.

RISK AND CAPITAL ASSESSMENT

The Group operates a standardised assessment framework for the identification and assessment of the risks it may be exposed to and how much capital should be held in relation to those exposures. This framework is applicable across the Group and establishes a basis, not only for the approach to risk assessment, management and reporting but also for determining and embedding capital management at all levels of the Group in line with Solvency II requirements.

Risk assessment activity is a continuous process and is performed on the basis of identifying and managing the significant risks to the achievement of the Group's objectives.

Stress and scenario tests are used extensively to support the assessment of risks and provide analysis of their financial impact.

Independent reviews conducted by Group Risk provide further assurance to management and Board that individual risk exposures and changes to our risk profile are being effectively managed.

QUALITATIVE INFORMATION ON MATERIAL RISKS

The Company's top principal risks and uncertainties are detailed in the table below together with their potential impact and mitigating actions which are in place. As economic changes occur and the industry and regulatory environment evolves, the Company will continue to monitor the potential impact of these principal risks and uncertainties facing the Company.

Risk	Impact	Mitigation
In times of severe market turbulence, the Company may not have sufficient capital or liquid assets to meet its cash flow obligations or may suffer a loss in value.	The emerging cash flows of the Company may be impacted during periods of severe market turbulence by the need to maintain appropriate levels of regulatory capital. The impact of market turbulence may also result in a material adverse impact on the Company's capital position. Since the introduction of Solvency II and a swaps-based discount rate, the Company is more sensitive to movements in swap yields, relative to gilts.	The Company undertakes regular monitoring activities in relation to market risk exposure, including limits in each asset class, cash flow forecasting and stress and scenario testing. In response to this, the Company has implemented de-risking strategies to mitigate against unwanted customer and shareholder outcomes. The Company also maintains cash buffers in its holding companies to reduce reliance on emerging cash flows. The Company's excess capital position continues to be closely monitored and managed, particularly in the low interest rate environment.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED
B.3.1 RISK MANAGEMENT FRAMEWORK CONTINUED
QUALITATIVE INFORMATION ON MATERIAL RISKS CONTINUED

Risk	Impact	Mitigation
Adverse changes in experience versus actuarial assumptions.	The Company has liabilities under annuities and other policies that are sensitive to future longevity, mortality and persistency rates. For example, if our annuity policyholders live for longer than expected, then their benefits will be paid for longer. The amount of additional capital required to meet those additional liabilities could have a material adverse impact on the Company's ability to meet its cash flow obligations.	The Company undertakes regular reviews of experience and annuitant survival checks to identify any trends or variances in assumptions. The Company continues to actively manage its longevity risk exposures, which includes the use of reinsurance contracts to maintain this risk within appetite.
Significant counterparty failure.	Assets held to meet obligations to policyholders include debt securities. The Life Companies are exposed to deterioration in the actual or perceived creditworthiness or default of issuers. This risk is reflected in the higher expected return, or spread, over less risky assets. An increase in credit spreads on debt securities, particularly if it is accompanied by a higher level of actual or expected issuer defaults, could adversely impact the value of the Company's assets. The Company is also exposed to trading counterparties failing to meet all or part of their obligations, such as reinsurers failing to meet obligations assumed under reinsurance arrangements.	The Company regularly monitors its counterparty exposure and has specific limits relating to individual exposures, counterparty credit rating, sector and geography. Where possible, exposures are diversified through the use of a range of counterparty providers. Material reinsurance and derivative positions are collateralised and guaranteed where appropriate.
Changes in the regulatory and legislative landscape may impact the way that the Company engages with its customers.	The conduct-focused regulator has had a greater focus on customer outcomes. This may continue to challenge existing approaches and/or may result in remediation exercises where the Company cannot demonstrate that it met the expected customer outcomes in the eyes of the regulator. Changes in legislation such as the Pension Freedoms and taxation can also impact the Company's financial position.	The Company puts considerable effort into managing relationships with its regulators so that it is able to maintain a forward view regarding potential changes in the regulatory landscape. The Company assesses the risks of regulatory change and the impact on our operations and lobbies where appropriate.
The Group fails to effectively integrate the acquired businesses.	The challenge of integrating two new businesses into the Group could introduce structural or operational inefficiencies that result in Phoenix failing to generate the expected outcomes for policyholders or value for shareholders.	The financial and operational risks of target businesses were assessed as part of the acquisition phase. Integration plans are developed and resourced with appropriately skilled staff to ensure that the target operating models are delivered in line with expectations.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.1 RISK MANAGEMENT FRAMEWORK CONTINUED

QUALITATIVE INFORMATION ON MATERIAL RISKS CONTINUED

The Company's senior management and Board also take emerging risks into account when considering potentially adverse outcomes and appropriate management actions prior to the risk crystallising. Some of the current emerging risks the Company considers are listed in the table below:

Risk Title	Description	Risk Universe category
Regulatory thematic reviews	The unknown consequences and the potential impact, including retrospective activity, as a result of Thematic Reviews conducted by the regulators.	Customer
Voluntary Charges Cap	The FCA has noted that they are seeking a 'voluntary solution' on exit charges for legacy products.	Customer
Political risk	Unexpected changes in the legislative environment and the impacts on financial markets driven by the political agenda following the UK's decision to leave the European Union.	Strategic
Market Disruptors	The impact of alternative providers in the market or those with more comprehensive digital propositions.	Strategic

PEOPLE AND REWARD

Effective risk management is central to the Group's culture and its values. Processes are operated that seek to measure both individual and collective performance and discourage incentive mechanisms which could lead to undue risk-taking. Training and development programmes are in place to support employees in their understanding of the operation of the RMF.

MANAGEMENT INFORMATION

Overall monitoring and reporting against the Risk Universe takes place in business unit management committees and Boards. This is then reported to the relevant Boards via regular risk reporting.

The PGH Board Risk Committee, the Phoenix Life Risk Committee and the Company's Risk Committee receive a consolidated risk report on a quarterly basis, detailing the risks facing the Group. The Committees are also provided with regular reports on the activities of the Group Risk function.

TECHNOLOGY AND INFRASTRUCTURE

The Group employs market leading risk systems to support the assessment and reporting of the risks it faces. This enables management to document key risks and controls and evidence the assessment of them at a frequency appropriate to the operation of the control.

B.3.2 OWN RISK AND SOLVENCY ASSESSMENT PROCESS

The Company carries out an Own Risk and Solvency Assessment ('ORSA') to assess its risk profile on an ongoing basis. The ORSA process is made up of a number of components which operate at regular frequencies, either within the Life Companies, at PLHL Group level or both.

Each Life Company and the PLHL Group produce an ORSA report. Each report is reviewed and approved by the Boards at least annually.

Such reporting includes an assessment of:

- the specific key risks to the business;
- the overall risk profile at any point in time;
- how that risk profile is expected to change over time (i.e. forward-looking perspective); and
- the SCR, currently derived from the Company's Standard Formula and following a successful application to the PRA later in 2017, from the Group's approved Internal Model.

Each ORSA process has an agreed owner and governance route for review and/or approval of the output. The Group's policy for performing and documenting the ORSA is set out in the Group's ORSA Framework which is reviewed at least annually.

In producing the ORSA report, senior management consider risk, capital and return coherently within the context of the business strategy, on a forward-looking basis. The ORSA is a fundamental part of the strategic risk and capital management processes of the business to prompt consideration of management actions and help shape strategic decision-making.

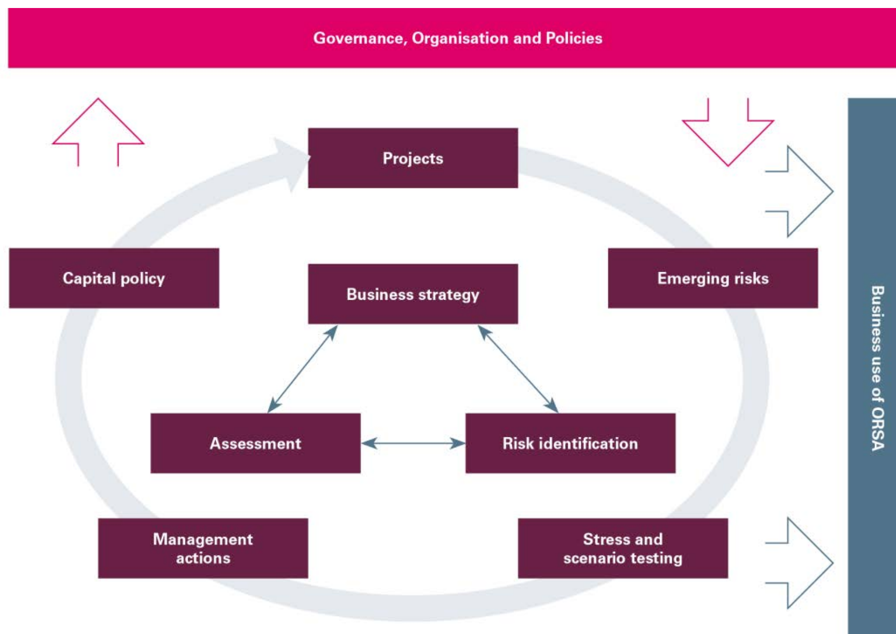
SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.2 OWN RISK AND SOLVENCY ASSESSMENT PROCESS CONTINUED

The process followed in undertaking the ORSA is illustrated below:



Business strategy is at the core of the ORSA process. The Company holds a strategy day at least once a year and this is informed by updated projections of the annual operating plan and an assessment of those projections against the Group's external targets and KPIs.

The risk appetite is set for both policyholder and shareholder risks. This is typically on an annual basis and occurs at the beginning of each ORSA cycle. The Company sets its capital policy in alignment with its policyholder risk appetite.

There is an ongoing evaluation of the risk profile, capital requirements and Own Funds. The risk profile evaluation is a process that operates throughout the business to report on changes to key risks in the context of the Group's risk appetite.

Solvency is monitored on a weekly basis within the Company. This is then collated to produce a weekly estimation of Group solvency and a quarterly evaluation of Own Funds and capital requirements.

Financial projections are prepared at a base level and subjected to stress and scenario testing as follows:

- sensitivity testing;
- risk appetite testing;
- quantitative and qualitative scenario testing; and
- reverse stress testing.

The Company operates a series of management oversight committees which together provide governance over all steps in the ORSA process. The Board is responsible for the ORSA report, which documents the outcome and results of the ORSA processes to support the Board's decision-making.

The ORSA process is integrated to the management and decision-making processes by:

- engagement and reinforcement at management committees;
- regular review (at least quarterly) of ORSA management information;
- production of one ORSA report per year linked to strategy and the AOP process;
- continuous improvements to the order/cycle of connected processes and the approach to and timing of reporting to the Boards; and
- maintenance of the ORSA record (provides evidence for the performance of the ORSA processes as described by the Framework, documents Board or committee discussion and sign-off, and records actions arising), which heightens awareness of the significance and role of each recorded process in the ORSA cycle.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.3 PRE-ACQUISITION RISK MANAGEMENT SYSTEM

The Company's risk management system prior to 30 December 2016 is set out below:

This section provides a description of the risk management system within the Company prior to 30 December 2016 when it was acquired by Phoenix Group, including information on how the risk management functions were implemented and integrated into the organisational structure and decision-making processes.

A strong risk culture is critical to the successful running of the Company. All staff were encouraged to consider risk, existing and emerging, and escalate any issues directly to their line manager, the Company Risk function, or at an appropriate governance meeting.

Staff received regular risk-related training. Five core behaviours had been identified that every member of staff was required to adopt in order to maintain and drive a strong risk culture. The risk culture was an integral part of the Company's overall culture. The behaviours were:

- being fully responsible for the Company's risks;
- inviting, providing and respecting challenge;
- being rigorous, forward-looking and comprehensive in the assessment of risk;
- troubleshooting collectively; and
- placing the Company and its reputation at the heart of all decisions.

The Company operated according to the following principles:

- All risks were managed within a defined risk appetite.
- Risks were monitored and managed and actions taken to control and mitigate as required.

These principles were supported by a dedicated risk team, the governance structure, a 'Three Lines of Defence' model, and the Company's risk culture.

B.3.3.1 Pre-acquisition Risk Management Framework

The Company's Risk Management Framework prior to 30 December 2016 is set out below:

A well-defined governance structure existed within the Company with risk management as a central component.

The Company's Risk Committee had been established under the chairmanship of a Non-Executive Director. It was a sub-committee of the Board and attended by the Company's Chief Risk Officer.

The Company's Risk Committee was responsible for the design and operation of an effective Risk Management Framework for the Company, and ensuring that the Company's Executive Committee, and hence the Board, were adequately briefed on all material risk exposures.

The Company's Risk Committee had been granted the powers by the Board to:

- Develop the Risk Appetite Statement for the Board approval.
- Formulate and approve the Company's risk policies, ensuring risk policies remained relevant to the stated Company risk appetite.
- Oversaw management of risk and ensured structures were in place for the effective monitoring and management of risk throughout the business.

Consideration of risk was also embedded throughout the organisation by the inclusion of 'new and emerging risks, issues and operational losses' as a standing agenda item at each of the governance committees which ultimately reported into the Company's Senior Management Committee.

Capita (the Company's outsourcer that provides policy administration services) reported risks relevant to the Company to the Company/Capita Risk, Audit and Compliance Committee which was also provided with a risk dashboard and copies of the relevant extracts from Capita's own risk register. Capita Risk Acceptances and Policy Non-Compliance Forms were discussed and agreed between Capita, the Company's Operational Oversight team and subject matter experts within the Company, before being submitted to this Committee for review and ratification. Capita also undertook a Control Risk Self Assessment process for each area providing services to the Company, with these being presented by the relevant manager to a subgroup of this Committee for challenge on a six-monthly basis.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.3 PRE-ACQUISITION RISK MANAGEMENT SYSTEM CONTINUED

B.3.3.1 Pre-acquisition Risk Management Framework Continued

During 2015/2016 the Company completed a risk and control assessment of non-financial risks recording:

- inherent risk assessment;
- identification of controls;
- assessment of controls and their design and operational effectiveness; and
- residual risk assessment.

This was signed off by the Company's CEO at that time.

The Company operated an outsourcing model and before the Company entered into a new contract with a service provider it conducted a rigorous risk assessment. The risk assessment was conducted in accordance with Deutsche Bank's Vendor Risk Management and Intra Group Outsourcing Procedures. The risk assessment covered both the service being outsourced (i.e. the risk of outsourcing the activity) and the provider supplying the service (risk associated with the specific provider). Once the initial risk assessment had been completed and relevant approvals obtained, the contract was signed. The assessment was then repeated regularly throughout the contract to ensure that the risks had not changed and/or remained within an acceptable range.

A new Outsourcing sub-committee of the Board was established in the fourth quarter of 2016 and was required to consider the effectiveness of current outsourcing arrangements and undertake detailed analysis of any proposed new outsourcing arrangements and provide challenges on behalf of the Board.

Throughout 2016 the Company complied with the requirements of Deutsche Bank's New Product Approvals ('NPA') and New Trade Approval ('NTA') processes when considering new products or transactions (e.g. longevity insurance swaps). Risk was one of the items considered as part of this process, and appropriate approvals across Deutsche Bank Group control functions, including Market Risk Management and Credit Risk Management, had to be obtained prior to the completion of any new transactions.

Alongside the NPA and NTA processes, the Company's New Deals Working Group ('NDWG') carried out risk due diligence of new transactions and made recommendations to the Company's Chief Risk Officer, the Risk Committee and ultimately the Board. The NDWG included representatives from Deutsche Bank Risk Management and Deutsche Bank Exposure Management Group and assessed insurance, market, counterparty and operational risk for new transactions in line with best practice for Deutsche Bank Group transactions. Operational risk for new transactions was also considered, with input from the Company's Chief Operating Officer as appropriate.

The Company's Pensions and Insurance Risk Pricing Committee was responsible for reviewing and directing the pricing and structure of potential pensions and insurance risk transactions, including longevity transactions, swaps and bulk purchase annuities. This Committee reported through to the Company's Executive Committee.

Post-execution ongoing risk monitoring was performed by the Company's Actuarial Operating Committee ('AOC') as the first line of defence and the Risk function as the second line of defence. The risk position was then reported to the Company's Risk Committee. Risk reports included, among other things, an analysis of historical performance of the trade and stress test scenarios to illustrate the change in value of the position for changes in the underlying market and insurance risk factors.

The Company's risk appetite was set out in its 'Risk Appetite Statement' which was reviewed and approved annually by the Board. The Company's Asset-liability Matching & Investment, Credit, Market, Insurance, Derivative, Liquidity, Conduct and Operational risk policies were also reviewed and approved by the Company's Risk Committee as appropriate.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.3 PRE-ACQUISITION RISK MANAGEMENT SYSTEM CONTINUED

B.3.3.1 Pre-acquisition Risk Management Framework Continued

In order to consider risk appetite, it was necessary to consider the requirements of the Company's stakeholders. The key stakeholders were the shareholders, policyholders, regulators and management. The key requirements/objectives of each stakeholder is summarised within the table below:

Stakeholder	Requirements			
Shareholder	IFRS earnings should be stable where possible and not have a significant adverse impact on results.	Economic value maintained allowing for distributions already made to shareholders.	New risks meet required risk/reward profile and or support franchise value.	Meets all regulatory requirements, including treating customers fairly.
Policyholder	Benefits received are in accordance with expectation (including investment of unit-linked funds).	High level of confidence that benefits will be paid.	Acceptable level of service.	
Regulators	Meets solvency capital and liquidity requirements including in stressed conditions.	Treats customers fairly.	Meets all other regulatory requirements.	
Management	Balance requirements of stakeholders to manage the risks and returns from the business.	Appropriate remuneration and development opportunities for staff.	Ensure management of shareholder understands the Company's business risks and constraints.	Utilise the Company's platform to optimise on opportunities.

The Company's risk appetite was developed taking into consideration the above requirements. Metrics were established that monitored against the parameters within the Risk Appetite Statement and the results reported to the Company's Risk Committee.

The risk appetite and control framework supported the Company and enabled it to operate within the boundaries of these statements by limiting the volatility of key parameters under a range of adverse scenarios agreed with the Board. Risk appetite limits were chosen which specified the maximum acceptable likelihood for breaching the agreed limits. Assessment against these limits was undertaken through extensive scenario and reverse stress testing.

B.3.3.2 Pre-acquisition Own Risk and Solvency Assessment process

The Company's ORSA process prior to 30 December 2016 is set out below:

The Company carried out an ORSA process which assessed its risk profile on an ongoing basis.

The 2016 ORSA report was reviewed and approved by the Board.

Such reporting included an assessment of:

– the specific key risks to the business;

– the overall risk profile at any point in time;

– how that risk profile was expected to change over time (i.e. forward-looking perspective); and

– the Solvency Capital Requirements ('SCR'), derived from the Standard Formula approach as prescribed by EIOPA.

The ORSA process had an agreed owner and governance route for review and/or approval of the output. The Company's policy for performing and documenting the ORSA was set out in the Company's ORSA policy together with the Actuarial Methodology document, which were both reviewed at least annually.

In producing the ORSA report, senior management considered risk, capital and return coherently within the context of the business strategy, on a forward-looking basis. The ORSA was a fundamental part of the strategic risk and capital management processes of the business to prompt the consideration of management actions and help shape strategic decision-making.

The ORSA results were reported through to the Board for consideration and approval.

Business strategy was at the core of the ORSA process.

The risk appetite was set for both policyholder and shareholder risks. This was typically on an annual basis and occurred at the beginning of each ORSA cycle.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.3 RISK MANAGEMENT SYSTEM, INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT CONTINUED

B.3.3 PRE-ACQUISITION RISK MANAGEMENT SYSTEM CONTINUED

B.3.3.2 Pre-acquisition Own Risk and Solvency Assessment process Continued

There was an ongoing evaluation of the risk profile, capital requirements and Own Funds. The risk profile evaluation was a process that operated throughout the business to report on changes to key risks in the context of the Company's risk appetite. Transactions and material projects were evaluated using return on capital metrics to ensure an efficient allocation of capital.

Solvency was monitored on a regular basis within the Company. This was then collated to produce a monthly solvency assessment and a quarterly evaluation of Own Funds and capital requirements.

Financial projections were prepared at a base level, with and without Matching Adjustment, and with and without equity transitionals. The projections were subjected to stress and scenario testing as follows:

- sensitivity testing;
- risk appetite testing;
- quantitative scenario testing;
- qualitative scenario testing; and
- reverse stress testing.

The Company operated a series of management oversight committees which together provided governance over all steps in the ORSA process. The Board was responsible for the ORSA report, which documents the outcome and results of the ORSA processes to support the Board decision-making.

The ORSA process was integrated to the management and decision-making processes by:

- engagement and reinforcement at management committees;
- production of an ORSA report each year, linked to strategy; and
- continuous improvements to the order/cycle of connected processes and the approach to and timing of reporting to the Board.

B.4 INTERNAL CONTROL SYSTEM

B.4.1 INTERNAL CONTROL FRAMEWORK

The Group's internal control system is outlined in the Internal Control Framework and is implemented consistently across the Group.

The framework has been embedded within the Group and plans for the proportionate roll-out into the Company are being developed. The roll-out of the framework into the Company, will where relevant, take account of the Group's plans for the integration of operations into the Phoenix business model and be the focus of activity in 2017.

The Internal Control Framework places reliance on the effective operation of the 'Three Lines of Defence' model described in section B.3.1 which is a recognised approach in supporting effective corporate governance and oversight.

There are five key elements to the effective operation of the Internal Control Framework to enable Lines 1, 2 and 3 to fully discharge their responsibilities:

- Identification of the key controls within the business to effectively manage risks within risk appetite, which is undertaken as part of the annual Group Policy refresh process. This includes identification of the Minimum Control Standards ('MCS') required in order to manage risk within appetite.
- For each MCS defined, a clear articulation of the expected evidence to support the assertion that the MCS is operating effectively.
- Self-assessment by designated control owners of the operating effectiveness of each MCS on a quarterly basis.
- Implementation of a proportionate programme of controls assurance activity by Line 1 supported by further review and assurance activities by Lines 2 and 3 which includes half-yearly completion of the Internal Control Self-Assessment Process ('ICSA').
- Reporting on MCS performance to provide assurance and management information to all stakeholders confirming that the controls are operating as expected or highlighting exceptions. This in turn enables the data to be incorporated and referenced with Line 1 and Line 2 risk reporting.

Each of these elements is an integral part of the RMF as outlined in section B.3.1, in particular risk appetite; governance, organisation and policies; management information; and technology and infrastructure.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.4 INTERNAL CONTROL SYSTEM CONTINUED

B.4.2 THE COMPLIANCE FUNCTION

The Compliance function is undertaken by the Compliance Monitoring team which sits within Group Risk. This is an independent function in the second line of defence and provides assurance to the Boards that the Group is operating within a compliant framework. Whilst compliance with regulation remains the responsibility of senior management assigned to specific roles, the Compliance function ensures that the appropriate mechanisms exist to support management in discharging their responsibilities to this end. In addition, the Compliance function provides assurance through its Line 2 Compliance Monitoring programme and is responsible for identifying and assessing the impacts of new regulations and disseminating these to the relevant parties.

An annual Compliance Monitoring plan is developed through a risk-based approach and approved by the Phoenix Life Risk Committee. This plan includes specific Solvency II requirements as determined through the regulations or internally, which are in addition to the independent validation in relation to the Internal Model.

The Regulatory Risk Policy and Guidance team monitor regulatory and industry developments which may impact the Group and its policyholders and ensure that these developments are identified in a timely manner, interpreted, cascaded appropriately, and that relevant actions are agreed and effectively implemented. The team, which supports both Group functions and Life Companies' functions, monitors the delivery of actions, providing challenge, oversight and senior management assurance around the effective management of regulatory risk in this regard.

B.4.3 PRE-ACQUISITION INTERNAL CONTROL SYSTEM

The Company's internal control system prior to 30 December 2016 is set out below:

The Company operated a 'Three Lines of Defence' model and the Company's Risk Committee oversaw the operation of the first and second lines and was responsible for:

- reviewing and approving the risk policies; and
- approving risk acceptances.

The First Line of Defence was managed on a day-to-day basis by the business through the risk framework processes and governance structure. The risk owners within the business were responsible for:

- accountability and ownership of all risks in the business;
- management of these risks through:
  - end-to-end process view;
  - proactive risk identification;
  - risk assessment;
  - risk mitigation;
  - risk remediation;
  - risk monitoring and reporting;
  - establishment of appropriate policies and procedures;
  - provision of relevant management information to the First and Second Lines of Defence; and
- complying with the First Line of Defence governance structure that includes representatives of the Second Line of Defence.

The Second Line of Defence was responsible for ensuring the risk framework was fit for purpose and operating in accordance with appropriate policies. This responsibility was performed by the Risk function headed by the Chief Risk Officer. It comprised the independent control functions Risk, Compliance, Anti-Financial Crime, Legal, Finance, Data Protection and Human Resources who were collectively responsible for the design of the control framework and independent risk assessments. Staff members in these functions were responsible for:

- defining and maintaining an effective Risk Management Framework;
- setting and monitoring of minimum control standards;
- independent risk assessment of the risk profile against the risk appetite; and
- monitoring of the First Line of Defence.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.4 INTERNAL CONTROL SYSTEM CONTINUED

B.4.3 PRE-ACQUISITION INTERNAL CONTROL SYSTEM CONTINUED

The Third Line of Defence was responsible for providing independent and objective assurance on the effectiveness of the risk management, internal controls and governance processes. Independent assurance was provided by Deutsche Bank Group Audit, which provided independent and objective assurance on the adequacy of the design and effectiveness of internal controls, risk management processes and governance processes across both First and Second Lines of Defence. Deutsche Bank Group Audit was organisationally separate from and independent of the First and Second Line of Defence divisions and neither owned nor designed Second Level of Defence controls.

B.4.3.1 Pre-acquisition Compliance function

The Company had a Head Office Compliance team based in Bournemouth which reported through to the Compliance Officer and provided the Company with a full range of compliance services. These included:

- Attendance at key corporate internal and external meetings ensuring compliance considerations were clearly understood.
- Compliance reporting.
- Technical review and interpretation of new regulatory requirements.
- Regulatory liaison (including the coordination of regulatory visits).
- Submission of regulatory returns.
- Compliance training.
- Oversight of the Life and Pensions Compliance Risk Assessment. This document listed all regulations deemed applicable to the Company, along with the related risks, mitigations (and owners) and evidence of the mitigations, and was submitted to the Board for review on an annual basis.
- Monitoring and oversight of both retained and outsourced activities.

In practice, the Company had delegated day-to-day compliance arrangements, in respect of the outsourced activities, to the compliance functions within Capita, Aberdeen Asset Management and Deutsche Asset Management. The implications from a monitoring perspective of this arrangement were that the Company's Head Office Compliance function monitored the effectiveness of the Outsourced Compliance function, rather than the first line activities outsourced.

B.5 INTERNAL AUDIT FUNCTION

The primary role of the Phoenix Group Internal Audit ('PGIA') function is to support the Board and Executive Management in protecting the assets, reputation and sustainability of the organisation. This is achieved by assessing whether all significant risks are identified and appropriately reported, assessing whether they are adequately controlled and challenging Executive Management to improve the effectiveness of governance, risk management and internal controls.

PGIA operates in compliance with the International Standards for the Professional Practice of Internal Auditing, the Internal Audit Code of Ethics and the recommendations from the Committee on Internal Audit Guidance for Financial Services.

B.5.1 STRUCTURE OF INTERNAL AUDIT

A summarised structure chart for the Internal Audit function is shown below:

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.5 INTERNAL AUDIT FUNCTION CONTINUED

B.5.2 ROLES AND RESPONSIBILITIES OF INTERNAL AUDIT

The Internal Audit scope is unrestricted and there are no aspects of the organisation which PGIA is prohibited from reviewing. Key business risk areas and industry themes, identified both internally and externally, will be prioritised to receive more extensive coverage, regular ongoing review and opinion formation.

The function has a number of responsibilities, including the following:

– Production of internal audit plans: PGIA plans, and material changes to plans, are approved by the Group BAC (further details on the committee are included in section B.1.1.1). They have the flexibility to deal with unplanned events to allow PGIA to prioritise emerging risks. Changes to the audit plan are considered through PGIA's ongoing assessment of risk.

– Reporting results: PGIA's reporting to the Group BAC includes details of significant control weaknesses, root-cause analysis, themes and a view on the adequacy of management's remediation plans. Bi-annually, PGIA provides an opinion on the strength of the design and operation of the Risk Management/Internal Control Framework.

– Oversight of Internal Audit functions: In the case of the Group's outsourced service providers ('OSPs'), PGIA operates a risk-based oversight model to ensure the activities of the outsourced Internal Audit functions meet PGIA standards (which are aligned to Chartered Institute of Internal Auditors standards).

B.5.3 REPORTING

PGIA attends, and issues reports to the PGH BAC and Life BACs and any other governing bodies and Board committees as appropriate.

PGIA's reporting to the PGH BAC includes significant control weaknesses, root-cause analysis, themes and a view on management's remediation plans. Bi-annually, PGIA provides an opinion on the strength of the design and operation of the Risk Management/Internal Control Framework (and the associated Risk, Control and Assurance standards).

B.5.4 INDEPENDENCE AND OBJECTIVITY OF THE INTERNAL AUDIT FUNCTION

In order to maintain its independence and objectivity from the activities it reviews, PGIA ensures the following:

– The Group Head of Internal Audit ('GHIA') reports to the Group BAC (through the Chair) and to the CEO on a day-to-day basis. The Group BAC Chair is the final approval point for recommendations made by the CEO regarding the performance objectives, appraisal, appointment or removal of the GHIA, as well as the overall compensation package of the GHIA which is further ratified by the RemCo.

– The remuneration of the GHIA and the Senior Internal Audit Managers is structured in a manner such that it avoids conflicts of interest, does not impair independence and objectivity and is not directly or exclusively linked to the short-term performance of the organisation.

– PGIA has the right to attend and observe all or part of executive management meetings and any other key management decision-making forums. It also has sufficient and timely access to all Board and Executive management information and a right of access to all of the organisation's records necessary to discharge its responsibilities.

– Effective Risk Management, Compliance and other assurance functions are an essential part of the Group's corporate governance structure. PGIA is independent of these functions and is neither responsible for, nor part of, them. In evaluating the effectiveness of internal controls and risk management processes, in no circumstances does PGIA rely exclusively on the work of these other assurance providers, and always examines for itself an appropriate sample of the activities under review. To the extent that PGIA places reliance, this is only after a thorough evaluation of the effectiveness of those functions in relation to the area under review.

B.5.5 PRE-ACQUISITION OF INTERNAL AUDIT FUNCTION

During 2016, the Company did not have its own dedicated Internal Audit function, but received services from Deutsche Bank Group Audit. Deutsche Bank Group Audit determined its Audit Plan for the wider Deutsche Bank Group based on risk-based principles. Deutsche Bank Group Audit was also responsible for undertaking reviews of the services provided by Deutsche Bank Group to the Company, including one of the Company's core outsourcers.

Progress on actions to address any issues identified as a result of Deutsche Bank Internal Audit Reports was reported to and monitored at the Company's Senior Management Committee.

With effect from 1 September 2016, Capita outsourced the performance of its internal audits to PricewaterhouseCoopers ('PwC'). Capita maintains an in-house team who are responsible for preparing the Audit Plan and overseeing the work undertaken by PwC, including quality assurance and signing off reports. In addition, an in-house Capita Business Assurance function is responsible for undertaking local audits to ensure that the audit coverage meets contractual requirements.

Capita Internal Audit prepared its own separate plan covering activities relevant to the Company (i.e. direct services and related support functions such as IT), which was submitted annually to the Company for review and ratification by the Board. Progress in respect of delivery of the plan was tracked at a formal monthly Company/Capita Risk, Audit and Compliance Committee meeting.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED
B.5 INTERNAL AUDIT FUNCTION CONTINUED
B.5.5 PRE-ACQUISITION OF INTERNAL AUDIT FUNCTION CONTINUED

The Company was provided with the draft terms of reference for each audit for approval. Final drafts of the Internal Audit Reports were also reviewed by the Risk function and subject matter experts within the Company's Head Office organisation, with the final reports themselves being approved by the Company's Risk function before being circulated.

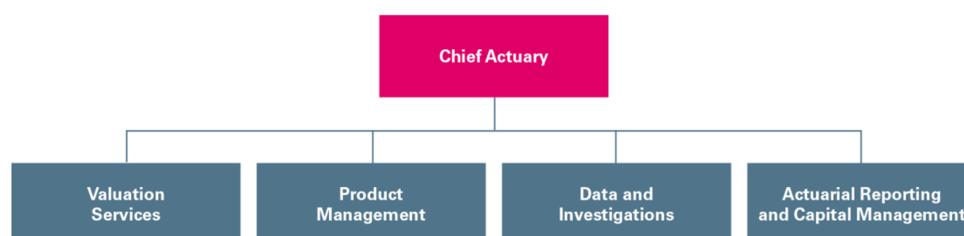
Risk ratings and actions in respect of all findings were agreed before the report was issued in final. Progress in resolving actions was again tracked through the formal monthly Company/Capita Risk, Audit and Compliance Committee meeting.

No employees of the Company were included in the internal audit work performed by Deutsche Bank Group Audit and PwC and this assisted in maintaining the independence and objectivity of their reviews.

B.6 ACTUARIAL FUNCTION

The Actuarial function provides a range of actuarial services and advice to the Board and the Management Team of the Company. The Actuarial function is headed up by the Chief Actuary who is a member of the Company's Management Board.

THE ACTUARIAL FUNCTION – ORGANISATION CHART



KEY TEAM ROLES

Actuarial Reporting and Capital Management

The Actuarial Reporting and Capital Management team is responsible for determining the technical provisions and confirming the reliability and accuracy of these to the Board. The appropriateness of the technical provisions is determined by carrying out a review of the technical provisions and producing the analysis of change. This activity is overseen and reviewed by the Chief Actuary. The team is responsible for ensuring all regulatory reporting timescales are met and that returns are made in a timely manner.

By accurate and timely reporting of the capital position, it ensures appropriate levels of capital are held to achieve the following objectives:

- Provide appropriate security for policyholders and meet regulatory requirements.
- Ensure sufficient liquidity is held to meet obligations to policyholders and other creditors.
- Meet the dividend expectations of the shareholder.

The Company maintains a capital management policy that aims to ensure these objectives can be met under a range of stress conditions.

The team also operates a regular solvency monitoring process to ensure these objectives can be met on a continuous basis.

Data and Investigations

The Data and Investigations team plays a critical role in determining the technical provisions in the following areas:

- data;
- assumptions; and
- validation of results.

The technical provisions rely on complete and accurate data being provided to the valuation system. The Data and Investigations team is responsible for the data used within this process and maintains a data dictionary with an assessment of all items of data for appropriateness, accuracy and completeness. The best estimate assumptions are derived from experience investigations conducted by this team with the results presented to the AOC for review and challenge before being presented to the Board for approval.

The analysis of change and validation of the results is undertaken by this team in conjunction with the Chief Actuary. This may include the study of control reports and analysing the profit and loss attribution. Ultimately the Chief Actuary is responsible for presenting the final results to the Board for approval.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.6 ACTUARIAL FUNCTION CONTINUED

KEY TEAM ROLES CONTINUED

Actuarial Services

The Actuarial Services team performs a number of roles to support the Actuarial function. One key responsibility is the Asset and Liability management to ensure that assets that back liabilities are appropriately matched. This work considers cash flow matching and the review of asset mixes, but also ensures ongoing compliance with the requirements of the Matching Adjustment fund to ensure the various test statistics and other monitoring metrics are met.

Product Management

The Product Management team is responsible for annuity pricing and ensuring products are administered and operated in accordance with the Company's risk appetites.

Actuarial function Report

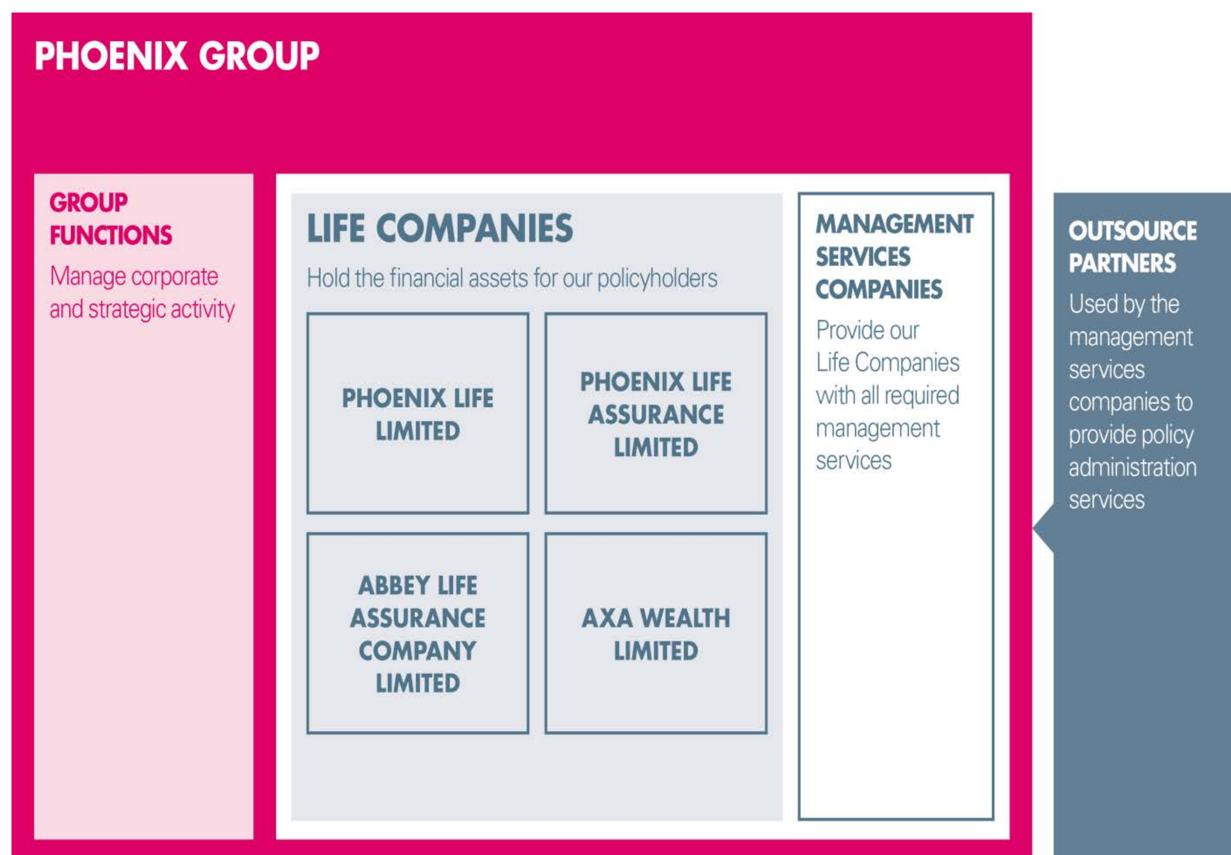
The key tasks of the Actuarial function are reported to the Boards and other stakeholders annually in the Actuarial function Report, which is prepared by the Chief Actuary. The report describes the results and outcome of the key tasks performed by the Actuarial function along with any material deficiencies arising from them, and provides recommendations as to how such deficiencies should be remedied.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.7 OUTSOURCING

This section provides information on the material outsourcing arrangements undertaken by the Group, and details the outsourcing policy. The diagram below summarises the outsourcing framework in place, with further details provided below the diagram.



In relation to Abbey Life all management services are currently provided by the Company directly. Going forward it is envisaged that the operating model will involve use of the management services companies.

B.7.1 Service Provider Relationships

One of the Group's key strategic decisions is to outsource to providers who deliver a range of key services. All service providers are carefully selected following appropriate due diligence.

The Group operates a supplier oversight model, which is a defined minimum control standard within the Sourcing and Procurement Policy detailed in section B.7.2 below. The sourcing model allows for all providers of service to be categorised based upon their risk and materiality to the business. The policy details the minimum standards which the Group are required to employ in establishing and overseeing suppliers, with particular focus on those suppliers who are deemed to be critical and strategically important. All critical and strategically important suppliers have been identified within a Supplier Management Model which defines the manner in which each supplier is overseen.

The contracts for strategically important and critical suppliers fully define the requirements of them as a provider of services to the Group. These contracts make clear the obligations which are placed on each supplier.

A Contingency Framework is also in place and recognises that there are risks associated with OSP failure/default which the Group may be accountable for. This framework is reviewed on an annual basis and outputs of any reviews are shared with the FCA.

The outsourced partners have scale and common processes, often across multiple clients, which provide several benefits for the Group, including reducing investment requirements, improving the technology used within our administrative capability, and reducing our operational risk.

Specialist roles such as finance, actuarial, risk and compliance and oversight of the outsourced partners are retained in-house, ensuring the management services companies and Life Companies retain full control over the core capabilities necessary to manage and integrate closed life funds.

SECTION B
Continued

SYSTEM OF GOVERNANCE CONTINUED

B.7 OUTSOURCING CONTINUED

B.7.1.1 Policy administration

Full policy administration for our policyholders, including:

- Call centre handling;
- Policy servicing; and
- Claims handling.

All policy administration services are principally UK-based, and fall under FCA jurisdiction. The Company's outsource provider of policy administration is listed below:

Capita Life and Pensions

A major supplier of business process services to the UK life and pensions industry. Specifically, Capita Life and Pensions provides life and pensions business process services to our policyholders delivering contact centre, policy servicing and claims administration for 769,382 individual policies as at 31 December 2016. In managing the Company's account, Capita operates out of one principal UK location, Bournemouth, and is supported by overseas locations in India.

B.7.1.2 Fund accounting and Investment Management

Service providers are used which provide the Life Companies with:

- Fund Accounting and Custody services.
- Investment management of assets owned by the Life Companies under agreed Investment Management Agreements and associated mandates.

Investment, Fund Accounting and Custody Services are all operated by service providers that are UK based. The Group's outsource providers of these services are listed below:

Deutsche Asset Management (DAM)

Investment Manager managing a portfolio of non-linked and shareholder assets for ALAC on a non-discretionary basis.

Aberdeen Asset Management (AAI)

An international investment management group managing all ALAC's unit-linked assets and a small number of non-linked portfolios on a discretionary basis.

State Street

Undertaking custodian, collateral and investment administration services for ALAC.

B.7.2 SOURCING AND PROCUREMENT POLICY

Sourcing is the structuring of the supply base, including the evaluation, selection and appointment of suppliers to support the operating model of the organisation and key functions. Procurement is the acquisition of goods or services to meet specific business needs and the creation of commercial and legal agreements to fulfil specific requirements.

The Group has a sourcing and procurement policy in place which seeks to manage sourcing and procurement risk (the risk of reductions in earnings and/or value through financial or reputational loss associated with procuring services and managing service providers).

The policy covers the Group's Minimum Controls Standards which are to be adhered to when evaluating, selecting, implementing and managing suppliers in order to ensure risk is managed appropriately. The policy also contains the key risks associated with sourcing and procurement and the minimum control standards in place to mitigate those risks to within an acceptable risk appetite. This aligns with the Risk and Control Framework operated across the Group to manage risk. Further details on the Risk and Control Framework can be found in section B.3.

B.7.3 BOARD OVERSIGHT

Management oversight committees are in place to oversee outsource providers. A material outsourcer report is produced monthly, and presented to the Operations Committee on a quarterly basis.

Risk and control reporting, including the outsourcer view, is maintained through the completion of a line 1 risk report (an outcome report, aligned to the Phoenix Risk Universe and RMF). This report is reviewed and approved by the relevant Board on a monthly basis and is submitted to the relevant Risk Committee on a quarterly basis.

B.8 ANY OTHER INFORMATION

B.8.1 SYSTEM OF GOVERNANCE – ASSESSMENT OF ADEQUACY

Overall, it has been deemed that the system of governance in place within the Company is adequate to meet the requirements of the Solvency II Directive, demonstrated by the framework described herein.

There is no further material information to be disclosed regarding the system of governance.

SECTION C

IN THIS SECTION

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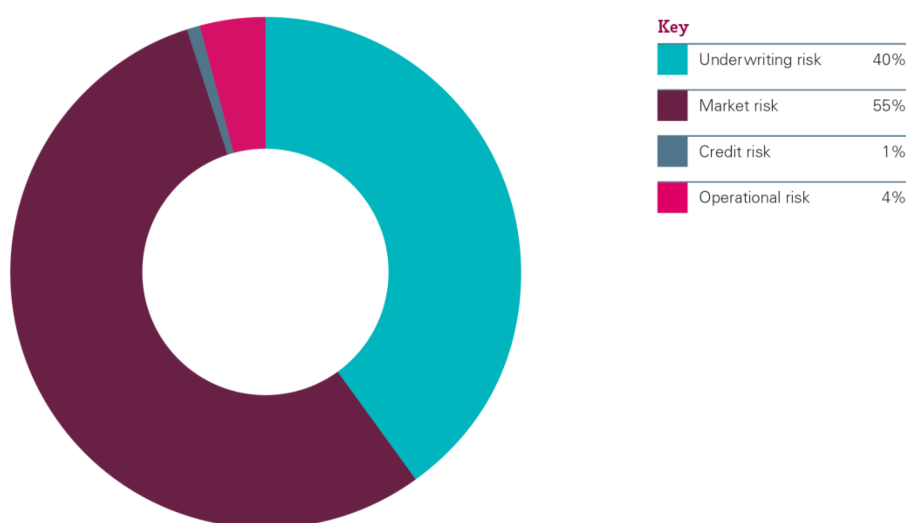
SECTION C

RISK PROFILE

Section B.3 set out the risk management system, including information on how the risk management function is implemented and integrated into the organisational structure and decision-making processes of the Group (including the Company).

This section provides information on the risk profile of the Company, including for each category of risk, description of the measures used to assess these risks, material risk exposures, concentrations and risk mitigation techniques. Sensitivity analysis for each category of risk is also provided.

The following chart shows the composition of the Standard Formula undiversified risk capital components at 31 December 2016.



For the purposes of the above analysis, spread risk (which represents 41% of undiversified SCR) is categorised as market risk rather than credit risk, with the latter comprising solely of counterparty default risk.

Further details regarding the SCR can be found in section E.2.

SECTION C
Continued

RISK PROFILE CONTINUED

C.1 UNDERWRITING RISK

C.1.1 RISK EXPOSURE

Underwriting risk refers to the risk that the frequency or severity of insured events may be worse than expected and includes expense risk. Contracts for the Company include the following sources of underwriting risk described in the table below:

Risk source	Description
Mortality risk (including catastrophe risk)	Higher than expected number of death claims on assurance products and occurrence of one or more significant claims.
Longevity risk	Lower than expected number of deaths experienced on annuity products or greater than expected improvements in annuitant mortality.
Morbidity risk	Higher than expected number of inceptions on critical illness or income protection policies and lower than expected termination rates on income protection policies.
Expense risk	Unexpected timing or value of expenses incurred.
Lapse risk	Adverse movement in either surrender rates or persistency rates on policies with guaranteed benefits leading to losses. This includes the risk of greater than expected policyholder option exercise rates giving rise to increased claims costs.
Policyholder behaviour risk	Unanticipated changes in policyholder option exercise rates giving rise to increased claims costs.

The Company has a portfolio of retail financial services products, covering life, health, pensions, savings/investments and annuity products. These products were sold in the UK, and policyholders are predominantly UK-domiciled. Excluding annuities, the majority of the policies are unit-linked, although there are other non-profit products and a small amount of with-profits business. The Company ceased to write new retail business in 2000, although it continues to offer annuities to customers holding existing pension policies as well as accepting increments and honouring customer options on existing policies where contractually obliged to do so.

The Company also has longevity insurance corporate transactions in place with various third party pension schemes and inward reinsurance of protection business with Santander.

In addition to exposure arising from its annuity in-payment book and existing pension policies with guaranteed annuity options, the Company is also exposed to longevity risk arising from the Company Staff Pension Scheme and longevity insurance corporate transactions with various third party pension funds.

The Company's own book of protection policies exposes it to mortality risk and, to a lesser extent, morbidity risk. In addition, mortality risk exists in respect of the reinsurance of protection business arrangement with Santander.

Lapse risk exists in respect of both the Company's own pension and protection policies and also in respect of the Santander arrangement noted above.

The Company operates an outsourcing model, with the majority of its costs relating to the outsourcing of policy administration and related IT and finance services, investment management, investment administration and custody services. Although some of these contracts can only be terminated at the Company's discretion (or on breach of contract), others can be terminated by the outsourced service provider subject to appropriate notice or at the end of the term. This gives rise to expense risk insofar as it may not be possible to secure extensions or replacement contracts on existing terms.

Policyholder behaviour risk arises from the existence of guaranteed annuity options and guaranteed insurability options on certain policies.

SECTION C
Continued

RISK PROFILE CONTINUED

C.1 UNDERWRITING RISK CONTINUED

C.1.1 RISK EXPOSURE CONTINUED

During the reporting period ended 31 December 2016, the following key changes in underwriting risk exposure have taken place:

- An increase in longevity risk due to the completion on 27 July 2016 of a longevity insurance transaction with the Manweb Group of the Electricity Supply Pension Scheme.
- Due to the Company being closed to new business, mortality and morbidity risk continue to reduce as existing protection policies mature, expire or lapse. There is a corresponding increase in longevity risk where maturing pension policies are converted into annuities.
- On 15 November 2016 the FCA issued a Policy Statement confirming that early exit charges on personal pension schemes (including individual and group/workplace pensions) will be capped at 1% for existing policies and 0%for new policies from 31 March 2017. This may result in changes in policyholder behaviour, with lapse rates potentially increasing as the cost of transferring schemes to other providers are reduced. Even if lapse rates remain unchanged, the decrease in charges will increase the impact of lapses on profit.
- Part of the Company's exposure to the BMW Pension Scheme under BMW longevity transaction is collateralised. On 16 September 2016 following a mortality review, a new model to determine the collateral amount was introduced which reduces the amount of collateral that the BMW Pension Scheme is required to post. This has the effect of slightly increasing the risk that the Company will not be able to recover all of the fees due in the event of a default by the BMW Pension Scheme.

C.1.2 RISK MEASUREMENT

The Company ceased to write new retail business in 2000, although it continues to offer annuities to customers holding existing pension policies as well as accepting increments and honouring customer options on existing policies where contractually obliged to do so.

The Company uses several methods to assess and monitor underwriting risk exposures both for individual types of risks insured and the overall risks. These methods include monitoring against Economic Capital limits experience analyses, external data comparisons, sensitivity analyses, scenario analyses and stress testing.

The risk capital requirement for underwriting risk is assessed using the Standard Formula methodology as prescribed by the regulations.

As of 31 December 2016, underwriting risk represented 40% of the Company's total undiversified SCR.

C.1.3 RISK CONCENTRATION

The Company is not exposed to any material demographic concentration of underwriting risk. For all underwriting risks described above, the Company's exposure is spread across a diversified portfolio of customers and products (comprising 769,382 individual policies as at 31 December 2016). No individual policyholder contract size is large enough to represent a material concentration as a proportion of the Company's total risk exposure.

C.1.4 RISK MITIGATION

The Company seeks to manage its exposure to underwriting risk by establishing minimum control standards and supporting practices that align with its agreed principles. Risk appetite statements have been established for underwriting risks and the risk exposures are monitored against agreed limits.

The hedging of underwriting risk through reinsurance and other forms of risk transfer is used to manage the overall level of exposure to underwriting risk. The Company has negative best estimated liabilities of £582,351k reinsured externally, and the list of counterparties and the negative exposure amount is presented below:

REINSURANCE RECOVERABLE ANALYSED BY COUNTERPARTY

Counterparty	£000
Challenger Life Company Limited	(146,850)
Hannover Rueckversicherung AG	(83,151)
Pacific Life Re Limited	(117,615)
Partner Reinsurance Europe Limited	(22,548)
RGA Reinsurance Company	(51,407)
SCOR Global Life SE	(55,439)
Swiss Re Life & Health	46,764
The Canada Life Assurance Company	(152,105)
Total	**(582,351)**

SECTION C
Continued

RISK PROFILE CONTINUED
C.1 UNDERWRITING RISK CONTINUED
C.1.4 RISK MITIGATION CONTINUED
REINSURANCE RECOVERABLE ANALYSED BY COUNTERPARTY CONTINUED

The majority of the underwriting risk that has been ceded is annuitant longevity risk on the Company's own annuities in payment and those pension payments covered by longevity reinsurance transactions with third party pension funds, which has been transferred by a mixture of conventional reinsurance treaties and longevity swaps.

The ongoing effectiveness of the reinsurance ceded externally by the Company is monitored on an ongoing basis by the AOC.

Expense risk has been partially mitigated by the exercise of an 'evergreen' option on the contract with Capita Life & Pensions Regulated Services Limited for policy administration and related IT/finance services. This means that from 2019 the per policy charges will be fixed at 2019 levels (adjusted for inflation) for as long as the Company requires the services to be provided. In addition, investment management fees charged by the investment manager on the retail funds and the annual management charges made to the policyholder are both based on the value of funds under management, ensuring a degree of matching between income and expenditure.

C.1.5 SENSITIVITY ANALYSIS

Insurance and pension scheme liabilities are sensitive to the assumptions which have been applied in their calculation, such as mortality, longevity and lapse rates.

The most significant underwriting risk sensitivities arise from mortality, longevity and lapse risk. As of 31 December 2016, the following sensitivities were estimated. The sensitivities presented allow for the impact to both the Own Funds and the SCR.

- An increase of 5% in annuitant longevity, with all other variables held constant, would result in an decrease in the Company's Solvency II surplus capital of £128,141k;
- A decrease of 6% in annuitant mortality, with all other variables held constant, would result in a decrease in the Company's Solvency II surplus capital of £58,346k;
- An increase of 10% in lapse rates, with all other variables held constant, would result in a decrease in the Company's Solvency II surplus capital of £3,728k; and
- An increase of 10% in assurance mortality, with all other variables held constant, would result in a decrease in the Company's Solvency II surplus capital of £8,575k.

C.2 MARKET RISK
C.2.1 RISK EXPOSURE

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market influences. The Company is exposed to the following sources of market risk described in the table below:

Risk source	Description
Interest rate risk	The risk that the fair value of future cash flows of a financial instrument will fluctuate relative to the respective liability due to the impact of changes in market interest rates on the value of interest-bearing assets and on the value of future guarantees provided under certain contracts of insurance.
Equity risk	The risk of reduction in earnings and/or value, from unfavourable movements in equity asset values and/or equity volatility. In this context, equity assets should be taken to include shares, equity derivatives and equity collectives (OEICs, unit trusts, investment trusts).
Property risk	The risk of reduction in earnings and/or value, from unfavourable movements in property asset values and/or property volatility. In this context, property assets should be taken to include direct property investment, shares in property companies, property collectives (OEICs, unit trusts, investment trusts) and structured property assets.
Spread risk	The risk of reduction in earnings and/or value, arising from changes in the spread between corporate bond yields and gilt yields or corporate bond yields and the swap curve.
Gilt swap spread risk	The risk of reduction in earnings and/or value, from unfavourable movements in the spread between government bond yields and swap rates
Inflation risk	The risk of reduction in earnings and/or value, due to inflation, e.g. price inflation or wage inflation, leading to an unanticipated change in insurance cost.
Currency risk	The risk of reduction in earnings and/or asset and liability values, arising solely as a consequence of changes to currency exchange rates.

SECTION C
Continued

RISK PROFILE CONTINUED

C.2 MARKET RISK CONTINUED

C.2.1 RISK EXPOSURE CONTINUED

The Company is predominantly exposed to market risk in respect of assets held in the Shareholder funds and those backing the annuity portfolio. These are mainly invested in bonds and cash/cash equivalents, with limited exposure to other asset types. As at 31 December 2016, the Company did not hold alternative assets or direct equity holdings.

There is further exposure in respect of the Abbey Life Staff Pension Scheme and in respect of the annual management fees receivable on the unit-linked funds, which are dependent on the value of funds under management.

As Abbey Life uses the Standard Formula no allowance is made for gilt swap spread risk within the capital calculations.

Over the reporting period ended 31 December 2016, the following key changes in market risk exposure have taken place:

– Markets have been particularly turbulent following the EU Referendum. Yields on UK government debt and swap rates have fallen markedly. Volatility is expected to remain at elevated levels until the political process and details of the negotiations are finalised;

– A tranche of shareholder funds previously managed under a discretionary mandate by Deutsche Asset Management Limited was de-risked in February 2016, with the assets being transferred to a UCITS bond fund thus reducing market risk on these assets; and

– During 2016, the inflation and interest rate hedges on the Abbey Life Staff Pension Scheme were rebalanced to cover 75% of Technical Provisions. This entailed increasing inflation cover and reducing cover for interest rates.

C.2.2 RISK MEASUREMENT

The Company uses several methods to assess and monitor market risk exposures both for market risk categories and for the aggregate exposure to all market risks. These methods include monitoring of asset portfolio composition, interest rate mismatch risk metrics, strategic asset allocation, and hedge effectiveness. In addition, risk is measured using sensitivity analyses, scenario analyses and stress testing.

The risk capital requirement for market risk is assessed using the Standard Formula methodology as prescribed by the regulations.

As of 31 December 2016, market risk represented 55% of the Company's total undiversified SCR.

C.2.3 PRUDENT PERSON PRINCIPLE REQUIREMENTS

The Company's policies and procedures in place for market risk include minimum control standards designed to ensure compliance with the Prudent Person Principle requirements of the Solvency II Directive, such compliance with the relevant policies is monitored on an ongoing basis (see section B for more details on governance). Examples of minimum control standards are set out below:

– Responsibility for agreeing the strategic asset allocation rests with the Life Company Boards, as advised by Aberdeen Asset Management, the Investment Management Committee and the Actuarial function;

– Investments for unit-linked and index-linked contracts are governed by the relevant investment mandates which meet the overarching requirements of Group policies, as well as close-matching rules and policy-specific requirements; and

– Derivatives are used in many of the Company's funds, within policy guidelines agreed by the Board. Derivatives are used for risk hedging purposes or for efficient portfolio management.

More details on how the Company achieves compliance with the requirements, (in particular, having the appropriate risk management capability for the invested assets, investments appropriate for the nature and term of the liabilities, use of derivatives for risk mitigation, diversification, and concentration risk) are described below in section C.2.5.

C.2.4 RISK CONCENTRATION

The asset concentrations are managed through the Company's strategic asset allocation process, with the allocation to each asset class being agreed by the Board.

The operation of agreed market risk concentration limits ensures that the Company is not overly exposed to any single country, sector or individual counterparty.

SECTION C
Continued

RISK PROFILE CONTINUED

C.2 MARKET RISK CONTINUED

C.2.4 RISK CONCENTRATION CONTINUED

A breakdown of the non-index-linked and non-unit-linked investment assets included in the 'Solvency II value' balance sheet is shown in the table below:

Category	£000	Percentage of total
Property	7,085	0.2
Holdings in related undertakings, including participations	1,752	–
Government Bonds	975,252	27.3
Corporate Bonds	1,532,459	43.0
Collateralised securities	187,115	5.2
Collective Investment Undertakings	820,337	23.0
Derivatives – net	25,571	0.7
Loans and mortgages	503	–
Cash	20,091	0.6
Total	**3,570,165**	**100**

The Collective Investment Undertakings includes liquidity funds of £741,566k.

As of 31 December 2016, the largest single counterparty exposure is the British Government representing 27.3% of total non-index-linked and non-unit-linked investment assets.

C.2.5 RISK MITIGATION

Interest rate risk

Interest rate risk is managed by matching assets and liabilities where practicable and by entering into derivative arrangements for hedging purposes where appropriate. This is particularly the case for the non-participating funds including the Matching Adjustment Portfolio fund. For participating business, some element of investment mismatching is permitted where it is consistent with the principles of treating customers fairly. In practice, the Company maintains an appropriate mix of fixed and variable rate instruments (including cash and derivatives) according to the underlying insurance or investment contracts and monitors these at regular intervals to ensure that overall exposure is kept within the risk profile agreed for each particular fund. This also requires the maturity profile of these assets to be managed in line with the liabilities to policyholders.

In the non-participating funds and particularly the Matching Adjustment Portfolio fund, policy liabilities' sensitivity to interest rates are matched primarily with fixed and variable rate income securities, with the result that sensitivity to changes in interest rates is low.

The with-profit funds are exposed to interest rate risk as guaranteed liabilities are valued relative to market interest rates and investments include fixed interest securities. For with-profits business the profit or loss arising from any mismatches between such assets and liabilities is largely offset by increased or reduced discretionary policyholder benefits dependent on the existence of policyholder guarantees.

The Abbey Life Staff Pension Scheme exposure to interest rates is largely hedged through the use of long-dated gilts and interest rate swaps.

Equity risk

As at 31 December 2016, the Company had no direct equity holdings. However, annual management charges received by the Company in respect of the retail funds are dependent on the value of funds under management, which are largely invested in equities. This is mitigated to an extent by the fact that the investment management fees charged by the investment manager are also based on the value of funds under management.

Property risk

The Company owns the building from which it operates, but it does not have any other direct property holdings as at 31 December 2016.

Annual management charges received by the Company in respect of the retail funds are dependent on the value of funds under management, some of which are invested in property. This is mitigated to an extent by the fact that the investment management fees charged by the investment manager are also based on the value of funds under management.

SECTION C
Continued

RISK PROFILE CONTINUED

C.2 MARKET RISK CONTINUED

C.2.5 RISK MITIGATION CONTINUED

Inflation risk

The Company is exposed to inflation risk through certain contracts, such as annuities (both on its retail book and in respect of the Abbey Life Staff Pension Scheme), which may provide for future benefits to be paid taking account of changes in the level of experienced and implied inflation, and also through the Company's cost base. The Company seeks to manage inflation risk through the holding of derivatives, such as inflation swaps, or physical positions in relevant assets, such as index-linked gilts, where appropriate.

Gilt swap spread risk

The Company accepts some residual exposure to gilt-swap spread risk. This exposure arises where UK gilts are held as assets but policyholder liabilities are discounted using the EIOPA risk-free reference rate, which is based on the swap curve.

Currency risk

The Company's financial assets are primarily denominated in the same currencies as its insurance and investment liabilities. There are no significant unhedged foreign currency exposures. However, the fees received from Santander in respect of a longevity reinsurance transaction are denominated in euro and are not covered by a currency hedge. Currency risk in this respect is therefore mitigated by taking action periodically to convert these fees into sterling.

C.2.6 SENSITIVITY ANALYSIS

As of 31 December 2016, the most significant market risk sensitivities arise from interest rate and equity risk, and their outcomes are set out below. The sensitivities presented allow for the impact on both the Own Funds and the SCR.

- An increase of 55bps in interest rates, with all other variables held constant, would result in a decrease in the Company's Solvency II surplus capital of £26,145k.
- A decrease of 80bps in interest rates, with all other variables held constant, would result in an increase in the Company's Solvency II surplus capital of £35,809k.
- A 20% decrease in equity prices, with all other variables held constant, would result in a decrease in the Company's Solvency II surplus capital of £19,815k.
- An average 150bps widening of credit spreads (weighted average across ratings), with all other variables held constant and no change in assumed expected defaults, would result in an increase in the Company's Solvency II surplus capital of £1,860k.

Sensitivity of surplus capital to fluctuations in currency exchange rates is not considered significant, since unhedged exposure to foreign currency is relatively low.

C.3 CREDIT RISK

C.3.1 RISK EXPOSURE

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge its obligations. These obligations can relate to both on and off balance sheet assets and liabilities. The Company is exposed to the sources of credit risk described in the table below:

Risk source	Description
Investment counterparty risk	The risk of reduction in earnings and/or value, arising from counterparty defaults (and/or credit rating downgrades) on investments such as bonds, derivatives and cash deposits. This also includes the residual risk of credit risk mitigation techniques being less effective than expected. For example, 'gap risk' where collateral fails to move in line with liabilities following a default event.
Reinsurance counterparty risk	The risk of reduction in earnings and/or value, arising from the failure of a reinsurance counterparty to meet its contractual obligations by way of default or delayed claim settlements.
Outsourcer default risk	The risk of reduction in earnings and/or value, arising from default by firms providing outsourced services such as administration and investment management.
Stock-lending risk	The risk of reduction in earnings and/or value, arising as a result of borrowers defaulting on their obligation to return the original stock and the risk arising from the investment of the collateral received in lieu of the borrowed stock.

The Company is exposed to investment counterparty risk in respect of its shareholder funds, those assets backing the annuity portfolio and the Abbey Life Staff Pension Scheme.

Reinsurance counterparty risk exists in respect of reinsurance agreements currently in place on the Company's own annuity portfolio and reinsurance arrangements set up to offset the exposure on the longevity insurance transactions with third party pension schemes and insurance companies.

SECTION C
Continued

RISK PROFILE CONTINUED

C.3 CREDIT RISK CONTINUED

C.3.1 RISK EXPOSURE CONTINUED

The Company is exposed to outsourcer default risk as a consequence of its outsourcing model, with policy administration and related IT and finance services, investment management, investment administration and custody services all being outsourced.

Although the Company does engage in stock lending on a small portion of its non-index-linked and non-unit-linked funds, the risk exposure is negligible.

Over the reporting period ended 31 December 2016, the following key changes in credit risk exposure have taken place:

- The Company entered into a longevity insurance transaction with the Manweb Group of the Electricity Supply Pension Scheme on 27 July 2016. This has resulted in an increase in reinsurance counterparty default risk as the majority of the longevity risk accepted has been reassured with third parties.
- Investment counterparty risk has been reduced following the decision in February 2016 to de-risk a tranche of shareholder funds previously managed under a discretionary mandate by Deutsche Asset Management Limited, with the assets being transferred to a UCITS bond fund.
- Markets have been particularly turbulent following the EU Referendum, with yields on UK government debt and swap rates having fallen markedly. Volatility is expected to remain at elevated levels until the political process and details of the negotiations are finalised.

C.3.2 RISK MEASUREMENT

The Company uses several methods to assess and monitor credit exposures. These methods include monitoring of asset portfolio composition and single name counterparty monitoring. In addition, risk is measured using sensitivity analyses, scenario analyses and stress testing.

The risk capital requirement for credit risk is assessed using the Standard Formula methodology as prescribed by the regulations.

As at 31 December 2016, credit risk represented 1% of the Company's total undiversified SCR.

C.3.3 PRUDENT PERSON PRINCIPLE REQUIREMENTS

The Company's policies and procedures in place for credit risk include minimum control standards designed to ensure compliance with the Prudent Person Principle requirements of the regulations, and such compliance is monitored on an ongoing basis. Examples of minimum control standards are set out in section C.2.3.

More details on how the Company achieves compliance with the requirements, in particular having the appropriate risk management capability for the invested assets, investments appropriate for the nature and term of the liabilities, use of derivatives for risk mitigation, diversification and concentration risk, are described in section C.3.5.

C.3.4 RISK CONCENTRATION

Concentration of credit risk exists where the Company has significant exposure to an individual counterparty or a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions.

The Company has most of its investment counterparty risk within its life business and this is monitored against the counterparty limits contained within the investment guidelines and investment management agreements.

SECTION C
Continued

RISK PROFILE CONTINUED

C.3 CREDIT RISK CONTINUED

C.3.4 RISK CONCENTRATION CONTINUED

A breakdown of the total non-index-linked and non-unit-linked investment assets by credit rating as at 31 December 2016 is given below:

Rating (*)	Market value £000	Percentage of total
Cash	767,107	21.5
AAA	137,127	3.8
AA	1,006,073	28.2
A	743,996	20.8
BBB	685,142	19.2
Non-investment grade	115,644	3.3
Unrated bonds	115,076	3.2
Total	**3,570,165**	**100.0**

(*) Ratings based on lower of S&P and Moody's

As of 31 December 2016, the largest counterparty exposure to a single name credit exposure in the Company's asset portfolio represents 22% of the total non-index-linked and unit-linked investment assets. The top 10 single name investment credit exposures are listed below:

Top 10 single name credit exposures	Exposure £000
United Kingdom of Great Britain and Northern Ireland – Gilts	785,073
Barclays Bank plc	59,609
Network Rail Infrastructure Finance plc	58,241
Republic of Italy	55,581
HSBC Holdings plc	51,417
Banco Santander SA	41,227
General Electric Company	40,471
Bank of America Corp	40,431
Cooperatieve Centrale Raiffeisen-Boerenleenbank BA/Netherlands	38,307
Lloyds Banking Group plc	36,151

The Company is exposed to concentration risk in respect of reinsurance ceded to external counterparties, although this is in part mitigated by collateral arrangements with the reinsurers. An analysis of the reinsurance recoverable as at 31 December 2016 by counterparty is set out in section C.1.4.

The Company is also exposed to concentration risk with operating partners. This is due to the nature of the outsourced services market. The Company operates a policy to manage outsourcer service counterparty exposures, and the impact from default is reviewed regularly by executive committees and measured through stress and scenario testing. Further details on the Company's outsourcing arrangements can be found in section B.7.

C.3.5 RISK MITIGATION

Credit risk is managed by monitoring of aggregate Company exposures to individual counterparties, by appropriate credit risk diversification and via the investment mandates. The Company manages the level of credit risk it accepts through credit risk tolerances. In certain cases, protection against exposure to particular credit risk types may be achieved through the use of derivatives. The credit risk borne by the shareholder on with-profit policies is dependent on the extent to which the underlying insurance fund is relying on shareholder support. Further specific mitigation techniques are set out below.

Matching Adjustment annuity funds

The Company has Matching Adjustment approval in respect of a block of non-participating immediate annuity business. Credit risk and Matching Adjustment are managed via the investment mandates and Matching Adjustment eligible assets.

SECTION C
Continued

RISK PROFILE CONTINUED
C.3 CREDIT RISK CONTINUED
C.3.5 RISK MITIGATION CONTINUED

Reinsurers

The Company cedes insurance risk in the normal course of business. The Company has policies and procedures in place for the management of reinsurance counterparty default risk, including the regular monitoring of reinsurance counterparties via the AOC.

Collateral

The Company receives and pledges collateral in the form of cash or non-cash assets in respect of derivative contracts, reinsurance arrangements, longevity swap transactions and longevity securitisation transactions in order to reduce the credit risk of these transactions. The amount and type of collateral required where the Company receives collateral depends on an assessment of the credit risk of the counterparty.

Outsourcers

The Company receives services from different suppliers in relation to policy administration, asset management and fund accounting services. As a result of receiving services from suppliers, the Company is exposed to the risk of default. Parental letters of credit are used to mitigate the risk for certain outsourcers.

The risk capital assessment takes account of the supplier's operating model, control factors and other forms of protection (such as letters of credit).

C.3.6 SENSITIVITY ANALYSIS

As at 31 December 2016, there are no material credit risk sensitivities.

C.4 LIQUIDITY RISK
C.4.1 RISK EXPOSURE

Liquidity and funding risk is defined as the failure of the Company to maintain adequate levels of financial resources to enable it to meet its obligations as they fall due. The Company has exposure to liquidity risk as a result of normal business activities, specifically the risk arising from an inability to meet short-term cash flow requirements.

There have been no significant changes to liquidity risk exposure during 2016.

C.4.2 RISK MEASUREMENT

Regular monitoring of liquidity takes place in order to establish that all liquidity management activities have been processed appropriately, and to ascertain available liquidity.

During 2016, the Company monitored the level of liquidity and reported this to the Risk Committee on a monthly basis.

As at 31 December 2016, the Company's total undiversified SCR does not include any allowance for liquidity risk, as liquidity risk does not form part of the Standard Formula calculation. During 2016, the Company maintained significant amounts of liquidity.

C.4.3 EXPECTED PROFITS IN FUTURE PREMIUMS

Own Funds are used to cover the SCR and further details can be found in section E.1. The value of liabilities takes into account expected future premium payments even if the policyholder is not contractually committed to make them. This methodology for valuing liabilities therefore implicitly allows for any Expected Profits In Future Premiums ('EPIFP') which acts to reduce the liability value.

The contribution of EPIFP to Own Funds is important from a liquidity perspective as the extent of future premiums assumed in the liability valuation may not emerge in practice (for example, due to higher than assumed policyholder lapse rates), thus potentially lowering the available Own Funds to cover the SCR.

As at 31 December 2016, the Company's total EPIFP was £70,874k and is included as a component of the reconciliation reserve. This comprised mainly future profits arising on protection and unit-linked business.

C.4.4 RISK CONCENTRATIONS

Uncertainty of cash outflows for the Company arises primarily as a result of mass lapse risk and catastrophe risk. However, the Company is not exposed to material concentrations of liquidity risk due to its holding sufficient liquidity to cover fluctuations in cash outflows in all foreseeable circumstances.

C.4.5 RISK MITIGATION

The Board has defined a number of governance objectives and principles and the liquidity risk framework is designed to ensure that:

- Liquidity risk is managed in a manner consistent with the Company's strategic objectives, risk appetite and Principles and Practices of Financial Management ('PPFM').
- Cash flows are appropriately managed and the reputation of the Company is safeguarded.
- Appropriate information on liquidity risk is available to those making decisions.

SECTION C
Continued

RISK PROFILE CONTINUED
C.4 LIQUIDITY RISK CONTINUED
C.4.5 RISK MITIGATION CONTINUED

The Company's policy is to maintain sufficient liquid assets of suitable credit quality at all times so as to be able to meet all foreseeable current liabilities as they fall due in a cost-effective manner.

The vast majority of the Company's derivative contracts are traded OTC and are settled within a two-day collateral settlement period. The Company's derivative contracts are monitored daily, via an end-of-day valuation process, to assess the need for additional funds to cover margin or collateral calls.

Most of the Company's cash and cash equivalents are held through collective investment schemes that have the power to restrict and/or suspend withdrawals, which would, in turn, affect liquidity. A significant proportion of the Company's non-index-linked and unit-linked investment assets are held in gilts, cash, supranational investments and investment grade securities which the Company considers sufficient to meet the liabilities as they fall due. The vast majority of these investments are readily realisable immediately since most of them are quoted in an active market.

For index-linked and 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 interest, price, currency or credit risk for the Company on these contracts. In extreme circumstances, the Company could be exposed to liquidity risk in its index-linked and unit-linked funds. This could occur where a high volume of surrenders coincides with a tightening of liquidity in an index-linked and unit-linked fund to the point where assets of that fund have to be sold to meet those withdrawals. Where the fund affected consists of property, it can take several months to complete a sale and this would impede the proper operation of the fund. In these situations, the Company considers its risk to be low since there are steps that can be taken first within the funds themselves both to ensure the fair treatment of all investors in those funds and to protect the Company's own risk exposure.

C.4.6 STRESS TESTING

Liquidity stress testing is carried out on a regular basis. A liquidity plan is in place for the Matching Adjustment fund and is monitored on a regular basis to ensure that adequate levels of liquidity are maintained. As at 31 December 2016, liquidity resources were sufficient to cover cash outflows under stress conditions.

C.5 OPERATIONAL RISK
C.5.1 RISK EXPOSURE

Operational risk is defined as the risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people-related or external events.

The Group's operational risk framework considers 21 sub-categories. For the Company, the following are the most material categories:

- Customer Treatment risk;
- Change risk;
- Legal risk;
- Operational risk & Control Framework risk;
- Regulatory Compliance & Data Protection risk; and
- Sourcing & Procurement risk.

Over the reporting period ended 31 December 2016, the following key changes in the qualitative operational risk exposure for the Company took place:

- Ongoing uncertainty regarding Customer Treatment and Regulatory Compliance risk pending the publication of regulatory reviews/announcements, and ongoing marketplace developments such as pension reforms.
- A reduction in Customer Treatment risk following steps taken by Capita to re-establish service level agreement measures within the contact centre and back office which had deteriorated due to the introduction at short notice of Pension Freedoms in 2015.
- The announcement in September 2016 of the proposed sale of the Company to Phoenix Group (which was completed on 30 December 2016) caused staff uncertainty and increased concerns around staff recruitment and retention, as well as the ability to secure services previously received directly from Deutsche Bank or its outsourced service providers during the transitional period and beyond.
- An increase in business continuity risk arising from the absence of tested business continuity plans for some systems operated by Capita in connection with the provision of the outsourced services.
- An increase in sourcing and procurement risk in respect of outsourced service providers' ability to resource and deliver the current high volumes of regulatory change.

SECTION C
Continued

RISK PROFILE CONTINUED

C.5 OPERATIONAL RISK CONTINUED

C.5.2 RISK MEASUREMENT

The risk capital requirement for operational risk is assessed using the Standard Formula methodology as prescribed by the regulations.

From a qualitative perspective, operational risks are regularly reported to the Company's Senior Management Committee and the Company's Risk Committee.

As at 31 December 2016, operational risk represented 4% of the Company's total undiversified SCR.

C.5.3 RISK CONCENTRATION

The Company also has concentrations of operational risk that are driven by its business model to outsource to specialist providers of key services covering customer services administration and related IT services, investment management and administration and asset custody.

The Company's key suppliers of services in this respect are outlined in section B.7.

From a geographical perspective, the Company is not exposed to any material concentration of operational risk, as the OSPs operate from multiple locations within the UK and offshore, ensuring that individual OSPs can maintain effective business continuity solutions which meet the requirements of the Company.

C.5.4 RISK MITIGATION

The Company seeks to manage its exposure to operational risk by establishing appropriate controls in accordance with the Company's Operational Risk Policy. These are designed to ensure that the Company operates within the risk appetite principles and qualitative and quantitative risk appetite limits defined within the Operational Risk Policy and the Company's Risk Appetite Statement. Periodic reporting by risk owners monitors risk exposure against these agreed limits. For outsourced activities, operational risks are managed in the first instance by the relevant outsourcers, with issues escalated to the Company where necessary, in accordance with contractual requirements. The Company exercises oversight of the outsourcers through relevant governance meetings.

The Company's Operational Risk Policy and Risk Appetite Statement, and the controls referenced within them, are two of the key mitigating tools used to manage the Company's operational risk exposure. In addition to these, the Company also places reliance upon:

- The transfer of operational risk to the OSPs as part of the outsourcing, with the obligations/liabilities for each outsource arrangement outlined in the relevant contract.
- Deutsche Bank Group's corporate insurance policies which provided cover in respect of a variety of operational risks, including employer's liability and premises. Cover under these policies ceased on 30 December 2016 when the Company was sold by Deutsche Bank to Phoenix Group, at which point cover commenced under the Phoenix Group corporate insurance policy, which provides cover in respect of a variety of operational risks. In addition, certain outsourced service providers are required to have fidelity/crime insurance.

These key elements of operational risk mitigation are taken account of on a prudent basis against those operational risk SCR scenarios in which subject matter experts assess that a valid claim could be made. The approach to insurance in the capital model is conservative, with haircuts made for mismatches, willingness of insurer to pay out and the residual term of policy from the date of a risk event occurring.

C.5.5 STRESS TESTING

Stress testing of operational risk scenarios at the 99.5 percentile confidence interval is carried out as part of the Company's Own Risk and Solvency Assessment ('ORSA') process.

In addition, the Company performs reverse stress testing, which includes a number of operational risk scenarios.

C.6 OTHER MATERIAL RISKS

Other material risks which should be highlighted are summarised below. As of 31 December 2016, there is no allowance for other material risks within the Company's total undiversified SCR as these do not form part of the Standard Formula calculation.

C.6.1 TAX RISK

Tax risk is defined as the risk of financial or reputational loss arising from lack of liquidity, funding or capital due to an unforeseen tax cost, or by the inappropriate reporting and disclosure of information in relation to taxation. The Company has exposure to tax risk through the annual statutory and regulatory reporting and through the processing of policyholder tax requirements. During 2016, tax risk was managed by maintaining an appropriately staffed tax team within Deutsche Bank who have the qualifications and experience to make judgements on tax issues, augmented by advice from external specialists where required.

SECTION C
Continued

RISK PROFILE CONTINUED

C.6 OTHER MATERIAL RISKS CONTINUED

C.6.2 EU REFERENDUM RISK

The eventual outcome of the political negotiations following the EU Referendum results could have an impact on the Company, as a consequence of the wider potential impacts on the economy, capital markets, regulations and trade freedoms and the continuing position of Scotland within the United Kingdom. Deutsche Bank Group performed a detailed ad hoc risk assessment in the lead-up to the referendum and continued to monitor developments on a regular basis up to 30 December 2016.

Given the ongoing uncertainty as to the outcome of the political process, the risks are currently assessed on a qualitative basis and no additional explicit risk capital is held specifically in relation to the possible outcome of EU Referendum negotiations. It should be noted that risk capital is already held against capital market risks at the 1-in-200 likelihood level (as described in sections C.2 to C.3), and that the Company does not believe there is any evidence to justify additional market or credit risk capital as a result of the EU Referendum outcome.

C.6.3 GEOPOLITICAL INSTABILITY RISK

The aftermath of the US election and forthcoming European elections could potentially lead to increased geopolitical uncertainty and market impacts. Given that risk capital is already held in respect of capital markets risks, the Company does not believe any additional risk capital needs to be held in respect of geopolitical instability.

C.6.4 CUSTOMER RISK

Customer risk is defined as the risk of reductions in expected earnings and/or value to the Company or customers, through financial, reputational or operational losses as a result of:

- Failure to have in place an appropriate culture, structures, governance and frameworks across the Company to drive ethical and responsible behaviours, attitudes and decision-making focused on customer interests and outcomes.
- Failure to understand our customers' experience, behaviours and needs and act in their interests ensuring they are treated fairly, in line with our strategic objectives, and supported in making good financial decisions.
- Inappropriate conduct or poor customer treatment or experience (including poor advice).

The conduct-focused regulator has had a greater focus on customer outcomes. This may continue to challenge existing approaches and/or may result in remediation exercises where the Company cannot demonstrate that it met the expected customer outcomes in the eyes of the regulator. Changes in legislation such as the Pension Freedoms and taxation can also impact the Company's financial position.

The Company puts considerable effort into managing relationships with its regulators so that it is able to maintain a forward view regarding potential changes in the regulatory landscape. The Company assesses the risks of regulatory and legislative change and the impact on our operations and lobbies where appropriate.

C.6.5 STRATEGIC RISK

Strategic risk is the risk to economic profit arising from a sub-optimal business strategy, or the sub-optimal implementation of the plan as agreed by the Board. In assessing strategic risk, consideration is given to both external and internal factors.

From a Company perspective, the challenge of integrating the business into the Phoenix Group during 2017 could introduce structural or operational inefficiencies that result in the Company failing to generate the expected outcomes for policyholders or value for shareholders. Integration plans are currently being developed and resourced with appropriately skilled staff to ensure that the target operating model is delivered in line with expectations.

C.7 ANY OTHER INFORMATION

There is no further material information to be disclosed regarding the Company's risk profile.

SECTION D

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SECTION D

VALUATION FOR SOLVENCY PURPOSES

This section covers the Company's valuation of assets (section D.1), technical provisions (section D.2) and other liabilities (section D.3) on the Solvency II balance sheet. Their valuation is determined in line with the regulations. The Balance Sheet QRT S.02.01.02 is included at Appendix 1.1.

For each material class of assets and liabilities in the Solvency II balance sheet, sections D.1.2 and D.3.2 provide a 'Solvency II value' amount and a description of the bases, methods and main assumptions used in their valuation for solvency purposes. A comparable 'Statutory accounts value' amount, based on the recognition and valuation methods as reported in the Company's International Financial Reporting Standards ('IFRS') financial statements, is also provided. Explanations are provided for any calculated differences between the 'Solvency II value' amount and the 'Statutory accounts value' amount. Certain reclassification adjustments have been made to the 'Statutory accounts value' column, where necessary, to enable comparison with the 'Solvency II value' column.

Some of the Company's assets (mainly financial instruments) and liabilities are determined using alternative valuation methods. Further details are included in section D.4.1.

D.1 ASSETS

D.1.1 INTRODUCTION

This section describes the bases, methods and main assumptions used in the valuation for each material class of asset on the Company's Solvency II balance sheet ('Solvency II value'). A quantitative and qualitative explanation is then provided for any material differences between the 'Solvency II value' and the valuation in the financial statements ('Statutory accounts value').

The table below compares the 'Solvency II value' of assets with the 'Statutory accounts value' of assets and any differences are quantified.

Assets	Note	Solvency II value £000	Statutory accounts value £000	Difference £000
Intangible assets	1	–	73,868	(73,868)
Deferred tax assets	2	23,764	28,829	(5,065)
Investments (other than assets held for index-linked and unit-linked contracts)	3	3,575,837	3,575,837	–
Property (other than for own use)		7,085	7,085	–
Holdings in related undertakings, including participations		1,752	1,752	–
Bonds		2,694,826	2,694,826	–
Collective Investment Undertakings		820,337	820,337	–
Derivatives		51,837	51,837	–
Assets held for index-linked and unit-linked contracts	4	7,503,345	7,511,959	(8,614)
Loans and mortgages	5	503	503	–
Reinsurance recoverables	6	(582,351)	531,961	(1,114,312)
Insurance and intermediaries receivables	7	7,681	7,681	–
Reinsurance receivables	8	2,797	2,797	–
Receivables (trade, not insurance)	9	40,598	43,611	(3,013)
Cash and cash equivalents	10	20,091	20,091	–
Total assets		**10,592,265**	**11,797,137**	**(1,204,872)**

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.1 ASSETS CONTINUED

D.1.2 ASSET VALUATION BASES, METHODS AND MAIN ASSUMPTIONS

The Company's Solvency II valuation principles (including the bases, methods and main assumptions) for each asset class are set out below. Unless otherwise stated (i.e. where there are differences in the 'Statutory accounts value' column), the valuation methods included in IFRS are consistent with the valuation methods of the regulations.

Note	Balance sheet item	Solvency II valuation principles for each material asset class
1	**Intangible assets (other than goodwill)**	**Valuation not consistent with IFRS.** Intangible assets are valued at zero unless the intangible assets can be sold separately and it can be demonstrated that there is value for the same or similar assets (i.e. that a value has been derived from quoted prices in active markets). The Company's intangible asset relates to deferred acquisition costs on investment contracts and is valued at zero. Any related deferred tax liability is also de-recognised. *For IFRS, all intangible assets are measured on the balance sheet at cost less accumulated amortisation and any impairment loss recognised to date.* *The difference of £73,868k is due to a zero valuation for 'Solvency II value' purposes when compared with the 'Statutory accounts value' under IFRS.*
2	**Deferred tax assets**	**Valuation consistent with IFRS as amended by Solvency II adjustments.** Deferred tax is determined on temporary differences between the fair value of assets and liabilities on the Solvency II and IFRS balance sheets at the valuation date. This means deferred tax should be provided on temporary differences between the IFRS and the Solvency II balance sheet. All valuation differences between the IFRS and Solvency II balance sheets are identified and deferred tax is calculated, where appropriate, on these differences. *Under IFRS, deferred tax is provided for on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not provided in respect of temporary differences arising from the initial recognition of goodwill and the initial recognition of assets or liabilities in a transaction that is not a business combination and that, at the time of the transaction, affected neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and laws enacted or substantively enacted at the period end.* *A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.* *The difference between the 'Solvency II value' amount and 'Statutory accounts value' amount is £5,065k. The difference consists of two amounts:* – *Deferred tax asset on deferred income of £11,836k that is recognised under IFRS but not under Solvency II; and* – *Deferred tax asset on FCA thematic provision of £6,771k that is recognised under Solvency II but not under IFRS.* Further details on the origin of the deferred tax assets are provided in section D.1.3.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED
D.1 ASSETS CONTINUED
D.1.2 ASSET VALUATION BASES, METHODS AND MAIN ASSUMPTIONS CONTINUED

Note	Balance sheet item	Solvency II valuation principles for each material asset class
3	**Investments (other than assets held for index-linked and unit-linked contracts)**	**Valuation consistent with IFRS.** The values of financial instruments are determined using fair value methodology as follows: – For financial instruments traded in active markets (such as exchange traded securities and derivatives), fair value is based on quoted market prices at the period end provided by recognised pricing services. Market depth and bid-ask spreads are used to corroborate whether an active market exists for an instrument; – Where the quoted market prices are not available, quoted market prices for similar assets or liabilities are used to determine the fair value; – Where either of the above is not possible, alternative valuation methods are used to determine fair value. Where discounted cash flow techniques are used, estimated future cash flows are based on contractual cash flows using current market conditions and market-calibrated discount rates and interest rate assumptions for similar instruments; and – Certain financial instruments are determined by valuation techniques using non-observable market inputs based on a combination of independent third party evidence and internally developed models. Further details are included in section D.4.1. The determination as to whether a market is active is based on the transactions for that asset taking place with sufficient frequency and volume to provide pricing information on an ongoing basis. It therefore considers factors such as the bid-offer spread and the market depth. Further details on each item within investments are outlined below. ***Property (other than for own use)*** Investment properties are measured at fair value by independent property valuers, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued. Further details are included in section D.4.1. ***Holdings in related undertakings, including participations*** The 'Holdings in related undertakings, including participations' consists of investments in Collective Investment Undertakings where the Company holds an interest of 20% or more (where the interest is less than 20%, it is included within 'Collective Investment Undertakings'). Where investments in Collective Investment Undertakings refer to unit-linked and index-linked contracts, these are reported in 'Assets held for index-linked and unit-linked contracts'. ***Bonds*** *Government bonds* Government bonds are valued using quoted market prices at the period end provided by recognised pricing sources. *Corporate bonds* For corporate bonds listed on a recognised stock exchange, quoted market prices are used. For other corporate bonds, these instruments are valued using pricing data received from external pricing providers, or in some cases broker quotes where observable market data is unavailable. The Company has two bonds which are valued using alternative valuation methods. Further details are included in section D.4.1. *Collateralised securities* For those collateralised securities listed on a recognised stock exchange, quoted market prices are used. For other collateralised securities, these instruments are valued using pricing data received from external pricing providers, or in some cases broker quotes where observable market data is unavailable.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.1 ASSETS CONTINUED

D.1.2 ASSET VALUATION BASES, METHODS AND MAIN ASSUMPTIONS CONTINUED

Note	Balance sheet item	Solvency II valuation principles for each material asset class
3	**Investments (other than assets held for index-linked and unit-linked contracts)** continued	***Collective Investment Undertakings*** The Company receives valuations from the investment managers of the underlying funds, based on quoted market prices. Where quoted prices are not available, they are estimated using pricing models or discounted cash flow techniques. Where pricing models are used, inputs are based on market-related data at the period end. Where discounted cash flows are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market-related rate for a similar instrument. Where the Company holds 20% or greater interest in an investment fund, this interest is recognised within 'Holdings in related undertakings, including participations'. Where the interest is less than 20%, it is included within 'Collective Investment Undertakings'. ***Derivative assets*** The fair value of over-the-counter assets is estimated using pricing models, with inputs based on market-related data at the period end. The fair value of exchange traded securities is based on quoted market prices at the period end provided by recognised pricing services. The Company values some of its derivatives using alternative valuation methods. Further details are included in section D.4.1.
4	**Assets held for index- linked and unit-linked contracts**	**Valuation consistent with IFRS.** Assets held for unit-linked contracts are measured based on the fair value of the underlying assets and liabilities (other than technical provisions) held within such funds. *Under IFRS, assets and liabilities of unit-linked contracts are separately reported on a line by line basis. Under Solvency II, all assets and liabilities backing unit-linked contracts are reported on a single line in 'Assets held for index-linked and unit-linked contracts'. The difference between the 'Solvency II value' and the 'Statutory accounts value' of £8,614k represents unit-linked derivative liabilities and payables.*
5	**Loan and mortgages**	**Valuation consistent with IFRS.** 'Loans and mortgages' consists of loans on policies and loans secured by mortgages and are valued at fair value.
6	**Reinsurance recoverables**	**Valuation not consistent with IFRS.** The value of reinsurance recoverables is dependent on the expected claims and benefits arising under the related reinsured policies. To the extent to which the Solvency II valuation of the related technical provisions differs from the valuation under IFRS, the valuation of the related reinsurance recoverable will also be impacted. *There is a difference of £1,114,312k between 'Solvency II value' and IFRS 'Statutory accounts value'. Further details are included in section D.2.*
7	**Insurance and intermediaries receivables**	**Valuation consistent with IFRS.** Given the short-term nature, the carrying amount as per the 'Statutory accounts value' is considered to represent the fair value for these assets.
8	**Reinsurance receivables**	**Valuation consistent with IFRS.** Given the short-term nature, the carrying amount as per the 'Statutory accounts value' is considered to represent the fair value for these assets.
9	**Receivables (trade, not insurance)**	**Valuation consistent with IFRS except for prepayments.** The receivables (trade, not insurance) are valued at fair value. No value is ascribed for prepayments (where they cannot be sold separately from a third party) under Solvency II. *Under IFRS, prepayments of £3,013k are recognised as an asset at amount paid less expenses incurred. The 'Solvency II value' amount is zero.*
10	**Cash and cash equivalents**	**Valuation consistent with IFRS.** Cash and cash equivalents comprise cash balances that are usable for all forms of payments without penalty or restriction.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.1 ASSETS CONTINUED

D.1.3 DEFERRED TAX ASSETS

The deferred tax asset on the Solvency II balance sheet of £23,764k has been recognised where it is probable that future taxable profit will be available, and consists of:

Item	Deferred tax asset value £000	Further details
Pension benefit obligations	16,757	Includes deferred tax asset of £14,830k on the deficit arising from the pension benefit obligation of £87,234k. Tax relief, subject to tax spreading rules, will be received over a period of ten years when employer contributions are paid into the pension scheme. The balance of £1,927k is a deferred tax asset that relates to tax relief on the employer's current year pension contribution of £10,096k that will be received equally over three years.
FCA thematic provision	6,771	Deferred tax asset on a FCA thematic provision. This is a temporary difference which reverses in 2017.
Acquisition costs	123	Deferred tax asset on Basic Life Assurance and General Annuity Business ('BLAGAB') acquisition expenses which are spread over seven years.
Fixed assets	113	Deferred tax asset on the difference between the tax written down value and the accounting net book value of assets.
Total Solvency II deferred tax assets	**23,764**	

With effect from 1 April 2015, the UK corporation tax was reduced to 20%. Further reductions to 19% (from 1 April 2017) and 17% (from 1 April 2020) were enacted during November 2015 and September 2016. These new rates have been factored into the closing deferred tax balances.

The Company has no excess unrelieved tax losses at the balance sheet date.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS

This section provides separately for each LoB the value of technical provisions, including the amount of the Best Estimate Liability ('BEL') and the risk margin, as well as a description of the bases, methods and main assumptions used in the valuation of technical provisions.

As outlined in section A.1.3, the LoBs relevant to the Company are:

– Insurance with-profit participation;

– Index-linked and unit-linked insurance;

– Health insurance;

– Other life insurance; and

– Life reinsurance.

The Company does not write non-life business.

This section also includes a quantitative and qualitative explanation of material differences between the bases, methods and main assumptions used by the Company for the valuation of technical provisions for solvency purposes and those used for their valuation in IFRS.

D.2.1 INTRODUCTION

The life business technical provisions tables presented in this section are as at 31 December 2016.

Effective 1 January 2016, the Company received PRA approval to apply the Matching Adjustment ('MA'), and as a result the technical provisions detailed in this section are inclusive of this.

The MA is applied to liabilities in the Matching Adjustment Portfolio only. Further detail on the application of the MA can be found in section D.2.8.1.

For all business, no allowance is currently made for the volatility adjustment, Transitional Measures on Technical Provisions or transitional risk-free interest-rate-term structure.

D.2.2 TECHNICAL PROVISIONS BY LINE OF BUSINESS

This section provides technical provisions split by Solvency II LoB.

Table D.2.2a Technical provisions by Line of Business

The following table summarises the Company technical provisions at 31 December 2016 by Solvency II LoB, including the amount of the BEL and risk margin.

Technical provisions by Line of Business	Insurance with-profit participation £000	Index-linked and unit-linked insurance £000	Health insurance £000	Other life insurance £000	Life reinsurance £000	Total technical provisions £000
Best Estimate Liabilities	40,245	7,382,005	16,869	1,695,077	(91,508)	9,042,688
Risk margin	315	92,644	400	83,909	20	177,288
Gross technical provisions	40,560	7,474,649	17,269	1,778,986	(91,488)	9,219,976
Reinsurance	(2,604)	(33,876)	(3,176)	570,721	51,286	582,351
Net technical provisions	37,956	7,440,773	14,093	2,349,707	(40,202)	9,802,327

The gross technical provisions shown in the table above are gross BEL plus a net of reinsurance risk margin.

Table D.2.2b Material differences between IFRS and Solvency II technical provisions

The table below outlines separately, for each LoB, material differences between the bases, methods and main assumptions used for Solvency II and those used for IFRS. The 'Statutory accounts value' gross technical provisions, includes the following IFRS items:

– Insurance contract liabilities – gross;

– Investment contract liabilities – gross;

– Longevity derivative liabilities; and

– Debt held at fair value.

Longevity derivative liabilities and Debt held at fair value represent longevity transactions and value in-force securitisation with corporate pension schemes and insurance undertakings which are not recognised as insurance contracts under IFRS, but are under Solvency II. Under IFRS, these transactions are valued at fair value, whereas under Solvency II they are valued as technical provisions using appropriate Solvency II valuation methodology.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.2 TECHNICAL PROVISIONS BY LINE OF BUSINESS CONTINUED

Table D.2.2b Material differences between IFRS and Solvency II technical provisions Continued

The ‘Statutory accounts value’ reinsurance recoverable includes the following IFRS items:

- Reinsurers’ share of insurance contract liabilities; and
- Longevity derivative assets; and
- Loan held at fair value.

Longevity derivative assets and Loan held at fair value represent longevity transactions and value in-force securitisation with corporate pension schemes and insurance undertakings which are not recognised as insurance contracts under IFRS, but are under Solvency II. Under IFRS, these transactions are valued at fair value, whereas under Solvency II they are valued as reinsurance recoverables using appropriate Solvency II valuation methodology.

The ‘Statutory accounts value’ for gross technical provisions is £10,606,184k and the ‘Solvency II value’ for gross technical provisions is £9,219,976k and the difference is £1,386,208k as reported in section D.3.

The ‘Statutory account value’ for reinsurance recoverable is £531,961k and the ‘Solvency II value’ for reinsurance recoverable is £(582,351)k and the difference is £1,114,312k as reported in section D.1.

The ‘Statutory accounts value’ net technical provisions are £10,074,223k and the ‘Solvency II value’ net technical provisions are £9,802,327k. The difference between the two net technical provisions of £271,896k is outlined in the table below:

Technical provisions – IFRS to Solvency II reconciliation	Note	Insurance with-profit participation £000	Index-linked and unit-linked insurance £000	Health insurance £000	Other life insurance £000	Life reinsurance £000	Total technical provisions £000
IFRS technical provisions – gross	1	34,241	7,696,753	20,577	2,495,985	–	10,247,556
Longevity derivative liabilities	2 & 3	–	–	–	17,458	254,419	271,877
Debt held at fair value	3	–	–	–	–	86,751	86,751
Statutory accounts value technical provisions – gross		**34,241**	**7,696,753**	**20,577**	**2,513,443**	**341,170**	**10,606,184**
IFRS reinsurers’ share	1	2,413	36,398	3,281	58,352	–	100,444
Longevity derivative assets	2	–	–	–	51,545	–	51,545
Loan held at fair value	3	–	–	–	–	379,972	379,972
Statutory accounts value reinsurance recoverable		**2,413**	**36,398**	**3,281**	**109,897**	**379,972**	**531,961**
Statutory accounts value technical provisions – net		**31,828**	**7,660,355**	**17,296**	**2,403,546**	**(38,802)**	**10,074,223**
Change in restriction for negative sterling reserves	1	–	(202,286)	–	–	–	(202,286)
Corporate deals recognised as derivatives, Debt held at fair value and Loan held at fair value under IFRS and Solvency II adjustments	2 & 3	–	–	–	(55,338)	(1,733)	(57,071)
Demographic margin	4	–	(123,981)	(3,708)	(106,680)	–	(234,369)
Policyholders' share of estate	5	5,813	–	–	–	–	5,813
Risk margin	6	315	92,644	400	83,909	20	177,288
Change to discount curve	7	–	9,921	–	22,958	–	32,879
Other		–	4,120	105	1,312	313	5,850
Solvency II technical provisions – net		**37,956**	**7,440,773**	**14,093**	**2,349,707**	**(40,202)**	**9,802,327**
Add/(deduct) Solvency II reinsurance recoverable		**2,604**	**33,876**	**3,176**	**(570,721)**	**(51,286)**	**(582,351)**
Solvency II technical provisions – gross		**40,560**	**7,474,649**	**17,269**	**1,778,986**	**(91,488)**	**9,219,976**

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.2 TECHNICAL PROVISIONS BY LINE OF BUSINESS CONTINUED

Table D.2.2b Material differences between IFRS and Solvency II technical provisions Continued

Notes on the reconciliation of technical provisions under IFRS to Solvency II are provided below:

Note	Item	Description
1	**Net technical provisions**	Under IFRS, insurance contracts are valued using a UK GAAP modified statutory basis. This means that each policy has a reserve (sum of unit and sterling reserves) that is at least the amount of the surrender value; this restriction means that on many contracts negative sterling reserves are restricted or zeroised. For investment contracts, the unit reserve is held. For Solvency II, negative sterling reserves are allowed as a reduction to technical provisions for both insurance and investment contracts.
2	**Longevity derivative assets and liabilities**	The Company has in place longevity arrangements with corporate pension schemes which do not meet the definition of insurance contracts under IFRS and are recognised as derivative financial instruments. Under these arrangements, the majority of the longevity risk has been passed to third parties. Derivative assets of £51,545k and derivative liabilities of £17,458k have been recognised as at 31 December 2016. Under Solvency II, these longevity swap arrangements are classified as insurance contracts.
3	**Longevity derivative liabilities, loan and debts held at fair value**	The Company has entered into a transaction under which it has accepted reinsurance on a portfolio of single and regular premium life insurance policies and retroceded the majority of the insurance risk. Taken as a whole, this transaction does not give rise to the transfer of significant insurance risk to the Company and therefore does not meet the definition of an insurance contract under IFRS. The amount due from the cedant is recognised as loan held at fair value of £379,972k. The amount due to the retrocessionaire is recognised as debt held at fair value of £86,751k and a derivative liability of £254,419k. Under Solvency II, these arrangements are classified as insurance contracts.
4	**Demographic margin**	A margin for demographic risk is included within the IFRS technical provisions for insurance business. The assumptions for demographic risks are loaded by a margin for prudence. Demographic risks are mortality, longevity and persistence. Solvency II does not require a margin to be held over and above best estimate. The removal of the margins included in the Solvency I assumptions leads to a release of reserves.
5	**Policyholders' share of estate**	The proportion of the with-profit estate which is expected ultimately to be distributed to policyholders is included within technical provisions on the IFRS basis. For Solvency II, the BEL is determined using bonus rates such that the BEL equals the fund.
6	**Risk margin**	Under Solvency II, an explicit risk margin is held. This represents the cost of capital.
7	**Change to discount curve**	Solvency II BEL is calculated using a yield curve set by EIOPA. Under IFRS, reserves for insurance business are determined using a prudent interest rate that is constant over time.

Life reinsurance refers to reinsurance accepted from life insurers in respect of Other life insurance business.

D.2.3 BASES, METHODOLOGY AND MAIN ASSUMPTIONS

Technical provisions represent the value of policyholder obligations, if these were to be transferred to a third party at the valuation date. The Company's approach to valuing all actuarial liabilities is to use BEL plus risk margin. The alternative 'technical provisions calculated as a whole' approach to valuing insurance contracts based on replicating portfolios is not used.

Sections D.2.3 to D.2.10 set out in detail the bases, methodology and main assumptions used to derive the BEL. Risk margin methodology is covered in section D.2.11.

All data used to calculate technical provisions is assessed for appropriateness, completeness and accuracy. Where there are any material weaknesses, limitations or errors associated with data, these are flagged in control and validation reports along with details of any rectifying appropriate adjustments made.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.3 BASES, METHODOLOGY AND MAIN ASSUMPTIONS CONTINUED

D.2.3.1 Best Estimate Liability

BEL is calculated gross, without deduction for amounts recoverable on reinsurance contracts. Amounts recoverable are valued separately, recognised as a reinsurance recoverable and calculated in the same manner as the BEL (see section D.2.8 for further details).

All assumptions are updated to reflect current economic conditions and demographic experience. Material changes in the relevant assumptions made in the calculation of technical provisions compared with the previous reporting period are covered in section D.2.5.

The following section details the methodology and key assumptions used to calculate the BEL.

D.2.3.2 Overview of methodology

A cash flow projection model is used to calculate BEL. This projects cash inflows and outflows required to meet the Company's obligations to policyholders over their lifetime, taking into account the Company's regulatory duty to treat its customers fairly.

The projection of future cash flows is performed using realistic assumptions regarding future experience. The relevant assumptions include expected future trends in mortality, longevity and lapse rates. An allowance is also made for future expenses.

The model takes account of the time value of money through discounting at an appropriate risk-free rate (see section D.2.3.3 below). When discounting liabilities in the Matching Adjustment Portfolio, the MA is applied as an addition to the risk-free rate curve.

The assessment of the expected cash flows underlying the BEL takes into account any taxation payments which are charged to policyholders, or which would be required to be made to settle the insurance obligations.

In certain specific circumstances, the BEL may be negative (e.g. for some protection business where the value of future premiums exceed future claims and expense). A negative BEL is permitted under the regulations.

D.2.3.3 Discount rates

For the purpose of calculating the Solvency II technical provisions, nominal discount rates (based on swap rates) prescribed by EIOPA are used. These rates vary by currency of liabilities.

An adjustment (also specified by EIOPA) is made to the swap curve for credit risk. At 31 December 2016 the sterling credit risk adjustment was 17bps at each duration. For euros, the adjustment was 10bps.

The vast majority of the Company's insurance obligations are denominated in sterling. The Company's main non-sterling currency exposure relates to euro denominated liabilities.

D.2.3.4 Tax assumptions

Tax assumptions have been updated as a result of the 2016 Finance Bill reducing tax rates. From 1 April 2017 the mainstream corporation tax rate will drop to 19% and from 1 April 2020 it will drop to 17%.

D.2.3.5 Contract boundary

Under the regulations the liability cash flows that need to be considered within the BEL are those that fall within the 'contract boundary'. Depending on the features of the contract type the contract boundary can vary (e.g. the contract boundary may be the original maturity date, the next policy anniversary or the valuation date).

For a significant majority of products the contract boundary used in the calculation of BEL are the original contractual maturity terms. The boundary used is based on a product level assessment which has been performed against the regulations. This assessment showed that a small number of products have a contract boundary at the valuation date, typically these are unit-linked Life and Pensions contracts with no discernible guarantees or insurance benefits. The total BEL for those contracts where a contract boundary was applied is £1,130,463k. The impact of the application of contract boundaries is a reduction in BEL of £350k.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.4 CALCULATION

The following sub-sections outline how each type of BEL is valued.

D.2.4.1 Insurance with-profit participation

BEL for with-profits business is determined using a cash flow projection methodology as described above. Future regular and terminal bonus amounts are determined such that the total BEL net of reinsurance is equal to the distributable fund. Expenses are those permitted to be charged to the fund as described in the fund's PPFM.

Cost of option and guarantees

With-profit policies have high levels of guarantees. Ordinarily, for policies with options and guarantees a stochastic valuation would be preferred to a deterministic one. However, given the small size of the funds and the cost of guarantees a deterministic methodology is appropriate.

D.2.4.2 Other life insurance (including health)

A deterministic valuation approach is used for annuity (i.e. non-profit) business.

The BEL for the immediate annuity business represents the present value of future annuity payments and associated policy administration expenses. For non-pension annuities, the annuity payments may include policyholder tax on the income element of any payments.

For liabilities in the Matching Adjustment Portfolio, a MA is added to the risk-free rates used for discounting liability cash flows.

For other business including health, BEL represents a realistic estimate of the present value of the difference between the projected claims, plus expenses and premium income.

D.2.4.3 Index-linked and unit-linked business

The BEL for unit-linked business is based on a realistic assessment of the present value of claim payments and associated policy administration expenses, less future allocated premiums and related premium charges.

D.2.4.4 Life reinsurance

BEL related to accepted reinsurance is valued in accordance with the approach used for the equivalent direct business.

D.2.5 DEMOGRAPHIC AND EXPENSE ASSUMPTIONS

All demographic and expense assumptions are determined on a best estimate basis (i.e. they include no allowance for prudence).

Assumptions are set in accordance with the regulations. In particular, they:

- are applicable to homogenous risk groups and LoBs;
- are in line with the Company's knowledge of the business and practices for managing the business; and
- ensure appropriate allowance for anticipated trends or future changes in both the Company and portfolio specific factors as well as legal, technological, social, economic or environmental factors.

Typically assumptions are reviewed annually, however for less material assumptions (such as morbidity) the updates may be less frequent.

The assumption setting process involves analysing experience data from the last seven years. This ensures data is detailed enough to allow credible statistical analysis to be performed and emerging trends to be identified.

For example, in order to set lapse assumptions for a particular group of policies, the annual percentage of policies lapsing over the last seven years is typically considered. The rates observed over the last seven years are then compared to the lapse assumption being used to value the BEL. Where the best estimate assumption is materially out of line with actual experience, changes to the best estimate assumption are considered.

Validations are performed to ensure the experience data is accurate, relevant and credible including the use of other industry data (e.g. industry trend data) where appropriate, to supplement the Company's experience data.

Expert judgement is applied to assess the impact on the proposed assumption of one-off events and likely future policyholder behaviour. It is also used where there is insufficient credible experience/other data to set the assumption.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED
D.2 TECHNICAL PROVISIONS CONTINUED
D.2.5 DEMOGRAPHIC AND EXPENSE ASSUMPTIONS CONTINUED

Key best estimate demographic assumptions are:

1) Mortality (using base table and future improvement rates);

2) Lapse rates;

3) Early retirement rates; and

4) Option take-up rates (e.g. early retirement options, GAO).

Other less material best estimate assumptions include morbidity and conversion from premium paying to paid up status.

D.2.5.1 Mortality

Base annuitant mortality

The base table mortality assumption review for annuitants is based on company mortality experience over a seven-year period. Fund level data is analysed by gender and type of annuity.

The mortality tables currently in use are RMV00 and RFV00 as these tables are most representative of the underlying Company experience. A base mortality multiplier is applied so that the assumption aligns to underlying experience.

RMV00 and RFV00 are examples of standard mortality tables used by Life Companies to value technical provisions. Adjustments are made to these tables to reflect mortality improvements from the date they were published to the current valuation date.

A separate allowance is made for future mortality improvements applicable after the valuation date, which is detailed below:

Pre-vesting mortality

Pre-vesting mortality assumptions apply to products such as term assurances and endowments.

The assumption review is based on mortality experience over a seven-year period. Criteria used to subdivide fund level data are gender, product group, smoker status and the company that originally sold the contract.

A base mortality multiplier that varies by gender is applied to a standard mortality table. Adjustments may be made to the mortality table to take account of changes in mortality improvements since the table was published.

Base multiplier and mortality assumptions are selected that are in line with the underlying experience data. In some cases, age specific percentages are used where they better match experience.

The main standard mortality tables currently in use are A1967-70, AM80 and AF80.

Additionally, company specific tables are used to value term policies and certain individual policies which include total and permanent disability benefits.

Future improvement in mortality rates

For immediate annuities, deferred annuities or products with GAOs, a separate allowance for future improvements in mortality rates is made when calculating technical provisions.

Assumptions for future mortality improvements are analysed by comparing the number of expected deaths predicted by the latest industry projection models with those predicted by the current assumptions.

When setting the assumption for future improvements in mortality rates, homogeneous risk groups are based solely on gender. These groupings appropriately balance the homogeneity and credibility of the available experience data. Expert judgement is applied to assess trends evident in the projected annual death rate.

The published projection model currently in use is an average of the CMI 2014 and CMI 2015 Mortality Projections Models. The model blend smoothed historic improvement rates with a long-term improvement rate assumption of 2% per annum for males and 1.75% per annum for females up to age 85 years, reducing linearly to zero at age 110 years.

D.2.5.2 Lapse rates

The assumption review is based on lapse experience over a seven-year period. The criteria used to subdivide fund level data are product type and premium payment status (i.e. regular premium or single premium/paid up). Where experience data is insufficient to perform a credible analysis, the experience from similar products may be aggregated.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.5 DEMOGRAPHIC AND EXPENSE ASSUMPTIONS CONTINUED

D.2.5.3 Early retirement rates

The assumption review is based on experience over a seven-year period.

The criteria used to subdivide fund level data are product type, gender, age and the company that originally sold the contract.

In setting the assumptions allowance is made for known or anticipated trends (e.g. changes in early retirement rates as a result of low interest rate environment or changes in pension's legislation from the Pension Freedoms Act).

D.2.5.4 Option take-up rates

The current best estimate assumptions for GAO take-up rates are based on experience data, with added weight given to the most recent experience, particularly since the 2014 Budget announcement where the requirement to take policy benefits in the form of an annuity was removed in the Pensions Freedoms Act. Given the significance of this change, it will take a few years for sufficient experience to build up to produce a stable take-up rate assumption.

D.2.5.5 Expense assumptions

Future expense assumptions are set on a going concern basis, which assumes that new vesting annuity business will be written in future, but that other LoBs are closed to new business.

The future expense assumptions include:

Administration fees payable to Capita – A charge is specified for each policy type together with associated increase rates (e.g. RPIX + 0.5%);

Direct and project costs – Within the expense assumptions, allowance is made for direct costs (i.e. costs directly attributed to the business) and some project costs. Any project costs not allowed for in expense assumptions are held as an actuarial provision within the overall calculation of BEL;

Investment management expenses – These fees may be explicit inputs to the valuation models, or in some cases they are applied via reductions to the investment returns used to calculate BEL. For with-profit funds investment expenses are set by considering the underlying asset mix of the asset shares and those assets backing other liabilities and Own Funds; and

Overhead expenses – These are allocated in a realistic and objective manner and on a consistent basis over time to the parts of the best estimate to which they relate.

D.2.6 STOCHASTIC MODEL

D.2.6.1 Economic Scenario Generators

An Economic Scenario Generator ('ESG') developed by a third party supplier has been used to support the stochastic valuation of all material options. A stochastic methodology is required for options and guarantees due to their potential volatility and asymmetric behaviour under different sets of future economic scenarios. The stochastic methodology involves valuing the options and guarantees under 1000 different future economic scenarios and then averaging over all scenarios. The central scenario in the ESG is equal to the 'single' deterministic scenario used to value unit-linked business.

The ESG generates projected asset returns consistent with asset prices observed in financial markets and assumes no arbitrage opportunities exist. The calibration of the parameters and scenarios is consistent with the relevant risk-free interest rate term structure used to calculate the BEL provided by EIOPA. Where possible the ESG has been calibrated to assets from deep, liquid and transparent markets which are appropriate to the nature of the funds' options and guarantees.

D.2.6.2 Management actions

No allowance for management actions is made in the calculation of BEL.

D.2.7 SOLVENCY II LONG-TERM GUARANTEE AND TRANSITIONAL MEASURES

The Company has regulatory approval to apply the MA, to liabilities in the Matching Adjustment Portfolio.

D.2.7.1 Matching Adjustment

The application of the MA allows insurers to use a (typically) higher discount rate based on the underlying assets when valuing liabilities that meet strict eligibility criteria, with the effect of increasing Own Funds and reducing the SCR.

The MA is based on the expected yield from eligible assets held to back eligible liabilities, less a margin for defaults and downgrades. It is applied as a flat increase to the Solvency II basic risk-free curve used to discount liabilities.

The calculation of the MA requires EIOPA specified assumptions for the basic risk-free curve and fundamental spreads. These assumptions are combined with the Company's Matching Adjustment Portfolio asset and liability cash flows to generate the MA. The assets and liabilities in the Matching Adjustment Portfolio meet the MA eligibility criteria as set out in the regulations.

Liabilities in the Matching Adjustment Portfolio consist of sterling denominated non-profit immediate annuities.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.7 SOLVENCY II LONG-TERM GUARANTEE AND TRANSITIONAL MEASURES CONTINUED

D.2.7.1 Matching Adjustment Continued

The financial impact of assuming a reduction in the MA to nil on the Solvency II balance sheet including technical provisions is £235,849k and £203,826k for Own Funds. This is reported in S.22.01.21 QRT in Appendix 1.5.

D.2.8 RECOVERABLES ON REINSURANCE CONTRACTS

The amounts recoverable on reinsurance contracts are recognised as a reinsurance recoverable on the Solvency II balance sheet and calculated in the same manner as the BEL. The amounts recoverable are adjusted to take account of expected losses due to default of the counterparty.

D.2.8.1 Assessment of reinsurers' default risk (counterparty default adjustment)

The regulations require that an adjustment is made to the value of the reinsurance recoverable to reflect the risk that a reinsurer may default on its obligations. This adjustment is known as the counterparty default adjustment.

A simplified method is used to calculate the counterparty default adjustment. The simplified calculation applies a best estimate probability of reinsurer default to the difference between the reinsured BEL and any collateral held under the arrangement. Further adjustments are then made to reflect the recovery rate from the reinsurer in excess of the collateral and the average duration of liabilities transferred.

There is no reinsurance with Solvency II Special Purpose Vehicles.

D.2.9 SIMPLIFICATIONS

Where it is proportionate, the Company adopts various simplifications in the calculation of BEL. These simplifications are split across the calculation methodology, and simplifications incorporated into the valuation models.

The most material areas where such simplifications are adopted are listed below.

D.2.9.1 Methodology simplifications

This section describes the significant simplifications within the Company's methodology for calculating the Solvency II BEL. Such simplifications are not considered to have a material impact on the BEL.

Dynamic policyholder behaviour

How valuable guarantees are to policyholders will vary with economic conditions. In the stochastic model, dynamic policyholder behaviour is not modelled in respect of the GAO take-up rates where the take-up rate varies depending on the level of projected interest rates at the policyholder's retirement date.

Variation in economic conditions would also affect the lapse and surrender rates. However, due to lack of relevant experience data and modelling complexity, dynamic lapse and surrender rates are not currently modelled.

Counterparty default adjustment

The methodology set out in section D.2.8.1 above is a simplification permitted by the regulations.

D.2.9.2 Modelling simplifications

Substantially all of the Company's BEL is calculated using probability weighted averages of future cash flows. However, simplified valuation techniques have been used in certain circumstances. These simplifications are typically used where material uncertainty exists around the size, incidence or timing of liability cash flows or, where further model development is required for a more robust assessment. Examples include provisions set aside to cover items such as additional service fees, data issues, project implementation costs, impact of system changes, impact of regulation changes, unknown claims and litigation costs.

The Company uses the skills, knowledge and experience of actuaries, accountants and other subject matter experts to perform these assessments, which are carried out in accordance with the Company's internal framework on expert judgement.

The proportion of gross BEL calculated using simplified methods was 0.31%.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.10 UNCERTAINTY ASSOCIATED WITH VALUE OF TECHNICAL PROVISIONS

The key sources and level of uncertainty associated with the technical provisions risk margin component are covered in section D.2.11.2 and for technical provisions BEL component are described below:

- uncertainty of demographic and economic assumptions;
- uncertainty in the timing and frequency of insured events;
- uncertainty in claim amounts, including uncertainty caused by path dependency (i.e. where the cash flows depend not only on circumstances such as economic conditions on the cash flow date, but also on those circumstances at previous dates);
- uncertainty in claims inflation;
- uncertainty in the amount of expenses and expense inflation;
- uncertainty in the actions that are assumed to be taken by management in response to changes in market conditions;
- uncertainty in expected future developments, where practicable; and
- uncertainty in policyholder behaviour.

Some of this uncertainty is addressed by using a stochastic model. In particular use of a stochastic model enables both the intrinsic and time value associated with options and guarantees to be determined with greater certainty.

Uncertainty may also emanate from the use of best estimate assumptions that did not accurately reflect the risk profile of the business being modelled. For example demographic best estimate assumptions are typically based on an analysis of past experience with adjustments to allow for expected future trends and developments. However these assumptions may not be borne out in practice for a number of reasons, including:

- Lack of credible historical data upon which to base the assumption. This may require experience data from different homogenous risk groups being grouped or the assumption being set by expert judgement, including making use of appropriate industry data (e.g. industry trend data).
- Allowance for future trends being different from expected.
- Random variation.

Any simplifications and approximations made when setting non-economic assumptions takes into account the sensitivity and materiality of the assumption.

The table below shows the increase in BEL that would result from a strengthening of each key demographic assumption at the 1-in-10 probability levels (i.e. the probability of the best estimate assumption being outside of this level is 10% respectively). This provides an indication of the level of uncertainty associated with the BEL. These impacts allow for the current risk mitigation techniques (e.g. reinsurance) in place.

Assumption	Increase in Best Estimate Liability 1-in-10 probability level £000
Longevity (base table)	37,083
Longevity (future improvements)	81,945
Mortality	13,685
Lapses	9,850
Expenses	28,967

No uncertainty is assumed to result from the basic risk-free curve used in the calculation of technical provisions, as this is specified by the regulations.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.2 TECHNICAL PROVISIONS CONTINUED

D.2.11 RISK MARGIN

The risk margin calculation represents the additional amount above the BEL that is required to be held to compensate a third party (i.e. the reference undertaking) for taking over those liabilities.

D.2.11.1 Methodology overview

The risk margin is an amount calculated so as to ensure that the total value of the technical provisions is equivalent to the amount that insurance and reinsurance undertakings would be expected to require in order to take over and meet the insurance and reinsurance obligations. The risk margin is calculated by determining the cost of providing an amount of Eligible Own Funds equal to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over the lifetime thereof and represents the cost of capital. It is calculated as follows:

Step 1: The effect of applying the Solvency II Standard Formula non-market risk stresses is calculated at each future year-end;

Step 2: At each year-end the stresses calculated in step 1 are combined using the Solvency II Standard Formula correlation matrices;

Step 3: This process is applied for the first 30 years. Beyond this period a simplified approach is taken. The risk margin is run off in proportion to future SCR;

Step 4: Step 2 gives a capital requirement at each future year-end. The cost of holding this capital is taken to be 6% (prescribed by EIOPA); and

Step 5: The amounts calculated in step 4 are discounted at the base risk-free discount rates to give the risk margin.

D.2.11.2 Level of uncertainty

The key sources and level of uncertainty associated with the risk margin component of technical provisions include all those set out for the BEL component of technical provisions as these would impact the calculation of the SCR. Any level of uncertainty on the Solvency II balance sheet assets and liabilities including assumptions employed in the valuation thereof, would affect the calculation of the SCR and hence the risk margin.

D.3 OTHER LIABILITIES

D.3.1 INTRODUCTION

This section covers the valuation of other liabilities on the Solvency II balance sheet. The valuation of technical provisions is covered in section D.2.

The table below sets out the 'Solvency II value' and 'Statutory accounts value' amounts of liabilities. Presentational adjustments have been made to the IFRS 'Statutory account value' amount where necessary to enable comparison to the 'Solvency II value' amount. Where relevant, any quantitative explanations provided below are between the 'Solvency II value' column and the 'Statutory accounts value' column.

Liabilities	Note	Solvency II value £000	Statutory accounts value £000	Difference £000
Gross technical provisions (Best Estimate Liabilities and risk margin)	1	9,219,976	10,606,184	1,386,208
Other technical provisions	2	–	6,013	6,013
Provisions other than technical provisions	3	39,186	5,331	(33,855)
Pension benefit obligations	4	87,234	87,234	–
Deferred tax liabilities	5	60,323	47,796	(12,527)
Derivatives	6	26,266	32,708	6,442
Insurance and intermediaries payables	7	119,145	190,066	70,921
Reinsurance payables	8	1,540	1,540	–
Payables (trade, not insurance)	9	23,278	25,439	2,161
Total liabilities		**9,576,948**	**11,002,311**	**1,425,363**

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.3 OTHER LIABILITIES CONTINUED

D.3.2 LIABILITY VALUATION BASES, METHODS AND MAIN ASSUMPTIONS

Note	Balance sheet item	Solvency II valuation principles for each material liability class
1	**Gross technical provisions (Best Estimate Liabilities and risk margin)**	**Valuation not consistent with IFRS.** Details regarding the valuation of technical provisions are covered in section D.2.
2	**Other technical provisions**	**Valuation not consistent with IFRS.** Only other technical provisions recognised in the IFRS financial statements, are reported in this line. For IFRS the 'Statutory account value' amount of £6,013k represents unallocated surplus which represents the excess of assets over the policyholder liabilities of the with-profit funds. This represents amounts which have yet to be allocated to shareholders since the unallocated surplus attributable to policyholders has been included within technical provisions. Unallocated surplus is classed as an accounting liability on the balance sheet.
3	**Provisions other than technical provisions**	**Valuation consistent with IFRS.** A provision is recognised when the Company has a present legal or constructive obligation, as a result of a past event, which is likely to result in an outflow of resources and where a reliable estimate of the amount of the obligation can be made. If the effect is material, the provision is determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. *The difference between the 'Solvency II value' amount and the 'Statutory account value' amount is a FCA thematic provision of £33,855k which has been recognised under Solvency II but not under IFRS.*
4	**Pension benefit obligations**	**Valuation consistent with IFRS.** The Company has a defined benefit staff pension scheme, the Company Staff Pension Scheme ('the Scheme'). The Scheme is administered by Abbey Life Trust Securities Limited. The pension scheme obligations are valued in accordance with the regulations which is consistent with the IFRS treatment (i.e. IAS19 Employee Benefits). See section D.3.4 for further information.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED
D.3 OTHER LIABILITIES CONTINUED
D.3.2 LIABILITY VALUATION BASES, METHODS AND MAIN ASSUMPTIONS CONTINUED

Note	Balance sheet item	Solvency II valuation principles for each material liability class
5	**Deferred tax liabilities**	**Valuation consistent with IFRS as amended by Solvency II adjustments.** Deferred tax is determined on temporary differences between the value of assets and liabilities on the Solvency II balance sheet and their tax base at the valuation date. The tax base is the value as determined under IFRS. This means that deferred tax is required to be provided on temporary differences between the IFRS and the Solvency II balance sheet. The valuation differences are identified between the IFRS and Solvency II balance sheets on a 'line by line' basis. Deferred tax is calculated, where appropriate, on these differences. *The difference between the 'Solvency II value' amount and 'Statutory account value' amount is a net increase in deferred tax liability of £12,527k. This represents an increase in deferred tax liabilities of £24,382k for a reduction in net technical provisions including risk margin from IFRS to Solvency II, offset by a decrease in deferred tax liabilities of £11,855k for the zero valuation under Solvency II for deferred acquisition costs.* Further details on the origin of the deferred tax liabilities are provided in section D.3.3.
6	**Derivatives**	**Valuation consistent with IFRS.** The fair values of over-the-counter derivative liabilities are estimated using pricing models, with inputs based on market-related data at the period end. The Company has derivatives which are valued using alternative valuation methods. Further details are included in section D.4.2. *The difference between the 'Solvency II value' and the 'Statutory account value' of £6,442k represents unit-linked derivative liabilities which are reported on their own line for IFRS, but under Solvency II, are included in 'Assets held for index-linked and unit-linked contracts'.*
7	**Insurance & intermediaries payables**	**Valuation consistent with IFRS except for deferred income.** These are short-term in nature and are valued at fair value, i.e. amounts payable on the balance sheet date. *The 'Solvency II value' is £70,921k lower than the 'Statutory accounts value' and represents deferred income which is recognised under IFRS but not under Solvency II.*
8	**Reinsurance payables**	**Valuation consistent with IFRS.** These are short-term in nature and are valued at fair value, i.e. amounts payable on the balance sheet date.
9	**Payables (trade not insurance)**	**Valuation consistent with IFRS.** The payables (trade not insurance) are short-term in nature and are valued at fair value. *The difference in Payables (trade not insurance) of £2,161k relates to £2,172k of index-linked and unit-linked payables that are reported as Payables under IFRS ('Statutory account value'), but for the 'Solvency II value' are reclassified to Assets held for index-linked and unit-linked contracts. The balance of £(11)k refers to other timing/valuation differences between the 'Solvency II value' and 'Statutory accounts value'.*

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.3 OTHER LIABILITIES CONTINUED

D.3.3 DEFERRED TAX LIABILITIES

The deferred tax liability on the Solvency II balance sheet of £60,323k is valued by reference to forecast future taxable profits and is comprised as shown in the table below:

Item	Deferred tax liability value £000	Further details
Unrealised investment gains and losses	35,449	Under IFRS and Solvency II, investments are valued at fair value and the deferred tax liability of £35,449k relates to unrealised gains and losses on investment assets that do not affect current year taxable profits and the tax base of the asset is not adjusted. The difference between the fair value of these investment assets and their tax base is a temporary difference and gives rise to a deferred tax liability.
IFRS transitional adjustments	481	This deferred tax liability relates to profits still to be brought into tax following the change to the basis of taxation for Life Companies from the PRA Regulatory Return to the IFRS Accounts from January 2013. The profits are brought into tax on a straight-line basis over a ten-year period ending in 2022.
Technical provisions	47,168	This deferred tax liability relates to the difference in valuation of net technical provisions between the IFRS 'Statutory account value' and 'Solvency II value' at the balance sheet date.
Risk margin	(22,775)	This is a specific 'Solvency II value' deferred tax asset that relates to the future tax deductions with respect to the risk margin. Further details on risk margin can be found in section D.2.
Total Solvency II deferred tax liabilities	**60,323**	

There are no unrecognised deferred tax liabilities at 31 December 2016.

D.3.4 PENSION SCHEME

D.3.4.1 Introduction

The Company sponsors a funded defined benefit pension plan for qualifying UK employees. The plan is administered by a separate board of Trustees which is legally separate from the Company. The Trustees are composed of representatives of both the employer and employees. The Trustees are required by law to act in the interest of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day-to-day administration of the benefits.

Under the plan, employees are entitled to annual pensions on retirement at age 62 of one-sixtieth of final pensionable salary for each year of service. Pensionable salary is defined as basic salary less the Basic State Pension. Benefits are also payable on death and following other events such as withdrawing from active service.

No other post-retirement benefits are provided to these employees.

The defined benefit obligation includes benefits for current employees, former employees and current pensioners. Broadly, about 5% of the liabilities are attributable to current employees, 59% to former employees and 36% to current pensioners.

The Scheme duration is an indicator of the weighted-average time until benefit payments are made. For the Scheme as a whole, the duration is around 18 years reflecting the approximate split of the defined benefit obligation between current employees (duration of 25 years), deferred members (duration of 21 years) and current pensioners (duration of 14 years).

UK legislation requires that pension schemes are funded prudently. The last funding valuation of the Scheme was carried out by a qualified actuary as at 31 March 2015 and showed a deficit of £106,900k. The Company is paying deficit contributions of £2,952k per annum which, along with an additional lump sum contribution of £15,000k and investment returns from return-seeking assets, is expected to make good this shortfall over a period of ten years. The next funding valuation is due no later than 31 March 2018 at which progress towards full-funding will be reviewed. The Company also pays contributions of 39.5% of pensionable salaries in respect of current accrual.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.3 OTHER LIABILITIES CONTINUED

D.3.4 PENSION SCHEME CONTINUED

D.3.4.2 Risks

The Scheme exposes the Company to a number of risks, the most significant of which are:

Risks	
Asset volatility	The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The Scheme holds a proportion of growth assets (equities) which, though expected to outperform corporate bonds in the long term, create volatility and risk in the short term. The allocation to growth assets is monitored to ensure it remains appropriate given the Scheme's long-term objectives.
Change in bond yields	A decrease in corporate bond yields will increase the value placed on the Scheme's liabilities for accounting purposes, although this will be partially offset by an increase in the value of the Scheme’s bond holdings.
Inflation risk	The majority of the Scheme’s benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The Scheme has hedged a significant proportion of its exposure to inflation meaning that an increase in inflation will also lead to an increase in the asset value.
Life expectancy	The majority of the Scheme’s obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension (‘GMP’). The UK Government intends to implement legislation which could result in an increase in the value of GMP for males. This would increase the defined benefit obligation of the plan. At this stage, it is not possible to quantify the impact of this change.

D.3.4.3 Assumptions

The results of the latest funding valuation at 31 March 2015 have been adjusted to the balance sheet date of 31 December 2016 taking account of experience over the period since 31 March 2015, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service cost, were measured using the Projected Unit Credit Method.

The principal assumptions used to calculate the liabilities under IAS 19 are set out below:

Main financial assumptions	31 December 2016 %
Retail Price Index Inflation	3.20
Consumer Price Index Inflation	2.20
Rate of general long-term increase in salaries	4.20
Pension increases (LP15)	3.05
Discount rate for scheme liabilities	2.70

The financial assumptions reflect the nature and term of the Scheme's liabilities.

Main demographic assumptions	31 December 2016 %
Mortality table adopted	100%/95% (male non-pensioners/pensioners) and 90% (female) of SAPS S2 ‘Light’, CMI2015 with long-term improvements of 1.25%
Life expectancy for male currently aged 65	23.7
Life expectancy for female currently aged 65	25.3
Life expectancy at 65 for male currently aged 45	25.0
Life expectancy at 65 for female currently aged 45	27.2
Cash commutation	Members assumed to exchange 15% of their pension for a cash lump sum at retirement

The mortality assumptions are based on the recent actual mortality experience analysis of Scheme members, and allow for expected future improvements in mortality rates.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED
D.3 OTHER LIABILITIES CONTINUED
D.3.4 PENSION SCHEME CONTINUED
D.3.4.4 Scheme assets, defined benefit obligation and Scheme fund status

The Scheme assets are invested in the following asset classes:

31 December 2016	£000	Percentage of total
Equities	24,488	10.4
Government bonds	115,411	48.9
Corporate bonds	122,719	51.9
Derivatives	(35,479)	(15.1)
Cash and cash equivalents	9,331	3.9
Total	**236,470**	**100**

All Scheme assets are quoted other than derivatives which are not quoted in an active market.

The present value of funded defined benefit obligations as at 31 December 2016 is £323,704k. The amount recognised on the Solvency II balance sheet is set out below:

Reconciliation of funded status to balance sheet value 31 December 2016	£000
Fair value of Scheme assets	236,470
Present value of funded defined benefit obligations	(323,704)
Funded status	(87,234)
Asset/(liability) recognised on the balance sheet	(87,234)

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED

D.4 ALTERNATIVE METHODS FOR VALUATION

This section provides information on alternative valuation methods employed by the Company in calculating the 'Solvency II value' of certain assets and liabilities. Further information is provided below on the amount of the 'Solvency II value', justification for the use of alternative valuation methods, the assumptions underlying this approach and an assessment of the valuation uncertainty.

D.4.1 ALTERNATIVE VALUATION METHODS — ASSETS

Some of the Company's financial instruments are valued using alternative valuation methods, which use a combination of observable and non-observable market inputs. A summary of assets, justification and assumptions are presented below:

Asset	Solvency II value £000	Alternative valuation method	Justification	Assumption
Property (other than for own use)	7,085	Royal Institute of Chartered Surveyor ('RICS') Appraisal and Valuation Manual.	Accepted market practice.	As per RICS valuation manual and professional judgement of independent valuers.
Corporate bonds	14,336	Income approach, which converts future amounts, such as cash flows or income or expenses, to a single current amount. The fair value shall reflect current market expectations about those future amounts. Valuation techniques consistent with the income approach include present value techniques, option pricing models and the multi-period excess earnings method.	Accepted market practice.	Consist of two bonds Winchester Street PLC and Intercontinental Hotel. Winchester Street PLC has a pool of underlying mortgages and is valued by discounting the expected mortgage payments and associated costs. The expected cash flows are modelled using assumptions for prepayments, defaults and recoveries. Intercontinental Hotel is valued by applying a price of 100% to the outstanding loan amount. This has been shown to produce an internal rate of return broadly similar to bonds of a similar term and credit rating.
Derivatives	47,012	Market approach, which uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or group of assets and liabilities. Valuation techniques consistent with the market approach include matrix pricing. Combination of observable and non-observable market inputs including modelling.	Accepted market practice.	Each swaption defines an option for the Company to pay the counterparty Deutsche Bank ('DB') a fixed series of cash flows in return for DB paying the Company a set of cash flows determined by the then current rate of LIBOR. These are referred to as the fixed and floating legs of the swap. At any point in time the value of the swaption is determined by valuing the net value of the two legs. A DB valuation of the swaptions is produced daily. The valuation is determined by a model which uses market data to produce the present value of the fixed leg payable and of the floating leg receivable. The value of the fixed leg is given by the present value of the fixed coupon payments known at the start of the swaption, i.e. for each payment date in each contract: Nominal x Fixed Rate x Discount Factor. The nominal amount and the fixed rates are those set out in each contract. A swap curve, based on market data as at the valuation date, is used to discount each payment on each payment date. The value of the floating leg is given by the present value of the floating coupon payments determined at the agreed dates of each payment. However, the floating rates are unknown. The rate for each floating payment date is calculated using forward swap curves based on market data as at the valuation date, i.e. Nominal x Floating Rate x Discount Factor. The nominal amount and the source of the floating rate are those set out in each contract. A swap curve, as at the valuation date, is used to determine the floating rate at each payment date.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED
D.4 ALTERNATIVE METHODS FOR VALUATION CONTINUED
D.4.1 ALTERNATIVE VALUATION METHODS — ASSETS CONTINUED

Asset	Solvency II value £000	Alternative valuation Method	Justification	Assumption
Derivatives continued				A second valuation is provided daily by State Street Bank. This acts as an independent check of the DB valuation. A spreadsheet is also maintained by the Company which can produce a third valuation. This is used to provide a separate valuation of the swaptions in the event that the DB and State Street values differ, and also to produce stressed valuations when required. It should be recognised that the value placed on the swaptions is very sensitive to small changes in the swap curve. Therefore it is not unusual to see a different value from each valuation tool. The Company generally uses the DB value as the definitive valuation unless the other two valuations produce a significantly different number and there is some doubt over the DB valuation.
	68,433			

Valuation uncertainty on the alternative methods of valuation is the possibility that the estimated value may differ from the price that could be obtained in a transfer of the same asset or liability taking place at the same time under the same terms and within the same market environment. A market valuation is an estimate of the most probable of a range of possible outcomes based on the assumptions made in the valuation process. However, even where assets are identical and exchanged in contemporaneous transactions, fluctuations in the prices agreed between different transactions can often be observed. These fluctuations can be caused by factors such as differences in the objectives, knowledge or motivation of the parties. Consequently, an element of uncertainty is inherent in most market valuations as there is rarely a single price with which the valuation can be compared. In some cases the degree of uncertainty is clearly negligible, for example where the valuation is made by reference to concurrent prices for identical assets in the same market, as in the case of publicly listed and frequently traded securities. In others, uncertainty may be immaterial in the context of the market for a particular asset or the valuation assignment because it falls within the range that would be expected, and accepted, by most market participants. Such uncertainty should not be a source of concern to users or need specific disclosure by the valuer.

The Company is of a view that the alternative methods of valuation employed in valuing the investment assets above and liabilities below fall within a range that would be expected and accepted by most market participants.

SECTION D
Continued

VALUATION FOR SOLVENCY PURPOSES CONTINUED
D.4 ALTERNATIVE METHODS FOR VALUATION CONTINUED
D.4.2 ALTERNATIVE VALUATION METHODS – LIABILITIES

As outlined in section D.4 the Company uses alternative valuation techniques using non-observable market inputs for certain financial liabilities.

Asset	Solvency II value £000	Alternative valuation method	Justification	Assumption
Derivatives	21,418	Market approach, which uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or group of assets and liabilities. Valuation techniques consistent with the market approach include matrix pricing. Combination of observable and non-observable market inputs including modelling.	Accepted market practice.	The cash flow swaps define a commitment for the Company to pay the counterparty Deutsche Bank ('DB') the total of a number of series of cash flows, in exchange for differently shaped series of cash flows. At any point in time the value of the swaps is determined by valuing the net value of the two legs, based exclusively on market data for forward rates of inflation (observable from differences between real and nominal forward interest rates) and discounting on a swap curve ('SONIA'). The basis for settlement value of the swap at any time is contractually specified and consistent with the valuation approach described above. DB provides daily valuations of the swap to the Company. In respect of any given valuation day the Company is able to observe (on request) and validate the implied inflation rates and discounting factors applied by DB in its valuation. Model Risk and Analytics reviewed the model and their sign-off is recorded on the DB internal New Trade Approval system. In relation to derivatives non-observable third party evidence in the form of net asset valuation statements are used as the basis for the valuation. Adjustments may be made to the net asset valuation where other evidence, for example recent sales of the underlying investments in the fund, indicates this is required.

D.5 ANY OTHER INFORMATION

There is no further material information to be disclosed regarding the valuation of assets and liabilities for solvency purposes.

SECTION E

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SECTION E

CAPITAL MANAGEMENT

E.1 OWN FUNDS

This section provides information on the Company's Own Funds, including changes over the reporting period, the SCR and explanation of material differences between equity under IFRS and the excess of assets over liabilities for solvency purposes.

E.1.1 MANAGEMENT OF OWN FUNDS

Following the implementation of the regulations from 1 January 2016, the Company's capital is managed on a Solvency II basis.

A Solvency II capital assessment involves valuation in line with Solvency II principles of the Company's Own Funds and a risk-based assessment of the Company's SCR. Solvency II surplus is the excess of Eligible Own Funds over the SCR.

The Company holds an amount of Eligible Own Funds that is greater than the SCR to allow for adverse events in the future that may use capital and might otherwise cause the Company to fail the minimum level of regulatory capital, the Minimum Capital Requirement ('MCR').

For the management of Own Funds, the Company adheres to a capital management framework that is consistent across the Group.

The Capital Management Framework for managing Own Funds is designed to achieve the following objectives:

- Provide appropriate security for policyholders and meet all regulatory capital requirements while not retaining unnecessary excess capital.
- Ensure sufficient liquidity to meet obligations to policyholders and other creditors.
- Optimise the overall financial leverage ratio to maintain an investment grade credit rating.
- Meet the dividend expectations of shareholders.

The Group and its insurance subsidiaries operate under a suite of capital management policies that govern the allocation of capital throughout the Group to achieve the framework objectives under a range of stress conditions. The policy suite considers policyholder security, creditor obligations, dividend policy and regulatory capital requirements. There have been no material changes to the Group's policy suite over the reporting period

A liquidity policy is set by the Board and monitored at both the executive and Board level. The policy ensures sufficient liquidity to meet creditor and dividend obligations through the combination of cash buffers and cash flows. Volatility in the latter is monitored at the executive and Board level through stress and scenario testing. Where cash flow volatility is judged to be in excess of the Board's risk appetite, de-risking activities are undertaken. Also see section C.4 on liquidity risk.

A capital policy is also set by the Board and monitored by management on a weekly basis, to ensure there is sufficient capital to meet the SCR under a range of stress conditions at a 1-in-10 level. The capital policy is managed according to the risk profile and financial strength of the Company.

The Company's future performance is projected over a five-year planning horizon as part of the Annual Operating Plan ('AOP') process.

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED

E.1 OWN FUNDS CONTINUED

E.1.2 STRUCTURE AND QUALITY OF OWN FUNDS

The Company's Own Funds consists entirely of Tier 1 – unrestricted Own Fund items. There are no Tier 1 – restricted, Tier 2 or Tier 3 Own Fund items.

The table below summarises the Company's Own Funds at 31 December 2016. The Own Funds QRT S.23.01.01 can also be found in Appendix 1.6.

	Note	31 December 2016 £000
Ordinary share capital	1	30,500
Share premium account related to ordinary share capital	1	253,619
Surplus funds	1	47
Reconciliation reserve	1 & 2	731,151
Total Basic Own Funds after deductions		**1,015,317**
Total Available and Eligible Own Funds to meet the Solvency Capital Requirement	3	**1,015,317**
Solvency Capital Requirement	4	(484,272)
Solvency II surplus		531,045
Ratio of Eligible Own Funds to Solvency Capital Requirement	7	210%
Total Available and Eligible Own Funds to meet the Minimum Capital Requirement	5	**1,015,317**
Minimum Capital Requirement	6	(121,068)
Excess over Minimum Capital Requirement		894,249
Ratio of Eligible Own Funds to Minimum Capital Requirement	7	839%

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED
E.1 OWN FUNDS CONTINUED
E.1.2 STRUCTURE AND QUALITY OF OWN FUNDS CONTINUED

Note	Own Fund item	Information
1	**Tier 1 – Unrestricted**	The Company's ordinary share capital, share premium account related to ordinary share capital, surplus funds and reconciliation reserve comply with the characteristics and features of Tier 1 unrestricted Own Funds as set out in the regulations. There are no movements in ordinary share capital and share premium account related to ordinary share capital for the financial period 1 January 2016 to 31 December 2016.
2	**Reconciliation reserve**	See table below. There are no deductions for restricted assets of ring-fenced funds, matching adjustment portfolio, encumbrances or foreseeable dividends.
3	**Total Available and Eligible Own Funds to meet the Solvency Capital Requirement**	As the Company's Available Own Funds consists wholly of Tier 1 – unrestricted Own Funds, these are not subject to any quantitative limits and the full amount can be recognised as Eligible Own Funds to meet the SCR. See section E1.3 for Analysis of change in Eligible Own Funds.
4	**Solvency Capital Requirement**	See section E1.3 for Analysis of change in SCR. See section E.2.1.
5	**Total Available and Eligible Own Funds to meet the Minimum Capital Requirement**	As the Company's Available Own Funds consists wholly of Tier 1 – unrestricted Own Funds, these are not subject to any quantitative limits and the full amount can be recognised as Eligible Own Funds to meet the MCR.
6	**Minimum Capital Requirement**	See section E.2.2.
7	**Solvency ratios**	Other than the Eligible Own Funds to SCR ratio and Eligible Own Funds to MCR ratio, the Company calculates no additional ratios.

The key elements of the reconciliation reserve	31 December 2016 £000
Excess of assets over liabilities – Solvency II value	1,015,317
Deduct	
Ordinary share capital	(30,500)
Share premium account related to ordinary share capital	(253,619)
Surplus funds	(47)
Reconciliation reserve	**731,151**

The Company has no items that are deducted from Basic Own Funds, no Basic Own-Fund items subject to transitional arrangements and no ancillary Own Funds.

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED

E.1 OWN FUNDS CONTINUED

E.1.3 ANALYSIS OF MOVEMENT IN CAPITAL POSITION

The table below provides an analysis of significant changes in the capital position during the year, including Eligible Own Funds, SCR and Solvency II surplus.

Analysis of movement	Note	Eligible Own Funds £000	Solvency Capital Requirement £000	Solvency II surplus £000
Opening position at 1 January 2016 – unaudited		**1,056,312**	**(439,468)**	**616,844**
New business	1	25,896	(7,301)	18,595
Experience variances (including changes to demographic assumptions)	2	(44,137)	(5,482)	(49,619)
Model and methodology changes	3	(19,309)	(2,435)	(21,744)
Economic variances	4	38,444	(69,991)	(31,547)
Shareholder investment return/de-risk shareholder fund	5	(5,189)	40,405	35,216
Pension funding and hedge	6	(36,700)	–	(36,700)
Closing position at 31 December 2016		**1,015,317**	**(484,272)**	**531,045**

Note	Item	Explanation
1	**New business**	**Eligible Own Funds:** The Company has written new insurance business which has increased Eligible Own Funds by £25,896k, with £16,842k arising from the longevity insurance contract with the Manweb Scheme and £9,054k from the new business arising from pension annuity contracts sold to existing policyholders. **SCR:** The new longevity swap with Manweb has increased SCR by £2,202k and new annuity sales to maturing pensions have increased SCR by £5,099k.
2	**Experience variances (including changes to demographic assumptions)**	**Eligible Own Funds:** The principal changes in the Eligible Own Funds of £(44,137k) arose from the following experience variances: – longevity / mortality basis change £(11,904k); – fixed expenses/additional integration costs £(20,032k); – VAT on investment expenses £(1,942k); and – inflation in 2016 higher than expected on expenses and index-linked annuities £(18,100k). **SCR:** The following experience variances have impacted SCR: – Assumption changes have reduced SCR by £2,820k; and – Changes to expenses have increased SCR by £2,168k.
3	**Model and methodology changes**	**Eligible Own Funds:** Changes to the Eligible Own Funds of £(19,309)k were due principally to the following model and methodology changes: – limit exit charges on pension contracts to 1% £(17,916)k; – MA calculation methodology £38,189k; and – FCA thematic provision of £(33,855)k. **SCR:** The SCR has been impacted by the changes to exit charges of £7,418k, by the refinement of calculation of the SCR for pension transfers and opt outs of £2,200k and the change in the MA calculation methodology of £684k. There is also a £6,971k increase in SCR as a result of the run-off of the equity transitional arrangement.

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED
E.1 OWN FUNDS CONTINUED
E.1.3 ANALYSIS OF MOVEMENT IN CAPITAL POSITION CONTINUED

Note	Item	Explanation
4	**Economic variances**	**Eligible Own Funds:** Economic variances have contributed £38,444k increase in Eligible Own Funds. This reflects the impact of reducing yields on the returns earned on the assets and the consequent change in the valuation of the liabilities. **SCR:** The SCR was impacted by the fall in the yield curve over the year and the change in the Matching Adjustment applied to the MA Portfolio.
5	**Shareholder investment return/de-risk shareholder fund**	**Eligible Own Funds:** The shareholders' negative net investment return of £5,189k reflects the Company's decision to de-risk its exposure to equities by dis-investing in equities in February 2016 and investing in a money market fund. **SCR:** The SCR was impacted by the decision to de-risk the shareholder fund as described above.
6	**Pension funding and hedge**	**Eligible Own Funds:** The pension benefit plan actuarial loss of £33,627k is due to a significant fall in interest rates over the year. There was an additional impact of £3,072k. Further information on the Pension Scheme is available in section D.3.4.

E.1.4 RECONCILIATION OF IFRS EQUITY TO SOLVENCY II VALUE EXCESS OF ASSETS OVER LIABILITIES

The table below provides an analysis of the key differences between the Company's equity under IFRS and the 'Solvency II value' excess of assets over liabilities.

Reconciliation of IFRS equity to 'Solvency II value' excess of assets over liabilities as at 31 December 2016

	Section	£000	£000
Total equity under IFRS			**794,826**
Valuation differences:			
Assets increase/(decrease):	D.1.1		
Intangible assets – Investment contract deferred acquisition costs	D.1.2	(73,868)	
Deferred tax assets	D.1.2	(5,065)	
Reinsurance recoverables	D.2.2	(1,114,312)	
Receivables – Prepayments	D.1.2	(3,013)	
Total asset valuation differences	D.1.1		(1,196,258)
Liabilities (increase)/decrease:	D.3.1		
Changes to Technical Provisions	D.2.2	1,386,208	
Other technical provisions (unallocated surplus)	D.3.2	6,013	
Provisions other than technical provisions	D.3.2	(33,855)	
Deferred tax liabilities	D.3.2	(12,527)	
Insurance & intermediaries payables	D.3.2	70,921	
Payables (trade, not insurance)	D.3.2	(11)	
Total liability valuation differences	D.3.1		1,416,749
'Solvency II value' excess of assets over liabilities	E.1.2		**1,015,317**

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED

E.2 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT

E.2.1 SOLVENCY CAPITAL REQUIREMENT

The Company's SCR is calculated in accordance with the Standard Formula and the position as at 31 December 2016 is presented below:

	Note	31 December 2016 £000	Percentage of undiversified Solvency Capital Requirement
Market risk	1	335,911	55
Underwriting risk	2 & 3	242,574	40
Operational risk	4	21,254	4
Credit risk	5	6,522	1
Undiversified Solvency Capital Requirement		**606,261**	**100**
Diversification	6	(110,724)	
Loss-absorbing capacity of deferred taxes	7	(11,265)	
Solvency Capital Requirement		**484,272**	

The final amount of the SCR is still subject to supervisory assessment. There are no capital add-ons and the Company has not applied to use undertaking specific parameters when calculating the life and health underwriting risk modules.

Note	Risk module	Information
1	**Market risk**	The risk arising from the level or volatility of market prices of financial instruments which have an impact upon the value of the assets and liabilities of the Company. It reflects the structural mismatch between assets and liabilities, in particular to the duration thereof and calculates the sensitivity of the values of assets, liabilities and financial instruments to changes in: (a) The term structure of interest rates, or in the volatility of interest rates (interest rate risk); (b) The level or in the volatility of market prices of equities (equity risk); (c) The level or in the volatility of market prices of real estate (property risk); (d) The level or in the volatility of credit spreads over the risk-free interest rate term structure (spread risk); (e) The level or in the volatility of currency exchange rates (currency risk); and (f) Additional risks to the Company stemming either from lack of diversification in the asset portfolio or from large exposure to default risk by a single issuer of securities or a group of related issuers (market risk concentrations).
2	**Life underwriting risk**	The risk of loss, or of adverse change in the value of insurance liabilities resulting from changes in the level, trend or volatility of: (a) Mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance liabilities (mortality risk); (b) Mortality rates, where a decrease in the mortality rate leads to an increase in the value of insurance liabilities (longevity risk); (c) Disability, sickness and morbidity rates (disability – morbidity risk); (d) Expenses incurred in servicing insurance or reinsurance contracts (life-expense risk); (e) The rates of policy lapses, terminations, renewals and surrenders (lapse risk); and (f) Pricing and provisioning assumptions related to extreme or irregular events (life-catastrophe risk).

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED

E.2 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT CONTINUED

E.2.1 SOLVENCY CAPITAL REQUIREMENT CONTINUED

Note	Risk module	Information
3	**Health underwriting risk**	The risk arising from the underwriting of health insurance obligations, and covers at least the risk of loss or of adverse change in the value of insurance liabilities resulting from: (a) Changes in the level, trend, or volatility of the expenses incurred in servicing insurance or reinsurance contracts; (b) Fluctuations in the timing, frequency and severity of insured events, and in the timing and amount of claim settlements at the time of provisioning; and (c) Significant uncertainty of pricing and provisioning assumptions related to outbreaks of major epidemics, as well as the unusual accumulation of risks under such extreme circumstances.
4	**Operational risk**	Includes the following: (a) Operational risks that are not already reflected in the risk modules referred to above; (b) With respect to life insurance contracts where the investment risk is borne by the policyholders, the calculation of the capital requirement for operational risk takes into account the amount of annual expenses incurred in respect of those insurance obligations; and (c) With respect to balance of the operations not covered by paragraph (b) above, the calculation of the capital requirement for operational risk shall take account of the volume of those operations, in terms of technical provisions which are held in respect of those insurance and reinsurance obligations. In this case, the capital requirement for operational risks shall not exceed 30 % of the Basic Solvency Capital Requirement relating to those insurance and reinsurance operations.
5	**Credit Risk**	Possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of the Company over the following 12 months. The counterparty default risk module covers risk-mitigating contracts, such as reinsurance arrangements, securitisations and derivatives, and receivables from intermediaries, as well as any other credit exposures which are not covered in the spread risk sub-module. It takes appropriate account of collateral or other security held by or for the account of the Company and the risks associated therewith. A simplified method is used to calculate the counterparty default adjustment. The simplified calculation applies a best estimate probability of reinsurer default to the difference between the reinsured BEL and any collateral held under the arrangement. Further adjustments are then made to reflect the recovery rate from the reinsurer in excess of the collateral and the average duration of liabilities transferred.
6	**Diversification**	Reduction in the risk exposure of the Company relating to the diversification of its business, resulting from the fact that the outcome from one risk can be offset by a more favourable outcome from another risk, where those risks are not fully correlated.
7	**Loss-absorbing capacity of deferred tax**	The adjustment for the loss-absorbing capacity of deferred taxes shall reflect potential compensation of unexpected losses through a simultaneous decrease in deferred taxes. The loss-absorbing capacity of deferred taxes is limited to the amount of the deferred tax balance on the Solvency II balance sheet.

SECTION E
Continued

CAPITAL MANAGEMENT CONTINUED

E.2 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENT CONTINUED

E.2.2 MINIMUM CAPITAL REQUIREMENT

As reported in section E.1.2, the Company's MCR as at 31 December 2016 is £121,068k.

The MCR is calculated as a linear function using the net best estimate liabilities and net capital at risk in accordance with the regulations.

The MCR is subject to a floor of 25% of the SCR or EUR 3,700k whichever is higher and a cap of 45% of the SCR.

Information on the inputs used by the Company to calculate MCR is as follows:

	Note	31 December 2016 £000
Linear Minimum Capital Requirement on net best estimate liabilities	1	99,203
Linear Minimum Capital Requirement on net total capital at risk		1,352
Linear Minimum Capital Requirement – Total		100,555
Solvency Capital Requirement	2	484,272
Minimum Capital Requirement cap (45% of Solvency Capital Requirement)	2	217,922
Minimum Capital Requirement floor (higher of 25% of SCR or EUR 3,700k)	2	121,068
Minimum Capital Requirement (post application of floor and cap)		121,068

The MCR at 31 December 2016 is based on the floor of 25% of SCR; hence the change in SCR is the driver for the changes in MCR.

Note	Risk module	Information
1	**Linear Minimum Capital Requirement on net best estimate liabilities**	The increase in Linear MCR on net best estimate liabilities is principally due to an overall increase in net technical provisions.
2	**Solvency Capital Requirement and Minimum Capital Requirement**	See section E.2.1 for change in SCR. Changes in MCR floor and cap are directly correlated to the SCR.

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

The use the equity risk sub-module in the calculation of the SCR is not employed by the Company. The UK has not implemented the member state option in the regulations to permit the use of this sub-module for the Standard Formula calculation.

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

Not applicable to the Company as the Standard Formula is used.

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

The Company held Own Funds in excess of both the SCR and MCR throughout the reporting period. As part of the Group's RMF various controls are in place ensuring continuing compliance with the SCR and MCR.

E.6 ANY OTHER INFORMATION

There is no further material information to be disclosed regarding the Company's Own Funds and SCR.

APPENDIX AND ADDITIONAL INFORMATION

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Glossary	**100**
Appendix 1 – Quantitative Reporting Templates	**102**

APPENDIX AND ADDITIONAL INFORMATION

GLOSSARY

ALM	Asset Liability Management – Management of mismatches between assets and liabilities within risk appetite
AOP	Annual Operating Plan – The Company's 5 year strategic plan approved by the Board
BEST ESTIMATE LIABILITY	Best Estimate Liability ('BEL') – The probability weighted average of future cash flows, taking into account of the time value of money (expected present value of future cash-flows), using the relevant interest rate term structure and taking into account economic and non-economic assumptions
BLACK-SCHOLES	A mathematical model used to calculate the value of an option
CLOSED LIFE FUND	A fund that no longer accepts new business. The fund continues to be managed for the existing policyholders
EIOPA	European Insurance and Occupational Pensions Authority
FAIR VALUE	The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction
FCA	Financial Conduct Authority – The body responsible for supervising the conduct of all financial services firms and for the prudential regulation of those financial services firms not supervised by the Prudential Regulation Authority ('PRA'), such as asset managers and independent financial advisers
IFRS	International Financial Reporting Standards – Accounting standards, interpretations and the framework adopted by the International Accounting Standards Board
INTERNAL MODEL	The agreed methodology and model, approved by the PRA, to calculate the Solvency Capital Requirement pursuant to Solvency II
LINE OF BUSINESS	The applicable lines of business as prescribed by Annex I of Commission Delegated Regulation (EU) 2015/35
LONG TERM GUARANTEE MEASURES	Are the extrapolation of risk-free interest rates, the Matching Adjustment, the Volatility Adjustment, the extension of the recovery period in case of non-compliance with the SCR, the transitional measures on the risk-free interest rates and the transitional measure on technical provisions
LTIP	Long-Term Incentive Plan – The part of an executive's remuneration designed to incentivise long-term value for shareholders through an award of shares with vesting contingent on employment and the satisfaction of stretching performance conditions linked to Group strategy
MSA	Management Service Agreement – Contracts that exist between the Phoenix Life and management services companies or between management services companies and their outsource partners
MATCHING ADJUSTMENT ('MA')	An allowance, subject to PRA's approval that allows insurers to use a higher discount rate, based on the underlying assets, when valuing liabilities that meet strict eligibility criteria.
OPERATING PROFIT	Operating profit is non-GAAP measure that is considered a more representative measure of performance than IFRS profit or loss after tax as it provides long-term performance information unaffected by short term economic volatility
OWN FUNDS	Basic Own Funds comprise the excess of assets over liabilities valued in accordance with the Solvency II principles and subordinated liabilities which qualify to be included in Own Funds under the Solvency II rules. Eligible Own Funds are the amount of Own Funds that are available to cover the Solvency Capital Requirements after applying prescribed quantitative limits and transferability and fungibility restrictions to Basic Own Funds
PARTIAL INTERNAL MODEL	A methodology of calculating SCR partially on an approved Internal Model basis and partially on a Standard Formula basis,
PART VII TRANSFER	The transfer of insurance policies under Part VII of FSMA 2000. The insurers involved can be in the same corporate group or in different groups. Transfers require the consent of the High Court, which will consider the views of the PRA and FCA and of an Independent Expert
PRA	Prudential Regulation Authority – The body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA and FCA use a Memorandum of Understanding to co-ordinate and carry out their respective responsibilities

APPENDIX AND ADDITIONAL INFORMATION
Continued

GLOSSARY CONTINUED

PPFM	Principles and Practices of Financial Management – A publicly available document which explains how the Company's with-profit business is run. As part of demonstrating that customers are treated fairly, the Board certifies that the PPFM has been complied with
RISK MARGIN	The amount used to ensure that the value of the technical provisions is equivalent to the amount that a Life Company would be expected to require in order to take over and meet insurance and reinsurance obligations
SOLVENCY II	A new regime for the prudential regulation of European insurance companies that came into force on 1 January 2016
SOLVENCY II SURPLUS	The excess of Eligible Own Funds over the Solvency Capital Requirement
SOLVENCY CAPITAL REQUIREMENT ('SCR')	SCR relates to risks and obligations to which the Company is exposed and calibrated so that the likelihood of a loss exceeding the SCR is less than 0.5% over one year. This ensure that capital is sufficient to withstand a broadly '1-in-200' event
STANDARD FORMULA	A set of calculations prescribed by the regulations for generating the SCR
TECHNICAL PROVISIONS	The sum of the Best Estimate Liabilities and the Risk Margin
TRANSITIONAL MEASURE ON TECHNICAL PROVISIONS	Transitional Measures on Technical Provisions ('TMTP') is an allowance, subject to the PRA's approval, to apply a transitional deduction to technical provisions. The transitional deduction corresponds to the difference between net technical provisions calculated in accordance with Solvency II principals and net technical provisions calculated in accordance with the previous regime. It is expected to decrease linearly over a period of 16 years starting from 1 January 2016 to 1 January 2032

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 – QUANTITATIVE REPORTING TEMPLATES

This report has been prepared in conjunction with the following Quantitative Reporting Templates ('QRT'), which are included below:

- S.02.01.02 Balance sheet.
- S.05.01.02 Premiums, claims and expenses by Line of Business.
- S.05.02.01 Premiums, claims and expenses by country.
- S.12.01.02 Life and Health SLT Technical Provisions.
- S.22.01.21 Impact of long term guarantees and transitional measures.
- S.23.01.01 Own Funds.
- S.25.01.21 SCR – for undertakings on Standard Formula; and
- S.28.01.01 MCR – only life or only non-life insurance or reinsurance activity.

All public disclosure QRTs shown in the Appendices are presented in sterling (£) rounded to the nearest thousands.

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.1 — S.02.01.02 BALANCE SHEET QRT

		Solvency II value
Assets		**C0010**
Intangible assets	R0030	
Deferred tax assets	R0040	23,764
Pension benefit surplus	R0050	
Property, plant & equipment held for own use	R0060	
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	3,575,837
Property (other than for own use)	R0080	7,085
Holdings in related undertakings, including participations	R0090	1,752
Equities	R0100	
Equities – listed	R0110	
Equities – unlisted	R0120	
Bonds	R0130	2,694,826
Government Bonds	R0140	975,252
Corporate Bonds	R0150	1,532,459
Structured notes	R0160	
Collateralised securities	R0170	187,115
Collective Investments Undertakings	R0180	820,336
Derivatives	R0190	51,837
Deposits other than cash equivalents	R0200	
Other investments	R0210	
Assets held for index-linked and unit-linked contracts	R0220	7,503,345
Loans and mortgages	R0230	503
Loans on policies	R0240	311
Loans and mortgages to individuals	R0250	
Other loans and mortgages	R0260	192
Reinsurance recoverables from:	R0270	(582,352)
Non-life and health similar to non-life	R0280	
Non-life excluding health	R0290	
Health similar to non-life	R0300	
Life and health similar to life, excluding health and index-linked and unit-linked	R0310	(616,227)
Health similar to life	R0320	3,176
Life excluding health and index-linked and unit-linked	R0330	(619,403)
Life index-linked and unit-linked	R0340	33,876
Deposits to cedants	R0350	
Insurance and intermediaries receivables	R0360	7,681
Reinsurance receivables	R0370	2,797
Receivables (trade, not insurance)	R0380	40,598
Own shares (held directly)	R0390	
Amounts due in respect of Own Fund items or initial fund called up but not yet paid in	R0400	
Cash and cash equivalents	R0410	20,091
Any other assets, not elsewhere shown	R0420	
Total assets	R0500	10,592,265

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 – QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.1– S.02.01.02 BALANCE SHEET QRT CONTINUED

		Solvency II value
Liabilities		**C0010**
Technical provisions – non-life	R0510	
Technical provisions – non-life (excluding health)	R0520	
TP calculated as a whole	R0530	
Best estimate	R0540	
Risk margin	R0550	
Technical provisions – health (similar to non-life)	R0560	
TP calculated as a whole	R0570	
Best estimate	R0580	
Risk margin	R0590	
TP – life (excluding index-linked and unit-linked)	R0600	1,745,327
Technical provisions – health (similar to life)	R0610	17,269
TP calculated as a whole	R0620	
Best estimate	R0630	16,869
Risk margin	R0640	400
TP – life (excluding health and index-linked and unit-linked)	R0650	1,728,058
TP calculated as a whole	R0660	
Best estimate	R0670	1,643,814
Risk margin	R0680	84,244
TP – index-linked and unit-linked	R0690	7,474,649
TP calculated as a whole	R0700	
Best estimate	R0710	7,382,005
Risk margin	R0720	92,644
Contingent liabilities	R0740	
Provisions other than technical provisions	R0750	39,186
Pension benefit obligations	R0760	87,234
Deposits from reinsurers	R0770	
Deferred tax liabilities	R0780	60,324
Derivatives	R0790	26,266
Debts owed to credit institutions	R0800	
Financial liabilities other than debts owed to credit institutions	R0810	
Insurance & intermediaries payables	R0820	119,145
Reinsurance payables	R0830	1,540
Payables (trade, not insurance)	R0840	23,278
Subordinated liabilities	R0850	
Subordinated liabilities not in BOF	R0860	
Subordinated liabilities in BOF	R0870	
Any other liabilities, not elsewhere shown	R0880	
Total liabilities	R0900	9,576,949
Excess of assets over liabilities	R1000	1,015,317

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.2 — S.05.01.02 PREMIUMS, CLAIMS AND EXPENSE BY LINE OF BUSINESS QRT

		Line of Business for: life insurance obligations						Life reinsurance obligations		
		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	Total
		C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
Premiums written										
Gross	R1410	1,306	170	62,877	61,142				82,903	208,398
Reinsurers' share	R1420	781	22	1,024	20,613				81,839	104,278
Net	R1500	525	148	61,853	40,529				1,064	104,119
Premiums earned										
Gross	R1510	1,306	170	62,877	61,142				82,903	208,398
Reinsurers' share	R1520	781	22	1,024	20,613				81,839	104,278
Net	R1600	525	148	61,853	40,529				1,064	104,119
Claims incurred										
Gross	R1610	2,323	5,658	675,380	188,087				40,677	912,126
Reinsurers' share	R1620	1,287	0	3,666	627				40,658	46,237
Net	R1700	1,036	5,658	671,714	187,460				20	865,889
Changes in other technical provisions										
Gross	R1710									0
Reinsurers' share	R1720									0
Net	R1800									0
Expenses incurred	R1900	241	48	36,291	13,317					49,897
Other expenses	R2500									
Total expenses	R2600									49,897

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.3 — S.05.02.01 PREMIUMS, CLAIMS AND EXPENSES BY COUNTRY

		Total Top 5 and home country	Home Country
		C0210	C0150
	R1400		United Kingdom
		C0280	C0220
Premium written			
Gross	R1410	208,398	208,398
Reinsurers' share	R1420	104,278	104,278
Net	R1500	104,119	104,119
Premium earned			
Gross	R1510	208,398	208,398
Reinsurers' share	R1520	104,278	104,278
Net	R1600	104,119	104,119
Claims paid			
Gross	R1610	912,126	912,126
Reinsurers' share	R1620	46,237	46,237
Net	R1700	865,889	865,889
Changes in other technical provisions			
Gross	R1710	0	
Reinsurers' share	R1720	0	
Net	R1800	0	
Expenses incurred	R1900	49,897	49,897
Other expenses	R2500		
Total expenses	R2600	49,897	

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 – QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.4 – S.12.01.02 LIFE AND HEALTH SLT TECHNICAL PROVISIONS

			Index-linked and unit-linked insurance		
		Insurance with profit participation		Contracts without options and guarantees	Contracts with options or guarantees
		C0020	C0030	C0040	C0050
Technical provisions calculated as a whole	R0010				
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0020				
Technical provisions calculated as a sum of BE and RM					
Best Estimate					
Gross Best Estimate	R0030	40,245		7,030,875	351,130
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080	2,604		33,876	0
Best estimate minus recoverables from reinsurance/SPV and Finite Re	R0090	37,641		6,996,999	351,130
Risk Margin	R0100	315	92,644		
Amount of the transitional on Technical Provisions					
Technical Provisions calculated as a whole	R0110				
Best estimate	R0120				
Risk margin	R0130				
Technical provisions – total	R0200	40,561	7,474,649		

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.4 — S.12.01.02 LIFE AND HEALTH SLT TECHNICAL PROVISIONS CONTINUED

		Other life insurance				Accepted reinsurance	
			Contracts without options and guarantees	Contracts with options or guarantees	Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations		Total (Life other than health insurance, incl. Unit-Linked)
		C0060	C0070	C0080	C0090	C0100	C0150
Technical provisions calculated as a whole	R0010						0
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0020						0
Technical provisions calculated as a sum of BE and RM							
Best Estimate							
Gross Best Estimate	R0030		1,665,198	29,879		(91,509)	9,025,819
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080		(577,804)	7,083		(51,286)	(585,528)
Best estimate minus recoverables from reinsurance/SPV and Finite Re	R0090		2,243,003	22,797		(40,223)	9,611,347
Risk Margin	R0100	83,906				22	176,887
Amount of the transitional on Technical Provisions							
Technical Provisions calculated as a whole	R0110						0
Best estimate	R0120						0
Risk margin	R0130						0
Technical provisions – total	R0200	1,778,984				(91,486)	9,202,707

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.4 — S.12.01.02 LIFE AND HEALTH SLT TECHNICAL PROVISIONS CONTINUED

		Health insurance (direct business)					
			Contracts without options and guarantees	Contracts with options or guarantees	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
		C0160	C0170	C0180	C0190	C0200	C0210
Technical provisions calculated as a whole	R0010						0
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0020						0
Technical provisions calculated as a sum of BE and RM							
Best Estimate							
Gross Best Estimate	R0030		16,869				16,869
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080		3,176				3,176
Best estimate minus recoverables from reinsurance/SPV and Finite Re	R0090		13,693				13,693
Risk Margin	R0100	400					400
Amount of the transitional on Technical Provisions							
Technical Provisions calculated as a whole	R0110						0
Best estimate	R0120						0
Risk margin	R0130						0
Technical provisions – total	R0200	17,269					17,269

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.5 — S.22.01.21 — IMPACT OF LONG TERM GUARANTEES AND TRANSITIONAL MEASURES

		Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions	Impact of transitional on interest rate	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
		C0010	C0030	C0050	C0070	C0090
Technical provisions	R0010	9,219,976				235,849
Basic own funds	R0020	1,015,317				(203,826)
Eligible own funds to meet Solvency Capital Requirement	R0050	1,015,317				(203,826)
Solvency Capital Requirement	R0090	484,272				162,522
Eligible own funds to meet Minimum Capital Requirement	R0100	1,015,317				(203,826)
Minimum Capital Requirement	R0110	121,068				40,630

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.6 — S.23.01.22 — OWN FUNDS QRT

		Total	Tier 1 – unrestricted	Tier 1 – restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation (EU) 2015/35						
Ordinary share capital (gross of own shares)	R0010	30,500	30,500			
Share premium account related to ordinary share capital	R0030	253,619	253,619			
Initial funds, members' contributions or the equivalent basic own – fund item for mutual and mutual-type undertakings	R0040					
Subordinated mutual member accounts	R0050					
Surplus funds	R0070	47	47			
Preference shares	R0090					
Share premium account related to preference shares	R0110					
Reconciliation reserve	R0130	731,151	731,151			
Subordinated liabilities	R0140					
An amount equal to the value of net deferred tax assets	R0160					
Other own fund items approved by the supervisory authority as basic own funds not specified above	R0180					
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	R0220					
Deductions						
Deductions for participations in financial and credit institutions	R0230					
Total basic own funds after deductions	R0290	1,015,317	1,015,317			
Ancillary own funds						
Unpaid and uncalled ordinary share capital callable on demand	R0300					
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual-type undertakings, callable on demand	R0310					
Unpaid and uncalled preference shares callable on demand	R0320					
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	R0330					
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	R0340					
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	R0350					
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0360					
Supplementary members calls – other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0370					
Other ancillary own funds	R0390					
Total ancillary own funds	R0400					
Available and eligible own funds						
Total available own funds to meet the SCR	R0500	1,015,317	1,015,317			
Total available own funds to meet the MCR	R0510	1,015,317	1,015,317			
Total eligible own funds to meet the SCR	R0540	1,015,317	1,015,317			
Total eligible own funds to meet the MCR	R0550	1,015,317	1,015,317			
SCR	R0580	484,272				
MCR	R0600	121,068				
Ratio of Eligible own funds to SCR	R0620	210%				
Ratio of Eligible own funds to MCR	R0640	839%				

		C0060
Reconciliation reserve		
Excess of assets over liabilities	R0700	1,015,317
Own shares (held directly and indirectly)	R0710	
Foreseeable dividends, distributions and charges	R0720	
Other basic own fund items	R0730	284,119
Other basic own fund items – Others		
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	R0740	
Reconciliation reserve	R0760	731,198
Expected profits		
Expected profits included in future premiums (EPIFP) – Life Business	R0770	70,874
Expected profits included in future premiums (EPIFP) – Non- life business	R0780	
Total Expected profits included in future premiums (EPIFP)	R0790	70,874

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.7 — S.25.01.21 — SOLVENCY CAPITAL REQUIREMENT — FOR UNDERTAKINGS ON STANDARD FORMULA

		Gross solvency capital requirement	USP	Simplifications
		C0110	C0080	C0090
Market risk	R0010	335,911		
Counterparty default risk	R0020	6,522		
Life underwriting risk	R0030	241,803		
Health underwriting risk	R0040	771		
Non-life underwriting risk	R0050			
Diversification	R0060	(110,724)		
Intangible asset risk	R0070			
Basic Solvency Capital Requirement	R0100	474,283		
Calculation of Solvency Capital Requirement		C0100		
Total capital requirement for operational risk	R0130	21,254		
Loss-absorbing capacity of technical provisions	R0140			
Loss-absorbing capacity of deferred taxes	R0150	(11,265)		
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	R0160			
Solvency capital requirement excluding capital add-on	R0200	484,272		
Capital add-on already set	R0210			
Solvency capital requirement	R0220	484,272		
Other information on SCR				
Capital requirement for duration-based equity risk sub-module	R0400			
Total amount of Notional Solvency Capital Requirements for remaining part	R0410	306,778		
Total amount of Notional Solvency Capital Requirements for ring fenced funds	R0420	4,338		
Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios	R0430	173,156		
Diversification effects due to RFF nSCR aggregation for article 304	R0440			

APPENDIX AND ADDITIONAL INFORMATION
Continued

APPENDIX 1 — QUANTITATIVE REPORTING TEMPLATES CONTINUED

APPENDIX 1.8 — S.28.01.01 — MINIMUM CAPITAL REQUIREMENT — ONLY LIFE OR ONLY NON-LIFE INSURANCE OR REINSURANCE ACTIVITY

Linear formula component for life insurance and reinsurance obligations

		C0040
MCR_{L} Result	R0200	100,555

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0050	**C0060**
Obligations with profit participation – guaranteed benefits	R0210	31,847	
Obligations with profit participation – future discretionary benefits	R0220	8,398	
Index-linked and unit-linked insurance obligations	R0230	7,348,130	
Other life (re)insurance and health (re)insurance obligations	R0240	2,239,269	
Total capital at risk for all life (re)insurance obligations	R0250		1,931,110

Overall MCR calculation

		C0070
Linear MCR	R0300	100,555
SCR	R0310	484,272
MCR cap	R0320	217,922
MCR floor	R0330	121,068
Combined MCR	R0340	121,068
Absolute floor of the MCR	R0350	3,200
		C0070
Minimum Capital Requirement	R0400	121,068

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