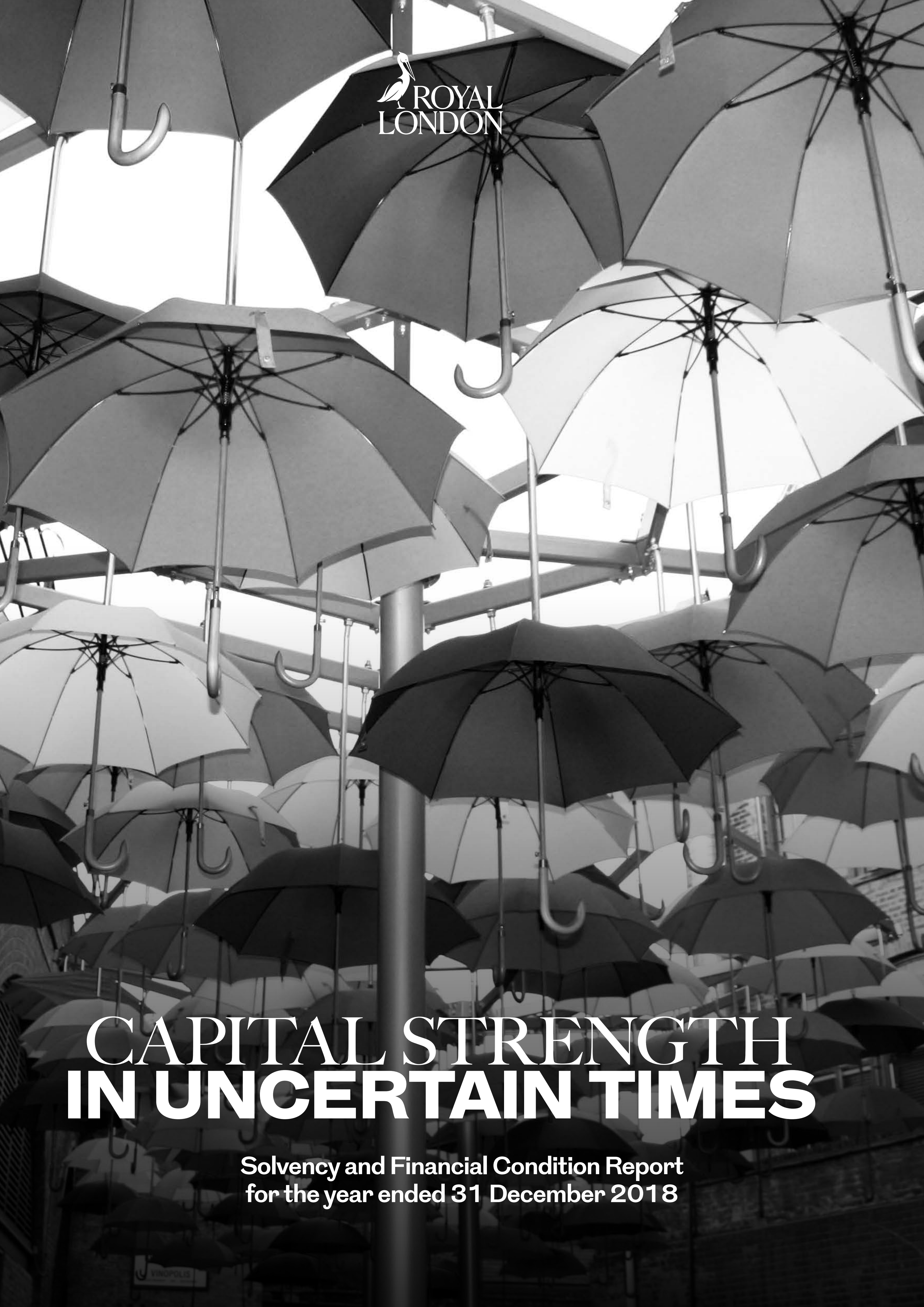


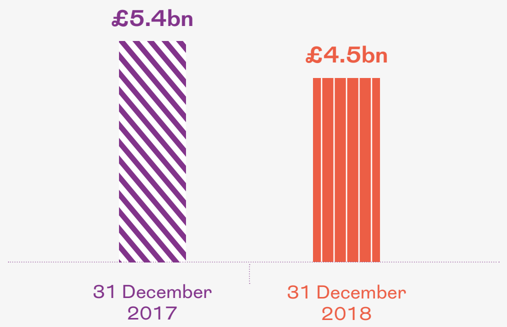
ROYAL LONDON

CAPITAL STRENGTH IN UNCERTAIN TIMES

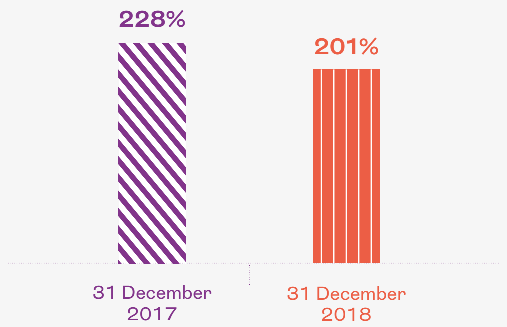
Solvency and Financial Condition Report
for the year ended 31 December 2018

Capital position at a glance

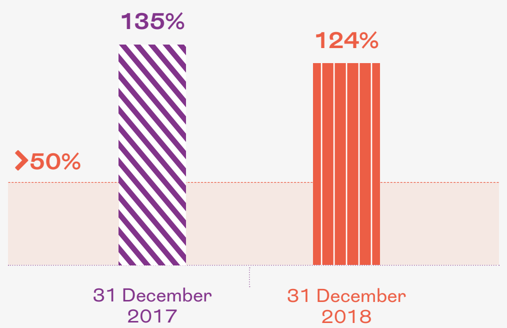
Solvency surplus (Investor View)



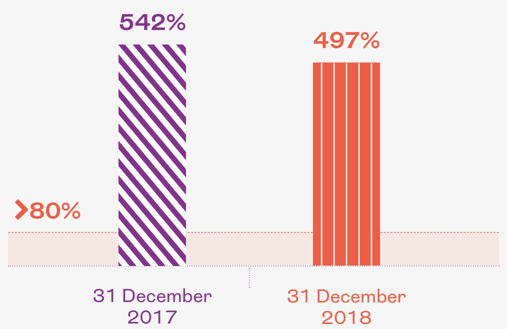
Capital cover ratio (Investor View)



Tier 1 capital (coverage of Solvency Capital Requirement)



Tier 1 capital (coverage of Minimum Capital Requirement)



Contents

Executive summary

What is this report?

The information in this report relates to The Royal London Mutual Insurance Society Limited, referred to in this report as RLMIS or 'the Company'. RLMIS is the parent entity of the Royal London Group ('the Group'), and for the year ended 31 December 2018 it is the sole insurance entity in the Group. This document covers the Solvency and Financial Condition Report (SFCR) of RLMIS as a Solo entity and provides information on our solvency (i.e. our ability to pay liabilities – primarily current and future policyholder claims) and how we manage the financial strength of the Company.

The information in this report is from our most recent financial year, which is the year ended 31 December 2018.

Why are we publishing this report?

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

Solvency II (SII) is a European Union (EU) directive for insurance companies embedded within UK national law, containing a set of rules designed to help insurance businesses across Europe calculate their available capital, assess and manage their risks and ensure that they hold sufficient capital to take account of those risks. 'Capital' is referred to in SII as 'own funds' and represents how much the Company has available to meet its financial obligations. In the case of the Company, the largest financial obligations are current and future payouts to policyholders and members.

Publishing an SFCR each year is a regulatory requirement under SII, and the year ended 31 December 2018 is the third reporting period since the SII rules came into effect.

In addition to fulfilling our regulatory requirements, we also believe that the information in this SFCR may be useful for RLMIS's members and other stakeholders. Publishing our SFCR is an opportunity for us to provide more information about our strong capital position, the governance processes we have in place to mitigate risks and our effective capital management strategies.

What does this report contain?

The following is a high level description of the contents of each section in this document and some of the information is quite technical. The content is prescribed by regulations. The regulations are complex and some jargon is unavoidable, but we have done our best to make this understandable to everyone and a glossary is included at the back to help explain the terminology.

A. Business and performance

This section describes our business performance and significant events during the year, our legal structure, how we are regulated and who our auditors are.

B. System of governance

This section outlines our system of governance and risk management, and how the Company is directed and controlled. We also describe our remuneration policy and practices, our compliance with the Senior Managers and Certification Regime (SMCR), which replaced the Senior Insurance Managers Regime (SIMR) and the Approved Persons Regime on 10 December 2018, and our adherence to the 'Fit and Proper Requirements' (F&P) from the FCA.

C. Risk profile

Risk can sometimes be seen as negative, however, as part of our business we are specialists at taking on enough 'good' risk which drives value, and not excessive risk that may be detrimental to members or policyholders. We call this balancing act our 'risk appetite'. This section describes our risk profile, including risk exposures, concentrations, mitigation and sensitivity. The Company's risk profile is stable and generally changes only gradually from year to year. However, the work we do to mitigate and manage risk is enhanced and strengthened each year.

D. Valuation for solvency purposes

In this section we describe the bases and methods used for the valuation of our assets, technical provisions and other liabilities. We also provide an explanation of any major differences in the bases and methods used for the SII valuations, compared to the International Financial Reporting Standards (IFRS) basis used for the 2018 Annual Report and Accounts (ARA).

E. Capital management
RLMIS has a strong capital position under SII and our capital is of a high quality. This section describes our approach to capital management, and includes information on the amount and quality of our own funds and the expected development of own funds.

We also provide more details of the capital we are required to hold, known as the Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR).

Forward-looking statement
This statement highlights that the actual future financial condition, performance and results may differ materially from this document and the Company has no obligation to update forward-looking statements.

Directors' approval statement
The statement is required by our regulators and our Directors sign this to acknowledge their responsibilities for preparing the SFCR in accordance with the PRA rules and the SII regulations.

Independent auditors' opinion
Our auditors, PricewaterhouseCoopers LLP (PwC), have audited certain sections of this document, notably the key solvency information presented in sections D and E. Further details on the elements of this document subject to audit can be found within the auditors' opinion on page 79.

Glossary
This explains some of the unavoidable jargon and technical terms relating to SII, as well as other terms used in our business.

Quantitative Reporting Templates (QRTs)
These are the detailed forms we submit to the PRA, which contain financial information prescribed by the SII regulations. The forms included in this document are required to be disclosed publicly, but additional forms are privately submitted to the PRA on an annual and quarterly basis.

Highlights of our SII reporting

Solvency surplus and Capital cover ratio
Solvency surplus is the amount by which our capital position (own funds) exceeds the SCR. SCR is the amount of capital needed to ultimately pay all policyholders in a very extreme scenario (a 1-in-200 year event). Capital cover ratio is the ratio of our capital position (own funds) compared to our SCR.

The Company has an Open Fund and a number of closed funds. The Open Fund is the part of the business which is open to new business, whereas the 'closed funds' are closed to new business. The Open Fund and the closed funds contain policies written by companies we have previously acquired.

Executive summary (continued)

The following table sets out the capital position and key SII metrics for the Company at 31 December 2018:

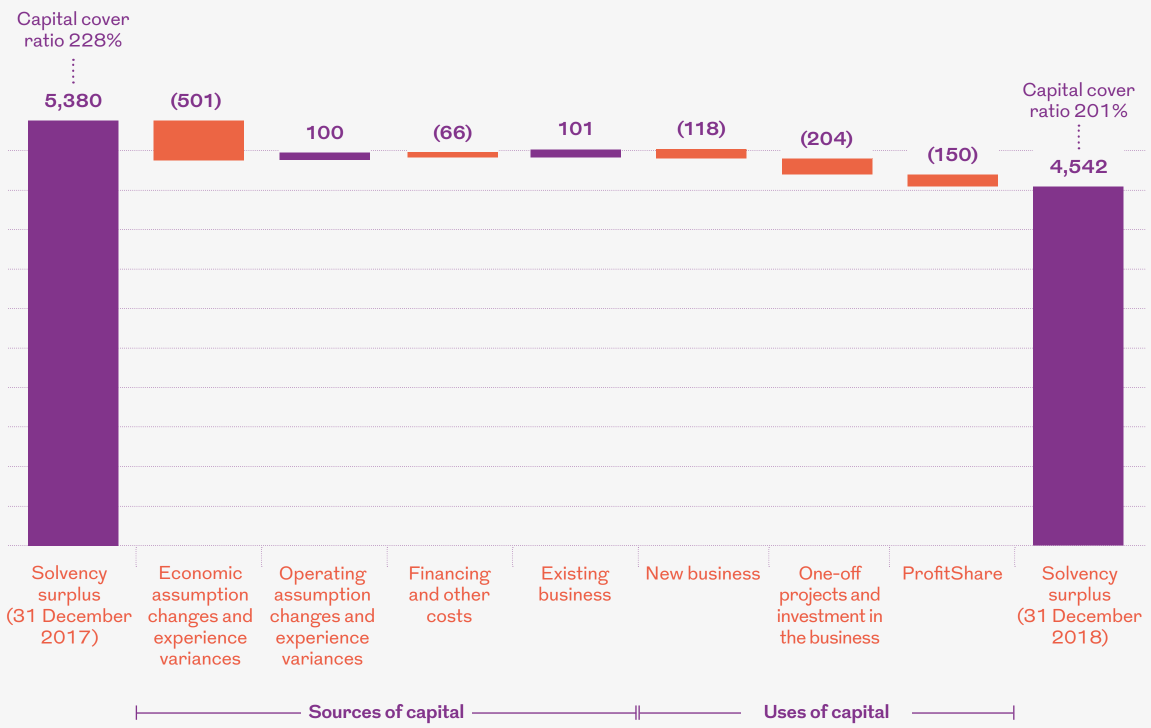
	Open Fund (£m)	Closed funds (£m)	Total Company (Investor View) (£m)	Closed funds restriction (£m)	Total Company (Regulatory View) (£m)
Own funds:					
Tier 1	3,313	4,900	8,213	-	8,213
Tier 2	806	-	806	-	806
Total own funds	**4,119**	**4,900**	**9,019**	-	**9,019**
Closed funds restriction[1]	-	-	-	(2,651)	(2,651)
Adjusted own funds (A)	**4,119**	**4,900**	**9,019**	**(2,651)**	**6,368**
SCR (B)	**2,228**	**2,249**	**4,477**	-	**4,477**
Solvency surplus (A-B) – 31 December 2018[3]	**1,891**	**2,651**	**4,542**	**(2,651)**	**1,891**
Solvency surplus – 31 December 2017	2,369	3,011	5,380	(3,011)	2,369
Capital cover ratio[2] (A/B) – 31 December 2018[3]	**185%**	**218%**	**201%**	**n/a**	**142%**
Capital cover ratio[2] – 31 December 2017	223%	233%	228%	n/a	156%

1 In common with the rest of the Industry, we present two views of our capital position: an 'Investor View' for analysts and investors in our subordinated debt (which does not restrict the surplus in the closed funds) and a 'Regulatory View' where the closed funds' surplus in excess of the SCR is excluded from total available own funds and treated as a liability, which is known as the closed funds restriction.
2 Figures presented in the table are rounded, and the capital cover ratio is calculated based on exact figures.
3 The 31 December 2018 final figures have been updated from the estimated figures presented in the 2018 ARA.

The Company had an Investor View solvency surplus of £4,542m at 31 December 2018 (31 December 2017: £5,380m) and an Investor View capital cover ratio of 201% at 31 December 2018 (31 December 2017: 228%).

Our estimated solvency surplus was adversely impacted by difficult market conditions during 2018, but we have been able to continue to invest in transforming the business and deliver ProfitShare, whilst maintaining a strong capital position. The following diagram sets out an analysis of the movement of the Investor View solvency surplus between 31 December 2017 and 31 December 2018.

Movement in investor view solvency surplus (£m)



The Investor View solvency surplus has decreased from £5,380m at 31 December 2017 to £4,542m at 31 December 2018 primarily from the following sources:

- adverse economic experience, driven by difficult investment market conditions, particularly in the last quarter of 2018, and an increase in insurance risk capital for the mass lapse scenario following further clarification on treatment of per policy expenses by the European Insurance and Occupational Pensions Authority (EIOPA);
- financing costs, specifically the payment of interest on our subordinated debt; partially offset by positive demographic assumption changes; and
- capital benefit from the run-off of existing business.

Our remaining capital position is strong, and as a result we have been able to use available capital (whilst still meeting target solvency levels) to:

- write new business during 2018, which had a strain on capital;
- progress with one-off projects and investment in the business, including the ongoing transformation of our pensions business (#thinkbeyond) and Royal London's Guaranteed Annuity Rate (GAR) Compromise Scheme, which allowed certain policyholders to exchange guarantees for a cash uplift in order to more effectively manage the run-off of the Scottish Life fund, and resulted in a one-off decrease in the capital position; and
- deliver a record ProfitShare, following an increase in eligible members in 2018.

The Investor View capital cover ratio is 201% including surplus in the closed funds (31 December 2017: 228%).

What does this tell me?

Our capital position is strong, reflecting the strength of our underlying business and effective capital management strategies.

Our available capital is well in excess of our capital requirements, meaning that even in an extreme scenario that occurs once every 200 years we would be able to settle claims and payouts for all of our policyholders. This underlines our financial strength and ability to meet our commitments to pay our policyholders and to support them through unexpected future events.

The solvency surplus and capital cover ratio are good indicators of our ability to withstand tough economic conditions, with higher numbers indicating more capital over and above our requirements. However, the solvency surplus and capital cover ratio should not be too high, as it is important that we continue to return value to our policyholders and members.

Sensitivities on the solvency surplus and capital cover ratio

The solvency surplus and capital cover ratio are sensitive to significant changes in assumptions and external market conditions. The following table sets out various sensitivities of the solvency surplus and capital cover ratio based on different possible scenarios:

Scenario	Solvency surplus (Investor View) (£m)	Capital cover ratio (Investor View) (% points)
SII solvency surplus - 31 December 2018	**4,542**	**201%**
25% decrease in all equity investments	(307)	(1)
25% decrease in property prices (commercial and residential)	(151)	(2)
100bps rise in interest rate (parallel shift)[1]	(496)	(9)
100bps fall in interest rate (parallel shift)[1,6]	158	(6)
50bps increase in government bond yields[2]	(292)	(6)
100bps widening in credit spreads (all ratings)	(14)	-
20% of assets downgrading to the next credit quality rating[3]	(33)	(1)
50bps increase in inflation[4]	(47)	(1)
25% fall in GBP exchange rates (against all other currencies)[5]	336	1

1 Interest rate sensitivities assume government and other bond yields and risk free rates all move by the same amount. Interest rates are allowed to be negative.
2 The government bond yield sensitivity assumes risk free rates and other yields remain constant.
3 The asset credit downgrade sensitivity applies to the liabilities only and not asset values. The calibration of the Fundamental Spreads by sector, rating and term is assumed to be unchanged.
4 Inflation change is calculated as real interest rates less nominal interest rates.
5 This sensitivity assumes an increase to the value of assets held in currencies other than GBP by 33% in GBP terms.
6 The results of this stress assume additional management actions are implemented which reduce the impact of the Standard Formula sensitivity.

Sensitivities presented in the table are consistent with the PRA's SS7/17: Solvency II: Data collection of market risk sensitivities, which is available at http://www.bankofengland.co.uk/pra/Documents/publications/ss/2017/ss717.pdf.

What does this tell me?

Our capital position (i.e. the solvency surplus) varies depending on economic and non-economic conditions. However, even in the face of market uncertainty our capital position remains strong, and if equity values (for example the FTSE 100) dropped as much as 25% our Investor View solvency surplus at 31 December 2018 would reduce by £307m (from £4,542m to £4,235m) and our capital cover ratio would reduce by 1 percentage point from 201% to 200%. In this scenario, it means that our funds held would still be well in excess of our capital requirements.

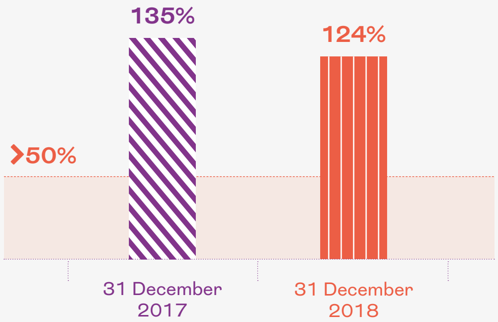
Executive summary (continued)

Tiers of capital

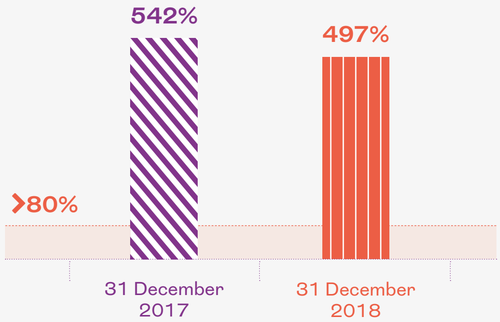
There are three tiers of capital defined by SII. The quality of capital is important, as the higher the quality, the more likely it will be available in the event that it is needed, for example, to pay out claims. The three tiers of capital are presented in order of highest quality (Tier 1 capital) to lowest quality (Tier 3 capital).

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

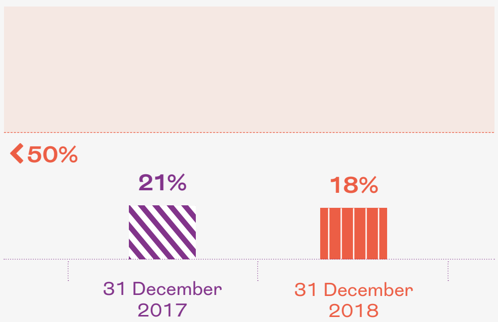
- Of the SCR, at least 50% must be covered by Tier 1 capital. The Company has complied with this and our SCR has 124% Tier 1 capital coverage.



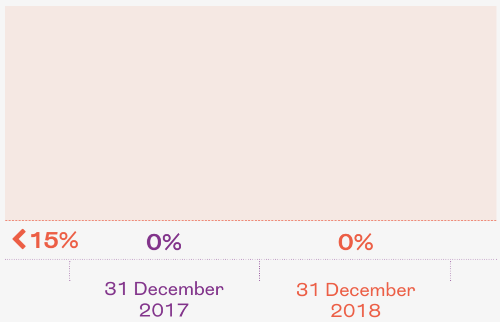
- Of the MCR, at least 80% must be covered by Tier 1 capital. The Company's MCR has 497% Tier 1 capital coverage which complies with the requirement.



- Tier 2 and 3 capital must not exceed 50% of the SCR. The Company's Tier 2 and 3 capital is only 18% of the SCR and therefore has complied with this requirement.



- Tier 3 capital must be less than 15% of the SCR. The Company does not have any Tier 3 capital and so has complied with this requirement.



The value of our Tier 1 and Tier 2 capital decreased in 2018, driven by investment market conditions, particularly in Q4 2018. Further detail on the movement in own funds is included in section E.1.3.

The Company has subordinated loan notes in issue with a fair value of £806m at 31 December 2018 (31 December 2017: £883m) which are included within Tier 2 capital. We do not rely on the subordinated debt in order to meet our solvency requirements.

What does this tell me?

Our capital position is strong. The figures illustrate that we meet our regulatory requirements to hold high-quality capital. The capital held fell in 2018, mainly due to difficult market conditions, however we are still comfortable exceeding our capital requirements.

Other key things to note

Basis of preparation

In line with our previous SFCRs, this document is a Solo SFCR for the Company. There are two key bases for measuring and reporting solvency which can be used under the SII regime: the 'Standard Formula' and an 'Internal Model'. An Internal Model takes into account individual firm-specific factors, but requires approval by the regulator before being used to report under SII.

The figures disclosed in our SII reporting, including this document, are currently prepared using the Standard Formula.

We use an internal capital model for the purposes of managing our capital. We have submitted an application to the PRA to use an Internal Model to calculate our capital requirements for regulatory purposes from Q4 2019. We expect to hear whether our application has been approved by the end of Q3 2019.

What does this tell me?

We have prepared our 2018 SII reporting in line with the SII rules. We would like to change the way in which we calculate our capital requirements in future to be more bespoke to the Company (which is how we manage our capital already) and so we are seeking approval from the regulator to report on this basis by the end of 2019.

Impact of Transitional Measure on Technical Provisions (TMTP)

The TMTP is included in the solvency surplus figures above and it smooths the transition from the old Solvency I regime (which was reported to the PRA up to the year ended 31 December 2015) to the new SII regime. One key difference in the two regimes is the valuation of technical provisions, which is described in more detail in section D.3.

The TMTP provides a capital benefit to the Company, however we are not reliant on it to meet our capital requirements. The TMTP benefit reduces on a straight-line basis over a 16 year period from 1 January 2016, so that it reduces to nil by 1 January 2032 and provides no benefit at that point.

The PRA has authorised use of the TMTP, and at 31 December 2018, the use of the TMTP contributed 51% to the Investor View capital cover ratio (31 December 2017: 58%) and 17% to the Regulatory View cover ratio (31 December 2017: 17%). The PRA last approved the recalculation of the TMTP for the year ended 31 December 2017, which has been reduced on a straight-line basis in 2018.

Volatility Adjustment (VA) and Matching Adjustment (MA)

The VA forms part of the calculation of technical provisions, and is made to ensure the appropriate treatment of insurance products with long-term guarantees under SII. The Company's use of the VA has been approved by the PRA, and is included in the capital information included throughout this document.

At 31 December 2018, the use of the approved VA contributed 8% to the Investor View capital cover ratio (31 December 2017: 6%) and 1% to the Regulatory View capital cover ratio (31 December 2017: 0%).

The use of an MA would require approval from the PRA. No MA has been applied for 2018 or 2017, and we have not sought approval from the PRA to use one.

What does this tell me?

The TMTP and VA provide a capital benefit to the Company and are included in the figures above, however, we are able to meet our SCR and MCR without them. The TMTP benefit reduces on a straight-line basis over a 16 year period from 1 January 2016, so that it reduces to nil by 1 January 2032 and provides no benefit at that point. The TMTP is recalculated at least every two years, with earlier recalculation triggered on material changes to the Company's risk profile. The VA is recalculated every year based on levels prescribed for the insurance industry, and the use of the VA has been approved by our regulator.

Impact of the UK's proposed departure from the EU (Brexit) and post balance sheet events

We do not expect Brexit to materially alter the Company's strategy and risk profile due to the vast majority of our business being written in the UK.

Following the referendum vote in favour of the UK leaving the EU in 2016, we took the decision to establish an authorised insurance business in the Republic of Ireland. This enables the Group to continue to sell new business in Ireland following Brexit and enables the Irish and German life insurance business previously underwritten by RLMIS to continue to be serviced. Our new subsidiary Royal London Insurance Designated Activity Company (RLI DAC) was authorised to write new life insurance business in the Republic of Ireland by the Central Bank of Ireland (CBI) with effect from 1 January 2019.

Certain technical provisions and related assets and liabilities were transferred from the Company to RLI DAC by way of a transfer made under Part VII of the Financial Services and Markets Act 2000 ('the Part VII transfer'). The Part VII transfer allows RLMIS to continue to service existing policyholders whose policies had been previously written in the EU. Specifically this results in the creation of two new closed funds within RLI DAC, relating to contracts previously written in the Republic of Ireland and Germany.

Following High Court approval the Part VII transfer took place on 7 February 2019 and was effective for accounting purposes on 1 January 2019. As this occurred after the balance sheet date, the numbers in this report have not been adjusted to reflect the transfer.

The following table sets out the impact of the post balance sheet events on the Investor View solvency surpluses and capital cover ratio for the new insurance Group, the Company and RLI DAC as at 1 January 2019.

	Group[1]		RLMIS		RL DAC	
Key metric	**31 December 2018**	**1 January 2019[2]**	**31 December 2018**	**1 January 2019[2]**	**31 December 2018[2]**	**1 January 2019[2]**
Solvency surplus (Investor View)	n/a	£4,411m	£4,542m	£4,548m	n/a	£68m
Capital cover ratio[2] (Investor View)	n/a	197%	201%	202%	n/a	241%

1 Group comprises the regulated insurance entities (RLMIS and RLI DAC), regulated and non-regulated subsidiary undertakings. The most significant non-insurance entities within the Group capital requirements are Royal London Asset Management (RLAM) and Investment Funds Direct Limited (IFDL, trading as Ascentric).
2 Figures presented in the table are rounded, and the capital cover ratio is calculated based on exact figures.

Further details of the post balance sheet events are set out in Appendix 1 of this report.

We continue to maintain a strong capital position and, given the vast majority of our business is written in the UK, we do not expect Brexit to materially alter our strategy. We continue to monitor and respond to ongoing developments relating to Brexit as they occur, particularly in relation to regulation and legislation.

Conclusion

We have met the regulatory requirements under SII and the information in this document has been prepared and disclosed in accordance with those requirements. We have also included some additional information, where we believe it is useful to understand the performance of the Company.

We have also set out the governance, risk and control structures which monitor our capital position. These ensure our capital position remains robust, and at a level where we are continuing to return value to our policyholders and members.

The Company continues to be well capitalised and solvent under the SII reporting regime. Not only have we met our capital requirements under the new regime, but the quality of our capital is well above the requirements of the SII rules.

Where can I find more information?

The Group publishes information throughout the year to meet the needs of different stakeholders. This information can be found on our website at royallondon.com.

If you are interested in finding out more about the Group, you can, for example, also read our:

- Annual Report and Accounts;
- Press releases and results presentations;
- Principles and Practices of Financial Management (PPFM);
- Research and consultation responses;
- Articles of Association; and
- Terms of Reference for our main committees.

What do I need to do?
You don't need to do anything.

This document has been produced in accordance with regulatory requirements and is for your reference only. However, if you have any questions about this report, please contact:

Mona Patel
Group Head of External Communications
0203 272 5133
mona.patel@royallondon.com
7919 171964

Company overview

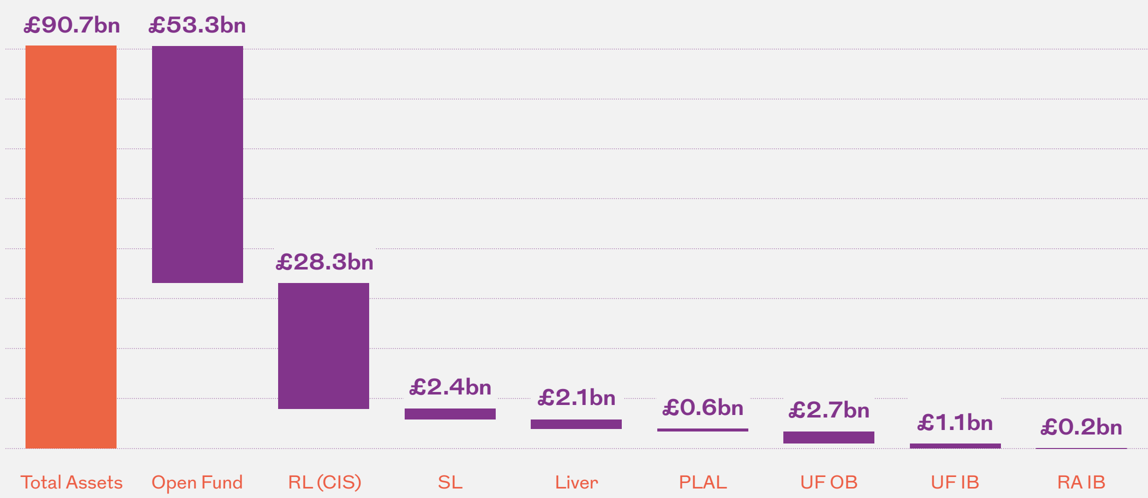
RLMIS is a company limited by guarantee, not having any share capital, and is registered in England and Wales. It was founded in 1861, initially as a friendly society, and became a mutual life insurance company in 1908. The Company is authorised by the PRA and jointly regulated by the FCA and the PRA. RLMIS is the ultimate parent entity within the Group.

The Group is the largest mutual life, pensions and investment company in the UK, with funds under management of £114bn at 31 December 2018 (31 December 2017: £114bn), 8.7m policies in force (31 December 2017: 8.8m) and 3,898 employees (31 December 2017: 3,637).

RLMIS, also referred to as the Royal London Long-Term Fund (RL LTF), consists of the Royal London Industrial Branch (IB) and Ordinary Branch (OB) Fund (the Open Fund) and seven closed funds at 31 December 2018:

- Royal London (CIS) Fund (RL (CIS));
- Scottish Life Fund (SL);
- Royal Liver With-Profits Fund (Liver);
- PLAL With-Profits Fund (PLAL);
- United Friendly Ordinary Branch Fund (UF OB);
- United Friendly Industrial Branch Fund (UF IB); and
- Refuge Assurance Industrial Branch Fund (RA IB).

RLMIS – Total assets by fund



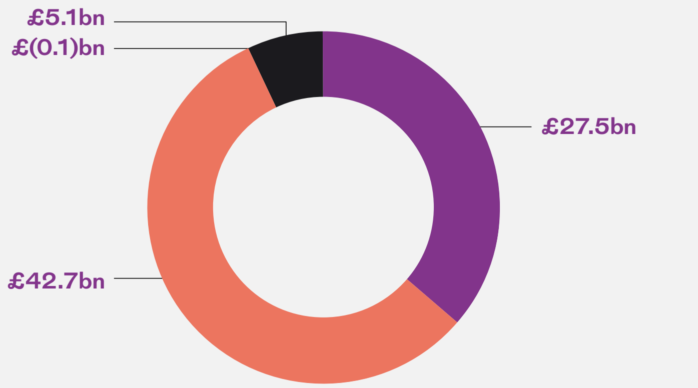
This chart illustrates the relative size of the funds within RLMIS. Figures quoted are asset balances within the funds as at 31 December 2018, and do not represent total funds under management (£114bn at 31 December 2018).

Company overview (continued)

New business is only written into the Open Fund. It includes the Royal London IB and OB with-profits and non-profit business (Royal London IB now being closed to new business) and most of the Company's unit-linked business.

The closed funds within RLMIS no longer write new business and were established on the acquisitions of the United Assurance Group (RA IB, UF IB and UF OB), Scottish Life, PLAL, Royal Liver and Royal London (CIS). Royal London (CIS) is the name given to the Co-operative Insurance Society Limited following its acquisition by the Group. The closed funds are all ring-fenced funds for SII purposes. The principles of financial management for these funds were established when they were transferred into RLMIS through transfers of long-term business and are summarised in the PPFM for each fund.

RLMIS – Total technical provisions by line of business



The chart illustrates the type of business written by RLMIS, and the relative size of related technical provisions at 31 December 2018.

1 Negative technical provisions arise in Health business as initial commission and expenses are paid out at the start of the contract, meaning only cash inflows remain over the life of the contract. SII rules require negative technical provisions to be recorded as a negative liability rather than an asset.

Key elements of the system of governance

The Administrative, Management or Supervisory Body (AMSB) (i.e. the Board) is responsible for the system of governance, as well as for reviewing its effectiveness. The Board is committed to high standards of corporate governance, which it believes are critical to business integrity and performance.

Our system of governance comprises:

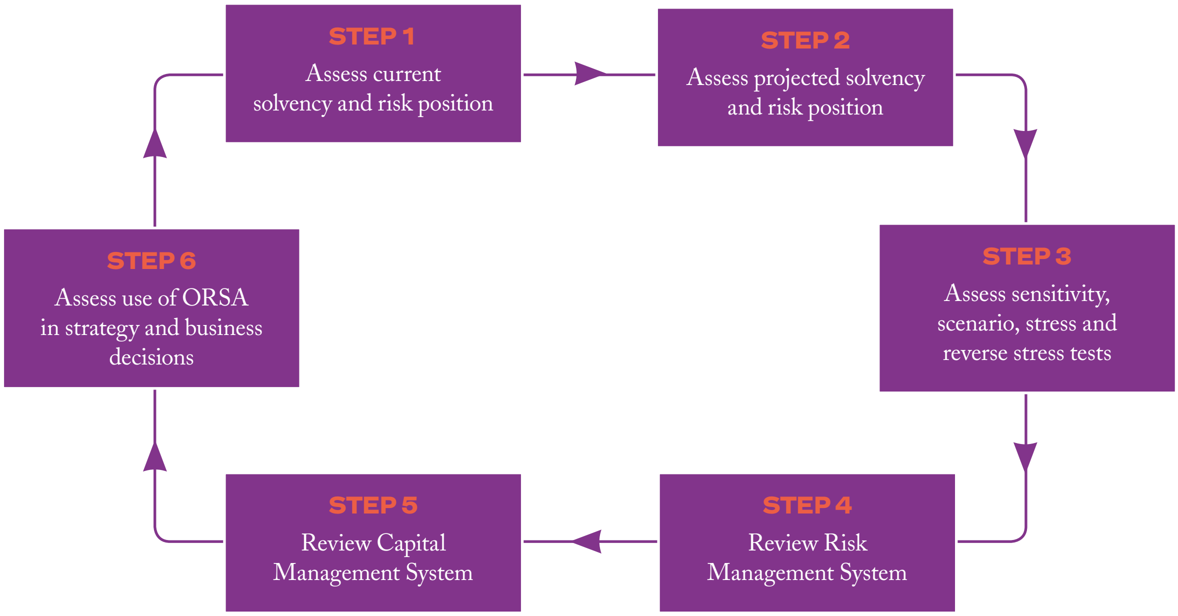
- **Governance structure** – the role of the Board and its committees in directing and controlling the Company, which includes setting the Company's strategy and risk appetite, and promoting a culture of effective risk management;
- **Organisational structure** – the reporting lines, roles and responsibilities of the directors and senior management to support the delivery of the Company's strategy and implement appropriate risk policies and controls;
- **Risk Management System (RMS)** – provides assurance that risks are being appropriately identified and managed in accordance with policies and within risk appetite. This helps to ensure that the achievement of the Company's performance and objectives is not undermined by unexpected events resulting in significant financial loss or damage to the Company's reputation; and
- **Internal Control System (ICS)** – methods and processes put in place to achieve effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

Summary of the Own Risk and Solvency Assessment (ORSA)

The ORSA is a continuous cycle (see diagram below) of monitoring and assessment intended to provide the Board with a thorough understanding of the underlying risk profile and level of solvency needed to sustain the Company now and in the future.

The ORSA process aims to ensure a bottom-up view of risk. The annual process is run alongside the Medium-Term Plan (MTP) timelines to allow the Risk function to challenge the strategic direction fully. The ORSA findings are summarised quarterly, with an overall annual report, although there may also be events requiring the process to be run on an ad hoc basis.

Further information on the ORSA is included in section B.3.2.



Summary of material changes over the reporting period

Performance for the year ended 31 December 2018

Financial highlights:

- Record European Embedded Value (EEV) operating profit before tax of £396m (2017: £329m), representing an increase of 20%;
- New business sales (Present value of new business premiums (PVNBP basis)) remained strong at £11,380m (2017: £12,002m). The expected decrease in Workplace Pensions following the end of auto-enrolment roll-out was offset by an 8% increase in Individual Pensions to £6,818m (2017: £6,339m);
- IFRS deduction from Unallocated Divisible Surplus (UDS) before Other Comprehensive Income (OCI) was (£48m) (2017: £352m transfer to UDS), reflecting the continued low interest rate environment and negative investment returns experienced in 2018. Despite the challenging economic conditions, our investment returns still performed well against benchmark;
- EEV profit before tax reduced to £351m (2017: £594m), representing a decrease of 41%. The EEV profit before tax was driven by strong new business sales with a reduced cost base, offset by negative investment returns which were positive in 2017;
- Record external net flows of £4.1bn (2017: £2.8bn) generated by RLAM. RLAM delivered another year of strong performance and maintained funds under management at £114bn (2017: £114bn) despite volatile market conditions and the sale of RLAM C.I. which resulted in a net outflow of £2.0bn;
- Record ProfitShare (after tax) distribution to eligible members of £150m (2017: £142m), bringing total ProfitShare payments to members to £942m since 2007; and
- Our capital position under SII remained strong, with an Investor View solvency surplus of £4.5bn (31 December 2017: £5.4bn) and a capital cover ratio at 31 December 2018 of 201% (31 December 2017: 228%). Our solvency surplus was adversely affected by difficult market conditions during 2018, but we have been able to continue to invest in transforming the business and deliver ProfitShare, whilst maintaining a strong capital position.

Changes to the system of governance

Section B sets out detail on the system of governance in place. Key highlights and changes during 2018 were as follows:

- The Capital Management Committee (CMC) (that assists the Deputy Group Chief Executive & Group Finance Director in undertaking his responsibilities) transferred strategic investment matters to a new Investment Strategy Committee (ISC). The ISC has no authority delegated to it, other than that delegated to the Executives who are members of the Committee; and
- Our new insurance subsidiary (RLI DAC) was incorporated in 2018 and authorised with effect from 1 January 2019. RLI DAC has its own Board of Directors, which includes two Non-Executive Directors and has also established Audit and Risk committees. RLI DAC was authorised to write new life insurance business in the Republic of Ireland by the CBI with effect from 1 January 2019, which enables us to continue to sell new business in the Republic of Ireland and service existing Irish and German insurance business following the UK's proposed departure from the EU. Further details are provided in Appendix 1.

Summary of material changes over the reporting period (continued)

Changes to the Company's risk profile

The Board has carried out a robust assessment and monitors principal risks and uncertainties on a quarterly basis, with an annual review undertaken through the ORSA process.

Our risk profile is stable and generally changes only gradually from year to year. The table below sets out updates to the principal risks and uncertainties during 2018.

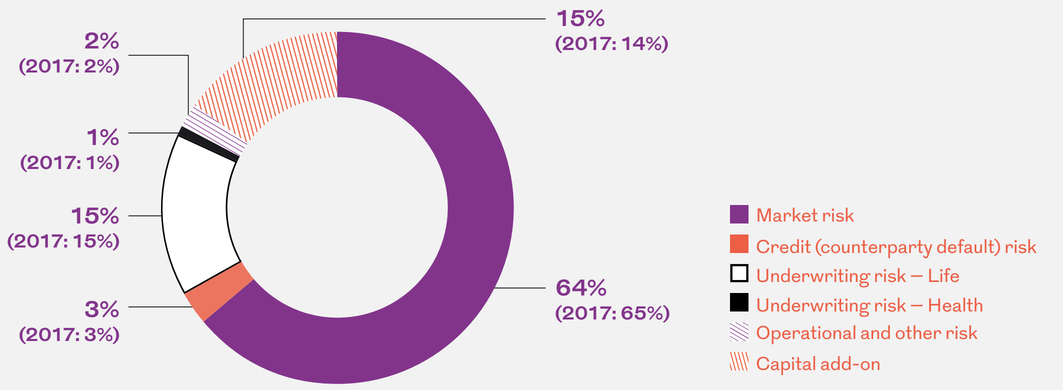
Risk	The cause of the change	Risk mitigation and management
Competitor risk	Competitive pressure exists within our industry. We recognise that this is a risk that could have an adverse impact on our ability to compete successfully in our chosen markets. Our continued success depends on our ability to sustain growth while managing economies of scale and continued strong financial discipline.	Our current corporate strategy has been successful to date and we feel that our ability to differentiate via value for money in our chosen markets remains our most appropriate mitigant to this risk. We are well placed to continue to offer value supported by our mutuality, customer centricity and service excellence. As a mutual with strong existing customer propositions we believe we have a unique ability to deliver a value for money strategy.
Brexit continues to create uncertainty over the prospects for financial markets and the UK economy, together with future regulation and legislation	This risk was included in 2017 but has been updated for developments in 2018. The impact on financial markets is likely to be a marked rise in uncertainty resulting in a further impact on economic confidence, on sterling and on the UK credit rating. There may be further consequences for interest rates, inflation, investment returns and the level of future flows into pension products. Uncertainty over the outcome of the negotiations with the EU leads to a lack of clarity over future regulation and legislation for the insurance and investment markets.	We do not expect Brexit to have a materially detrimental impact on our strategy and business due to our focus on the UK. A new authorised insurance subsidiary (RLI DAC) has been set up which enables the Group to continue to sell new business in Ireland. We recognise the potential impact of Brexit on our existing contracts written in Ireland and Germany, and we have completed a Part VII transfer of Irish and German contracts to RLI DAC to allow us to continue to service existing policyholders. Risks related to financial markets are mitigated through our normal market risk monitoring and capital management activity. Our primary market is the UK, therefore we have limited exposure to the risk of failing to access the single European market. We will continue to maintain a watching brief on developments relating to Brexit as they occur, particularly in relation to regulation and legislation, and will prepare appropriate responses.
Changes in the legislative and regulatory landscape may alter the design and marketing of propositions	The risk was included in 2017 but has been updated for developments during 2018. Unprecedented levels of change in legislation and heightened regulatory activity could adversely impact our ability to implement and deliver changes, as well as our reputational, operational and financial position. The conduct and prudential environment is still developing and this could impact how we develop and distribute new propositions, as well as how we administer and deal with contracts sold in the past. It is possible that thematic industry-wide reviews from the regulators may have a significant impact on the Group.	Meeting the expectations of customers and our regulators is at the forefront of everything we do. To that end, we engage with regulators on an ongoing basis. We continue to monitor the impact of developments, and where necessary, enhance our processes to meet any new requirements. Our conduct risk framework is in place, together with an associated proposition development and review process designed with the aim to achieve fair outcomes and experiences for our customers. We continue to be represented on industry bodies including Association of British Insurers (ABI) senior committees.
Legacy remediation	We have a large number of legacy products in which policyholders are still invested. There is a risk of historic remediation required within these books as there are a large number of legacy systems and propositions involved, and often manual and/or complex processes which can lead to historic issues being found.	Significant focus has been placed on managing this risk, including delivering activities related to our proposition reviews, Longstanding Customer Thematic Review programme and Remediation programme. In 2018, we reviewed the majority of propositions within the legacy book, with any remaining lower-risk propositions to be completed in 2019. All propositions will continue on a regular review schedule. We have established the Legacy division to ensure our legacy products continue to be managed and monitored for our long-standing customers.

The full principal risks and uncertainties are set out in the 2018 ARA on pages 41 to 44.

Summary of material changes over the reporting period (continued)

Changes in our risk profile are reflected in our capital requirements (SCR). The chart below shows the composition of the undiversified SCR for the Company, calculated on a Standard Formula basis as at 31 December 2018.

SCR as at 31 December 2018



The definitions of the risk categories are provided in section C with more details on the SCR set out in section E.2.

Our risk profile and capital requirements have remained stable between 2017 and 2018, reflecting effective risk management through our RMS.

A. Business and Performance

Plain English introduction

In this section, we describe our business, which is the UK's largest mutual life insurance, pensions and investment company:

- We describe our legal structure;
- We explain how we are regulated and who our external auditors are; and
- We also describe how the business has performed during the year, any significant factors which contributed to this performance and any significant events which have occurred.

A.1 Business

A.1.1. Name and legal form

The Royal London Mutual Insurance Society Limited was founded in 1861, initially as a friendly society, and became a mutual life insurance company in 1908. Royal London is authorised by the PRA and jointly regulated by the FCA and the PRA.

A.1.2. Supervisory authority details

The name and contact details of the supervisory authorities for financial supervision of the Company are set out in the table below:

Supervisory Authority	Details
FCA	12 Endeavour Square, London, E20 1JN +44 (0)20 7066 1000
PRA	20 Moorgate, London, EC2R 6DA +44 (0)20 7601 4444
CBI*	New Wapping Street, North Wall Quay, Dublin 1 +353 1 224 6000

* In the Republic of Ireland: The Royal London Mutual Insurance Society Limited is authorised by the PRA in the UK and is regulated by the CBI for conduct of business rules. Our new subsidiary (RLI DAC) is authorised and regulated by the CBI with effect from 1 January 2019. Refer to Appendix 1 for further details.

A.1.3. External auditors

Our external auditors are PricewaterhouseCoopers LLP (PwC), based at the following address:
PricewaterhouseCoopers LLP,
7 More London Riverside,
London,
SE1 2RT

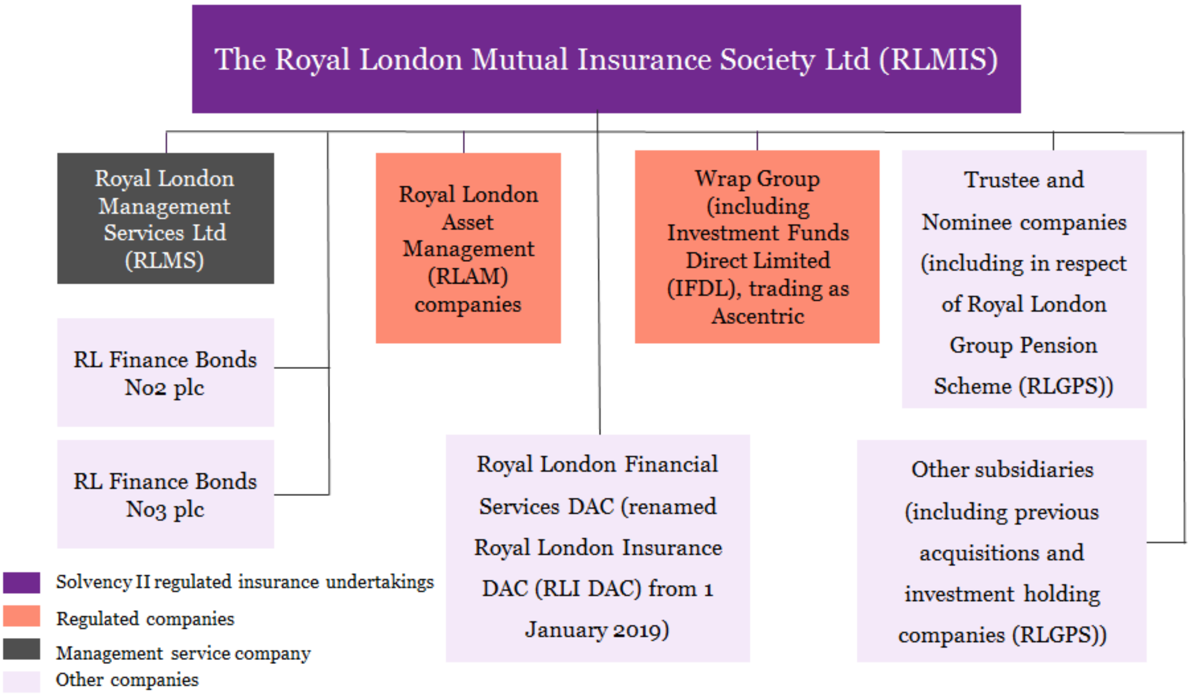
A.1.4. Shareholdings

As a mutual society, the Company has no shareholders and is owned by its members. Membership is granted to those taking out policies that entitle the holder to participate in Royal London's profits. All members have equal voting rights and as at 31 December 2018 there were over 1.4 million members (31 December 2017: over 1.2 million members).

On an annual basis the Company considers the allocation of a Royal London ProfitShare, which shares the benefits of its performance to eligible policyholders. We were able to deliver a record ProfitShare (after tax) distribution to eligible members of £150m (2017: £142m), bringing total ProfitShare payments to members to £942m since being established in 2007.

A.1.5. Legal structure

A simplified structure chart of the Company at 31 December 2018 is shown below.



A full list of the Company's subsidiaries is included in note 22 (a) of the 2018 ARA on pages 138 to 141 and details of its other related undertakings are given in notes 22 (b), (c), (d) and (e) on pages 142 to 145. The Company has a fully owned subsidiary (RLI DAC) which is incorporated in the Republic of Ireland.

A.1.6. Material lines of business and geographic areas

The Group operates in the protection, retirement, savings and investments markets, predominantly in the UK. It writes protection business in the Republic of Ireland; in 2018 through its Royal London Irish branch within the Intermediary division and from 2019 onwards through its subsidiary RLI DAC.

In 2018 the Group updated its structure for internal reporting. This restructure has resulted in the creation of two new operating segments: Legacy, which was previously reported within the Consumer reporting segment; and RLAM which was previously reported within Wealth. The other component previously included in the Wealth division was Ascentric, which is now classified within Other. The Group is therefore now organised into the divisions set out in the table below.

Division	Description
Intermediary	Intermediary business is sold via advisers and comprises: › Our pensions business, providing pensions and other retirement products to individuals and to employer pension schemes in the UK; and › Our protection businesses in the UK and Republic of Ireland which provide protection products to individuals.
Consumer	The Consumer division sells and administers insurance and protection products directly to consumers.
RLAM	RLAM provides investment management services to the other entities within the Group and to external clients, including pension funds, local authorities, universities and charities, as well as individuals.
Legacy	The Legacy division comprises the operations of the Group which are closed to new business.
Other	Other comprises mainly central Group functions and includes Ascentric, the Group's wrap platform.

A.1.7. Significant events over the reporting period

New insurance subsidiary in the Republic of Ireland and Part VII transfer

RLI DAC was incorporated during 2018 and was authorised to write new life insurance business in the Republic of Ireland by the CBI with effect from 1 January 2019. Further details of becoming a SII insurance Group and the impact of the Part VII transfer on RLMIS are set out in Appendix 1.

Royal London GAR Compromise Scheme ('the Scheme')

Prior to implementation of the Scheme, a number of policies within the SL Fund included a guarantee known as a GAR (also known as a Guaranteed Annuity Option (GAO)). The GAR enabled policyholders to purchase an annuity at a guaranteed rate as opposed to the market rate, provided an annuity was taken through the Company. The Scheme provides eligible policyholders with an uplift to their retirement savings without the restriction of having to take out an annuity through the Company.

On 7 November 2018 legal approval was obtained for the Scheme. Under the Scheme the fund value of certain policies, together with any future regular premiums, has been uplifted in exchange for the removal of the policies' GAR. The Scheme's effective date was 7 December 2018. Of the 31,959 eligible plans, with an aggregate GAR value of approximately £520m, 27,034 have had their GARs removed and their plan values uplifted. The remainder retained their GARs. As this occurred before the balance sheet date, the numbers reported in this document include the impact of the Scheme.

Rating agencies

In July 2018, Standard and Poor's reaffirmed Royal London's counterparty credit rating of A, with a stable outlook. In September 2018 Moody's affirmed our existing A2 insurance financial strength rating with a stable outlook.

A.2 Underwriting performance

A.2.1. Underwriting performance

Management monitors the performance of the business using EEV. EEV is prepared in accordance with the EEV Principles issued in April 2016 by the CFO Forum. EEV operating profit before tax is a key metric to demonstrate the underwriting performance of the business. Alongside our EEV reporting, the Company also reports its results under IFRS. The key differences are outlined in notes (i) and (j) on pages 196 and 197 of the 2018 ARA.

The EEV operating profit by operating segment is shown in the following table, together with a reconciliation of the total EEV operating profit before tax to the IFRS result before tax. The 2017 comparatives have been restated following the restructure of internal reporting. The vast majority of the Company's business is written in the UK. The Irish branch within the Intermediary division wrote some Protection business in 2018 (from 2019 onwards this will be reported by RLI DAC), but it is not currently significant in the overall context of the Company so no split of the underwriting performance by geographical area has been provided.

Split of EEV operating profit by business unit

	2018 £m	2017 Restated £m
Intermediary		
› Pensions	**388**	363
› Protection	**5**	54
Consumer	**25**	(8)
RLAM	**105**	76
Legacy	**80**	82
Other items	**(207)**	(238)
EEV operating profit before tax	**396**	329
Amortisation of intangibles	**(7)**	(11)
Valuation differences between EEV and IFRS	**(71)**	(22)
Economic assumption changes and investment return variances	**(204)**	352
Pension scheme's costs recognised in profit	**(27)**	(4)
Financing costs	**(48)**	(47)
ProfitShare	**(150)**	(142)
IFRS result before tax and before (deduction from)/transfer to the UDS	**(111)**	455
Tax credit / (charge)	**63**	(103)
(Deduction from) / transfer to the UDS	**(48)**	352
Transfer to the unallocated divisible surplus (OCI)	**53**	82

As a mutual, the transfer to the UDS is a key measure of accumulation of funds available for us to share, at our discretion, with eligible customers and members.

Our IFRS total transfer to UDS, including OCI of £53m (2017: £82m), was £5m (2017: £434m). The decrease from 2017 was a result of challenging economic conditions in 2018. This was driven primarily by equity market losses as a result of continued political and economic uncertainty impacting global stock markets and monetary policy.

Premiums, claims and expenses by SII line of business for the Company are included in S.05.01.02 in Appendix 2. The QRT provides details of premiums, claims and changes in technical provisions, which are components of underwriting performance, by SII line of business.

A.3 Investment performance

A.3.1. Investment income and expenses split by asset class

The Company uses investment return as a measure of investment performance. The following tables show investment return, including income and expense components for the Company split by SII asset class.

	Investment income/(expenses) for year ended 31 December 2018					
	Bonds £m	Equities £m	Loans £m	Investment property £m	Other financial investments[1] £m	Total £m
Dividends	-	342	-	-	795	1,137
Interest	668	-	-	-	11	679
Net realised gains/(losses)	(285)	(24)	-	-	(132)	(441)
Net unrealised gains/(losses)	(568)	(848)	-	64	(2,792)	(4,144)
Rental income	-	-	-	178	-	178
Total investment return	**(185)**	**(530)**	**-**	**242**	**(2,118)**	**(2,591)**
Investment expenses						**(112)**
Net investment return after deduction of investment management expenses						**(2,703)**

	Investment income/(expenses) for year ended 31 December 2017 - Restated					
	Bonds £m	Equities £m	Loans £m	Investment property £m	Other financial investments[1] £m	Total £m
Dividends	-	321	-	-	569	890
Interest	740	-	-	-	(32)	708
Net realised gains/(losses)	(126)	66	-	178	274	392
Net unrealised gains/(losses)	403	665	1	80	2,181	3,330
Rental income	-	-	-	214	-	214
Total investment return	1,017	1,052	1	472	2,992	5,534
Investment expenses						(103)
Net investment return after deduction of investment management expenses						5,431

1 Other financial investments include unit trusts and collectives, derivatives, deposits with credit institutions and other investments.

Investment income and expenses were previously reported in this report in line with our IFRS disclosures in the ARA. The 2017 comparatives have been restated to present investment income and expenses by SII asset class and to be consistent with the 2018 presentation.

Our investment performance is measured both in absolute terms and against benchmarks looking at different asset returns, such as property, equities and bonds. Each of our funds has different benchmarks to reflect their mix of assets and to ensure we are comparing like with like.

Global equity markets have experienced an increased level of volatility in 2018, driven by continued political and economic uncertainty as well as talk of trade wars. Initial gains across equity markets were outweighed by market losses during the last quarter of 2018.

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During the year our investments backing the asset shares of the Open Fund, our largest fund, achieved a return of -2.2% against a benchmark of -2.4% (2017: a return of 9.5% against a benchmark of 9.0%). This performance was across a number of asset classes underpinning the fund. 2018 returns on key asset classes such as equities and bonds (and other financial investments which track those indices such as collectives) were negative following positive returns in 2017; albeit still outperforming benchmark returns.

The increase in investment expenses in 2018 is primarily a result of higher investment management expenses relating to the property fund which was launched in the last quarter of 2017, partially offset by a reduction in the fees paid to RLAM driven by the lower investment returns in 2018 compared to the strong investment returns in 2017.

There were no gains or losses recognised directly in equity (i.e. UDS) during the reporting period (2017: none).

A.3.2. Investment in securitisations

Securitisations are where various types of contractual debt (including for example residential and commercial mortgages) are pooled together and the related cashflows are sold to third party investors, with repayments made from the principal and interest cash-flows.

At 31 December 2018, an amount of £474m (31 December 2017: £368m) was held in collateralised securities, representing approximately 0.5% (31 December 2017: 0.4%) of the total bonds on the balance sheet.

There are two main categories of securitisations that are defined in the SII regulations: Type 1 and Type 2 securities. Type 1 securities are deemed less risky due to the fact that they are listed on a regulated market in the European Economic Area (EEA) or Organization for Economic Co-operation and Development (OECD). Type 2 assets are higher risk; the difference in risk is reflected in their impact on the SCR.

Of the total exposure to securitisations of £474m, 38% (31 December 2017: 27%) was in Type 2 securities, which relates to mortgage bonds considered to have higher risk. The remaining amount is all held in Type 1 securities and these are considered to be higher quality.

A.4 Performance of other activities

A.4.1. Other income and expenses

EEV operating income and expenses are illustrated in section A.2.1 above. The EEV Consolidated income statement on page 187 of the 2018 ARA includes 'Strategic development costs and other items' of £111m (2017: £208m). These items represent a combination of:

- corporate costs and other development costs, which are typically investments made to improve future profits (for example, by reducing ongoing expense levels or increasing new business volumes); and
- other non-recurring items. As an example, this would include the impact of any changes in the way the business is modelled and improvements to valuation techniques.

A breakdown of these items is shown in the table below.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Strategic development costs	(105)	(23)
Corporate and other development costs	(82)	(222)
Modelling and other changes	76	5
Restructure of reinsured unit-linked funds	-	32
Total	(111)	(208)

In 2018:

- The 'strategic development costs' continue to include development of our Pensions platform and brand.
- The 'corporate and other development costs' include provisions that have been set up to cover the costs associated with the servicing of remediation and future developments arising from regulatory change.
- The 'modelling and other changes' component reflects modelling and methodology changes. Total model changes of £35m relate to improvements in our modelling as a result of the completion of our actuarial model transformation. Other changes include an increase in Funeral Bond annual management charges and the acquisition of RLUM by the Open Fund (a unit trust subsidiary previously owned by RL (CIS)).

In 2017:

- The 'strategic development costs' included development of our Pensions platform and brand.
- The 'corporate and other development costs' included provisions that had been set up for providing future change such as IFRS17, MiFID II and upgrading our premises. Other items included provisions relating to the costs of servicing historic remediation and expected costs associated with setting up a new legal entity in the Republic of Ireland following Brexit.
- The 'modelling and other changes' component reflected modelling and methodology changes.
- The 'restructure of reinsured unit linked funds' reflected the restructure of the £2.5bn unit linked funds previously reinsured with BlackRock Life. A benefit of £32m was generated from the release of the provision for reinsurer default.

A.4.2. Material leasing arrangements

The most material finance lease arrangements for the Company are in relation to leasehold investment properties. The total future minimum lease payments due under these non-cancellable leases were £4m in 2018 (2017: £11m), with the amount being recognised within 'payables and other financial liabilities' in the 2018 ARA. The future minimum lease payments due under operating lease arrangements were £27m at 31 December 2018 (31 December 2017: £15m) and mainly relate to rent payable on properties used for operational activities.

A.5 Any other information

A.5.1. Other disclosures

The Company's material intra-group transactions can be summarised as follows:

- Subordinated liabilities;
- Subsidiary transactions with Open-Ended Investment Companies (OEICs) and other investment funds;
- Administration and investment management services provided by related undertakings;
- Loans (and related interest) provided to related undertakings;
- Other income received from related undertakings (primarily OEIC distributions, OEIC management fee rebates, subsidiary dividends received and rental income);
- Acquisitions and sales of holdings in OEICs and other funds; and
- Transactions with key management personnel (primarily remuneration only).

The intra-group transactions are set out in detail in note 38 of the 2018 ARA on pages 165 to 166.

B. System of Governance

Plain English introduction

In this section, we describe our system of governance. This means the system through which the Company is directed and controlled. The Board of Directors (the Board) has ultimate responsibility for the financial condition of Royal London and is answerable to its owners; the members.

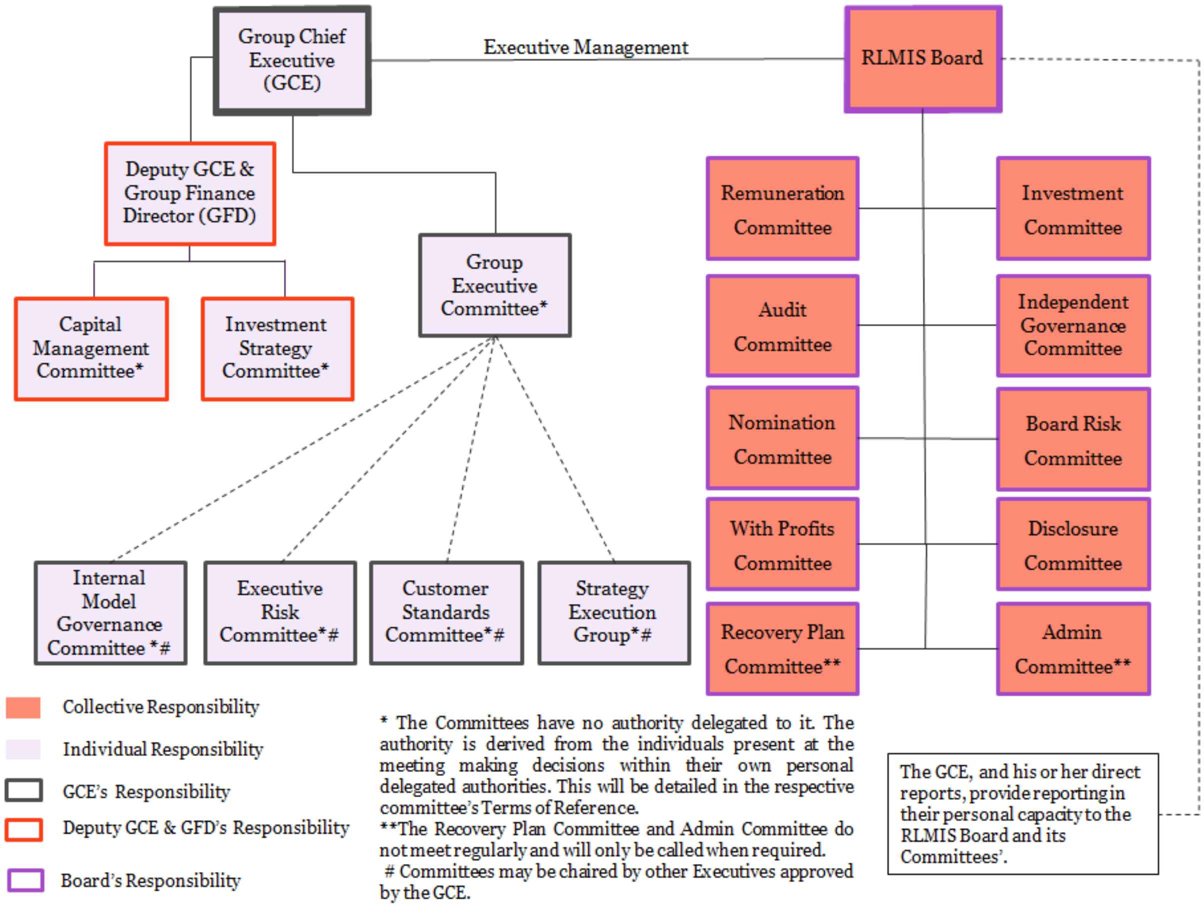
We also describe here our remuneration policy and practices and our adherence to the 'Fit and Proper Requirements', which is the standard required by the regulators when appointing employees who effectively run the Company or have other key functions.

The Board is committed to high standards of corporate governance, which it believes are critical to business integrity and performance. The Board believes that implementing an effective Risk Management System (RMS) is fundamental to achieving these high standards, and we describe how this works in detail in this section of the report.

B.1 General information on the system of governance

B.1.1. Governance structure

The following diagram illustrates the Company's corporate governance structure.



The Board

The Board's actions are subject to applicable laws, regulations and the direction of the members in general meetings. Good governance however goes beyond compliance with statutes, rules and regulations and is core to how the Company carries on its business. The Board maintains a focus on the strategic objectives of the Company, to ensure that it is appropriately managed and that it achieves these objectives.

The directors are responsible for promoting the success of the Company. A director must act in the way he or she considers, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- The likely consequences of any decision in the long term;
- The interests of the Company's employees;
- The need to foster the Company's business relationships with suppliers, customers and others;
- The impact of the Company's operations on the community and the environment;
- The desirability of the Company maintaining a reputation for high standards of business conduct; and
- The need to act fairly with members of the Company.

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The Board is committed to maintaining high standards of corporate governance and believes that a sound corporate governance framework enables efficient and effective decision making with clear responsibilities, which contribute to achieving the Company's objectives and delivering long-term value to members.

The Board sets the Company's strategic aims, ensures that the necessary financial and human resources are in place for the Company to meet its objectives and reviews management performance. The Board sets the Company's values and standards and ensures that its obligations are understood and met.

In carrying out these responsibilities, the Board must have regard to what is appropriate for the Company's business and reputation, the materiality of the financial and other risks inherent in the business and the relevant costs and benefits of implementing specific controls.

A description of the Board's roles and responsibilities, composition and an assessment of the Board's effectiveness, is set out on pages 52 to 56 of the Corporate Governance Statement in the 2018 ARA.

The professional biographies of all the directors can be found in the 2018 ARA on pages 48 to 49. The biographies summarise the directors' experience, qualifications and any other significant commitments outside the Company.

The GCE delegates certain responsibilities to his direct reports. The Group Executive Committee (GEC) has been put in place by the GCE to support him in the discharge of his responsibilities. A number of committees have been created to assist the GCE in his decision making or to monitor certain Company activities.

In turn the GCE's direct reports may delegate this authority to their direct reports and so forth. This is detailed in their role profiles as well as being inherent in the positions which they hold within the Company.

The GCE and his direct reports may choose to form a committee to assist them in their respective decision making. The authority for these 'Executive' committees comes from the individuals themselves. It is important to highlight that a key element of corporate governance is good risk governance. Risk governance is defined as the application of the principles of sound corporate governance to the identification, assessment, management, monitoring and reporting of risks within the defined risk appetite (which is determined by the Board).

The Company operates within a RMS that is applied Group-wide. An effective RMS has been implemented across the Group and Company.

The RMS enables the Board to gain assurance that the risks to which the Group and Company may be exposed are being appropriately identified and managed within risk appetite, and that risks that may present significant financial loss or reputational damage are being minimised.

The RMS seeks to support our business ambitions, enabling us to select those risks that can give sustainable returns, whilst closely managing those risks that are unrewarded, and to optimise the capital that is held so that we can deliver our strategy for the benefit of policyholders and members. The Board ensures that senior management implements risk policies, delivers the business plan within risk appetite and manages the risk profile.

Key functions

The key functions, their roles and broad responsibilities are summarised below:

Key Function	Main roles and responsibilities
Risk	As the second line of defence, provides independent oversight and challenge over the identification, assessment and management of all significant risks to ensure the Company is operating within agreed risk appetite. Designs and maintains the RMS, facilitating and overseeing its embedding. Supports the Board in its ownership of the Company's Internal Model including testing and validation. See sections B.3 and B.4.1 for more detail.
Compliance	Oversees and monitors regulatory compliance as the second line of defence, to ensure that the business is managing its regulatory risk exposures appropriately and that controls are effective. See section B.4.2 for more detail.
Actuarial	The Actuarial function coordinates the calculation of technical provisions, provides opinions on the underwriting policy and reinsurance arrangements and contributes to the effectiveness of the RMS. See section B.6 for detail.
Internal audit	Acts as the third line of defence in assessing the adequacy and effectiveness of the RMS and ICS. Reviews Group Risk & Compliance (GR&C) activity to assess its capability as a second line of defence. See section B.5 for detail.

System of Governance (continued)

The PRA's definition of key functions extends beyond Risk, Compliance, Actuarial and Internal Audit.

The system of governance also includes additional key functions that are considered of specific importance to the sound and prudent management of the Company. They are recorded on the Company's responsibilities map.

Key functions may be identified as having one or more of the following characteristics:

- Essential for the Company's proper functioning, taking account of its business activities and risks;
- Is responsible for material financial risks within the Company;
- Contains a competence that is difficult to replace; and
- May pose a serious threat to the interests of the Company or policyholders if ineffective.

The SMCR replaced the PRA's SIMR and the FCA's Approved Persons Regime, on 10 December 2018. SMCR was already applicable to the banking sector and now applies to insurers regulated by the PRA and FCA, with the aim of strengthening individual accountability in regulated UK financial services firms. The Company is fully compliant with this regime and a responsibilities map containing Senior Management Functions (SMF) and Key Function Holders (KFH) has been produced and provided to the regulator.

The following points are relevant to the role of KFHs within the Company:

- KFHs are designated SMF holders, or report directly to a SMF holder;
- Key functions are allocated according to the nature, scale and complexity of the Company's risks and consistent with individuals' delegated authorities; and
- None of the Company's key functions are outsourced.

B.1.2. Material changes in the governance structure

During the year, the CMC (that assists the Deputy GCE and GFD in undertaking his responsibilities) transferred strategic investment matters to a new ISC. The ISC has no authority delegated to it, other than that delegated to the Executives who are members.

RLI DAC was incorporated during 2018 and was authorised to write new life insurance business in the Republic of Ireland by the CBI with effect from 1 January 2019. Further details are provided in Appendix 1. RLI DAC has its own Board of Directors, which includes two Non-Executive Directors and has also established Audit and Risk committees.

B.1.3. Remuneration policy and practices

The Company implements a remuneration policy which has four main aims:

- To align executives' interests with those of members and customers;
- To support the delivery of the Company strategy, whilst ensuring adherence to the Company's risk appetite;
- To ensure remuneration is competitive to enable the Company to attract and retain talent whilst ensuring remuneration packages do not encourage the taking of undue risk; and
- To ensure fair outcomes for our people, members and customers.

The Company has a Remuneration Committee (Remco), made up of Non-Executive Directors and advised by independent remuneration consultants. The Committee fully understands its obligations in respect of the appropriate balance between risk and reward and overseeing the development of the Company's remuneration policies and practices. The Remco's primary role is to ensure that the Company's pay structure is fully aligned with these aims.

Full details of the principles of the Company's remuneration policy and practices, including the pay structure and components for the Board are included in the Directors' remuneration report on pages 72 to 83 of the 2018 ARA, together with the contents of Executive and Non-Executive Director remuneration with comparatives for the prior year.

B.1.4. Transactions with shareholders and/or management
There were no material transactions between the Company and members of the Board or senior management, other than remuneration.

As a mutual, the Company has no shareholders. We return value to our members and policyholders in the following methods:

- Positive investment returns on policies;
- Payouts made to maturing policies during the year; and
- ProfitShare.

ProfitShare is a way of sharing financial success with eligible policyholders, and is allocated by an enhancement to the asset shares and unit fund values of eligible policies. The allocation of ProfitShare each year is at the discretion of the Board. Whether a ProfitShare allocation is made, and how much is distributed to members, will depend on the Board's view on matters such as our financial performance, capital position and the risks and volatility in financial markets.

We welcomed more than 200,000 new members to the Group in 2018, taking the total to 1.4 million. This shows a dramatic increase over time – in 2012 at the start of our new strategy, membership totalled 530,000.

ProfitShare increased to £150m (2017: £142m) following growth in membership while maintaining the level of award to existing members.

There were no other transactions with the members or management of the Company, other than in their capacity as policyholders during 2018 (2017: none).

B.2 Fit and proper requirements

B.2.1. Skills, knowledge and expertise
An F&P policy is adopted by the Company to ensure functions are led by appropriately skilled people. The policy has been refreshed following implementation of the SMCR, effective from 10 December 2018.

The policy sets out the approach for managing and assessing the governance arrangements, regulatory requirements and minimum standards to be adhered to within the Company.

The specific requirements within the policy in respect of skills and experience can be summarised as follows:

- Senior management must ensure that employees are aware of the procedures which must be followed for the proper discharge of their responsibilities;
- Each business division within the Company must be appropriately structured to ensure there is a collective understanding in the areas of market knowledge, business strategy and business model, system of governance, financial and actuarial analysis (where required) and the regulatory framework and requirements of that business;
- There must be an ongoing training and development programme designed and delivered for members of boards within the Company as well as for executive management; and
- The Company must employ personnel for any role with the skills, knowledge and expertise necessary to discharge the responsibilities allocated to them. This includes an employee's ability to achieve a good standard of ethical behaviour.

B.2.2. Assessing fitness and propriety
The Company adopts appropriate systems and controls for the recruitment and ongoing assessment of any individual in the Company, in particular those performing specific controlled functions, to ensure that identified individuals meet the PRA's and FCA's F&P criteria.

The processes include assessing the required qualities, both professional competence and the propriety of the person. Professional competence, i.e. management and technical competence in the relevant areas for each role, is based on the person's experience, knowledge and professional qualifications and also whether this person has demonstrated due skill, care, diligence and compliance with relevant standards in the area in which he/she has worked. Such a person should also be of good repute and the assessment includes obtaining relevant references.

EXECUTIVE SUMMARY
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At Board level, the Nomination Committee ensures there is a rigorous procedure for appointment to the Board and is responsible for evaluating the skills, knowledge and experience of the Board. The responsibilities of the Nomination Committee are set out on page 61 of the Corporate Governance statement in the 2018 ARA.

At a functional level, an appropriate recruitment process for managerial roles is adhered to within the people and corporate affairs processes outlined above. The processes that operate before and during a person's employment include, but are not restricted to:

- Identity checks;
- Previous employment references;
- Criminal record checks; and
- Verification of qualifications and satisfactory personal and professional references.

In addition, the Company also carries out continuing assessment: at functional and local levels there are performance appraisal processes in place to assess the F&P requirements on an ongoing basis.

B.3 Risk management system including the Own Risk and Solvency Assessment (ORSA)

B.3.1. Risk management strategies and processes

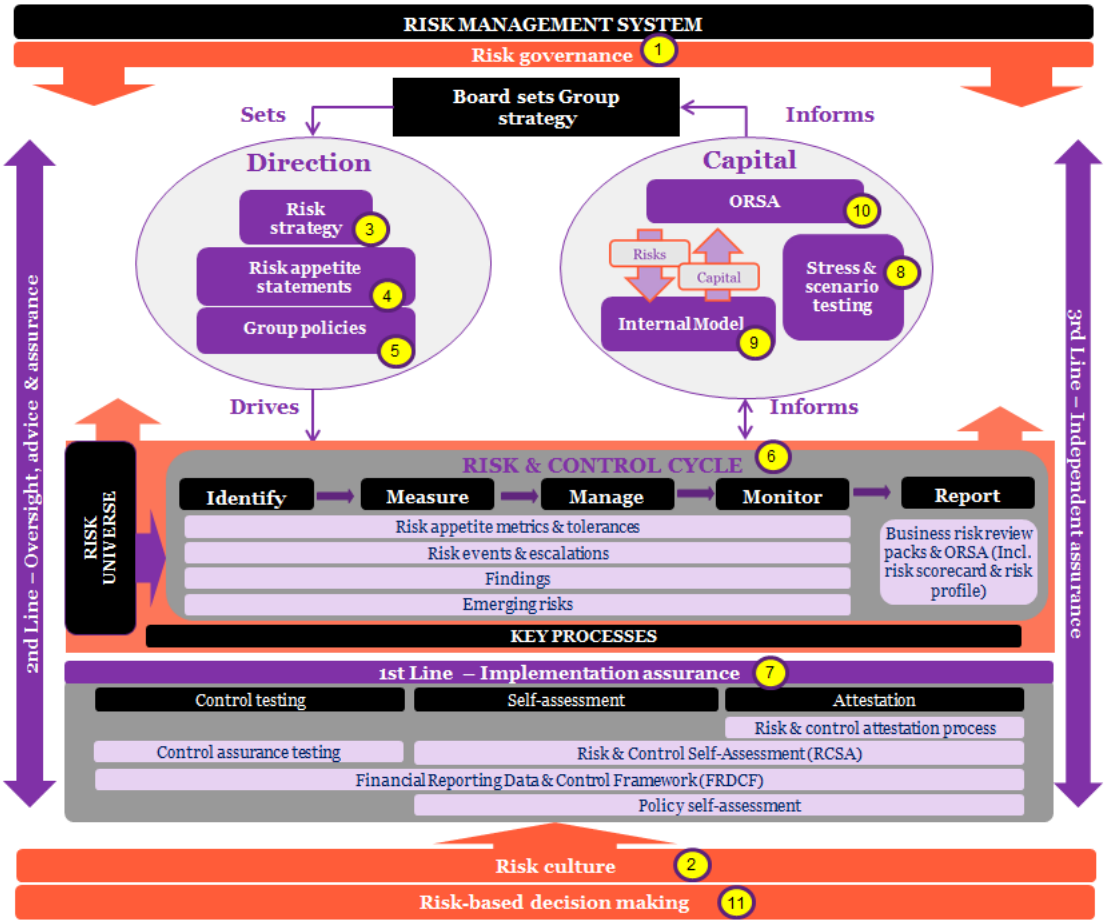
The Board ensures that senior management implement risk policies, deliver the business plan within risk appetite and manage the risk profile. This is achieved by implementing robust risk management and internal control systems. These are described in detail on pages 38 to 44 of the 2018 ARA.

The RMS enables the Board to gain assurance that the risks to which the Group and Company may be exposed are being appropriately identified and managed within risk appetite, and that risks that may result in significant financial loss or reputational damage are being minimised. This helps to ensure that the achievement of our performance and objectives is not undermined by unexpected events.

The governance structure for risk management is based on the 'three lines of defence' model. Primary responsibility for risk management lies with the business units and specialist operational process functions. A second line of defence is provided by the independent Risk and Compliance function, a specialist function which undertakes monitoring, challenge and policy setting. The third line of defence is provided by Group Internal Audit (GIA), which provides independent assurance.

System of Governance (continued)

The diagram below depicts, at a high level, the RMS and its interaction with the capital management framework:



These RMS components and their integration into the organisational structure are further explained below.

(1) Risk governance
Risk governance is the application of sound corporate governance principles to the identification, assessment, management, monitoring and reporting of risks within the risk appetite determined by the Board.

(2) Risk culture
People at all levels of the organisation are engaged in the management of risk. This is realised through a strong 'tone from the top' which emphasises the importance of effective risk management in day to day activities and decision making, of making management accountable for their management of risk and of the embedding of risk management in their business units.

(3) Risk strategy
The risk strategy sets out the key principles underlying how the Company approaches and manages the risks that it is or could be exposed to, in the pursuit of its business objectives. These principles, along with the business strategy, help define the risk preferences. Risk preferences articulate the extent to which the Company views certain risks as being desirable or undesirable to take on and manage, or is neutral towards, thereby providing structure to the decision making processes.

The risk strategy and risk preferences are used to provide direction and assistance in making key decisions relating to risk and capital management, including business planning, acquisitions, project/resource prioritisation, product design and pricing, risk management, performance management and external reporting.

(4) Risk appetite statements
The Board recognises that a well-defined risk appetite supports business decision making and business planning. It helps establish the framework for strategy setting, planning and risk management. Together with risk preferences it provides guidance to management on balancing risk and reward in making key decisions. The risk appetite framework consists of the risk strategy, risk appetite statements, metrics and tolerances.

The Board sets and approves the risk appetite framework annually, on the recommendation of the Board Risk Committee (BRC). The risk appetite framework and the high-level risk categories under which the Board-approved risk appetite statements are constructed are set out on pages 63 to 64 of the 2018 ARA.

The key metrics and associated tolerances, which form the basis for risk reporting, help the Company and its business units monitor their risk profile and assess their position against risk appetite. The regular management information (MI) received by the Board and BRC includes a risk appetite dashboard setting out actual risk positions relative to the targets and limits set in the risk appetite.

(5) Group policies
Group policies set out the standards to be maintained in order to manage risk effectively. The Board ensures that policies are regularly reviewed to reflect the changing commercial and regulatory environments as well as the organisational structure. The principal risks facing the Company are set out on pages 41 to 44 of the 2018 ARA.

The Company has established strategies for managing insurance, market, credit, liquidity, operational, conduct, strategic and MTP, and emerging risks. Formal policies define the approach to risk management and the minimum control standards that should be applied in managing significant risk exposures. This is explained further in section C – Risk Profile.

(6) Risk and control cycle
a) Risk universe
A key element of effective risk management is to ensure that the business has a complete and robust understanding of the risks it faces. The risk universe is a common categorisation of risks, split into three levels with each level providing a deeper level of detail than the previous one.

b) Risk identification and assessment
The Company operates a risk identification and assessment process under which business units regularly consider changes in the profile of existing and emerging risks. The assessment process evaluates the risks that are inherent in products as well as those that are caused by changes in the environments in which it operates.

The Company's risk identification and assessment process forms part of its broader ORSA process designed to evaluate the resilience of the Company's balance sheet to a range of market conditions and external events and to monitor target levels of capital.

c) Key processes
The common categorisation of key processes ensures the business has a consistent understanding of the key processes that it operates. This also supports the Company in identifying key risks and controls specific to these processes and assigning them to appropriate owners.

d) Risk management and monitoring
Key Risk Indicators (KRIs) at Company and business unit level are developed to assess performance against stated risk appetite. Legal entity or business unit specific KRIs are used allowing different risk profiles to be monitored effectively. KRIs provide beneficial information to management about whether a risk has crystallised or the probability of it crystallising is decreasing or increasing. This information allows management to take early mitigating actions. A range of risk management techniques is deployed to manage and mitigate risks, thereby controlling risk exposures in line with risk limits. These mitigating techniques are described in more detail in section C – Risk Profile.

e) Risk management information and reporting
The Company's MI is structured to enable all significant risk positions to be monitored: actual risk exposures and capital positions are compared to targets/limits and those tolerances which have been established as part of the risk appetite framework.

(7) Risk implementation and assurance
The Company operates a 'three lines of defence' model in line with industry standards as described on pages 38 to 39 of the 2018 ARA. This provides assurance to the Board that the RMS, together with the internal control system (see section B.4), has been designed, adhered to and maintained to the highest standard. Risk assurance activities also help to identify deficiencies or limitations which require mitigating actions and to ensure that the RMS is aligned with external best practice.

In order to demonstrate that the RMS has been designed and is operating effectively, and to identify potential improvements, a programme of independent risk assurance is in place. This includes several components that involve all three lines of defence:

- Risk and business control policy owners are required to review the extent to which their policies have been properly embedded;
- The Risk and Control Self-Assessment (RCSA) process requires first line managers to assess their own risk management and control processes;
- The Financial Reporting Data & Control Framework (FRDCF) requires certain staff to assess their financial controls, and management to certify the adequacy of the internal controls over the Company's Internal Model data and financial reporting risks;
- The risk and control attestation process requires executive management and their direct reports across the Company's functions and business units to certify the adequacy of the risk and control data maintained, and the effectiveness of the RMS operated;
- First line independent control testing is planned using a risk-based approach and carried out on risks and respective controls;
- GR&C carries out independent reviews on the operation of embedding activities and maturity across the Company, reviewing specific risk-related matters that are both thematic and business unit or Company function specific;
- The Chief Risk Officer (CRO) works closely with the BRC and the Board on articulating acceptable risk taking and ensuring the effective operation of the risk and capital framework. GR&C provides objective advice and guidance on a range of risk matters to business managers, including matters such as product development and business transactions. GR&C also plans and carries out structured reviews of compliance with regulatory requirements; and
- GIA reviews GR&C activity to assess its capability as a second line of defence in addition to reviewing the adequacy of risk management and associated internal control activity.

(8) Stress and scenario testing
In order to understand the nature of the risks better and identify weaknesses in the management of risk, various stress and scenario tests are performed. This may involve specialist areas such as GR&C and the Actuarial function to assist in providing test scenarios and metrics. These range from simple sensitivity analysis where the impact of a change in an individual assumption is assessed, through more complicated stress tests involving a combination of different changes to the consideration of scenarios that have more wide-ranging impacts. The scenarios can concentrate on operational risks or can consider all types of risk arising from the chosen scenario. These include reverse stress tests, which consider circumstances that could result in failure of the Company's business model. Stress testing and scenario analysis are described further in section C – Risk profile.

(9) Internal Model
The Internal Model reflects processes, systems and calculations that together allow the Company to control the risks that it faces and quantify the capital needed to support those risks. It includes a calculation engine to quantify capital requirements, the Company's risk management framework and its system of governance. Our internal capital model is already used for internal capital management purposes. We have submitted an application to the PRA to use an Internal Model to calculate our capital requirements for regulatory purposes and anticipate that our application will be approved before the end of 2019.

(10) ORSA
The ORSA is described in section B.3.2.

(11) Risk based decision making
The role of the ORSA in informing decision making is described in section B.3.2.

To support the Board and Committees with risk based decision-making, risk information must be provided by the business, using the Internal Model to quantify it where possible for making key decisions.

B.3.2. Own Risk and Solvency Assessment (ORSA)

The ORSA process is connected to the business planning process and is conducted as part of the overall governance and control system.
The ORSA process tests the business strategy, as articulated by the Company's business plan, against the agreed risk and capital appetite and limits through rigorous and business-relevant stress and scenario testing. The results are then fed back into decision-making processes to ensure the residual risk remains within the Company's risk appetite.

The ORSA is based on a range of inputs, processes and outputs as illustrated in the diagram below.

The key findings, results and conclusions are combined to form reports to the Board. The ORSA is reviewed and approved by the Board on an annual basis.

Consideration of any distributions (i.e. to policyholders or movements in own funds to be paid by the Company) will have regard to the actual level of capital compared to target, which is set by reference to the Capital Management Framework.

The ORSA is governed by the ORSA policy which is reviewed annually to ensure it remains fit for purpose and complies with relevant requirements.

All elements of the ORSA were considered during the course of the year and the most recent ORSA document was submitted to the PRA in December 2018.

The stages below describe how the Company conducts its ORSA and how it is integrated into the organisational structure by engaging key people throughout the Company in assessing and challenging its key findings.

- Each key function or area provides key data required for the ORSA process. The data inputs are required to be consistent with the Financial Reporting Data Quality Standards (part of the Data Quality Framework), which stipulates that the data supplied must be appropriate, complete and accurate, and meet SII data quality requirements;
- There are six main steps performed in order to assess the inputs and complete the ORSA. The Business divisions and Company functions complete elements of these which feed into the overall assessment. Each process needs to be documented in full, providing both a record of the process followed and supporting the drafting of the ORSA report; and
- The key findings, results and conclusions are combined to form reports to the BRC and the Board for their challenge and sign off. The report is also distributed to the various key stakeholders. In addition, a record of the ORSA process is maintained to provide evidence of the process performed.

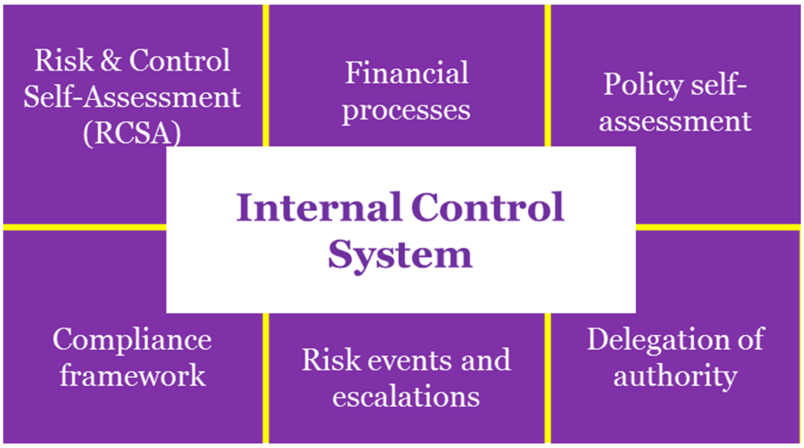
The conclusions of the ORSA report address/cover the following key themes:

- Evaluation of the Company's risk profile taking into account emerging risks relative to its Risk Appetite Framework and Capital Management Framework which are approved by the Board;
- Review of the appropriateness of the risk and capital management frameworks and actions/ recommendations where improvements have been identified;
- Verification of whether the Company has operated within its risk appetite and capital requirements; and
- Informing the Board and management committees of areas where actions are required in the decision making processes.

B.4 Internal Control System

B.4.1. Internal Control System (ICS)
The ICS is designed to provide reasonable assurance to the Board and Senior Management over the effectiveness and efficiency of the Company's internal control environment. The ICS supports our RMS by putting methods and processes in place to achieve effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The following diagram illustrates the key elements of the ICS:



The ICS is supported by the internal control policy and its components are explained further below:

Component	Description
RCSA	RCSA is an ongoing process performed by first line business management across the Company. It provides a systematic approach for the identification and assessment of risks, contributing factors to weaknesses that could prevent achievement of process, business and Company objectives, and clear oversight of the control environment to enable the Company to operate and evidence effective controls. In conjunction with control assurance testing and attestation, the RCSA validates processes are operating effectively, and enables timely identification and addressing of any potential failure to control risk as well as potential gaps or inaccurate data in the ICS. The RCSA forms an input to the annual review by the Board and Audit Committee on the effectiveness of internal controls.
Financial processes	Finance is responsible for the regular assessment of the adequacy and appropriateness of the control environment over Finance and Actuarial activities that could have an impact on the financial position of the Company. FRDCF provides assurance over this regular assessment. This includes internal and external financial reporting, management of payments and receipts, tax management, valuation of assets and liabilities, management of staff pension schemes and compliance with relevant regulatory standards and law. Finance activities include establishing appropriate controls over: › the production of accurate and timely financial MI, reports and the monitoring of these both within Finance and from the appropriate data sources; › the calculation, use and reporting of technical provisions and capital numbers; › the distribution of surplus; and › actuarial models including valuation models. Finance is also responsible for monitoring required and available Company-wide capital levels on both regulatory and internal bases, and reporting on these.

Component	Description
Policy self-assessment	The policy self-assessment is performed by first line management across the Company over how well each policy has been embedded and their compliance with each of the policy requirements. As part of the annual assessment all business units are required to: › have action plans in place to address gaps against requirements; › provide a self-assessment rating (red, amber or green) based on prescribed criteria; and › justify the rating, supported by appropriate evidence/documentation. Executive policy owners, supported by policy content owners (subject matter experts) are responsible for reviewing and challenging the self-assessment and reporting findings to the Executive Risk Committee (ERC).
Delegation of authority	Executive management of the Company is delegated by the Board to the GCE, who may further delegate to his direct reports. Authority delegated in this way is detailed in the role profiles of the individuals, as well as being inherent in the position which they hold within the Company. The GCE and his direct reports may choose to form Executive Committees to assist them in their respective decision making. The authority for these committees comes from the individuals themselves and the committees have no executive powers delegated to them. Levels of delegation principles are set out in the Corporate Governance Manual, role profiles and monetary authority limits.
Risk events and escalations	As part of the Company's risk event process, an escalation process is in place to capture, communicate and respond to the most significant issues facing the Company at any one time. These cover events where a breakdown in controls has led to significant loss, customer impact, regulatory censure and/or reputational damage. The significance of each breach and escalation is assessed in terms of the number of customers impacted and the potential or actual customer detriment. If this is a material breach then the details are notified to the appropriate regulator.
Compliance framework	The compliance framework is in place to safeguard the Company, its customers, members, reputation and assets and help the business achieve its objectives by creating a culture of compliance with regulatory requirements, and identifying and mitigating regulatory risk. See section B.4.2 for further detail on the compliance framework and function.

GR&C act as a second line of defence by providing independent oversight and challenge of the RCSA and policy self-assessment to ensure the Company is operating within agreed risk appetite. GIA performs independent assurance activity by testing and validating the internal controls and informs the Board of the effectiveness of the ICS. The Audit Committee and BRC perform an annual joint review of the GIA and GR&C assurance plans.

B.4.2. Compliance function

The financial risk team within GR&C performs a second line of defence role to oversee and monitor SII compliance. This forms part of GR&C's overall responsibilities for overseeing and monitoring compliance with all applicable laws and regulations, including our conduct responsibilities, with the first line having responsibility for implementing controls to manage and mitigate regulatory risks. Under SMCR, the CRO, with the support of the Head of Compliance Advisory is responsible for overseeing compliance with SII requirements. In overseeing and monitoring compliance with SII requirements, including the assessment of the adequacy of measures adopted to prevent non-compliance, the financial risk team manages a plan of activity to ensure the Company manages its regulatory risk exposures appropriately and has effective controls in place.

The Group Compliance Function (GCF) works within an agreed regulatory footprint and is the key point of liaison with all regulators. All monitoring and oversight processes, whether covering prudential or conduct regulatory requirements, follow established and consistent practices.

B.5 Internal audit function

B.5.1. Overview

The Company operates a Group-wide GIA function. The primary role of GIA is to help the Board protect the assets, reputation and sustainability of the organisation. GIA operates as the third line in the 'Three Lines of Defence' Model and assesses whether all significant risks are identified and appropriately reported by line management and GR&C to the Board and executive management. GIA also challenges management to improve the effectiveness of governance, risk management and internal controls. Its scope is unrestricted and covers the Company, its undertakings and all activities undertaken by and on behalf of the Company.

GIA's work is determined by an annual planning process which is driven by a risk assessment of the operations, informed by the risk profile of the business. Resources are prioritised to focus on the highest perceived risk whilst supporting the business strategy. GIA's risk assessment and annual audit plan is discussed with the GEC and approved by the Audit Committee annually.

In developing the audit plan GIA's scope includes consideration of:

- The design and operating effectiveness of the internal governance structures and processes;
- The information presented to the Board and GEC for strategic and operational decision making;
- The setting of, and adherence to, risk appetite;
- The risk and control culture;
- The risks related to poor customer outcomes, and associated conduct or reputational risk;
- Capital and liquidity risks;
- Key activities such as significant business process changes, the introduction of new products and services, outsourcing decisions, acquisitions and divestments;
- The outcomes achieved by the implementation of policies and processes, and whether these are in line with the Company's objectives, risk appetite and values;
- Trends and emerging issues that could impact the Company; and
- Planned assurance work in the first and second line.

GIA presents a report to the Audit Committee four times a year summarising the results and analysis of audit activity in the preceding period. GIA's reporting focusses on significant control weaknesses and any thematic issues identified. The Audit Committee oversees the work of GIA and monitors progress being made against the achievement of the annual plan. It also tracks management's responses to issues identified by GIA and the timeliness of their resolution.

The Company has outsourcing arrangements in place with Capita covering the administration of the former Scottish Provident protection business and for closed life and pensions business previously belonging to both the Co-operative Insurance Society and Phoenix Life Assurance Limited. Under the terms of these outsourcing agreements, the Company outsources its audit activity to Capita's internal audit function. A comprehensive governance structure is in place to ensure that GIA has oversight of the development and delivery of Capita's annual internal audit plan. This includes ongoing reporting of performance to the Audit Committee. GIA also sees and challenges audit terms of reference and draft audit reports prior to these being issued. In addition, GIA undertakes periodic audit effectiveness reviews (at least every five years) over Capita's internal audit function. The last review in H2 2017 resulted in a 'some improvement required' audit opinion being given by GIA.

The Company also has outsourcing arrangements in place with HSBC who provide Custodian and Fund Administration Services. A governance framework is in place within RLAM to provide oversight of these services. This includes review of risk reporting, ongoing service provision and error rates. GIA has periodic meetings with RLAM's Head of Outsourced Operations and Investment Compliance to gain an overview of HSBC activities, including review and oversight. HSBC is included in GIA's audit universe and is subject to regular audit. RLAM first line risk also includes HSBC within the scope of its control reviews.

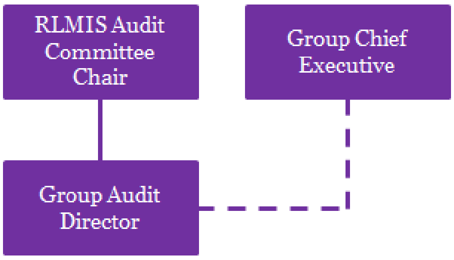
In line with the Chartered Institute of Internal Auditors' (IIA) International Standards a review of GIA is performed by an independent third party and reported to the Audit Committee on a periodic basis. The Audit Committee oversees and approves the appointment process of the independent assessor. The last External Quality Assessment (EQA) was completed by an external party in 2017, which reported favourably on its ongoing performance. Recommendations from the EQA were adopted by GIA during 2018.

GIA also liaises with the external auditors and regulators on a regular basis to ensure there is effective communication and collaboration.

System of Governance (continued)

B.5.2. Independence and objectivity

The following diagram illustrates GIA's organisational structure and reporting lines, where Internal Audit derives its authority from the Board through the Audit Committee:



GIA's independence and objectivity is evidenced as follows:

- The Chair of the Audit Committee sets objectives for the Group Audit Director and recommends remuneration for the Group Audit Director to the Remco;
- The Group Audit Director communicates and interacts directly with the Audit Committee and has access to its Chair and members in between Audit Committee meetings;
- The Group Audit Director attends GEC meetings, but not in a decision-making capacity or as a member. The purpose of this is to challenge decisions taken by the GEC;
- GIA has a process for managing conflicts of interest, including internally recruited auditors, and safeguards will be put in place to limit any impairments to independence or objectivity. This also includes managing any potential conflicts of interest where team members hold other related roles outside of the organisation; and
- The Audit Committee evaluates GIA's performance. The Group Audit Director confirms to the Audit Committee the organisational independence of the GIA team at least annually.

The Group Audit Director maintains a dotted reporting line to the GCE to report on the outcome of audit activity and the overall opinion on the control environment, and for day-to-day administrative purposes.

Any person carrying out the internal audit function does not assume any other key functions within the Company.

B.6 Actuarial function

The Actuarial function (as defined by SII), led by the Group Chief Actuary (GCA), is within the Finance function and the GCA reports to the Deputy GCE and GFD.

The Actuarial function is responsible for the following key tasks:

- Expressing opinions about underwriting and reinsurance;
- Ensuring quality of the applied methods, including data quality;
- Follow-up of actual developments of best estimates by comparing with experience;
- Informing the Board on the reliability and adequacy of the above;
- Contributing to the RMS and risk management skills;
- Advising the Board on the potential implications of the Company's risk profile and the probability of both realistic insolvency and failing to meet the SCR or the regulatory MCR;
- Advising on the extent to which the investment risk taken is consistent with the Company's commitment to treat customers fairly;
- ORSA – providing input to ensure the Company continuously covers its technical provisions, including identifying risks arising from the uncertainties within calculations; and
- Overseeing the calculation of technical provisions in the cases set out in Chapter 12 of the PRA's Technical Provisions Rulebook (completeness, accuracy and appropriateness of data used in the calculations of technical provisions).

System of Governance (continued)

B.7 Outsourcing

B.7.1. Outsourcing of critical operational functions

In line with other large financial services organisations, the Company has a number of material relationships with outsourcers and suppliers.

The Company's material outsourcers and suppliers include those providing services relating to back office policy and investment administration, customer support and complaints handling, IT application support and hosting, actuarial modelling, underwriting, and printing/mailing services.

These partners have scale and common processes, often across multiple clients, which provide several benefits for the Company, including minimising fixed costs as policies run off and improving the technology used within our administrative capability. Whilst processing or specialist work is undertaken by these organisations, which is an effective use of Company resources, the Company remains fully responsible for the oversight, management and performance of the activity.

Key roles such as finance, actuarial, risk and compliance and oversight of these partners are retained in-house, ensuring the Company retains full control over the core capabilities necessary to manage its business objectives effectively.

The framework for the governance and oversight of material outsourcer and supplier arrangements (categorised as 'Tier 1 and Tier 2') is set out on page 44 of the 2018 ARA.

The following is a list of the material outsourcer and supplier arrangements within the Company and the jurisdiction in which they are incorporated.

Service provider company name	Description of services	Jurisdiction
Capita Life and Pensions	Life and pensions policy administration and transfer agency administration for unit trust business.	UK
HUB Financial Solutions	Specialist annuity brokering service for Royal London Consumer customers.	UK
Dataspace	Storage of physical copies of customer data/commercial data.	UK
APS	Printing of customer documentation.	UK
Fujitsu	Data hosting and IT application support services.	UK
Milliman	Actuarial modelling solution.	UK/US
Sopra Steria	IT application support and maintenance.	UK
IBM	IT mainframe services.	UK
Oracle	Oracle software hosting.	UK
UnderwriteMe	Underwriting for Intermediary protection.	UK
BT	Telecoms and associated networks/services.	UK
Cognizant	Provide specialist resources to Royal London on a number of key projects and support the management and oversight of key systems.	UK
HSBC	Investment assets administration and investment accounting. Custodian for the Company's assets.	UK
DST	UK Transfer Agency, maintaining records for investment transactions.	UK
Statestreet	Transfer Agency, Fund Accounting, Custody and Depositary services.	Ireland
Bravura	Design and provisions of the pensions systems for #thinkbeyond and wrap platform for Ascentric.	UK/Australia
BCL	Actuarial application/code for RLI Protection diabetes product.	UK (parent company in South Africa)

B.7.2. Outsourcing policy

The Company has developed a Group Outsourcing & Supplier Management Policy (GOSMP) that applies to the management of all material (Tier 1 and Tier 2) outsourcers and suppliers across the Company.

The purpose of the policy is to ensure that the Company is effectively managing its material relationships in a manner that minimises risk and cost and maximises value to the Company and its members. It supports the Company in meeting its outsourcing risk appetite by providing a standardised framework for the oversight and monitoring of supplier performance across the following three key areas:

- Contract governance;
- Risk management; and
- Business continuity.

The policy requirements include key controls that have been designed to satisfy FCA rules and SII regulations. The business relationship owners for all material outsourcers or suppliers are accountable for ensuring that these controls are effectively implemented and must be able to provide evidence to support the attestation of compliance with the policy on an annual basis.

The Company has developed a segmentation tool which uses a scoring mechanism to identify all material relationships. The segmentation tool scores all of the Company's outsourcers and suppliers against spend, value generation, risk and business criticality criteria. The outputs of the exercise enables the Company to categorise all of its outsourcers and suppliers into four Tiers, with all those aligned to Tier 1 and Tier 2 requiring full compliance to the GOSMP.

The segmentation process is undertaken at the start of the sourcing cycle before the Company enters into a new tender exercise, in the event of a change to the arrangement/contract and on an annual basis thereafter.

Examples of material (i.e. high risk and business critical) outsourcer or supplier services are:

- IT functions and processes;
- Systems maintenance;
- Data storage;
- Claims handling; and
- Policy administration.

Intra-group outsourcing arrangements
There are other companies within the Group who provide services to RLMIS, and are considered 'intra-group outsourcers' for RLMIS for SII purposes. The most significant of these include:

- RLAM – asset management services; and
- RLMS – administration services.

Given the entities are wholly within the Company's control they are covered directly by the same governance, risk management framework and control environment as the Company. For the intra-group outsourcing services the Company takes full responsibility for oversight and control of the function, and the service or activity is managed in a robust manner.

B.8 Adequacy of the governance structure

The Company monitors and assesses its system of governance on an ongoing basis as described in the above sections.

The Board has confirmed its compliance with the relevant provisions of the UK Corporate Governance Code 2016: An Annotated Version for Mutual Insurers (the 'Code') published in September 2016. The Code is published by the Association of Financial Mutuals with the permission of the Financial Reporting Council, and is a revised version of the UK Corporate Governance Code published in April 2016. Following the publication of the revised UK Corporate Governance Code in June 2018, we are reviewing any changes that we may want to make to enhance our Corporate Governance Framework. The review would also have regard to the Association of Financial Mutuals Corporate Governance Code, published in January 2019 and effective from 1 January 2019. During this period of change, the Board remains focused on the principles of good corporate governance; accountability, transparency, probity and a focus on the sustainable success of an entity over the longer term. The Board practices are appropriate and offer necessary levels of protection for our members.

B.9 Any other information

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

C. Risk profile

Plain English introduction

Managing risk is fundamental to the Company's activities in order to generate returns for policyholders. We have a system in place to identify, manage, monitor and report risks, supported by risk tools and processes such as contingency planning, escalation of events, assessing scenarios and reverse stress tests.

In this section we describe our risk profile, including separately for each category of risk:

- Risk exposure;
- Risk concentration;
- Risk mitigation; and
- Risk sensitivity.

Royal London's risk profile is stable and generally changes only gradually from year to year.

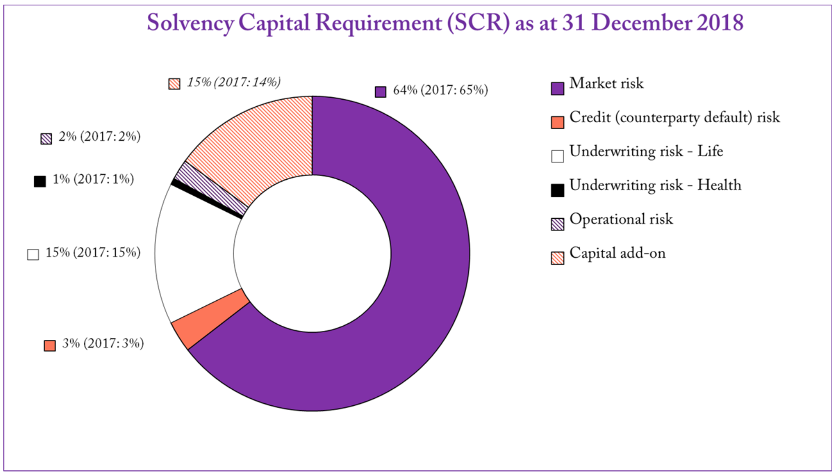
As a financial service provider, the Company's business is the managed acceptance of risk. The Company operates within a RMS that is applied Group-wide. The Company has a set of risk preferences which define the types of risk the Company views as being desirable, neutral or undesirable and which form a core part of the Company's RMS and control techniques. The risk management framework established within the Company is designed to manage, rather than eliminate, the risk of failure to meet business objectives as well as to ensure that the Company is well capitalised. The material risks faced by the Company are set out in the table below:

Underwriting risk*	Market risk	Credit risk	Liquidity risk**	Operational risk	Other material risks
Section C.1	**Section C.2**	**Section C.3**	**Section C.4**	**Section C.5**	**Section C.6**
Mortality	Interest rate	Sovereign debt default	Short term	Conduct	Strategic
Morbidity	Corporate bond spread	Financial counterparty default	Long term	Processing	MTP execution
Longevity	Equity	Other counterparty default		Information security	Emerging
Persistency	Property			Outsourcing	
Guarantees and options	Currency			Change	
Expense				Business continuity	
				Information Technology	
				Legal and regulatory	
				Financial crime	
				People	

* The Company uses the term 'insurance risk' to refer to 'underwriting risk'. This term is used throughout section C.

** The Company does not hold SCR for liquidity risk, as explained further in section C.4.

The following diagram illustrates the breakdown of the Standard Formula SCR by risk category, which is detailed in sections C.1 to C.6. There have been no key changes to the risk profile during 2018.



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Stress and scenario testing – overview

The Company conducts a range of sensitivity analysis and stress and scenario testing activity in order to help it understand its risk profile and assess and manage its risks. This is a key element of the RMS, as well as being a regulatory requirement.

Stress testing is embedded in the planning process of the Company and is applied to the base case five-year MTP.

Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities. These are provided as input into the ORSA and are used to inform strategic planning. This allows senior management and the Board to assess the base case plan in adverse circumstances and to adjust strategies and propose mitigating actions if the plan does not meet risk appetite in a stressed scenario.

The following types of sensitivity analysis and stress and scenario activities were carried out during 2018:

- Sensitivity analysis, stress tests or scenarios as part of business as usual activity;
- Broad-based scenarios (covering multiple events and/or a sequence of events);
- Recovery plans;
- Business model analysis; and
- Reverse stress tests.

More details on each of these can be found on pages 180 to 181 of the 2018 ARA.

We also participated in EIOPA's 2018 Insurance Stress Test exercise, which is carried out every two years and provides regulators with sensitivity analysis for a range of scenarios.

Prudent Person Principle

Under the Prudent Person Principle (PPP), firms are expected to understand fully the risks involved with their investments, make proper provision for them via the SCR and ensure that investment decisions are made in the best interests of policyholders. All investment risks must be properly identified, measured, monitored, managed, controlled and reported.

Investment risks are managed and overseen across the Company including the Investment Office, Investment Proposition Owners, Finance Operations and Actuarial areas. The Company invests its assets in accordance with PPP by way of a robust investment governance structure. Oversight is provided by the Investment Committee (IC) in their role to assist the Board in the discharge of its responsibilities in respect of investment related matters. The With Profits Committee (WPC) exercise independent judgement in advising the Board on the achievement of the fair treatment of all with-profits and unit-linked with-profits policyholders, including where appropriate, investment-related matters.

The agreed investment philosophy as developed by the Investment Office and approved by the Board is used to inform the Company's investment strategy. The asset allocations developed are consistent with the Company's investment strategy, policyholders' best interests and the specific investment objectives of each product and fund. The strategy and asset allocations in turn are supported by Investment Management Agreements (IMA) between the Company and the asset manager, and policies covering market, credit, liquidity, derivatives, proposition development and review and conflicts of interest risk management. The Company's assets are largely, but not exclusively, managed by RLAM.

The investment strategy sets out the investment categories in which assets may be invested, supported by asset allocation and performance benchmarks consistent with the Company's risk appetite (as guided by the Company's Capital Management Framework) and asset liability matching. This balances the risks relating to the liabilities under the Company's insurance contracts against the risks inherent in its assets and the capital available. The Company has established approaches for matching assets and liabilities, including hedging. Where appropriate matching cannot be achieved, management actions are in place to manage the market risk resulting from the mismatch.

The asset allocation benchmarks ensure that each fund has an appropriate mix of assets and is not over or under exposed to a particular asset category or specific investment. In addition, there are limits to the exposures of non-government bonds in terms of their external credit rating and also to the overall exposure to unrated bonds.

C.1 Underwriting risk

The Company defines underwriting risk (referred to as 'insurance risk') as 'the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities'. These risks principally arise in relation to:

- Changes in persistency, GAO take-up rates, longevity, mortality, morbidity or expenses;
- Inappropriate product design, pricing or selling; and
- Erroneous interpretation of experience or assumptions.

Insurance risk within the Company arises primarily in relation to its life assurance and pension products.

C.1.1. Insurance risk exposure and material changes over the reporting period

The Company's exposure to insurance risk and the principal components are set out on pages 169 to 171 of the 2018 ARA.

The following chart 'Insurance risk capital as at 31 December 2018' illustrates the split of the Company's insurance risk capital as at 31 December 2018 before diversification between risks.

The chart shows that the Company has a diversified insurance risk exposure with the capital being spread over a variety of insurance sub-risks.

The Company's insurance risk portfolio is relatively mature and the profile generally changes only gradually from year to year, with a shift from older savings products towards new protection and pensions business. This trend tends to increase persistency and expense risk. During the reporting period there have been no new products that have a substantially different risk profile from the existing book and no material changes have been made to the Company's reinsurance strategy or its underwriting standards.

C.1.2. Measures used to assess the risk profile

Insurance risks are assessed and monitored using a combination of measures. For example, the Company calculates its capital requirements in respect of insurance risk by looking at the sensitivity of its insurance liabilities to changes in the insurance risks faced by the Company (primarily persistency, GAO take-up rates, longevity, mortality, morbidity and expenses).

The primary measures are the impacts on:

- Regulatory liabilities (e.g. those in SII annual returns);
- Regulatory capital (SII SCR);
- Realistic capital (e.g. the calculation of required capital amounts under SII, using an internal capital model);
- The profitability of new business (e.g. changes due to new business mix and volume); and
- Demographic and expense experience analyses looking at how actual experience compares to the assumptions used.

There have been no material changes to the measures used to assess insurance risk over the reporting period.

C.1.3. Management and mitigation of insurance risk

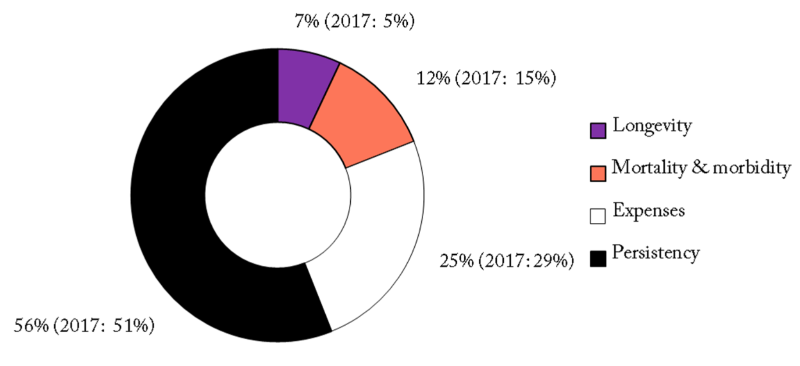
Insurance risk is largely mitigated, monitored and managed by the various business units/divisions, in particular Pensions, UK and Ireland Protection, and Consumer. Risk relating to the Company's final salary pension schemes is managed separately by a specialist area in the People function, supported by external advisers.

Insurance risks are managed through the following mechanisms:

- The use of the policy framework, guidelines, limits and authority levels for concluding insurance contracts, assuming insurance risks and handling insurance claims;
- Regular monitoring of actual exposures compared to agreed limits to ensure that the insurance risk accepted remains within risk appetite;
- The use of reinsurance to mitigate exposures in excess of risk appetite, to limit the Company's exposure to large single claims and catastrophes and to alleviate the impact of new business strain;
- The diversification of business over several classes of insurance and over large numbers of individual risks to reduce variability in loss experience; and
- Control over product development and pricing.

Further detail is set out on page 170 of the 2018 ARA.

Insurance risk capital as at 31 December 2018



Another process for monitoring the continued effectiveness of these risk-mitigation techniques is the requirement within the Company's Insurance Risk Policy for an annual review of the policy by the policy owner. As the policy provides Company-wide guidelines around the identification, assessment, mitigation, monitoring, reporting and control of insurance risks then a review will include a review of their effectiveness. The policy owner must make sure that the policy is implemented appropriately within the Company.

The Company, in common with its competitors, uses reinsurance as a key tool in managing its exposure to insurance risk. Reinsurance is used to mitigate exposures in excess of risk appetite, to limit the Company's exposure to large single claims/catastrophes and to alleviate the impact of new business strain. The Company does not make use of Special Purpose Vehicles to mitigate insurance risk.

The Company has long term relationships with large reinsurers active in the UK and has ceded large volumes of mortality, morbidity, disability and longevity risk into the reinsurance market.

The Company monitors the effectiveness of its reinsurance arrangements via the management of:

- Counterparty risk: covering limits on exposure to reinsurance entities or groups and current and prospective reinsurers meeting minimum financial strength criteria.
- Contracts in existence: covering contractual amendments, the adherence to existing treaties and the production of reinsurance MI. In relation to the management of existing contracts, the Company benefits from having experienced professionals who have worked for both insurers and reinsurers.
- New reinsurance transactions: covering the governance of the approval of all new reinsurance contracts, the type and rationale for entering into an arrangement, whether to facilitate competitive new business pricing and/or more efficient capital usage or to extract value on existing business through reducing reserves and/or reducing risks on the Company's balance sheet.

C.1.4. Insurance risk concentrations
The Company's approach to concentration risk is outlined on page 170 of the 2018 ARA; in summary the Company seeks to mitigate the risk of excess concentrations of risk through the use of reinsurance, portfolio analysis and risk limits.

Although the Company's portfolio of employer-sponsored pension schemes includes some large schemes, there are no schemes that represent an excessive percentage of the relevant portfolio.

The Company's diverse portfolio of business helps mitigate concentration risk across sectors (pensions, protection, intermediated, direct) but there is some concentration risk within sectors, for example to the extent that legislative changes affecting pensions business could result in a marked worsening in persistency. Due to the nature of the UK market, another potential area of concentration is the reliance of the Company on new business from key adviser networks, but this is not considered to be material.

C.1.5. Insurance risk sensitivities
The Company routinely assesses the sensitivity of its Best Estimate Liabilities (BEL) to changes in various insurance risks. The liabilities are recalculated by changing each assumption in isolation. The risks and the main assumptions used in the Standard Formula stresses for the SCR are tabulated below.

Risk type	Assumption
Persistency including take up of GAOs	Broadly speaking, 50% increase or reduction in exit and paid-up rates, the direction applying to each product group being according to which direction is the more onerous, coupled with an increase in GAO take up rates.
Persistency mass exit	40% of policies exit immediately.
Expense	10% increase in future expenses coupled with a 1% p.a. increase in expense inflation.
Mortality	15% permanent increase in mortality rates.
Mortality catastrophe	0.15% absolute increase in mortality rates during the next 12 months.
Morbidity	35% permanent increase in morbidity rates during the next 12 months followed by a 25% permanent increase, coupled with a 20% reduction in recovery rates.
Longevity	20% permanent reduction in mortality rates.

The results of the analysis show that the Open Fund is particularly sensitive to changes in persistency and expenses. In the closed funds the RL (CIS) Fund and the Liver Fund are sensitive to improvements in longevity and changes in persistency and expense assumptions, while the SL Fund is sensitive to improvements in longevity.

C.2 Market risk

The Company defines market risk as the risk that fluctuations in values of, or income from, assets, or in interest or exchange rates, cause a divergence in the value of the Company's assets and liabilities. Where policy benefits are linked to the value of investments, the majority of this risk rests with the customer.

C.2.1. Market risk exposure and material changes over the reporting period

The Company's exposure to market risk arises principally from equity risk, property risk, interest rate risk, corporate bond spread risk and currency risk.

The Company's exposure to market risk and the principal components and management strategies are set out in more detail on pages 172 to 174 of the 2018 ARA.

The Company makes use of derivatives for the purposes of mitigating certain market risks, in particular for mitigating equity and interest rate risk. The Company makes very little use of derivatives for other purposes. The use of derivatives to mitigate certain market risks generates other types of risk, for example counterparty risk, but generally reduces the overall market risk exposure in that the values of the derivatives and the associated liabilities move more consistently with each other than if other assets were held.

The chart below illustrates the split of the Company's market risk Standard Formula capital requirement as at 31 December 2018, for the Open Fund (which includes RLGPS), after diversification between risks. The equity capital requirement decreased during 2018 (with increases to corporate bond spreads and currency in particular), primarily driven by:

- negative investment performance in the year which reduced equity values and a reduction in the size of the prescribed equity stress;
- a more granular approach for analysing assets within collective investment schemes was adopted in 2018, which resulted in lower equity assets within collective investment schemes and an increase in corporate bond assets; and
- investment strategy and decisions during 2018 moving investment in UK equities to overseas equities, resulting in an increase in currency capital requirements.

There were no material changes to the nature of the underlying risk profile.

C.2.2. Measures used to assess the risk profile

Market risk is assessed using several measures. The impact on Value at Risk (measuring the capital required to withstand a 1-in-200-year event) is assessed in respect of the different major types of market risk, as is the impact on the Company's excess capital. Sensitivity testing and scenario analysis are used to assess the impact on these measures of movements in equity values, interest rates and other variables in isolation and in combination.

The market risk associated with derivatives is also assessed using sensitivities to changes in the underlying economic variables, such as interest rates and interest rate volatility, as appropriate to the derivative. Value at Risk analysis over short-term periods is also used.

The average duration of the fixed interest portfolios is monitored as part of asset liability management practice.

The amount of divergence of the actual asset allocation percentages from the benchmark percentages is also used to measure market risk. Within the equity investment portfolios, market risk is assessed by reference to the divergence of actual stock weightings from the benchmark (or index) weightings. The sector profile of the UK equity portfolio is also used to assess market risk.

There were no material changes to the measures used to assess market risk during 2018 (2017: none).

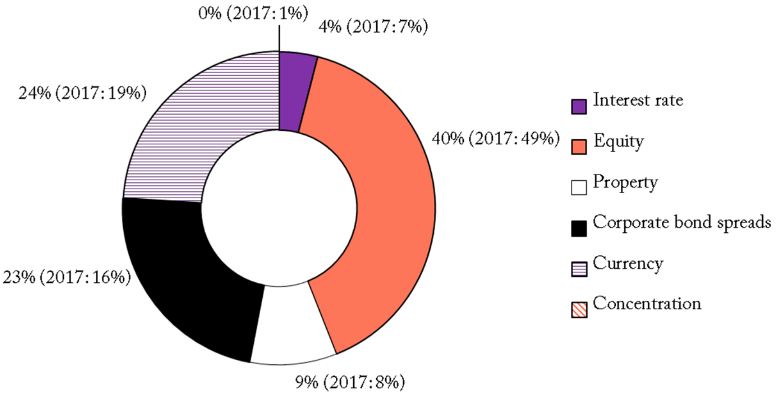
C.2.3. Management and mitigation of market risk

The principal techniques employed to manage market risk are the establishment of asset allocation and performance benchmarks consistent with the Company's risk appetite and asset-liability matching. The Company's management of market risk is described in more detail on page 172 of the 2018 ARA.

The IMA in place between the Company and its asset management company, RLAM, specifies the limits for holdings in certain asset categories. The agreement also requires that asset holdings are within the regulatory limits that restrict excessive concentrations within particular asset classes.

A comprehensive system of limits is in place in order to control exposure to market risk within the equity portfolios. In particular, risk appetite limits for the amount of capital required for different types of market risk are set by reference to the amount of available capital.

Market risk capital as at 31 December 2018



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The Company has a robust framework in place relating to the use of derivatives, including a derivatives risk management policy, requirements for only sufficiently knowledgeable individuals to be involved in the management of derivatives, and for approval of hedging strategies at Board level. The risks associated with the use of derivatives, both before and after they are transacted, are identified and closely monitored. The policy details legal, collateral and valuation requirements.

Exposures to market risk are monitored by the CMC and are included in the MI prepared for the BRC.

The Company uses derivatives as a risk-mitigation technique for certain types of market risk.

Risk type	Description
Equity risk and property risk	The Company hedges a small amount of equity risk arising from investment guarantees and from variations in future annual management charges on unit-linked business. This risk is hedged using options and swaps.
Interest rate risk	The Company manages interest rate risk using performance benchmarks with appropriate durations and in some instances, derivatives to achieve a closer cash flow match. The Company uses interest-rate swap overlays to provide interest-rate sensitivity hedging in the Open Fund, the SL Fund and the RL (CIS) Fund.
Inflation risk	The Company mitigates some inflation risk in its defined benefit pension schemes and in the RL (CIS) Fund by the use of inflation swap derivatives.
Currency risk	The Liver Fund uses a programme of currency forward derivative contracts to manage its euro exposure.

The CMC and the BRC monitor the effectiveness of the various processes in place to manage market risk, in particular by reviewing the continuing appropriateness of the hedges that are in place and of the asset allocation benchmarks.

C.2.4. Market risk concentrations

The Company's liabilities are predominantly UK-based and a high proportion of its assets are therefore UK-based. As such, the market risk profile is heavily dependent on the state of and outlook for the UK and global economy, in particular equity and property values.

The Company has material liabilities in respect of GAOs and is therefore capable of being exposed to changes in interest rates. However, such liabilities are extensively hedged and although the exposure to interest rate risk is material, at present there is relatively low sensitivity in the Open Fund to changes in interest rates.

The assets within each investment portfolio, for example in respect of equities or property, are well diversified and there is no material concentration risk arising.

C.2.5. Market risk sensitivity

The Company routinely assesses the sensitivity of its BEL to changes in various market risks. The liabilities are recalculated by changing each assumption in isolation. The risks and the main assumptions used in the Standard Formula stresses for the SCR are tabulated below:

Risk type	Assumption
Equity	Reductions in equity values of around 33% for type 1 equities and around 43% for type 2 equities.
Currency	25% reduction in the value of non-sterling assets.
Interest rate	Increases and reductions in sterling risk-free yields.
Bond spreads	Widening of credit spreads on bonds and certain securitisation products.
Property	25% reduction in property values.

The results of the analysis show that the Open Fund is particularly sensitive to reductions in equity values and a strengthening of sterling against other currencies. In the closed funds, the RL (CIS) Fund and the SL Fund are particularly sensitive to changes in interest rates, and the Liver Fund is sensitive to a strengthening of sterling against the euro.

MI provided to the Board and CMC includes the sensitivity of surplus capital to changes in equity values, interest rates, the gilt yield curve and credit spreads.

The ORSA includes the impact on EEV operating profit and capital of favourable, adverse and hard Brexit economic scenarios that are set by the Actuarial function (with input from an internal economist). This includes a combination of stresses to equity returns, gilt yields, inflation, growth, property returns and credit spreads. All four scenarios have shown positive levels of profit and growth over the 2019-2023 horizon. The adverse and hard Brexit scenarios have shown lower overall levels of profit than the base and the favourable scenarios showing marginally higher levels of profit. The scenario results do not take into account management actions that would be taken to adjust the Company's strategy and mitigate the reduction in profitability in the downside scenario.

C.3 Credit risk

The Company defines credit risk as the risk of loss if a counterparty fails to perform its obligations or fails to perform them in a timely fashion. Exposure to credit risk may arise in connection with a single transaction or an aggregation of transactions (not necessarily of the same type) with a single counterparty.

C.3.1. Credit risk exposure and material changes over the reporting period

The Company's exposure to credit risk, its management thereof, and mitigation techniques used are set out on pages 174 to 177 of the 2018 ARA. The majority of the exposure derives from the Company's holdings of government and corporate bonds. The exposure in respect of the reinsurers' share of insurance liabilities is almost all related to the annuity reinsurance arrangements of the Company. In 2018 there was an increase in assets with a AA credit rating and a reduction in assets with a BBB credit rating.

During 2018 there were no material changes to the total amount of non-linked assets subject to credit risk (2017: none).

C.3.2. Measures used to assess the risk profile

Credit risks are assessed and monitored using a combination of measures. The primary measure is the gross amount of the exposure with no allowance made for any expected recoveries in the event of default. The gross amount takes into account exposure arising from different sources of credit risk, in particular from sovereign debt and corporate bonds, cash and derivatives. Exposure in respect of equity holdings is also taken into account, but not treated as credit risk, in order to help assess the overall risk to the Company of a failure of the counterparty.

The credit rating of the counterparty, based on available ratings from external rating agencies coupled with an internal view of the credit rating, is also used to assess the risks. Further due diligence of counterparties is carried out where deemed advisable in order to assess the risk with more confidence.

The Company also assesses the risk based on its capital requirements for such risk. The Company calculates its capital requirements in respect of credit risk by a combination of a separately identifiable amount held in respect of failure of a reinsurer or a derivative counterparty and an amount that represents the impact of an overall economic stress that affects bond credit spreads and other factors such as equity movements.

C.3.3. Management and mitigation of credit counterparty risk

In order to reduce its exposure to credit risk, the Company limits exposure primarily to counterparties with a long-term rating of at least BBB. Where possible, significant counterparty exposures, particularly in respect of stock lending and derivatives are mitigated by the use of collateral.

A comprehensive system of limits is in place in order to control exposure to credit risk.

The one exception is exposure to the UK government. Investment in government debt is a key part of the Company's investment and asset-liability management strategies and it has been decided that no limit should be set. If the UK's credit standing were to deteriorate further however, this decision would need to be reviewed.

Exposures arising in respect of cash holdings, deposits, derivatives and sovereign debt are monitored against the agreed limits by the Credit, Counterparty and Liquidity Risk Committee (CCLRC), which reports to the CMC. The CCLRC may recommend changes to specific exposure limits to the CMC.

Where external ratings are not available, the Company uses an internal rating process as described on page 175 of the 2018 ARA.

The Company mitigates certain credit risk exposures, in particular those arising through its holdings of derivatives and its largest reinsurance arrangements, through the use of collateral. The Company does not use collateral as a means of mitigating other risks.

The Company does not use derivatives for the purpose of mitigating credit risk.

C.3.4. Credit risk concentrations

The material credit risk concentrations which the Company is exposed to through direct holdings are as follows:

Concentration	Description
UK sovereign debt	The Company's largest exposure is to UK sovereign debt, of which it held £10,938m as at 31 December 2018 (31 December 2017: £10,787m). These fixed interest and index-linked stocks are held primarily to back its liabilities, in particular guaranteed liabilities.
Eurozone sovereign debt	The Company held £454m of sovereign debt of other European countries as at 31 December 2018, almost all of which are in the Eurozone (31 December 2017: £556m). This was largely concentrated in the largest and highest rated countries, in particular Germany and France. Investment in lower graded countries is very limited and not material.
HSBC	HSBC acts as custodian for the Company's investment assets and certain amounts of cash deposits. The latter are subject to credit risk in the event of default by HSBC. The Company has market risk exposure to HSBC through investment in equity and corporate bonds issued by HSBC and it also holds a £2.8bn (31 December 2017: £3.0bn) loan note with HSBC which is fully collateralised. The loan note is held as part of a reinsurance arrangement, and its value is exactly matched by a financial liability to Swiss Re.
UK and European banking sector	Although the Company mitigates concentration risk by diversifying its counterparties for cash and amounts held on deposit and by investing a high proportion in Global Systemically Important Financial Institutions, the Company has a material combined exposure to the UK and European banks in which it holds cash and deposits.
Reinsurance arrangements	The Company has large reinsurance arrangements with certain counterparties. There are significant exposures arising from various annuity reinsurance arrangements, which are collateralised or subject to a floating charge.

The Company is exposed to credit risk in respect of its reinsurance arrangements. The largest reinsurance exposures, borne directly by the Company, are referenced above. Mortality and morbidity reinsurance exposures represent the reduction in the value of future profits from a failure of the reinsurer and claims recoverable from the reinsurer.

In each case of exposure to credit risk the risk of loss is perceived to be extremely low in view of the external ratings, supported by internal analysis.

All exposures are consistent with the Company's business model and strategy, the Company's risk appetite and limits. Minor breaches occur from time to time, which are reviewed and decisions taken as to corrective action or to accept the position.

Any losses arising would not impact on short-term liquidity. The Company has access to a large amount of readily realisable assets and does not rely on any single counterparty to provide liquid funds. The failure of HSBC as a counterparty would, however, create major operational challenges and could cause the Company's contingency funding plan to be invoked in order to provide liquid funds at short notice.

C.3.5. Credit risk sensitivities

The main method that the Company uses to assess sensitivity to credit risk is scenario analysis whereby a counterparty (to which there is a large exposure) defaults on its obligations. The Company has a significant counterparty exposure to HSBC, meaning a default of their obligations is a material sensitivity to analyse. For this purpose it is assumed that HSBC is in default and that there is no recovery of any amounts due to the Company in respect of cash held on deposit and corporate bond holdings, and that the equity investments would be worthless.

The analysis shows that the Company would remain sufficiently liquid and that management actions could be taken to reduce the impact on solvency to an acceptable level. This does not consider wider operational and financial impacts on the UK or global financial system as a whole.

C.4 Liquidity risk

The Company defines liquidity risk as the risk that the Company, though solvent, either does not have sufficient financial resources available to enable it to meet its obligations as they fall due or can secure them only at excessive cost.

C.4.1. Liquidity risk exposure and material changes over the reporting period
The Company has limited exposure to liquidity risk primarily due to its financial strength and availability of liquid assets. However, we recognise that extreme liquidity issues could have a serious impact on the Company.

The Company's exposure to liquidity risk is described in further detail on pages 178 to 179 of the 2018 ARA.

The longer-term matching of assets and liabilities is covered within market risk in section C.2. As a result of the policies and procedures in place for managing its exposure to liquidity risk, the Company considers the residual liquidity risk arising from its activities to be well controlled.

There have been no material changes to the Company's liquidity risks over the reporting period.

C.4.2. Measures used to assess the risk profile
The Company uses liquidity coverage ratios to measure the exposure of its long-term life funds to short-term liquidity risk. The ratios are calculated based on 3-month forecast cash outflows after applying a 50% stress. Two ratios are calculated, the first with cash and UK gilts as liquidity and a target of 100%. The second is a cash only ratio with a target of 33%, equivalent to one month's stressed cash outflow, with no allowance for income from premiums or investments.

The Company also assesses its long-term liquidity risk profile by considering the relationship between when assets might be able to be sold even in stressed conditions and when the liabilities in each long-term fund become due.

The Company assesses the liquidity risk within its least liquid unit-linked funds, specifically those linked to property, by measuring the proportion of the funds' assets invested in cash and deposits.

C.4.3. Management and mitigation of liquidity risk
The Company does not hold risk capital against liquidity risk. The Company's liquidity management process is set out on pages 178 to 179 of the 2018 ARA.

The Company does not use risk mitigation techniques to transfer liquidity risk to third parties.

C.4.4. Liquidity risk concentrations
Generally, the Company is not exposed to material concentrations of residual liquidity risk. There is concentration of liquidity risk through the Company's reliance on two banks, NatWest, to process payments to its customers, suppliers and employees and HSBC for investment activities. If either bank were to fail or have a major IT problem, then the Company may not be able to meet its obligations as they fall due for a period.

C.4.5. Liquidity risk sensitivities
Liquidity coverage ratios compare the assets that could be realised for cash by the end of the following business day with projected stressed gross outflow during a period of three months, with no allowance for any income from premiums or investments or undertaking actions to source additional liquidity. The measure therefore allows for an element of sensitivity above the expected cash flows and the calculated ratios still show a liquidity position well within risk appetite for all funds.

C.4.6. Expected Profit Included in Future Premiums
The total amount of expected profit included in future premiums (EPIFP) as at 31 December 2018 was £1,416m (31 December 2017: £1,406m). This has increased due to significant volumes of unit-linked pensions and protection business sold in the year, largely offset by the impact of demographic assumption changes, in particular the strengthening of mortality and morbidity assumptions for protection business.

C.5 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events (excluding market events which are included in market risk in section C.2).

The aim of operational risk management is to manage operational risks in line with defined appetites, and to protect both policyholders and the Company, whilst delivering sustainable growth. The Company's operational risk framework is the method by which operational risks are managed in terms of setting risk appetite, evaluating key exposures, measuring risk, mitigating risk, and monitoring risks on an ongoing basis, as set out in this section.

C.5.1. Operational risk exposure and material changes over the reporting period

The principal operational risks that the Company is exposed to are listed below. The impact arising from all operational risks could be on the Company's members, customers, people, processes and systems.

Operational risk	Description
Conduct	The risk of unfair outcomes to the end customer.
Processing	The risk associated with the Company's operational processes, for example incorrect or poorly designed processes, data entry or loading errors, accounting and attribution errors or incorrect use of models.
Information security	The risk associated with protecting the Company's customers, MI and information processing facilities from threats.
Outsourcing	The risk arising from outsourcing processes or obtaining key goods or services from third–party providers. This includes the management of the contract and/or relationship and ongoing monitoring of the third-party provider.
Change	The risk arising from the Company's change management processes and programmes.
Business continuity / Disaster recovery	The risk associated with business continuity management and disaster recovery processes and plans.
Information Technology (IT)	The risk arising from development, delivery and maintenance activity for the Company's IT infrastructure.
Legal and regulatory	The risk of a poor level of regulatory compliance and the materialising of breaches which would pose a risk to the regulator's objectives and the Company's relationship with them.
Financial crime	The risk that the Company's customers or assets are subject to any kind of criminal conduct relating to money, data or to financial services.
People	The risk associated with the Company's processes to attract and retain capable people and provide an appropriate performance-based culture.

During 2018, the Company's operational risk profile reflects gradual progress from its programme of control enhancements and strengthening control standards, such as the Security Investment Programme to upgrade IT security and measures including a framework to be compliant with the new General Data Protection Regulation (GDPR).

The Company has continued to manage its exposure to risks arising from change management, following the conscious decision in 2016 to operate a significantly larger change portfolio. Our most significant strategic transformation and change programmes, including agile working capabilities, is our core pensions administration system being implemented and a new Wrap platform in Ascentric. These programmes have quality assurance processes built into our internal management and governance and are also subject to independent oversight by our GIA and GR&C functions.

C.5.2. Measures used to assess the risk profile

Operational risk is managed within the Company's RMS, as set out in section B.3. A variety of measures are used, such as: scoring of potential risks using impact and likelihood, KRI thresholds aligned to the risk appetite statements above, assessment of the effectiveness of controls and monitoring of events and losses by size.

The Company's operational risks are assessed using a risk matrix system that considers the worst case occurring for each operational risk and the likelihood of this worst case occurring within the next 12 months.

In addition to the measurement of individual risks as they arise, stress and scenario testing is used to enable the Company to get a better understanding of the significant risks that it may face under extreme conditions and the level of capital it needs to hold to protect against these risks.

The scenarios and sensitivity are described in section C.5.5.

C.5.3. Management and mitigation of operational risk
The Company makes limited use of techniques that transfer operational risk to third parties. The main risk-mitigation technique used is to effect insurance against some risks, in particular of loss to its buildings and contents, and of loss arising from legal claims against its directors and managers.

Legal agreements with outsourcers transfer some risks to the outsourcers, for example those arising from errors in servicing customers. However, the outsourcing arrangements themselves generate different types of risk which would not otherwise exist.

C.5.4. Operational risk concentrations
The primary source of concentration risk from an operational risk perspective is the Company's reliance upon its material outsourcers to provide a broad range of services to key businesses. Further detail of this is set out in section B.7.

Consideration of future risk mitigation techniques
The Company is not currently considering the use of further risk mitigation techniques for operational risk.

C.5.5. Operational risk sensitivities
Operational risk stresses and scenarios are completed to calculate the operational risk capital requirement. The stresses allow an assessment of the extreme impacts arising from a given risk by way of assessment of the frequency of occurrence and the distribution of impacts. Scenarios are largely bottom up but can be top down. Top-down scenarios concern the analysis of a number of macro or corporate-level events, whereas bottom-up scenarios link to risks within the risk register and refer to single, but potentially severe, events. A wide variety of operational risk scenarios are assessed providing coverage across specified risk categories. Separately, expert judgement is used to derive the degree of interdependence between different types of operational risk.

In addition to the scenarios that are carried out to support the calculation of operational risk capital, specific scenarios are carried out to consider the Company's resilience to different types of operational risk. As well as regular scenario testing of how business continuity events would be handled, there is also consideration of operational risk when constructing broad based scenarios such as a pandemic or a major change in pensions legislation.

C.6 Other material risks

C.6.1. Other material risk exposure and material changes over the reporting period
The following table describes the other material risks faced by the Company.

Risk	Description
Strategic risk	Risks that arise from the Company's choice of strategy, deficient planning processes and inappropriate or misapplied decisions. This type of risk could directly impact the Company's future, its position in the market, its profitability, and its solvency or capital adequacy.
MTP execution risk	Risks to business plans (including budgets and resource allocations) that potentially prevent the firm from achieving its business objectives.
Emerging risk	Newly developing or changing risks which are difficult to quantify and which may have a major impact on the Company. Typically the drivers for these risks are socio-political, technological, economic or regulatory.

Examples of the risks in the table above are contained within the principal risks and uncertainties set out in the 2018 ARA on pages 41 to 44.

During 2018 there were no material changes to the risk profiles for strategic and MTP execution risks (2017: none).

An emerging risk relates to Brexit. Brexit is not expected to have a materially detrimental impact on our strategy and risk profile due to the vast majority of our business being written in the UK. We recognise the potential impact on our existing contracts written in the Republic of Ireland and Germany and we have completed a Part VII transfer of Irish and German contracts to RLI DAC to allow us to continue to service existing policyholders. Further details are included in Appendix 1.

We are confident that there will be no significant impact to our operations or capital strength. We continue to monitor and respond to ongoing developments relating to Brexit as they occur, particularly in relation to regulation and legislation.

C.6.2. Measures used to assess the risk profile
Strategic, MTP execution and emerging risks are scored using the combination of impact and probability as described in section C.5.2.

C.6.3. Management and mitigation of other material risks
The management of the Company's strategic, MTP execution and emerging risks are managed in a similar manner to all the other risk types that the Company faces, this includes:

- the use of the policy framework, guidelines, limits and authority levels. Senior management has a primary responsibility for the management of other material risks through developing policies, procedures and controls across the different products, activities, processes and systems under their control and for the allocation of responsibilities;
- regular monitoring of actual exposures by accountable executives and their teams and review on an aggregated basis by the ERC and BRC; and
- risk details on an inherent (before controls) and residual (after controls) basis are maintained on risk and control registers. These registers and the MI reported from them are used as a basis for review and challenge by senior management, risk committees and the Board.

Independent oversight and assurance is performed by GR&C and GIA to assess the effectiveness of risk mitigation and management activity.

The Company does not use risk mitigation techniques to transfer other material risks to third parties (2017: none).

C.6.4. Other material risk concentrations
There are no other material risk concentrations (2017: none).

C.6.5. Other material risk sensitivities
The methods and assumptions used for sensitivity analysis include the impact on profit of upside and downside commercial scenarios. These are set at a business unit level so they consider the risks that would lead to positive and negative changes to the competitive position faced by each particular business unit. These include changes in direct competition, re-pricing activity or changes to the regulatory landscape.

C.7 Any other information
There is no additional material information regarding risk profile to disclose in this section (2017: none).

D. Valuation for solvency purposes

Plain English introduction

In this section we provide a reconciliation between the SII balance sheet and the International Financial Reporting Standards (IFRS) basis used in the preparation of our statutory financial statements (referred to as Annual Report & Accounts (ARA)).

We also describe the methodology used for the valuation of our:

- Assets (D.2);
- Technical provisions (D.3); and
- Other liabilities (D.4).

D.1 Balance sheet

D.1.1. 2018 IFRS to SII balance sheet reconciliation

Differences between an IFRS and SII balance sheet can be summarised into one of the following two categories:

SII presentation adjustments

Under the SII rules, certain assets and liabilities are categorised differently from their classification under IFRS. Presentation adjustments therefore align the IFRS balance sheet in the 2018 ARA to the prescribed format of the SII balance sheet. Further information on the SII presentation adjustments is included in section D.1.2.

Valuation differences

The SII rules require that assets and liabilities are valued for solvency purposes at fair value, unless a specific rule requires otherwise. Fair value is essentially what we would receive if we sold an asset or what we would have to pay to settle a liability in an arm's length transaction between willing parties. This is equivalent to the IFRS fair value that we use for the ARA and therefore the majority of assets and liabilities are held at the same value on the IFRS and SII balance sheets. Where there are differences in valuation between the IFRS and SII values, these have been separately presented in the following table. A description of the valuation differences is presented in sections D.2 (assets), D.3 (technical provisions) and D.4 (other liabilities).

The table on page 50 reconciles assets and liabilities as reported in the 2018 ARA to amounts reported in the SII balance sheet as at 31 December 2018. The IFRS figures are presented in the SII balance sheet format where possible and therefore do not directly correspond to the line item descriptions in the 2018 ARA. Comparatives are included in section D.1.3.

Valuation for solvency purposes (continued)

31 December 2018	Statutory accounts IFRS value £m	SII presentation adjustments £m (D.1.2)	SII valuation differences £m	SII value £m	SFCR note
Assets					
Goodwill	229	-	(229)	-	D.2.1
Other intangible assets	153	-	(153)	-	D.2.1
Deferred acquisition costs	304	-	(304)	-	D.2.2
Pension benefit surplus	213	-	-	213	-
Property (other than for own use)	4,073	(3,910)	-	163	-
Holdings in related undertakings, including participations	35,474	(23,235)	(263)	11,976	D.2.3
Equities	7,325	(889)	-	6,436	-
Bonds[1]	25,123	(8,902)	-	16,221	-
Collective Investment Undertakings	8,042	(6,619)	-	1,423	-
Derivatives	3,171	(3)	-	3,168	-
Deposits other than cash equivalents[2]	1,408	(531)	-	877	-
Assets held for index-linked and unit-linked contracts	-	44,360	-	44,360	-
Loans and mortgages	3	-	-	3	-
Reinsurance recoverables	5,070	(93)	(256)	4,721	D.2.4
Insurance, reinsurance and intermediaries receivables[3]	66	108	-	174	D.2.5
Receivables (trade, not insurance)[3]	565	(133)	-	432	D.2.5
Cash and cash equivalents	688	(116)	-	572	-
Any other assets, not elsewhere shown[3]	1	-	-	1	-
Total assets	**91,908**	**37**	**(1,205)**	**90,740**	
Liabilities					
Technical provisions	80,625	(321)	(5,141)	75,163	D.3
Provisions other than technical provisions[4]	418	(43)	(257)	118	D4.1
Deferred tax liabilities	145	-	-	145	D.4.2
Derivatives	1,390	(15)	-	1,375	-
Debts owed to credit institutions[5]	558	-	-	558	-
Financial liabilities other than debts owed to credit institutions	4	(4)	-	-	D.4.4
Insurance and intermediaries payables[5]	206	321	-	527	-
Reinsurance payables	2,796	-	-	2,796	-
Payables (trade, not insurance)[5]	946	99	(5)	1,040	D.4.5
Subordinated liabilities	745	-	61	806	D.4.3
Any other liabilities, not elsewhere shown	4,075	(4,075)	-	-	-
Total liabilities	**91,908**	**(4,038)**	**(5,342)**	**82,528**	
Excess of assets over liabilities	**-**	**4,075**	**4,137**	**8,212**	
Total liabilities plus excess of assets over liabilities	**91,908**	**37**	**(1,205)**	**90,740**	

1. Bonds presented include government bonds of £12,040m, other quoted bonds of £10,087m, other unquoted bonds of £2,981m in note 20(a), plus short-dated debt of £15m in note 24 of the 2018 ARA.
2. Deposits other than cash equivalents include deposits with credit institutions of £906m in note 20(a) and short-term bank deposits of £502m in note 24 of the 2018 ARA.
3. The total of insurance, reinsurance and intermediaries receivables (£66m), receivables (trade, not insurance) (£565m) and any other assets, not elsewhere shown (£1m) is equal to £632m, which equates to the sum of trade and other receivables (£587m) in note 23 of the 2018 ARA plus the current tax asset (£45m) on the 2018 IFRS balance sheet.
4. Provisions other than technical provisions include provisions of £266m in note 32 and other liabilities of £152m in note 33 of the 2018 ARA.
5. The total of debts owed to credit institutions (£558m), insurance and intermediaries payable (£206m) and payables (trade, not insurance) (£946m) is equal to £1,710m, which equates to sum of amounts due to customers (£193m), amounts due to brokers (£34m), cash collateral (£1,214m), amounts due to other group entities (£151m), bank overdrafts (£45m) and other payables (£71m) in note 31 of the 2018 ARA and current tax liability of £2m in the IFRS balance sheet within the 2018 ARA.

Valuation for solvency purposes (continued)

D.1.2. 2018 SII presentation adjustments

The structure of the SII balance sheet is different to the IFRS balance sheet presented in the 2018 ARA. The table below sets out the presentation adjustments as at 31 December 2018 which reconcile the IFRS assets and liabilities reported in the ARA with the presentation of assets and liabilities in the SII balance sheet.

31 December 2018	Total SII presentation adjustment £m	Assets held for index & unit-linked contracts £m (Note 1)	Participations £m (Note 2)	Investment classification £m (Note 3)	UDS £m (Note 4)	Other £m (Note 5)
Assets						
Property (other than for own use)	**(3,910)**	(3,942)	-	32	-	-
Holdings in related undertakings, including participations	**(23,235)**	(24,541)	1,305	1	-	-
Equities	**(889)**	(473)	(2)	(414)	-	-
Bonds	**(8,902)**	(9,282)	-	380	-	-
Collective Investments Undertakings	**(6,619)**	(5,797)	(1,303)	481	-	-
Derivatives	**(3)**	(3)	-	-	-	-
Deposits other than cash equivalents	**(531)**	(88)	-	(443)	-	-
Assets held for index-linked and unit-linked contracts	**44,360**	44,460	-	(100)	-	-
Reinsurance recoverables	**(93)**	-	-	15	-	(108)
Insurance, reinsurance and intermediaries receivables	**108**	-	-	-	-	108
Receivables (trade, not insurance)	**(133)**	(327)	-	-	-	194
Cash and cash equivalents	**(116)**	(164)	-	48	-	-
Total assets	**37**	**(157)**	**-**	**-**	**-**	**194**
Liabilities						
Technical provisions	**(321)**	-	-	-	-	(321)
Provisions other than technical provisions	**(43)**	(43)	-	-	-	-
Derivatives	**(15)**	(15)	-	-	-	-
Financial liabilities other than debts owed to credit institutions	**(4)**	(4)	-	-	-	-
Insurance and intermediaries payables	**321**	-	-	-	-	321
Payables (trade, not insurance)	**99**	(95)	-	-	-	194
Any other liabilities, not elsewhere shown	**(4,075)**	-	-	-	(4,075)	-
Total liabilities	**(4,038)**	**(157)**	**-**	**-**	**(4,075)**	**194**
Excess of assets over liabilities	**4,075**	-	-	-	4,075	-
Total liabilities plus excess of assets over liabilities	**37**	(157)	**-**	**-**	**-**	**194**

The presentation adjustments required to align the IFRS balance sheet to the SII balance sheet are summarised below. These adjustments are required for SII presentation purposes only and do not result in valuation differences.

Note 1 – Assets held for index-linked and unit-linked contracts
Under IFRS, assets and liabilities relating to index-linked and unit-linked contracts are separately reported on a 'line-by-line' basis. For SII, all assets and liabilities relating to index-linked and unit-linked contracts are reported in a single line item within 'assets held for index-linked and unit-linked contracts'.

Note 2 – Participations
Under SII, the Company has a participation in another undertaking when it has ownership, directly or indirectly, of 20% or more of the voting rights or capital of an undertaking. Investment holdings within Collective Investments Undertakings under IFRS which are greater than 20% are therefore reclassified to Participations for SII purposes.

Note 3 – Investment classification
Presentation adjustments are required to reclassify certain investment assets within the IFRS balance sheet to the appropriate balance sheet line items for SII purposes. For example, certain equity securities held as equities on the IFRS balance sheet are required under the SII rules to be classified as 'collective investment undertakings' on the SII balance sheet. Additionally, certificate of deposits which are classified as 'deposits with credit institutions' under IFRS are required to be classified as 'bonds' on the SII balance sheet.

Note 4 – UDS
The UDS is the IFRS surplus within the Company's Open Fund that has not been allocated to policyholders. For the IFRS accounts this value is included in the balance sheet as a liability. For SII the equivalent item is the excess of assets over liabilities in the Open Fund. The presentation adjustment therefore reallocates the UDS from 'any other liabilities, not elsewhere shown' to 'excess of assets over liabilities' on the SII balance sheet.

Note 5 – Other
Other comprises presentation adjustments relating to interfunding of £194m (31 December 2017: £279m), policyholder claims of £321m (31 December 2017: £339m) and reinsurance of £108m (31 December 2017: £109m). These adjustments are required to align the IFRS balance sheet to the appropriate balance sheet line items for SII purposes. The interfunding adjustment of £194m primarily relates to balances owed between funds within RLMIS. Under IFRS these amounts are eliminated on consolidation, however SII reporting is at ring-fenced fund level and therefore interfunding balances are presented gross on the balance sheet. The remaining two adjustments are required to reclassify £321m of policyholder claims liabilities from technical provisions to insurance and intermediaries payables and £108m from reinsurance assets to insurance and intermediaries receivables, in accordance with prescribed SII balance sheet classifications.

D.1.3. 2017 IFRS to SII balance sheet reconciliation
The table on page 53 reconciles assets and liabilities as reported in the 2017 ARA to amounts reported in the SII balance sheet as at 31 December 2017. The 2017 comparatives have been represented to be consistent with the 2018 presentation, and total assets and total liabilities in the SII balance sheet are consistent with the 2017 SFCR.

Valuation for solvency purposes (continued)

31 December 2017	Statutory accounts IFRS value £m	SII presentation adjustments £m (D.1.4)	SII valuation differences £m	SII value £m	SFCR note
Assets					
Goodwill	232	-	(232)	-	D.2.1
Other intangible assets	111	-	(111)	-	D.2.1
Deferred acquisition costs	262	-	(262)	-	D.2.2
Pension benefit surplus	186	-	-	186	-
Property (other than for own use)	3,404	(3,203)	-	201	-
Holdings in related undertakings, including participations	33,182	(22,007)	(209)	10,966	D.2.3
Equities	8,598	(947)	-	7,651	-
Bonds[1]	24,976	(7,046)	-	17,930	-
Collective Investments Undertakings	8,547	(7,027)	-	1,520	-
Derivatives	4,260	-	-	4,260	-
Deposits other than cash equivalents[2]	1,921	(476)	-	1,445	-
Assets held for index-linked and unit linked	-	40,719	-	40,719	-
Loans and mortgages	4	-	-	4	-
Reinsurance recoverables	5,326	(37)	(254)	5,035	D.2.4
Insurance, reinsurance and intermediaries receivables[3]	60	109	-	169	D.2.5
Receivables (trade, not insurance)[3]	379	105	-	484	D.2.5
Cash and cash equivalents	881	(121)	-	760	-
Any other assets, not elsewhere shown[3]	2	-	-	2	-
Total assets	**92,331**	**69**	**(1,068)**	**91,332**	
Liabilities					
Technical provisions	80,108	(339)	(5,754)	74,015	D.3
Provisions other than technical provisions[4]	425	(27)	(291)	107	D4.1
Deferred tax liabilities	233	-	6	239	D.4.2
Derivatives	1,510	-	-	1,510	-
Debts owed to credit institutions[5]	749	-	-	749	-
Financial liabilities other than debts owed to credit institutions	11	(4)	-	7	D.4.4
Insurance & intermediaries payables[5]	217	339	-	556	-
Reinsurance payables	2,991	-	-	2,991	-
Payables (trade, not insurance)[5]	1,487	101	(5)	1,583	D.4.5
Subordinated liabilities	745	-	138	883	D.4.3
Any other liabilities, not elsewhere shown	3,855	(3,855)	-	-	-
Total liabilities	**92,331**	**(3,785)**	**(5,906)**	**82,640**	
Excess of assets over liabilities	**-**	**3,854**	**4,838**	**8,692**	
Total liabilities plus excess of assets over liabilities	**92,331**	**69**	**(1,068)**	**91,332**	

1. Bonds presented include government bonds of £11,977m, other quoted bonds of £9,831m, other unquoted bonds of £3,163m in note 19(b), plus short dated debt of £5m in note 22 of the 2017 ARA.
2. Deposits other than cash equivalents include deposits with credit institutions of £1,545m in note 19(b) and short-term bank deposits of £376m in note 22 of the 2017 ARA.
3. The total of insurance, reinsurance and intermediaries receivables (£60m), receivables (trade, not insurance) (£377m) and any other assets, not elsewhere shown (£4m) is equal to £441m, which equates to trade and other receivables (£439m) in note 21 of the 2017 ARA plus the current tax asset (£2m) on the 2017 IFRS balance sheet.
4. Provisions other than technical provisions include provisions of £268m in note 31 and other liabilities of £157m in note 32 of the 2017 ARA.
5. The total of debts owed to credit institutions (£749m), insurance and intermediaries payable (£217m) and payables (trade, not insurance) (£1,487m) is equal to £2,453m, which equates to amounts due to customers (£204m), amounts due to brokers (£107m), cash collateral (£1,943m), amounts due to other group entities (£45m), bank overdrafts (£45m) and other payables (£74m) in note 30 of the 2017 ARA and current tax liability of £35m in the IFRS balance sheet within the 2017 ARA.

Valuation for solvency purposes (continued)

D.1.4. 2017 SII presentation adjustments

The following table sets out the presentation adjustments as at 31 December 2017 which reconcile the IFRS assets and liabilities reported in the ARA with the presentation of assets and liabilities in the SII balance sheet. Commentary on each adjustment is included in section D.1.2.

31 December 2017	Total SII presentation adjustment £m	Assets held to cover index & unit-linked £m (Note 1)	Participations £m (Note 2)	Investment classification £m (Note 3)	UDS £m (Note 4)	Other £m (Note 5)
Assets						
Property (other than for own use)	(3,203)	(3,203)	-	-	-	-
Holdings in related undertakings, including participations	(22,007)	(23,306)	1,296	3	-	-
Equities	(947)	(465)	-	(482)	-	-
Bonds	(7,046)	(7,329)	-	283	-	-
Collective Investment Undertakings	(7,027)	(6,288)	(1,296)	557	-	-
Deposits other than cash equivalents	(476)	(71)	-	(405)	-	-
Assets held for index-linked and unit linked	40,719	40,853	-	(134)	-	-
Reinsurance recoverables	(37)	-	-	72	-	(109)
Insurance, reinsurance and intermediaries receivables	109	-	-	-	-	109
Receivables (trade, not insurance)	105	(173)	-	-	-	278
Cash and cash equivalents	(121)	(227)	-	106	-	-
Total Assets	**69**	**(209)**	**-**	**-**	**-**	**278**
Liabilities						
Technical provisions	(339)	-	-	-	-	(339)
Provisions other than technical provisions	(27)	(27)	-	-	-	-
Financial liabilities other than debts owed to credit institutions	(4)	(4)	-	-	-	-
Insurance & intermediaries payables	339	-	-	-	-	339
Payables (trade, not insurance)	101	(177)	-	-	-	278
Any other liabilities, not elsewhere shown	(3,855)	-	-	-	(3,855)	-
Total Liabilities	**(3,785)**	**(208)**	**-**	**-**	**(3,855)**	**278**
Excess of assets over liabilities	3,854	(1)	-	-	3,855	-
Total liabilities plus excess of assets over liabilities	**69**	**(209)**	**-**	**-**	**-**	**278**

D.2 Assets

Assets and liabilities have been valued according to the requirements of the SII Directive and related guidance. The basis of the SII valuation principle is the amount for which the assets or liabilities could be exchanged between knowledgeable willing parties in an arm's length transaction. This is equivalent to the IFRS fair value that we use for the ARA and therefore the majority of assets and liabilities are held at the same value on the IFRS and SII balance sheets. The description of valuation differences between SII and IFRS balance sheets, by material asset class, are provided below:

D.2.1. Goodwill and Other intangible assets

Goodwill is always valued at zero under the SII valuation rules, and other intangible assets can only be valued at an amount other than zero if they could be sold separately and the Company is able to demonstrate that there is a value for the same or similar assets that has been derived from quoted prices in active markets. This is not the case for the other intangible assets recognised in the Company's IFRS statutory accounts, therefore these are valued at zero in the SII balance sheet.

Valuation for solvency purposes (continued)

D.2.2. Deferred acquisition costs

The valuation difference of £304m (31 December 2017: £262m) between the SII and IFRS balance sheets is due to deferred acquisition costs which are not recognised in SII. Under the SII valuation the cashflows that underpin these assets are included within the calculation of the BEL and therefore are included within the SII technical provisions.

D.2.3. Holdings in related undertakings, including participations

The valuation difference of £263m (31 December 2017: £209m) between the SII and IFRS balance sheets relates to participations valued using the adjusted equity method for the Company.

Under IFRS the value of the participations is the amount at which the participation can be expected to be sold. This is estimated using a combination of net asset value (NAV), applying a price earnings (PE) multiple and discounted cash flow techniques. The IFRS valuations therefore include an element of goodwill, other intangible assets and fair value adjustments. For the SII balance sheet these participations are valued using the adjusted equity method, which are the net assets of the participations valued on a SII basis and excludes goodwill, other intangible assets and fair value adjustments.

D.2.4. Reinsurance recoverables

This difference is due to the recalculation of the reinsurance recoverable balance using the SII requirements for technical provisions within Articles 76 to 86 of the SII Directive, as opposed to IFRS rules. Further information is included in section D.3.13.

D.2.5. Insurance, reinsurance and intermediaries receivables and receivables (trade, not insurance)

There is no observable market for these specific assets or any similar assets that could be regarded as a suitable basis for the valuation. The SII value is therefore based on an estimate of the potential cash flows with reductions made for anticipated bad debts, i.e. the settlement value. No account has been taken of the effect of discounting short-dated receivables as the effect is immaterial. This produces a value equal to the IFRS amortised cost.

D.2.6. Asset valuation methodology

Further information on the IFRS valuation bases which underpin the SII valuations for the Company can be found in the IFRS accounting policies set out in note 1 on pages 98 to 105 of the 2018 ARA. There have been no material changes affecting the valuation methodology of assets and other liabilities in the SII balance sheet in 2018.

All investment assets are measured at fair value for SII in accordance with a fair value hierarchy (see table below), with quoted market prices in an active market being the default valuation. Active markets are determined by trading volumes, for example for equities Bloomberg is used to establish trading activity in the period around the valuation date to prove that the year-end price is derived from an active market. Similarly for OEICs an analysis is carried out to show that the funds are all daily priced and operating in an active market.

The following table sets out the SII valuation methods used when valuing assets:

Hierarchy Level	Valuation Method
1	Quoted market price in active markets for the same assets
2	Quoted market price in active markets for similar assets
3	Alternative valuation methods
4	Adjusted equity methods (applicable for the valuation of participations)
5	IFRS equity methods (applicable for the valuation of participations)

Where quoted prices are not available, alternative valuation methods are used making maximum use of market inputs (refer to section D.2.7). This is the same fair value as is used for IFRS. Further information on how this fair value is derived and the bases and key assumptions used can be found in the 2018 ARA in note 20 on pages 124 to 133 for the Company.

D.2.7. Alternative valuation methods

The table below provides more details on those assets and other liabilities valued using an alternative valuation model rather than quoted market prices. This includes all assets and liabilities within levels 3 to 5 (set out in section D.2.6) of the SII valuation hierarchy. Asset valuation sensitivities are disclosed in note 20(d) of the 2018 ARA for the Company.

The Company has a Valuation Oversight Committee (VOC) which reports to the Audit Committee. The VOC is responsible for the valuations and disclosure of investment assets, including those assets within levels 3 to 5 of the SII hierarchy. Due to their nature, assets within levels 3 to 5 of the SII hierarchy have the risk of a greater valuation uncertainty.

For illiquid debt securities which are marked to model the process includes a review of the valuation methodology, periodic assessment of both observable and judgemental model inputs, as well as reviewing any secondary trading activity in the asset to assess the appropriateness of the valuation methodology.

Valuation uncertainty is higher in asset classes where there is no secondary source available and there is no secondary trading activity. In these instances, processes are in place to validate the valuations such as backtesting for private equity investments and external surveyor's transaction reviews for unquoted property.

The table shows non-linked assets and liabilities only but the same valuation techniques are applied to equivalent assets held within the Company's unit-linked funds.

Assets/Liabilities	2018 SII value £m	2017 SII value £m	Valuation techniques and key inputs
Assets			
Property (other than for own use)	**163**	201	Income capitalisation and market comparison valuation methods are used
Participations – shares	**411**	284	Adjusted equity method, net present value of future projected cash flows, PE multiple and NAV
Participations – unquoted investment funds	**11,537**	10,671	NAV provided by external fund managers/third party administrators adjusted for any cash flows occurring after the NAV date and before the reporting date
Participations – loans	**28**	11	IFRS carrying value used as a proxy for fair value
Equities – unlisted (including unquoted private equity investments and unquoted property funds)	**107**	41	NAV provided by external fund managers/third party administrators adjusted for any cash flows occurring after the NAV date and before the reporting date
Bonds	**2,984**	3,169	Third party prices and mark to model using a gross redemption yield
Collective Investments Undertakings - unquoted	**247**	269	NAV provided by external fund manager/administrator
Derivative assets – equity options	**52**	65	Mark to model using expected dividend yields and market implied volatility
Derivative assets – interest rate swaps	**2,892**	3,972	Mark to model using market swap rates
Derivative assets – interest rate swaptions	**182**	196	Mark to model using forward swap rates and interest rate volatility
Derivative assets – total return swaps	**16**	-	Mark to model using market swap rates
Derivative assets – inflation swaps	**24**	19	Mark to model using market swap rates
Derivative assets – currency forwards	**2**	8	Mark to model using expected foreign exchange rates
Loans & mortgages	**3**	4	IFRS carrying value used as a proxy for fair value
Liabilities			
Derivative liabilities – equity options	**-**	14	Mark to model using expected dividend yields and market implied volatility
Derivative liabilities – interest rate swaps	**1,368**	1,482	Mark to model using market swap rates
Derivative liabilities – total return swaps	**-**	12	Mark to model using market swap rates
Derivative liabilities – inflation swaps	**-**	1	Mark to model using market swap rates
Derivative liabilities – currency forwards	**7**	1	Mark to model using expected foreign exchange rates
Reinsurance payables	**2,753**	2,957	Discounted cash flows are used to derive the fair value

Valuation for solvency purposes (continued)

The Company reviews the appropriateness of those valuations within levels 3 to 5 of the hierarchy as set out in the table below:

Property	The valuations are obtained from external valuers and are assessed on an individual property basis. Valuation techniques include income capitalisation and market comparison and key inputs to the valuation comprise equivalent yield, estimated rental per square foot and price per acre. The principal assumptions will differ depending on the valuation technique employed. The IAS 40 revaluation model has been adopted in the IFRS statutory accounts and is a good proxy of economic value for solvency purposes.
Participations - shares, unquoted investment funds and loans	Shares are valued using the adjusted equity method, i.e. the value of the net assets on a SII basis. Unquoted investment funds are valued using NAV provided by external fund managers/third party administrators, adjusted for any cash flows occurring after the NAV date and before the reporting date. The IFRS carrying value is used as a proxy for the SII value of loans.
Equities - unlisted	Private equity fund and property fund valuations are provided by the respective managers of the underlying funds and are assessed on an individual investment basis, with an adjustment made for any cash flows occurring between the date of valuation and the end of the reporting period. Sensitivities are determined by comparison to the market.
Bonds	Predominantly valued using single broker unadjusted quotes obtained from third party pricing sources. Sensitivities are determined by flexing the single quoted prices provided using a sensitivity to yield movement.
Collective Investments Undertakings - unquoted	The value of investment funds, for which quoted prices are not available, are the NAVs provided by the third party fund managers.
Derivatives	Derivatives are recorded at fair value which is consistent between IFRS and SII, using mark to model valuation techniques and market rates.
Loans & mortgages	The IFRS carrying value is used as a proxy for the SII value.
Reinsurance payables	The amount is valued using a discounted cash flow model which determines the present value of expected future cashflows using a discount rate.

The table below provides information on key assumptions, valuation techniques and unobservable inputs for those assets measured as levels 3-5 of the SII hierarchy above (equivalent to level 3 in the IFRS fair value hierarchy shown in note 20(d) of the 2018 ARA):

SII Balance sheet asset class	Valuation technique	Unobservable input	Range (weighted average)
Property (other than for own use)	Income capitalisation	Equivalent yield	4.9% – 8.5% (5.1%)
		Estimated rental value per square foot	£13.06 – £21.00 (£13.77)
	Market comparison	Price per acre	£2,695,000
Equities – unlisted	Adjusted NAV	Adjustment to NAV	n/a
Bonds	Single broker quotes	Unadjusted single broker quotes	n/a
Loans & mortgages	Carrying value	Adjustment to carrying value	n/a
Collective Investments Undertakings – unquoted	Adjusted NAV	Adjustment to NAV	n/a
Participations - shares	Net present value of future projected cashflows and PE multiple	RLUM	
		Fees (bps) p.a.	19.5
		Expenses (bps) p.a.	10.7
		Investment return (%)	1.5
		Surrender rate (%) p.a.	15
		Funds under management end 2018 (£m)	3,548
		Tax	Enacted corporation tax rate
		RLAM	
		PE multiple	15
Participations - unquoted investment funds	Adjusted NAV	Adjustment to NAV	n/a
Participations - loans	Carrying value	Carrying value	n/a

D.3 Technical provisions

D.3.1. Technical provisions by line of business

The Company's technical provisions split by the SII lines of business and by component are shown in the tables below.

	31 December 2018 – £m					
			Technical provisions calculated as a whole	TMTP – unaudited		
Line of Business	Best Estimate Liability (BEL)	Risk Margin (RM)	(TPCAW)	BEL	RM	Total technical provisions
Insurance with-profits participation	**27,920**	**1,071**	**–**	**(492)**	**(1,009)**	**27,490**
Index-linked and unit-linked insurance	**(1,576)**	**575**	**44,221**	**(28)**	**(464)**	**42,728**
Health insurance	**(135)**	**20**	**–**	**–**	**(16)**	**(131)**
Other life insurance	**5,065**	**260**	**–**	**(37)**	**(212)**	**5,076**
Total	**31,274**	**1,926**	**44,221**	**(557)**	**(1,701)**	**75,163**

	31 December 2017 – £m					
				TMTP – unaudited		
Line of Business	BEL	RM	TPCAW	BEL	RM	Total technical provisions
Insurance with-profits participation	30,271	1,164	–	(489)	(1,145)	29,801
Index-linked and unit-linked insurance	(1,247)	520	40,484	(17)	(518)	39,222
Health insurance	(134)	24	–	–	(24)	(134)
Other life insurance	5,156	209	–	(31)	(208)	5,126
Total	34,046	1,917	40,484	(537)	(1,895)	74,015

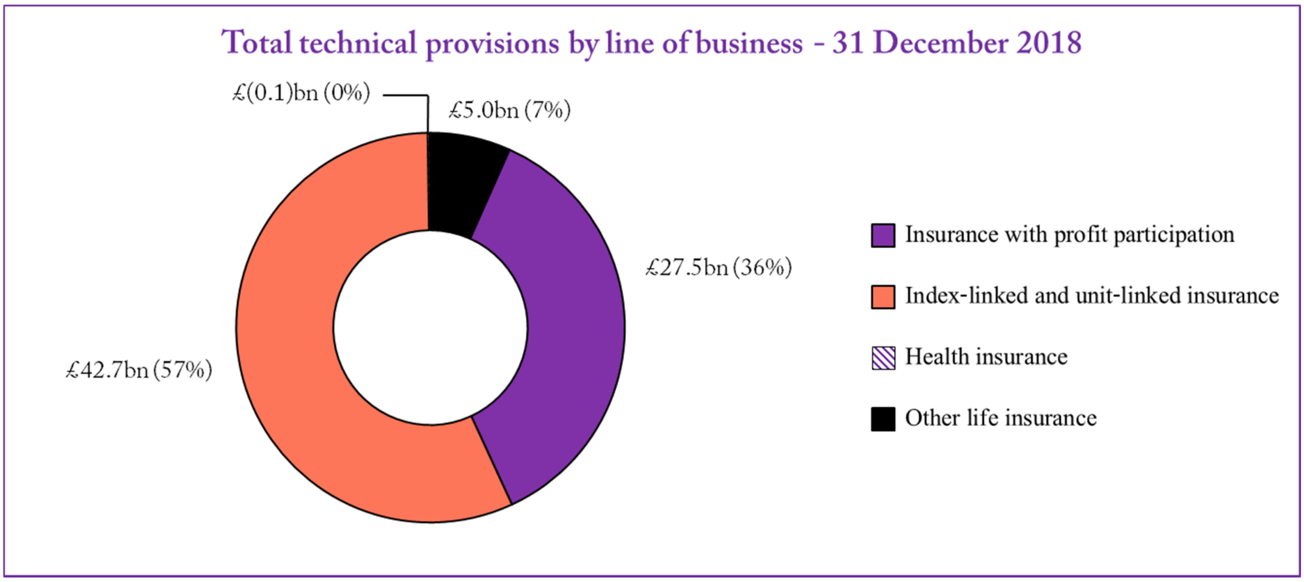
Key movements between the 31 December 2018 and 31 December 2017 technical provisions are shown in the table below:

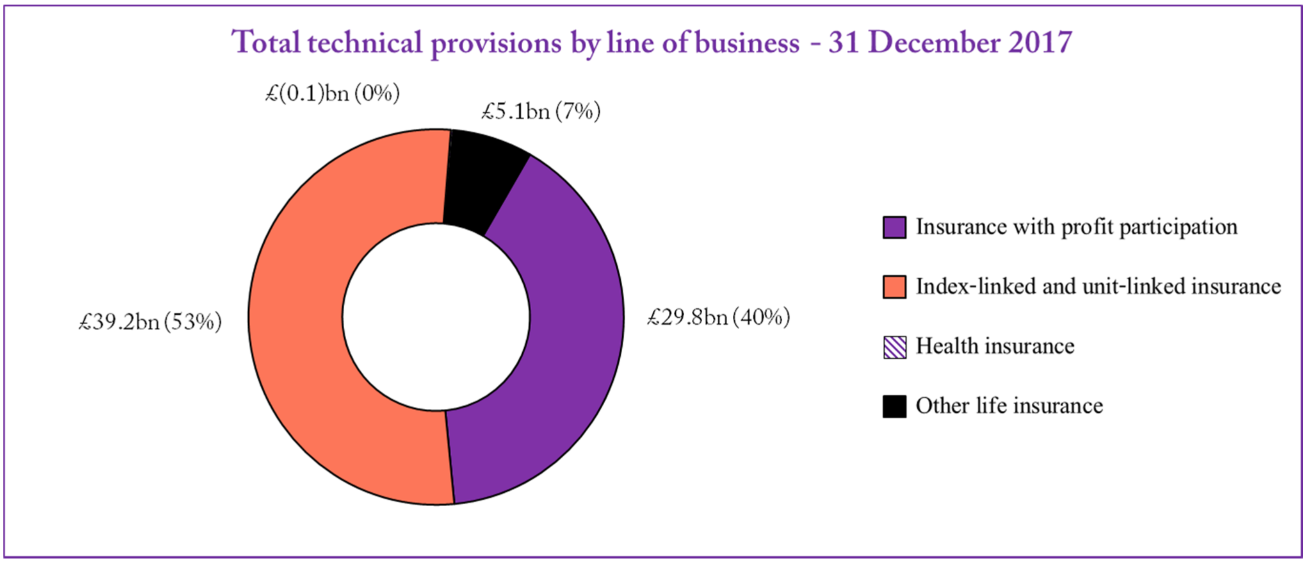
Technical provisions	£m	£m
31 December 2017		**74,015**
BEL and TPCAW increased/(decreased) due to:		
› New business sold during 2018	7,287	
› Expected changes[1]	(5,359)	
› Economic experience	(2,309)	
› Economic assumption changes	(522)	
› Demographic experience	1,455	
› Demographic assumption changes	(56)	
› Methodology changes	(150)	
› Other management actions	454	
› ProfitShare	150	
› Other	15	
Increase in BEL and TPCAW		**965**
RM increased/(decreased) due to:		
› Change in projected SCRs	39	
› Change in discount rates	(30)	
Increase in RM		**9**
TMTP decreased due to:		
› Amortisation of TMTP	174	
Increase through lower TMTP - unaudited		**174**
31 December 2018		**75,163**

1. Expected changes is the reduction in technical provisions based on opening assumptions set at the start of the year, including demographic and economic assumptions and the unwind of the risk-free rate.

Valuation for solvency purposes (continued)

The technical provisions (after TMTP) at 31 December 2018 and 31 December 2017 are further illustrated in the diagrams below. Technical provisions relating to index-linked and unit-linked insurance have increased to £42.7bn at 31 December 2018 (31 December 2017: £39.2bn) due to significant sales of new unit-linked pensions business. Technical provisions relating to with-profits business have decreased to £27.5bn at 31 December 2018 (31 December 2017: £29.8bn), primarily due to the run-off of in-force business.





D.3.2. Overview of technical provisions valuation methods

Technical provisions are calculated as the sum of BEL and RM. Technical provisions for the unit liability part of unit-linked business are calculated as a whole, rather than as the sum of BEL and RM.

The BEL is the probability-weighted value of future cash flows required to fulfil obligations to policyholders under existing contracts, without allowance for cash flows under associated reinsurance arrangements. A negative BEL is allowed if the present value of the future cash flows is negative (i.e. future income exceeds future outflows).

The RM is an addition to the BEL to ensure that the technical provisions as a whole are equivalent to the amount that third party insurance undertakings would be expected to require in order to meet the insurance obligations. The RM is calculated as the amount of capital needed to support the SCR over the lifetime of the business at a prescribed cost of capital rate of 6% (2017: 6%) per annum.

Valuation for solvency purposes (continued)

Segmentation

The Company's life business products are segmented into lines of business on the basis of the nature of the underlying risks as described in the SII guidance. The following table sets out how products are mapped to lines of business.

Line of business	Royal London products
Health insurance	Stand-alone critical illness
	Waiver of premium
	Income protection
	Permanent health insurance
Insurance with-profits participation	Traditional with-profits
	Deposit administration
	Unitised with-profits
	Accumulating with-profits
Index-linked and unit-linked insurance	Property-linked
Other life insurance	Non-profit
	Accelerated critical illness
	Index-linked where the policyholder does not bear the risk
	With-profits business that has been converted or re-classified as non-profit

Unbundling across lines of business

The following types of contract are unbundled on the basis that different benefits within the same policy fall under different SII lines of business.

Main product	Components	SII line of business
Unit-linked	Unit-linked	Index-linked and unit-linked
	Unitised with-profits***	Insurance with-profits participation
	Non unit-linked rider*	Other life insurance or health business
Unitised with-profits	Unitised with-profits	Insurance with-profits participation
	Unit-linked***	Index-linked and unit-linked
	Non-profit rider	Other life insurance or health business
Conventional with-profits	Conventional with-profits	Insurance with-profits participation
	Non-profit rider	Other life insurance or health business
Conventional non-profit**	Conventional non-profit	Other life insurance or health business
	Non-profit rider	Other life insurance or health business

* Not unbundled where the non unit-linked riders are embedded within the contract e.g. paid for from deduction from units.
** The conventional non-profit and non-profit rider component can be mapped to different lines of business, i.e. other life or health.
*** Hybrid products consisting of unitised with-profits and unit-linked funds are unbundled.

Contract boundary

The term 'contract boundary' under SII defines:

- When a policy is first included within technical provisions (inception);
- Which premiums should be included within the technical provisions calculation; and
- When the policy ends and is excluded from technical provisions (payment of final benefit or policy expiry or lapse).

Future regular premiums are included in the technical provisions calculation in the following cases:

- All conventional non-profit business;
- All with-profits policies; and
- Unit-linked policies where a waiver of premium benefit is provided, or if there is a death, disability, accident or sickness benefit which is equal to or more than 101% of the unit fund or there is a cap on potential expense charges. Future premiums are excluded for unit-linked policies that do not contain these risk benefits.

The contract end boundary is determined as follows:

- For policies with no renewal dates, the end boundary is based on the contract term or retirement date selected by the policyholder. Early and late retirements are reflected based on best estimate assumptions for future experience;
- Certain contracts such as annuities, pensions with GAOs and whole of life products have no specific contract end date;
- Where there are premium review dates on business providing risk benefits and the Company does not have the option to re-underwrite at the premium review date, the end boundary is based on the contract term. Where the Company has the option to amend premiums and/or benefits to fully reflect the risks, the boundary is the first review date; and
- For reviewable reinsurance ceded the reinsurance contract end boundary is the same as for the underlying reinsured policies as the reinsurers do not have a unilateral right to amend the premiums.

D.3.3. Best estimate liabilities (BEL) for with-profits insurance
For the majority of with-profits business, the BEL is calculated as the sum of:

- asset shares; and
- value of future policy-related liabilities.

Asset shares are an accumulation to the valuation date of premiums paid allowing for investment returns, expenses and/or charges, and any enhancements from miscellaneous surplus. Principles and practices underlying the asset share methodology are set out in the PPFM. Asset shares for some products are calculated using prospective (or other methods) rather than retrospective methods, for example for some whole life policies and paid-up policies.

The value of future policy-related liabilities is calculated as follows:

- The cost of providing financial guarantees (costs and other benefits not reflected in the asset share) determined using a stochastic valuation. A stochastic valuation is derived from estimating probability distributions of potential outcomes, when one or more of the variables are random;
- **Plus or less** (as applicable) the cost of smoothing pay-outs to policyholders determined using a stochastic valuation in accordance with the smoothing rules;
- **Plus** the cost of providing financial options determined using a stochastic valuation;
- **Less** the value of policy charges for providing options and guarantees using a stochastic valuation;
- **Less** the value of other charges deducted from asset shares net of future expenses;
- For UF OB, UF IB and RA IB funds only, **less** the value of 1/9th cost of bonus transfers (this deduction is to comply with guideline 8 of the EIOPA *Guidelines on ring-fenced funds* as the transfers, being future charges from asset shares (above), would otherwise be treated as a liability); and
- For Open Fund only, **less** the value of expense charging arrangements in respect of the SL, PLAL, Liver and RL (CIS) Funds.

BEL for index-linked and unit-linked insurance
With the exception of the unit fund liability part of unit-linked liabilities (which are classified as TPCAW), the BEL for linked life insurance business is calculated from a prospective deterministic valuation, as the present value of future cash flows. Cash flows are projected based on product terms, a set of demographic assumptions and assumed returns on unit-linked funds reflecting risk-free returns and fund charges. This leads to the BEL corresponding to the probability-weighted average of future cash flows.

For linked insurance business with options and guarantees, the BEL is calculated as the present value of cash flows for an identical contract without options and guarantees plus the cost of the options and guarantees.

BEL for health insurance and other insurance
The BEL for health insurance and other life insurance business is generally calculated from a prospective deterministic valuation, as the present value of future cash flows. Cash flows are projected based on a set of demographic assumptions and product features. This leads to the BEL corresponding to the probability-weighted average of future cash flows.

Simplified BEL calculations
The methods for calculating BEL described above are varied and simplifications are used for less material classes of business where their application would not be practical or proportionate. Simplifications used are chosen only where they are expected to produce a more prudent provision than applying the methods described above.

Valuation for solvency purposes (continued)

Data quality
There are data quality standards which set out the management approach, governance arrangements and the minimum standards used to ensure that data used for financial reporting is appropriate, complete and accurate.

The standards are part of FRDCF and assume a proportionate and risk-based approach. They are in line with the principles of SII and are also consistent with the overarching Risk Management Policy.

There are no known limitations or inaccuracies in data that materially impact the technical provisions. Where there are inaccuracies, an adequate additional provision is held.

D.3.4. Use of stochastic techniques
Stochastic methods are used to calculate the costs of options, guarantees and smoothing, i.e. part of the BEL. A market-consistent set of economic scenarios is generated and the costs valued in each scenario using a discount curve equal to the projected future risk-free curve for that scenario (net of any I-E tax).

The BEL calculation is consistent with information provided by the financial markets as a market-consistent valuation is placed on the value of options and guarantees. This requires a specific set of scenarios to be produced as an input. These scenarios are produced by an economic scenario generator (ESG). The scenarios are validated against market data at the valuation date and meet certain properties to enable a market-consistent value of the liabilities to be produced.

D.3.5. Risk Margin (RM)
The RM calculation assumes the Company's business is transferred to another insurance undertaking (reference undertaking) and represents the cost to the reference undertaking of providing capital covering its SCR over the expected lifetime of the business. The RM has been calculated on the basis of the Standard Formula SCR.

Residual market risk in the reference undertaking is taken as zero, as it is assumed that a reference undertaking could hedge all market risk if they wanted to, leaving the business with no exposure to market risk. Hence the RM is calculated based on the run-off of non-market risk SCR.

A risk driver approach is used to project the SCR, under which the individual risk components of the Standard Formula SCR are projected in line with selected risk drivers. The risk drivers are selected so as to provide a true run-off of each risk component.

D.3.6. Assumptions used
Demographic assumptions for future experience are set on a best estimate basis as described below:

- Mortality and morbidity risks are inherent in most lines of business. For protection business, an increase in mortality and morbidity rates leads to increased claim levels and hence an increase in liabilities. For annuity business the mortality risk is that policyholders live longer than expected. Reinsurance arrangements have been put in place to mitigate mortality and morbidity risks. The rates of mortality and morbidity are set in line with recent company experience, where it is available in sufficient volume to provide reliable results. Where company experience is not considered sufficient, rates have been set by reference to either industry experience or the terms on which the business is reinsured.
- Persistency is the extent to which policies remain in-force and are not for any reason lapsed, made paid-up, surrendered or transferred prior to maturity or expiry. The rates of persistency are set in line with recent company experience. Where appropriate, these rates are adjusted to allow for expected future experience being different from past experience. The rates vary by product line, sales channel, duration in force and for some products by fund size.
- GAO take-up rates, where at retirement a customer chooses to receive a guaranteed regular income rather than take the pension fund as cash, are also key assumptions set using expert judgement and recent experience.
- For the main classes of business, expense assumptions are set in accordance with management service agreements and for business transferred to the Company, in accordance with the appropriate scheme of transfer. Expenses for those classes of business not covered by either a management service agreement or a scheme of transfer are based on the actual expenses incurred. Expenses are assumed to inflate in line with the change in the UK Retail Price Index or the Republic of Ireland Consumer Price Index as appropriate, plus a margin. The margin varies between open and closed books of business.

The key assumption changes during 2018 relate to:

- Mortality assumptions for annuity business. The assumptions have been updated to use the 2017 projection model issued by the Continuous Mortality Investigations Bureau (CMIB). The new assumptions reflect the latest forecasts that future life expectancy will not improve by as much as previously predicted;
- Mortality and morbidity risks for UK protection business. The assumptions have been updated to use the 2017 mortality tables issued by the CMIB and for latest experience. The new assumptions reflect higher levels of mortality than previously assumed;

- Persistency assumptions have been updated for both pensions and protection business, and were generally strengthened which reflects latest experience;
- Mortality and persistency assumptions have been updated for customers involved in the GAR Compromise Scheme implemented in 2018 (see section A.1.7). The implementation of the Scheme creates two new groups of policyholders: policyholders who choose to retain their GAR and not take part in the Scheme (opt-outs) and policyholders who choose to exchange their GAR for a cash uplift (opt-ins). Mortality and persistency assumptions for each group of policyholders have been updated to reflect expected future experience of the policyholders; and
- Per policy expenses on unit-linked pensions have been reduced, reflecting the latest experience following large volumes of new business sold in recent years. Future expense inflation rates have also been updated in line with latest future projections of expenses. Expense inflation assumptions on unit-linked policies have reduced, whilst future expense inflation rates on closed books of business have increased.

Where the BEL is calculated as the sum of an asset share (whether retrospective or prospective) and future policy-related liabilities, a projection of future annual and terminal bonuses is required for the future policy-related liabilities. The level of future annual bonus is assumed to change progressively from the most recently declared rates to a long-term assumption.

In addition, economic assumptions are used, based on:

- initial curve of risk-free rates of interest by currency as defined for SII (including VA for applicable business); and
- inflation (linked to ESG where stochastic methods are used).

D.3.7. Level of uncertainty within the technical provisions

Technical provisions are calculated as the sum of BEL and RM. The BEL part of technical provisions represents the mean of a probability distribution and the RM part is a cost of providing capital on non-hedgeable risk over the run off of existing business.

Uncertainties associated with the BEL arise principally from:

- risks considered in the SCR/ORSA (including market risk, credit risk and insurance risk);
- volatility in the best estimate assumptions from year to year; and
- uncertainty that assumptions experience in the recent past can be assumed to apply over the future life of the business.

Uncertainties in the RM arise from future interest rates and factors affecting the methodology assumed for the run off of SCR components.

The approach taken for complex risk structures (options, guarantees, policyholder behaviour and future management actions) and limitations and approximations in the methodology are detailed in section D.3.3. Technical provisions are most sensitive to persistency, mortality, expense and economic assumptions.

D.3.8. Comparison of technical provisions for SII purposes and IFRS

The tables below show the differences between the technical provisions under SII and IFRS for the Company.

Technical Provisions as at 31 December 2018	SII value £m	IFRS statutory accounts value £m[1]	Difference £m
Insurance with-profits participation	27,490	32,423	(4,933)
Index-linked and unit-linked insurance	42,728	42,694	34
Health insurance	(131)	(119)	(12)
Other life insurance	5,076	5,305	(229)
Total	75,163	80,303	(5,140)

1. Total IFRS technical provisions of £80,303m exclude claims outstanding of £322m, which are included in technical provisions (£80,625m) in the 2018 IFRS balance sheet. Further information on SII presentation adjustments is included in section D.1.2 above.

Valuation for solvency purposes (continued)

Technical Provisions as at 31 December 2017	SII value £m	IFRS statutory accounts value £m[1]	Difference £m
Insurance with-profits participation	29,801	35,190	(5,389)
Index-linked and unit-linked insurance	39,222	39,310	(88)
Health insurance	(134)	(124)	(10)
Other life insurance	5,126	5,393	(267)
Total	74,015	79,769	(5,754)

1. Total IFRS technical provisions of £79,769m exclude claims outstanding of £339m, which are included in technical provisions (£80,108m) in the 2018 IFRS balance sheet.

The table below shows an analysis of the difference between the total technical provisions under SII and the IFRS statutory accounts value as at 31 December 2018 and 31 December 2017.

		2018 £m	2017 £m
	IFRS technical provisions	**80,303**	79,769
1.	Removal of closed fund surplus included in IFRS	**(3,903)**	(4,265)
2.	Deferred acquisition costs	**(155)**	(181)
3.	Value of In-Force business (VIF) excluded from IFRS investment business	**(54)**	(81)
4.	Deferred front end loads (DFEL)	**108**	128
5.	Economic assumptions	**(532)**	(437)
6.	Margins of prudence	**(422)**	(482)
7.	Contract boundaries	**116**	134
8.	RM	**1,926**	1,917
9.	TMTP – unaudited	**(2,258)**	(2,432)
10.	Other	**34**	(55)
	SII technical provisions	**75,163**	74,015

The items included in the table above are described as follows:

- There is a presentation difference for the surplus in closed funds (1). IFRS treats this as a liability whereas in SII it is an adjustment to own funds.
- IFRS for investment business uses a fair value principle and not a discounted cash flow methodology which is different to SII (2, 3 and 4).
- For business classed as insurance under IFRS, the underlying discounted cash flow methodology is the same for IFRS and SII. The key differences are economic assumptions (5), removal from the IFRS values of implicit margins of prudence (6) and contract boundaries (7) but inclusion of an explicit RM (8) and the TMTP (9).

D.3.9. Matching adjustment (MA)
The MA has not been applied for 2018 or 2017.

D.3.10. Volatility adjustment (VA)
The PRA has authorised use of the VA. The prescribed VAs as in the table below have been applied to with-profits business and annuities in payment:

Business	2018 VA	2017 VA
GBP	**27bps**	18bps
EUR	**24bps**	4bps

The impact of reducing the VA to zero on the Company SII balance sheet (including technical provisions, own funds and SCR) is set out below and shown in S.22.01.21 in Appendix 2.

	2018			2017		
	Including VA £m	Excluding VA £m	Impact of removing VA £m	Including VA £m	Excluding VA £m	Impact of removing VA £m
Technical provisions	75,163	75,707	544	74,015	74,453	438
Basic own funds	6,368	6,298	(70)	6,565	6,488	(77)
Eligible own funds to meet SCR	6,368	6,298	(70)	6,565	6,488	(77)
SCR	4,477	4,461	(16)	4,196	4,161	(35)
MCR	1,119	1,115	(4)	1,049	1,040	(9)
Investor View – Solvency surplus	4,542	4,169	(373)	5,380	5,094	(286)
Investor View – Capital cover ratio	201%	193%	(8pp)	228%	222%	(6pp)
Regulatory View – Solvency surplus	1,891	1,837	(54)	2,368	2,328	(40)
Regulatory View – Capital cover ratio	142%	141%	(1pp)	156%	156%	(0pp)

D.3.11. Transitional risk-free interest rate term structure
The transitional risk-free interest rate term structure has not been applied for 2018 or 2017.

D.3.12. Transitional measure on technical provisions (TMTP) - unaudited
The PRA has authorised use of the TMTP. The PRA last approved the recalculation of the TMTP for the year ended 31 December 2017, which is next due to be recalculated at 31 December 2019. The TMTP is amortised on a straight-line basis over a 16 year period from 1 January 2016 so that it reduces to nil by 1 January 2032. The TMTP was £2,258m at 31 December 2018 (31 December 2017: £2,432m), with the reduction reflecting the amortisation.

The TMTP can be no greater than the excess of the SII technical provisions over the Individual Capital Adequacy (ICA) technical provisions as at the date of calculation on business written before 1 January 2016. When last recalculated in 2017 the TMTP was restricted to ensure that, as at the date of calculation, the Financial Resources Requirement (FRR) under SII was no lower than that under Solvency I. The FRR is the sum of the technical provisions, other liabilities and capital requirements.

The impact of reducing the TMTP to zero on the Company SII balance sheet (including technical provisions, own funds and SCR) is set out below and shown in S.22.01.21 in Appendix 2.

	2018			2017		
	Including TMTP £m	Excluding TMTP £m	Impact of removing TMTP £m	Including TMTP £m	Excluding TMTP £m	Impact of removing TMTP £m
Technical provisions	75,163	77,421	2,258	74,015	76,447	2,432
Basic own funds	6,368	5,601	(767)	6,565	5,838	(727)
Eligible own funds to meet SCR	6,368	5,601	(767)	6,565	5,838	(727)
SCR	4,477	4,479	2	4,196	4,198	2
MCR	1,119	1,120	1	1,049	867	(182)
Investor View – Solvency surplus	4,542	2,281	(2,261)	5,380	2,945	(2,435)
Investor View – Capital cover ratio	201%	151%	(50pp)	228%	170%	(58pp)
Regulatory View – Solvency surplus	1,891	1,121	(770)	2,368	1,640	(728)
Regulatory View – Capital cover ratio	142%	125%	(17pp)	156%	139%	(17pp)

D.3.13. Reinsurance recoveries
The Company uses reinsurance to reduce the insurance risks associated with the following material business:

- RL (CIS) Fund annuities in payment are reinsured in tranches with XL, Swiss Re and RGA. These arrangements are collaterised;
- The majority of the pre-2017 pension vestings in the Open Fund are reinsured with Prudential. Whilst the benefit payments are 100% reinsured, some expense risk is retained. There is a floating charge over the assets of Prudential in the event of default; and
- Protection business is reinsured with a range of reinsurers. In each case, a high proportion of the insurance risk is reinsured, leaving RLMIS with a low retained benefit/risk.

Reinsurance is also used for some other business. These product lines are not material.

The Company does not use any finite reinsurance arrangements or any Special Purpose Vehicles to conduct its reinsurance programme.

Projection of reinsurance recoveries cash flows
Reinsurance cash flows are generally projected using the same methodology as for the underlying reinsured product. All of the reinsurance cash flows are included, specifically:

- Reinsurance premium ceded;
- Reinsurance claim recoveries;
- Reinsurance commission payable;
- Reinsurance expenses;
- Income or outflow arising from profit sharing arrangements; and
- Any tax associated with these commissions/expenses.

These cash flows are discounted using the same yield curve used to derive the BEL for the same contract.

The timing of reinsurance claim recoveries is taken to be the same as for claim payments to the policyholder as it is expected, on average, to be within three months of the claim payment to the policyholder.

Reinsurer counterparty default adjustments
The amounts recoverable from each reinsurance arrangement are adjusted to allow for estimated losses due to reinsurer default. The estimated losses are calculated at each future time period as:

- the probability of default for each reinsurer at that time (based on a credit assessment of the reinsurer); multiplied by
- the expected percentage loss on default (50%); multiplied by
- the future value of expected reinsurance recoveries less payments (i.e. the value of future net income expected to be received from the reinsurer had they not defaulted).

D.4 Other liabilities

Other liabilities valuation basis and comparison to IFRS
The 2018 IFRS to SII balance sheet reconciliation is presented in section D.1, including an explanation of the presentation adjustments required to align the IFRS balance sheet to the prescribed format of the SII balance sheet. There have been no material changes affecting the valuation methodology of other liabilities in the SII balance sheet in 2018. The description of valuation differences between the SII and IFRS balance sheet for the Company, by material liability class, is provided below:

D.4.1. Provisions other than technical provisions
The total valuation difference of £257m (2017: £291m) is due to provisions for renewal commission of £149m (2017: £163m) and deferred fee income of £108m (2017: £128m) which are not recognised in SII. Under the SII valuation the cash flows that underpin these liabilities are included within the calculation of the BEL and therefore are included within the SII technical provisions.

The remaining balance relates to provisions recognised in the SII balance sheet which are the same value under SII and IFRS, which are determined by discounting the expected cash flows required to settle the obligation. The provisions mainly relate to regulatory projects and rectification programmes.

D.4.2. Deferred tax liabilities
The deferred tax balances in the SII balance sheet are recognised on the same basis as under IFRS, are calculated using the balance sheet liability method and have been provided for on the basis of the expected realisation/settlement of the carrying amount of assets and liabilities. The IFRS basis for recognising deferred tax is reported in note 35 on pages 163 and 164 of the 2018 ARA. Differences in the deferred tax balances arise where balance sheet items have different carrying amounts under SII and IFRS.

D.4.3. Subordinated liabilities
Subordinated liabilities (also known as subordinated debt) are recognised at their fair value under SII whereas in the IFRS balance sheet they are valued at amortised cost, resulting in a valuation difference of £61m (2017: £138m). The SII fair value is based on the quoted price and includes accrued interest. The SII value excludes material changes in the issuer's own credit rating if contained within the quoted price.

D.4.4. Financial liabilities other than debts owed to credit institutions
The balance included in 'Financial liabilities other than debts owed to credit institutions' relates to finance lease obligations in respect of property leased by the Company and is calculated as the present value of minimum lease payments in accordance with IAS 17. This is considered a good representation of the valuation for solvency purposes and, since the amounts are not material, the IFRS values have been used with no adjustment to account for market-consistent factors.

There are no material liabilities arising from operating leases. The commitment to make payments in the future under operating leases is shown in note 37(c) on page 164 of the 2018 ARA.

D.4.5. Payables (trade, not insurance)
Payables (trade, not insurance) are measured at amortised cost for IFRS and are valued at fair value for SII, resulting in a valuation difference of £5m (2017: £5m). The valuation difference relates to interest on subordinated liabilities, which is included within payables under IFRS but is already included in the fair value of subordinated liabilities for SII. No account has been taken of the effect of discounting short-dated payables as the effect is deemed to be immaterial.

D.5 Alternative methods for valuation
The valuation principles and methodology for valuing assets and other liabilities, including where alternative methods are used in accordance with Article 10(5), is described in section D.2.7.

D.6 Any other information
There is no material information on the valuation of assets and liabilities for solvency purposes that is not already included above.

E.Capital management

Plain English introduction

The Company has a strong capital position under SII and our capital is of a high quality. However, the capital position should not be too high, as it is important that we continue to return value to our policyholders and members.

In this section, we describe our approach to capital management. Capital (which is broadly assets minus liabilities) absorbs a firm's losses in periods of stress and provides a buffer to increase resilience against unexpected losses. When a firm's capital is depleted, it is less likely to be able to meet policyholder claims as they fall due. In this way, the quantity of capital a firm has on the balance sheet can be used as a tool to understand the strength and solvency position of the firm. Capital is referred to as own funds under SII.

In this section we provide information on our own funds, including:

- The objectives, policies and processes for managing our own funds;
- The amount and quality of our own funds; and
- Expected development of own funds, including the intention to redeem items or raise additional own funds.

We also provide details of our Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR). The capital (own funds) in excess of our requirements (SCR) is referred to as 'solvency surplus'.

Our capital position is robust, reflecting the strength of our underlying business and effective capital management strategies. The Open Fund had an excess surplus of £1,891m at 31 December 2018 (31 December 2017: £2,369m) and a capital cover ratio of 185% at 31 December 2018 (31 December 2017: 223%). The closed funds are also well capitalised with an excess surplus of £2,651m at 31 December 2018 (31 December 2017: £3,011m) and a capital cover ratio of 218% at 31 December 2018 (31 December 2017: 233%). The Investor View capital cover ratio for Royal London is 201% at 31 December 2018 (31 December 2017: 228%) including surplus in the closed funds.

The majority (80% (31 December 2017: 79%)) of total own funds within the Open Fund is made up of Tier 1 capital, with subordinated debt valued at £806m at 31 December 2018 (31 December 2017: £883m) classified as Tier 2 capital. Own funds within the closed funds are entirely Tier 1 capital.

In common with many in the industry, we present two key metrics: an 'Investor View' for analysts and investors in our subordinated debt, which does not restrict the surplus in the closed funds, and a 'Regulatory View' where the closed funds' surplus in excess of the SCR is excluded from total own funds and treated as a liability, which is known as the closed funds restriction.

The SII position has been prepared in accordance with the SII Directive for insurance entities operating in Europe. We have adopted the Standard Formula approach for the purposes of measuring regulatory capital under SII. Royal London received approval for the use of the TMTP and a capital add-on from the PRA. Both the TMTP and capital add-on are included in figures throughout this section and are unaudited.

Key SII metrics

£m	Royal London Open Fund	Royal London closed funds	Total Company (Investor View)	Closed fund restriction	Total Company (Regulatory View)
Own funds:					
Tier 1	3,313	4,900	8,213	–	8,213
Tier 2	806	–	806	–	806
Total own funds	**4,119**	**4,900**	**9,019**	**–**	**9,019**
Closed funds restriction	–	–	–	(2,651)	(2,651)
Adjusted own funds (A)	**4,119**	**4,900**	**9,019**	**(2,651)**	**6,368**
SCR (B)	**2,228**	**2,249**	**4,477**	**–**	**4,477**
Solvency surplus (A-B) – 31 December 2018	**1,891**	**2,651**	**4,542**	**(2,651)**	**1,891**
Solvency surplus – 31 December 2017	2,369	3,011	5,380	(3,011)	2,369
Capital cover ratio[1] (A/B) – 31 December 2018	**185%**	**218%**	**201%**	**n/a**	**142%**
Capital cover ratio[1] – 31 December 2017	223%	233%	228%	n/a	156%

1 Figures presented in the table are rounded, and the capital cover ratio is calculated based on exact figures.

Capital management (continued)

Movement in our capital position

The table below sets out an analysis of the movement in the Investor View solvency surplus between 31 December 2017 and 31 December 2018.

	Total Company (Investor View) £m
31 December 2017	**5,380**
Existing business Own Funds generation, excluding RM and TMTP from current back book	83
TMTP run off	(174)
Existing business RM run off from current back book	155
Existing business SCR run off from current back book	37
Total Existing Business Excess Capital Generation from current back book	**101**
Existing business Own Funds generation excluding RM from new business	212
Existing business RM run off from new business	(109)
Existing business SCR run off from new business	(221)
Total Existing Business Excess Capital Generation from new business	**(118)**
Experience variance and change in operating assumptions	100
Economic variance	(501)
Other	(20)
Total Organic Excess Capital Generation	**(421)**
Excess capital generation arising from model changes and other management actions	(203)
Interest expense[1]	(47)
ProfitShare	(150)
Total Change in Excess Capital	**(838)**
31 December 2018	**4,542**

1 Interest expense relates to the subordinated liabilities in the form of the Fixed Rate Reset Callable Guaranteed Subordinated Notes due 2043 (the 2043 notes) and the Guaranteed Subordinated Notes due 2028 (the 2028 notes).

The solvency surplus (Investor View) has decreased from £5,380m at 31 December 2017 to £4,542m at 31 December 2018 due to the following sources:

- adverse economic experience, driven by difficult investment market conditions, particularly during the last quarter of 2018, and an increase in insurance risk capital for the mass lapse stress following further EIOPA clarification on treatment of per policy expenses (-£501m); and
- financing costs, specifically the payment of interest on our subordinated debt (-£47m); partially offset by
- positive demographic assumption changes (+£100m); and
- capital benefit from the run-off of existing business (+£101m).

Our remaining capital position is strong, and as a result we have been able to use available capital (whilst still meeting our target solvency levels) to:

- write significant new business during 2018, which had a strain on capital (-£118m);
- carry out management actions, specifically progress with one-off projects and investment in the business, including the ongoing transformation of our pensions business (#thinkbeyond) and the Royal London GAR Compromise Scheme, which allowed certain policyholders to exchange guarantees for a cash uplift in order to more effectively manage the run-off of the SL fund and resulted in a one-off decrease in the capital position (-£203m); and
- deliver record ProfitShare, following an increase in eligible members 2018 (-£150m).

Sensitivities on the solvency surplus

The solvency surplus is sensitive to changes in economic assumptions. The table below sets out various sensitivities of the capital cover ratio and solvency surplus based on different possible scenarios:

Scenario	Solvency Surplus (Investor View) (£m)	Capital Cover Ratio (Investor View) (%)
SII Solvency Surplus – 31 December 2018	4,542	201
25% decrease in all equity investments	(307)	(1)
25% decrease in property prices (commercial and residential)	(151)	(2)
100bps rise in interest rate (parallel shift)[1]	(496)	(9)
100bps fall in interest rate (parallel shift) [1, 6]	158	(6)
50bps increase in government bond yields[2]	(292)	(6)
100bps widening in credit spreads (all ratings)	(14)	–
20% of assets downgrading to the next credit quality rating[3]	(33)	(1)
50bps increase in inflation[4]	(47)	(1)
25% fall in GBP exchange rates (against all other currencies)[5]	336	1

1 Interest rate sensitivities assume government and other bond yields and risk-free rates all move by the same amount. Interest rates are allowed to be negative.
2 The government bond yield sensitivity assumes risk-free rates and other yields remain constant.
3 The asset credit downgrade sensitivity applies to the liabilities only and not asset values. The calibration of the Fundamental Spreads by sector, rating and term is assumed to be unchanged.
4 Inflation change is calculated as real interest rates less nominal interest rates.
5 This sensitivity assumes an increase to the value of assets held in currencies other than GBP by 33% in GBP terms.
6 The results of this stress assume that additional management actions are implemented to ensure that the direction of the lapse risk in the SII Standard Formula remains unchanged.

Sensitivities presented in the table are consistent with the PRA's SS7/17: Solvency II: Data collection of market risk sensitivities, which is available at www.bankofengland.co.uk/pra/Documents/publications/ss/2017/ss717.pdf.

E.1 Own funds

E.1.1. Unrestricted Capital Cover Ratio

The SII capital cover ratio (Regulatory View) restricts the capital in the closed funds to the level of the Standard Formula SCR only, which has the effect of reducing the capital cover ratio.

Without this restriction in the closed funds, the capital cover ratio (Investor View) as at 31 December 2018 would be 201% (31 December 2017: 228%).

E.1.2. Objectives, policies and processes for managing own funds

The Company manages its own funds within a Board-approved Capital Management Framework. This sets a target range for capital of being able to withstand between a 1-in-50 and a 1-in-20-year event, and still be able to meet an internal capital requirement.

The capital position relative to the target acts as a guideline to inform distribution or determine if management actions are necessary. The amounts paid to policyholders, or management actions taken, are subject to Board discretion to allow wider business factors to be considered.

The future progression of own funds, including the position against the target set out in the Capital Management Framework, is considered under a range of scenarios as part of the ORSA.

E.1.3. Amount and quality of own funds by tier

The structure of own funds for the Company is shown in the following table.

		31 December 2018		31 December 2017	
Classification of own funds		**£m**	**Tier amount as a % of total own funds**	£m	Tier amount as a % of total own funds
Tier 1 - unrestricted	Surplus funds	**8,284**		8,562	
	Reconciliation reserve	**(2,722)**		(2,880)	
Total Tier 1 - unrestricted		**5,562**	**87%**	5,682	87%
Tier 2	Subordinated debt	**806**	**13%**	883	13%
Total available own funds		**6,368**	**100%**	6,565	100%

The main own funds items and explanations of the material differences between the Company's financial statements and the excess of assets over liabilities as calculated for SII purposes are detailed further in the following sections. The Company does not have any ancillary own funds.

The majority (80% (31 December 2017: 79%)) of total own funds within the Open Fund is made up of Tier 1 capital, with subordinated debt valued at £806m (31 December 2017: £883m) classified as Tier 2 capital. Own funds within the closed funds are entirely Tier 1 capital.

Own funds has decreased by £197m from 2017 with the Open Fund own funds decreasing by £184m and the closed funds' SCR (and therefore own funds, after RFF deduction) decreasing by £13m. The Open Fund own funds decreased due to:

- adverse economic variances (including the performance of RLGPS);
- costs relating to one-off projects and investment in the business;
- the allocation of ProfitShare; and
- an increase in the RM arising from an increase in the SCR and a reduction in the value of the TMTP; partially offset by
- strong new business sales;
- positive demographic assumption changes; and
- methodology changes arising from the introduction of our new actuarial modelling system.

E.1.4. Surplus funds

The Company comprises the Open Fund and a number of with-profits closed funds arising from businesses that have been acquired in the past.

Surplus funds are the accumulated profits of a with-profits fund, which have not been made available for distribution to policyholders and which meet the conditions to qualify as Tier 1 own funds. Consequently, any expected discretionary benefits from future estate distributions are excluded from the BEL component of technical provisions and included in surplus funds.

Surplus funds have been calculated as:

- Total assets;
- **Less:** liabilities (other than technical provisions);
- **Less:** the BEL component of technical provisions (which as above excludes any benefits from future estate distributions) and TPCAW – these figures include any reduction in the BEL from TMTP;
- **Less:** (for the ex-UAG funds only) the value of future 1/9th of cost of bonus transfers from those funds to the Open Fund resulting from future discretionary benefits assumed in the BEL (as these transfers are excluded from the SII BEL in line with Guideline 8 of the ring-fenced fund guidelines).

Although the Company is a mutual and has no shareholders, under the terms of the transfer to the Company of the ex-UAG funds (RA IB, UF OB and UF IB) the Open Fund receives a profit transfer of 1/9th of cost of bonus of those funds. These transfers are similar to shareholder transfers described in Guideline 8 and accordingly have been accounted for in line with that Guideline.

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E.1.5. Reconciliation reserve

The reconciliation reserve is the excess of assets over liabilities, adjusted for surplus funds and the closed fund surplus restriction.

Reconciliation reserve at 31 December 2018	**£m**
Excess of assets over liabilities	**8,213**
Less: Other basic own fund items	**(8,284)**
Less: Restricted own fund items due to ring fencing	**(2,651)**
Total	**(2,722)**

Reconciliation reserve at 31 December 2017	£m
Excess of assets over liabilities	8,692
Less: Other basic own fund items	(8,562)
Less: Restricted own fund items due to ring fencing	(3,010)
Total	(2,880)

The other basic own fund items are equal to the surplus funds. The ring-fenced fund adjustment is described further below.

E.1.6. Ring-fenced fund adjustment

As noted above, the Company comprises the Open Fund and a number of closed funds. These closed funds are ring-fenced funds.

The own funds of a ring-fenced fund are only available to absorb losses in that ring-fenced fund and are not (on a going concern basis) available to other parts of the Company. For this reason they are known as 'restricted own funds'. The maximum amount of restricted own funds that can be recognised in the Company's overall own funds is the value of the ring-fenced fund's notional SCR (the notional SCR is also included in the Company's overall capital requirement). Any restricted own funds over and above the notional SCR is deducted from the Company's total own funds to derive the eligible own funds, which are available to cover the capital requirement for the entity as a whole.

The calculation of the ring-fenced fund deduction is presented in the table below.

	31 December 2018 – £m			
	Notional SCR	**Own funds**	**RFF deduction**	**Own funds eligible for undertaking**
Open Fund	**2,228**	**4,119**	**n/a**	**4,119**
Closed funds	**2,249**	**4,900**	**(2,651)**	**2,249**
Total	**4,477**	**9,019**	**(2,651)**	**6,368**

	31 December 2017 – £m			
	Notional SCR	Own funds	RFF deduction	Own funds eligible for undertaking
Open Fund	1,933	4,303	n/a	4,303
Closed funds	2,262	5,272	(3,010)	2,262
Total	4,195	9,575	(3,010)	6,565

Capital management (continued)

E.1.7. Subordinated debt

The subordinated debt within the Company's own funds relates to subordinated liabilities in the form of the Fixed Rate Reset Callable Guaranteed Subordinated Notes due 2043 (the 2043 notes) and the Guaranteed Subordinated Notes due 2028 (the 2028 Notes). These notes were issued by RL Finance Bonds No 2 plc and RL Finance Bonds No 3 plc. Further information on these liabilities is given in the table below and note 30 on page 159 of the 2018 ARA.

The key terms and conditions of the notes in issue are unchanged from the prior year and are set out in the table below.

	2043 Notes	2028 Notes
Issuer	RL Finance Bonds No 2 plc with subordinated guarantee by RLMIS. The proceeds of the issue were loaned to RLMIS on the same interest, repayment and subordination terms as those applicable to the Notes.	RL Finance Bonds No 3 plc with subordinated guarantee by RLMIS. The proceeds of the issue were loaned to RLMIS on the same interest, repayment and subordination terms as those applicable to the Notes.
Subordination	In the event of winding up, the Notes are subordinated to the claims of all policyholders and other unsubordinated creditors and in priority to any issuer of junior securities.	In the event of winding up, the Notes are subordinated to the claims of all policyholders and other unsubordinated creditors and in priority to any issuer of junior securities and rank pari passu with all claims of holders of other subordinated debt.
Maturity	30 November 2043	13 November 2028
Principal	£400m	£350m
Coupon	6.125% fixed rate to the tenth anniversary of issue. Resets on 30 November 2023 and on the fifth anniversary thereafter to a rate equal to the five-year gilt rate plus 3.321% (the initial margin) plus 1%.	6.125% fixed rate.
Optional redemption	Yes – on 30 November 2023 and on each interest payment date thereafter. Regulatory approval/notification is required for any redemption, variation and purchase before the maturity date. Mandatory deferral of redemption when the SCR is breached or if redemption would lead to an SCR breach.	No
Optional interest deferral	Yes	Yes
Mandatory interest deferral/cancellation	Mandatory deferral of interest payments when SCR breached or payment would lead to an SCR breach.	Mandatory deferral of interest payments when SCR breached or payment would lead to an SCR breach.
Special event redemptions	Redemption option in the event of certain changes in tax treatment or change in applicable law/regulation. All redemptions require prior regulatory approval and any redemption within five years of issue must be made from the proceeds of a fresh issue of the same or higher quality.	Redemption option in the event of certain changes in tax treatment or change in applicable law/regulation. All redemptions require prior regulatory approval and any redemption within five years of issue must be made from the proceeds of a fresh issue of the same or higher quality.

E.1.8. Eligible own funds covering the SCR and MCR by tier

The eligible amounts of own funds to cover the SCR and the MCR, classified by tiers together with the solvency ratios are set out below. The ratio of the eligible own funds to SCR or MCR is calculated by dividing the total eligible own funds to meet the SCR or MCR by the value of the SCR or MCR respectively.

	31 December 2018 – £m			31 December 2017 - £m		
	Total	Tier 1 unrestricted	Tier 2	Total	Tier 1 unrestricted	Tier 2
Total eligible own funds to meet the SCR	**6,368**	**5,562**	**806**	6,565	5,682	883
Total eligible own funds to meet the MCR	**5,786**	**5,562**	**224**	5,892	5,682	210
SCR	**4,477**			4,195		
MCR	**1,119**			1,049		
Ratio of eligible own funds to SCR	**142%**			156%		
Ratio of eligible own funds to MCR	**517%**			562%		

There is no Tier 1 restricted or Tier 3 own funds at 31 December 2018 (31 December 2017: nil).

E.1.9. Differences between own funds and net assets on a financial reporting basis

As a mutual entity the Company does not have equity. The UDS in the IFRS financial statements represents the surplus in the Open Fund on an IFRS basis for which the allocation between participating policyholders has yet to be determined. The UDS is effectively the net assets of the Company on an IFRS basis.

The reconciliation below shows the differences between the UDS in the IFRS financial statements and the SII own funds.

	Notes	31 December 2018 £m	31 December 2017 £m
UDS per IFRS financial statements		**4,075**	3,855
Adjustments to a SII basis:			
Adjustment to the value of technical provisions and reinsurance assets	1	**982**	1,235
Goodwill, other intangible assets and deferred acquisition costs	2	**(686)**	(605)
Other valuation differences	3	**(61)**	(58)
Inclusion of closed funds surplus classified as an IFRS liability	4	**3,903**	4,265
Excess of assets over liabilities in SII balance sheet		**8,213**	8,692
Subordinated debt	5	**806**	883
Ring-fenced fund adjustment (includes TMTP and add-on which are unaudited)	6	**(2,651)**	(3,010)
Total own funds under SII		**6,368**	6,565

1. The adjustment to the value of technical provisions and reinsurance assets results from the recalculation of these balances using SII requirements. This includes the removal of the margins of prudence included in the IFRS values (so that assumptions are all best estimate), the inclusion of the SII RM, the use of the SII yield curve including the VA for appropriate lines of business, the adoption of SII contract boundary definitions (mainly affecting unit-linked business) and also any benefit from the SII transitional provisions.
2. Goodwill, other intangible assets and deferred acquisition costs are recognised in the IFRS balance sheet. Under the SII valuation rules, these assets are valued at nil.
3. Other valuation differences relate principally to the value of participations, renewal commission and subordinated liabilities. In the IFRS balance sheet participations are valued at fair value, and for SII the valuation equates to the value of net assets on a SII basis. Renewal commission is recognised in the IFRS balance sheet but not on a SII basis. Subordinated liabilities are held at amortised cost for IFRS and at fair value for SII.
4. For IFRS any excess of assets over liabilities within the closed funds is included within liabilities so the UDS includes amounts relating to the Open Fund only. For SII, the excess within the closed funds is included within total available own funds, but only up to the value of the capital requirement (SCR) of the closed funds.
5. Subordinated liabilities in the form of the 2043 Notes and the 2028 Notes are included within available own funds on a SII basis, whereas IFRS treats subordinated debt as a liability.
6. The ring-fenced fund adjustment is where the closed funds' surplus in excess of the SCR is excluded from total available own funds and treated as a liability.

E.1.10. Basic own funds subject to transitional arrangements

No basic own funds were subject to transitional arrangements in either 2018 or 2017.

E.2 Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR)

E.2.1. Amount of the SCR and MCR

	31 December 2018 £m	31 December 2017 £m
SCR	**4,477**	4,195
MCR	**1,119**	1,049

The SCR increased by £282m from 31 December 2017 to 31 December 2018. This was driven by an increase to the Open Fund SCR of £295m primarily due to:

- an increase in market risk reflecting an increase in assets exposed to currency risks and the widening of credit spreads, partially offset by a small reduction in the prescribed Standard Formula equity stress;
- an increase in insurance risk capital for the mass lapse stress due to new business written in the period, an increase in payout ratios on with-profits business and amendments to the modelling of per policy expenses in the mass lapse scenario following further EIOPA guidance; and
- an increase in the capital-add on in the Open Fund agreed with the PRA in December 2018. Refer to section E.2.3 for further details.

The SCR in the closed funds decreased overall by £13m.

The MCR remained at 25% of the SCR through 2018 for the Company and has therefore also increased in line with the increase in SCR.

The SCR and MCR have been calculated using the Standard Formula approach set out in the SII Directive. No material simplified methods or undertaking specific parameters have been used in their calculation.

E.2.2. SCR split by risk category

The table below provides a breakdown of the Standard Formula SCR, by risk module. The risk modules comprise a similar proportion of the diversified basic SCR between 2017 and 2018.

	31 December 2018		31 December 2017	
	Total SCR £m	% of total diversified basic SCR	Total SCR £m	% of total diversified basic SCR
Market risk	6,256	91	7,249	91
Counterparty default risk	312	5	353	4
Life underwriting risk	1,407	21	1,707	21
Health underwriting risk	65	1	67	1
Diversification	(1,179)	(18)	(1,397)	(17)
Basic SCR	**6,861**	**100**	7,979	100
Operational risk	203		187	
Loss-absorbing capacity of technical provisions	(3,906)		(5,312)	
Loss-absorbing capacity of deferred taxes	(132)		(145)	
SCR excluding capital add- on	**3,026**		2,709	
Capital add-on	1,451		1,487	
SCR	**4,477**		4,196	

The QRT S.25.01.21 in Appendix 2 provides further detail.

E.2.3. Capital add-on

The capital add-on takes into account certain risks that are not appropriately captured by the Standard Formula and is agreed with the PRA for each reporting period.

On 21 December 2018 a new capital add-on was agreed with the PRA, mainly as a result of movements in the balance sheet since the last time it was set. The capital add-on at 31 December 2018 is equal to £1,451m (31 December 2017 £1,487m), representing an increase for the Open Fund and decrease for the closed funds, which is included within the 2018 capital position presented.

We use an internal capital model for the purposes of managing our capital. We have submitted an application to the PRA to use an Internal Model to calculate our capital requirements for regulatory purposes and anticipate that our application will be approved before the end of 2019.

E.2.4. Inputs used to calculate the MCR
The QRT S.28.01.01 in Appendix 2 sets out the information on the input used by the Company to calculate the MCR. The components of the overall calculation of the MCR as at 31 December 2018 are:

Calculation of MCR at 31 December 2018	**£m**
MCR before the application of floors and caps	**181**
MCR cap (45% of SCR)	**2,015**
MCR floor (higher of 25% of SCR or €3.7m)	**1,119**
MCR (post application of floors and caps)	**1,119**

Calculation of MCR at 31 December 2017	£m
MCR before the application of floors and caps	132
MCR cap (45% of SCR)	1,888
MCR floor (higher of 25% of SCR or €3.7m)	1,049
MCR (post application of floors and caps)	1,049

The MCR is calculated according to a formula prescribed by the regulations and is subject to a floor of 25% of the SCR or €3.7m, whichever is higher, and a cap of 45% of the SCR. The MCR formula is based on factors applied to the technical provisions and capital at risk as at 31 December 2018.

Before any cap/collar is applied, the MCR has been calculated at £181m as at 31 December 2018 (31 December 2017: £132m). However, SII regulations prescribe that the MCR has to fall within a range of 25% to 45% of the Standard Formula SCR. Hence, the value of the MCR to be reported to the regulator at 31 December 2018 is £1,119m (31 December 2017: £1,049m) consistent with the lower limit.

E.3 Use of a duration-based equity risk sub-module in the calculation of the SCR
The duration based equity risk sub-module in Article 170 of the Commission Delegated Regulation (EU) 2015/35 has not been applied in either 2018 or 2017.

E.4 Differences between the Standard Formula and any Internal Model used
This does not apply, the Company uses the Standard Formula to derive its SCR in both 2018 and 2017.

E.5 Non-compliance with the MCR and SCR
The Company has maintained own funds in excess of the MCR and the SCR throughout both 2018 and 2017.

E.6 Any other information
There is no additional material information regarding capital management to disclose in this section (2017: none).

Forward-looking statement

This document may contain 'forward-looking statements' with respect to certain of the Company's plans, its current goals and expectations relating to its future financial position. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond the Company's control. These include, among others, UK economic and business conditions, market-related risks such as fluctuations in interest rates, the policies and actions of governmental and regulatory authorities, the impact of competition, the timing, impact and other uncertainties of future mergers or combinations within relevant industries.

As a result, the Company's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in the Company's forward-looking statements. The Company undertakes no obligation to update the forward-looking statements.

Directors' approval statement

The Royal London Mutual Insurance Society Limited ('the Company')

Approval by the Board of Directors of the Solvency and Financial Condition Report (SFCR) and Annual Quantitative Reporting Templates

Financial year ended 31 December 2018

We acknowledge our responsibility for preparing the SFCR in all material respects in accordance with the Prudential Regulation Authority (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 the 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.

Tim Harris
Deputy Group Chief Executive and Group Finance Director
For and on behalf of the Board of The Royal London Mutual Insurance Society Limited
17 April 2019

Independent Auditors' opinion

Report of the external independent auditors to the Directors of The Royal London Mutual Insurance Society Limited ('the Company') pursuant to Rule 4.1 (2) of the External Audit Part of the PRA Rulebook applicable to Solvency II firms

Report on the Audit of the relevant elements of the Solvency and Financial Condition Report

Opinion

Except as stated below, we have audited the following documents prepared by the Company as at 31 December 2018:

- The 'Valuation for solvency purposes' (pages 49 to 67) and 'Capital Management' (pages 68 to 76) sections of the Solvency and Financial Condition Report of the Company as at 31 December 2018, ('**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 and S.28.01.01 ('**the Templates subject to audit**').

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

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

- The 'Executive Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S.05.01.02 and S.05.02.01;
- Information calculated in accordance with the previous regime used in the calculation of the transitional measure on technical provisions, and as a consequence all information relating to the transitional measure on technical provisions being:
  - 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 on technical provisions
- The written acknowledgement by management of their responsibilities, including the preparation of the Solvency and Financial Condition Report ('**the Responsibility Statement**'); and
- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

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

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Company as at 31 December 2018 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as supplemented by supervisory approvals.

Basis for opinion

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

Conclusions relating to going concern

ISAs (UK) require us to report to you where:

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

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

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

Emphasis of Matter – Basis of Accounting

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

Other Information

The Directors are responsible for the Other Information.

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

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

Responsibilities of Directors for the Solvency and Financial Condition Report

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

Approvals

- Approval to use the volatility adjustment in the calculation of technical provisions; and
- Approval to use the transitional measure on technical provisions.

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

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

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

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

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

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

Report on Other Legal and Regulatory Requirements

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

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
London
17 April 2019

Glossary

A

Association of British Insurers (ABI)
The ABI represents the collective interests of the UK's insurance industry.

Adviser
Someone authorised by the FCA, who is qualified by experience and examination to provide financial advice. See also Independent Financial Adviser in this glossary.

Annuity
An insurance policy that provides a regular income in exchange for a lump-sum payment. Enhanced annuities are sometimes offered, which provide a higher level of income to the purchaser than normal taking into account health and lifestyle.

Asset share
A policy's asset share is calculated by accumulating the premiums paid, deducting all applicable expenses and tax, and adding its share of the investment returns achieved by the with-profits fund over the policy's lifetime.

B

Best estimate liability (BEL)
The expected (or probability weighted average) value of the present value of future cash flows for current obligations, projected over the expected life of the contract, taking into account all available market and other information.

Board
Royal London Mutual Insurance Society Board.

Brexit
The UK's proposed departure from the EU, following the UK referendum on 23 June 2016 where British citizens voted to leave the EU.

Business unit
A sub-division of the Company that focusses on a specific product offering, market or function. A business unit may be a statutory entity or part of one or more separate statutory entities.

C

Capital Cover Ratio
Own funds divided by Solvency Capital Requirement.

Capital add-on
The PRA can apply judgement to determine additional capital requirements (add-ons) to individual firms, which are included when calculating the SCR. Their judgement takes into account a variety of considerations including capital projections, the maturity of the risk management framework and peer group comparisons.

CFO Forum
A high-level discussion group formed and attended by the Chief Financial Officers of major European insurance companies to discuss and harmonise reporting standards.

CIS
The Co-operative Insurance Society Limited purchased by the Group on 31 July 2013. On 1 August 2013 it was renamed Royal London (CIS) Limited.

Closed funds
Our funds that are closed to new business.

Company
The Royal London Mutual Insurance Society Limited.

Consumer division
Our business division that sells life and pensions business directly to customers.

Contract boundary
The point where the insurer can unilaterally terminate the contract, refuse to accept a premium, or amend the benefit or premium without limit.

Covered business
The business covered by the EEV methodology. This includes life and pensions business defined as long-term business by UK and overseas regulators and asset management business (excluding cash management).

Critical illness cover
Cover that pays a lump sum if the insured person is diagnosed with a serious illness that meets the cover's definition.

D

Deferred acquisition costs (DAC)
The method of accounting whereby certain acquisition costs on long-term business are deferred and therefore appear as an asset. This leads to a smoothed recognition of acquisition costs instead of recognising the full amount in the year of acquisition.

Deferred fee income
The method of accounting whereby up-front policy charges are deferred and therefore appear as a liability. This leads to a smoothed recognition of these charges instead of recognising the full amount in the year of acquisition.

Defined benefit scheme
A type of occupational pension scheme, where the benefits are based on the employee's salary and service.

Discounting
The process of expressing a future cash transaction in terms of its present value using a discount rate which reflects the time value of money.

Division
A sub-division of the Group that focuses on a specific product offering market or function. A business unit may be a statutory entity or part of one or more separate statutory entities.

E

Economic assumptions
Assumptions of future interest rates, investment returns, inflation and tax. The impact of variances in these assumptions is treated as non-operating profit or loss under EEV.

European Embedded Value (EEV)
The EEV basis of reporting attempts to recognise the true economic value added over a period and is calculated according to guidelines issued by the CFO Forum. The total profit recognised over the lifetime of a policy is the same as that recognised under the IFRS basis of reporting but the timing of the recognition is different.

EEV operating profit
The profit on an EEV basis resulting from our primary business operations namely: life insurance and pensions; managing and administering investments; and acquiring and administering closed long-term insurance funds.

EIOPA
The European Insurance and Occupational Pensions Authority (EIOPA) is a European Union financial regulatory institution.

Expected profit included in future premiums (EPIFP)
Profits which result from the inclusion in technical provisions of premiums on existing (in-force) business that will be received in the future, but that have not yet been received.

F

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.

Financial Conduct Authority (FCA)
An independent conduct of business regulator, which ensures that business is conducted in such a way that advances the interests of all users of, and participants in, the UK financial sector.

Financial options and guarantees
For Royal London business, 'financial options' refers principally to guaranteed annuity options. 'Guarantees' refers to with-profits business where there are guarantees that part of the benefits will not reduce in value, or are subject to a minimum value.

Financial Reporting Council (FRC)
The Financial Reporting Council is the UK's independent regulator responsible for promoting high-quality corporate governance and reporting to foster investment.

Fit and Proper (F&P)
The standard required by the regulators to be applied when appointing those employees who effectively run the Company or have other key functions, to make sure they are suitably competent and reputable.

FTSE 100
This is the share index of the 100 largest companies by market capitalisation listed on the London Stock Exchange.

Funds under management (FUM)
The total of assets actively managed or administered by, or on behalf of, the Group, including funds managed on behalf of third parties.

G

Group
The Royal London Mutual Insurance Society Limited and its subsidiaries.

Guaranteed Annuity Option (GAO) or Guaranteed Annuity Rate (GAR)
These primarily arise in connection with pension business as either:

- a guaranteed income rate specified in the policy; or
- guaranteed terms (option) for converting the pension fund of a policy into an income for life at the policy's pension date.

I

Industrial Branch (IB)
Life insurance where (often relatively small) premiums were originally collected at the policyholder's home.

Individual Capital Adequacy (ICA)
Capital requirements applied in the UK from 2005, which were firms' own risk-based assessments subject to regulatory supervision. The ICA regime was replaced with the introduction of Solvency II in 2016.

Intermediary division
Our business division that sells life and pensions business through intermediaries, primarily independent financial advisers.

Internal Model (IM)
The processes, systems and calculations that together allow the Company to control the risks that it faces and quantify the capital needed to support those risks. It includes a calculation engine to quantify capital requirements, the Company's risk management framework and its system of governance. Our internal capital model is used for internal capital management purposes. We have submitted an application to the PRA to use an Internal Model to calculate our capital requirements by the end of 2019.

International Financial Reporting Standards (IFRS)
Accounting standards issued by the International Accounting Standards Board (IASB).

M

Maintenance expenses
Expenses related to the servicing of the in-force book of business, including investment and termination expenses and a share of overheads.

Market-consistent basis
A basis of valuation in which assets and liabilities are valued in line with market prices and consistently with each other. In principle, each cash flow is valued using a discount rate consistent with that applied to such a cash flow in the capital markets.

Matching adjustment
An adjustment made to the risk-free interest rate when the insurer sets aside a portfolio of assets to back a predictable portion of their liabilities.

Medium-Term Plan (MTP)
The MTP is an internal forecast and business plan, which is approved by the Board annually. This sets out Royal London's forecast and targets over a five year time horizon; the latest MTP was approved in December 2018 and covers the period 2019 – 2023.

Minimum Capital Requirement (MCR)
The minimum level of capital required by the PRA, below which the amount of financial resources should not fall.

Mutual
A company owned by its members which is not listed on the stock market. A member of a mutual company can vote at its Annual General Meeting.

N

Net worth
The excess of assets over liabilities on the EEV basis of reporting, where assets exclude PVIF and the pension scheme surplus.

New business contribution
The expected present value on the EEV basis of reporting of all cash flows arising from new business.

New business margin
The new business contribution as a percentage of the present value of new business premiums.

Non-profit policy
Long-term savings and insurance products other than with-profits policies.

O

Open Fund
The part of the Royal London Fund into which all of the Company's new insurance business is written.

Open-ended investment company (OEIC)
Investment funds which pool together investors' money and invest this in a broad range of shares and other assets. They are similar to unit trusts.

Operating assumptions
Assumptions in relation to future levels of mortality, morbidity, persistency and expenses. The impact of variances in these assumptions is included within operating profits under EEV.

Operating experience variances
The impact of actual mortality, morbidity, persistency and expense experience being different to that expected at the start of the period.

Operating profit
Operating profit is the profit resulting from our business operations. Our primary business operations are providing life assurance and pensions, managing and administering investments and acquiring and administering closed long-term insurance funds.

Own funds
Regulatory capital under SII. Broadly it is the excess of assets over liabilities (plus subordinated debt and less the Ring Fenced Fund restriction), as measured by the PRA's regulatory reporting requirements under SII.

Own Risk and Solvency Assessment (ORSA)
The ORSA is defined as the entirety of the processes and procedures employed to identify, assess, monitor, manage and report the risks the Company faces or may face over the business planning period and to determine the own funds necessary to ensure that its overall solvency needs are met at all times over that period.

P

Part VII transfer
The court process that enables groups of insurance policies to be moved between insurers, under Part VII of the Financial Services and Markets Act 2000.

Participating
Contracts which are with-profits in type.

Pension
A means of providing income in retirement for an individual and possibly his/her dependants. Our pension products include personal and group pensions, stakeholder pensions and income drawdown.

Pension date
The date at which income can be taken from a pension either through a cash lump sum or investment in an annuity.

Personal pension
A pension plan for an individual policyholder.

Pillar 1/2/3
Solvency II regulatory reporting requirements that came into force on 1 January 2016 include three 'Pillars':

- Pillar 1 covers the quantitative requirements, for example calculating the amount of capital an insurer should hold.
- Pillar 2 sets out requirements for effective governance and risk management frameworks.
- Pillar 3 focuses on disclosure, reporting and transparency requirements. Insurers must produce two key reports, the Solvency and Financial Condition Report (SFCR) and the Regular Supervisory Report (RSR), in addition to other specific templates.

PLAL
The business formerly written by Phoenix Life Assurance Limited. PLAL's assets and liabilities were transferred into the Company with effect from 29 December 2008.

Principles and Practices of Financial Management (PPFM)
A document detailing how we manage our with-profits funds.

Present value of in-force business (PVIF)
The present value of the projected future profits after tax arising from the business in-force at the valuation date.

ProfitShare
ProfitShare is an allocation of part of our operating profits by means of a discretionary enhancement to asset shares or unit fund values of eligible policies.

Protection
A policy providing a cash sum or income on the death or critical illness of the life assured.

Prudential Regulation Authority (PRA)
Part of the Bank of England that is responsible for the authorisation, regulation and day-to-day supervision of all insurance firms that are subject to prudential regulation.

Present value of new business premiums (PVNBP)
The PVNBP is the total of new single premium sales received in the year plus the discounted value, at the point of sale, of the regular premiums we expect to receive over the term of the new contracts sold in the year.

Q

Quantitative Reporting Templates (QRTs)
Forms required under Solvency II for regulatory reporting. They disclose detailed information including technical provisions, own funds and SCR. QRTs must follow a prescribed format.

R

Rating agencies
A rating agency (also called a credit rating agency) is a company that assigns credit ratings, which rate a debtor's ability to pay back debt and the likelihood of default.

Glossary (continued)

Regular premium
A series of payments for an insurance contract, typically monthly or annually.

Regular Supervisory Report (RSR)
A report required under Pillar 3 of the Solvency II directive. This is a private report to the PRA and is not disclosed publicly. Life insurers in the UK are required to submit this report to the PRA in full at least every three years and in summary every year. The RSR includes both qualitative and quantitative information.

Reverse stress test
Valuation simulations carried out to assess the impact of a range of scenarios that start with a business failure outcome, in order to identify potential business vulnerabilities.

Ring-Fenced Fund (RFF)
Royal London contains seven ring-fenced funds (RAIB, UFOB, UFIB, SL, PLAL, Liver, and RL (CIS)). The ring-fenced funds are closed to new business and were established when business from various acquisitions was transferred to Royal London. They are in run-off, with surplus to be distributed to policyholders in line with the PPFM for each fund.

Risk margin
Forms part of the calculation of the technical provisions, and represents the amount needed, should all surplus and capital be used up, to transfer all obligations to another insurer. The risk margin, like BEL, is sensitive to interest rate changes.

Risk-free rate
The theoretical rate of return of an investment with no risk of financial loss.

Risk Management Framework (RMF)
A disciplined and structured process that is designed to manage, rather than eliminate, the risk of failure to meet business objectives as well as to ensure that the Company is well capitalised.

Risk Management System (RMS)
Provides assurance that the risks to which the Group may be exposed are being appropriately identified and managed within risk appetite, and that risks that may result in significant financial loss or reputational damage are being minimised.

Royal London Asset Management (RLAM)
Royal London's asset management business responsible for managing the Group's financial assets as well as funds for external clients, including multi-managers, pension funds for FTSE 250 companies, local authorities, universities, charities and individuals.

Royal London (CIS) Limited
On 31 July 2013, the Group acquired the life assurance and asset-management business of the Co-operative Banking Group (CBG) by acquiring the entire issued share capital of the Co-operative Insurance Society Limited (CIS) and The Co-operative Asset Management Limited (TCAM). On 1 August 2013 CIS was renamed as Royal London (CIS) Limited (RL (CIS)) and TCAM was renamed Royal London Asset Management (CIS) Limited (RLAM (CIS)).

Royal London
The Royal London Mutual Insurance Society Limited.

Royal London Group
The Royal London Mutual Insurance Society Limited and its subsidiaries.

Royal London Ireland
Rebranded from Caledonian Life in 2014, the Royal London business unit providing protection products in the Republic of Ireland through intermediaries.

Royal London Insurance Designated Activity Company (RLI DAC)
Royal London's regulated Irish insurance subsidiary. The Company was incorporated on 11 July 2018 with regulatory permissions effective from 1 January 2019. It is 100% owned by RLMIS.

Royal London Platform Services (trading as Ascentric)
Royal London's independent wrap platform service which trades as Ascentric, providing investment administration and consolidation services to long-term investors and financial advisers through its online wrap service.

Royal London Long-Term Fund
The long-term business fund of Royal London, comprising the Royal London Open Fund and a number of closed funds from businesses acquired in the past.

S

Sales
Sales represent PVNBP for life and pensions business.

Scottish Life
Royal London business unit providing pensions and retirement-planning products to the UK market and third-party administration services to external clients. Scottish Life was rebranded as Royal London during 2014.

Scottish Provident
Royal London business unit providing protection products in the UK through intermediaries. Scottish Provident was rebranded as Royal London during 2015, when it was combined with Bright Grey.

Securitisations
Where various types of contractual debt (including for example residential and commercial mortgages) are pooled together in a 'structure' and the related cash-flows are sold to third party investors, with repayments made via the structure from the principal and interest cash-flows.

Senior Insurance Managers Regime (SIMR)
A range of policy changes introduced by the FCA and PRA on 7 March 2016 which aim to increase individual accountability within the insurance sector. The revised list of Senior Insurance Management Functions (SIMFs) is a much more granular and role-specific list than was the case with the previous Approved Persons Regime. Solvency II requires that as part of its governance a firm identifies key function holders (KFHs) in the business and notifies the FCA and PRA.

Senior Manager and Certification Regime (SMCR)
A regime introduced by the FCA and PRA which is designed to make individuals at financial firms more accountable. This applies to insurers from 10 December 2018 and replaces SIMR.

Solo
Solo refers to The Royal London Mutual Insurance Society Limited (RLMIS).

Solvency II (SII)
A European Union directive which became fully applicable to European insurers and reinsurers on 1 January 2016. It covers three main areas, related to capital requirements, risk management and supervisory rules.

Solvency II Directive
The Solvency II Directive (2009/138/EC) is a Directive in European Union law that codifies and harmonises the EU insurance regulation. Primarily this concerns the amount of capital that EU insurance companies must hold to reduce the risk of insolvency. This applies from 1 January 2016, and was adopted into UK national law in June 2016.

Solvency Capital Requirement (SCR)
The amount of capital that the PRA requires a UK Life insurer to hold which is calculated using Solvency II requirements. This can be calculated using the Standard Formula or the Internal Model methods.

Solvency and Financial Condition Report (SFCR)
A report required under Pillar 3 of the Solvency II directive. Life insurers in the UK are required to disclose this report publicly and to report it to the PRA on an annual basis. The SFCR includes both qualitative and quantitative information.

Solvency surplus
The excess of own funds over the Solvency Capital Requirement.

Standard Formula (SF)
A prescribed method for calculating the Solvency Capital Requirement that aims under Solvency II to capture the material quantifiable risks that a life insurer is exposed to. If the Standard Formula is not appropriate for the risk profile of the business, a capital add-on may also be applied after agreement with the PRA.

Stochastic techniques
Valuation techniques that allow for the potential future variability in assumptions by the running of multiple possible scenarios.

Stress testing
Valuation simulations carried out to assess the impact of a range of adverse scenarios with different probabilities and severities.

Subordinated debt
In the event of bankruptcy, dissolution or winding-up, the payments arising from this debt rank after the claims of other creditors.

T

Technical provisions
The amount the Company requires to fulfil its insurance obligations and settle all expected commitments to policyholders and other beneficiaries arising over the lifetime of the portfolio of insurance contracts.

Three lines of defence model
The three lines of defence model can be used as the primary means to demonstrate and structure roles, responsibilities and accountability for decision making, risk and control to achieve effective governance, risk management and assurance.

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

Transitional Measure on Technical Provisions (TMTP)
The transitional measure smooths the transition from the previous Solvency I regime to the SII regime, and spreads the capital impact over 16 years. Once approved by the PRA, this is included within the valuation of technical provisions.

U

UK Corporate Governance Code (the Code)
This sets out guidance in the form of principles and provisions on how companies should be directed and controlled to follow good governance practice.

Unallocated divisible surplus (UDS)
The amount of surplus under the IFRS basis of accounting which has not been allocated to policyholders at the balance sheet date.

Uncovered business
Business not valued according to EEV principles for Royal London. This includes our wrap platform and cash mandates within our asset management business.

Unit-linked policy
A policy for which the premiums buy units in a chosen investment fund.

Unit trust
A collective investment which invests in a range of assets such as equities, fixed interest investments and cash. A unit trust might be a general fund or specialise in a particular type of asset, for example property, or in a particular geographical area, for example South East Asia.

Unitised with-profits policy
A policy for which the premiums buy units in a with-profits fund.

V

Value of in-force business (VIF)
See definition of 'Present value of in-force business (PVIF)'.

Volatility adjustment (VA)
An adjustment made to the risk-free interest rate. It is designed to protect insurers with long-term liabilities from the impact of volatility on the insurers' solvency position. It is provided and updated by EIOPA and can differ for each major currency and country.

W

With-profits policy
A policy which participates in the profits of a with-profits fund. This participation may be in the form of one or more of a cash bonus, an annual bonus or a bonus paid on the exit of the policy.

Wrap platform
A trading platform enabling investment funds, pensions, direct equity holdings and some life assurance contracts to be held in the same administrative account rather than as separate holdings.

Wrap provider
An investment company, such as Ascentric, that offers investors the opportunity to consolidate their different investments under a single administrative account.

Appendix 1 — Post balance sheet events (SII Group and Part VII transfer) - unaudited

SII Group

RLI DAC was authorised by the CBI to write new life insurance business in the Republic of Ireland with effect from 1 January 2019. This results in Royal London becoming an insurance Group for SII purposes from that date. RLI DAC is wholly owned by RLMIS and the Group accordingly has two regulated insurance undertakings:

- RLMIS; and
- RLI DAC.

The establishment and authorisation of RLI DAC enables the Group to sell new business in the Republic of Ireland following Brexit, and enables the Irish and German life insurance business previously underwritten by RLMIS to continue to be administered.

Part VII transfer

Certain technical provisions and related assets and liabilities were transferred from RLMIS to RLI DAC by way of a transfer made under Part VII of the Financial Services and Markets Act 2000 (the "Part VII transfer"). Following High Court approval the Part VII transfer took place on 7 February 2019, and was effective for accounting purposes on 1 January 2019. As this occurred after the balance sheet date, the 2018 balances in this report have not been adjusted to reflect the transfer. The contracts transferred were:

- The protection contracts written in the Republic of Ireland by RLMIS since 1 July 2011 ("Ireland Protection contracts");
- The contracts which were originally written in the Republic of Ireland by:
  - Royal Liver Assurance Limited, Caledonian Life and Irish Life Assurance plc, subsequently transferred to RLMIS on 1 July 2011 by way of a scheme of transfer under section 86 of the Friendly Societies Act 1992; and
  - GRE Life Ireland Limited, transferred to RLMIS on 1 July 2012 by way of a scheme of transfer under the Assurance Act 1909 and European Communities (Life Assurance) Framework Regulations 1994 (together the "Ireland Liver contracts"); and
- The German bond contracts previously written by RLMIS ("German bond contracts").

Financial assets of £927m and liabilities of £811m were transferred resulting in an excess of assets over liabilities of £116m in RLI DAC.

Immediately after the Part VII transfer, internal reassurance agreements were effected to reinsure all of the Ireland Liver contracts and German bond contracts from RLI DAC back to RLMIS. The Ireland Protection contracts are not part of the internal reinsurance arrangements.

Impacts of non-adjusting post balance sheet events

The impact of becoming a SII Group and the Part VII transfer is not material to the solvency position of RLMIS. The table below sets out the impact of the post balance sheet events at 1 January 2019 on key SII reporting metrics:

	Group		RLMIS Solo		RLI DAC Solo	
Key metric	31 December 2018	1 January 2019	31 December 2018	1 January 2019	31 December 2018	1 January 2019
Solvency surplus (Investor View)	n/a	£4,411m	£4,542m	£4,548m	n/a	£68m
Capital cover ratio (Investor View)	n/a	197%	201%	202%	n/a	241%
Solvency surplus (Regulatory View)	n/a	£1,761m	£1,891m	£1,901m	n/a	£65m
Capital cover ratio (Regulatory View)	n/a	139%	142%	143%	n/a	236%

Appendix 2- Quantitative Reporting Templates

S.02.01.02 – Balance sheet[1] [audited]

Assets		Solvency II value £000
		C0010
Intangible assets	R0030	–
Deferred tax assets	R0040	–
Pension benefit surplus	R0050	212,693
Property, plant & equipment held for own use	R0060	–
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	40,263,903
Property (other than for own use)	R0080	162,740
Holdings in related undertakings, including participations	R0090	11,975,799
Equities	R0100	6,436,030
Equities – listed	R0110	6,328,583
Equities - unlisted	R0120	107,447
Bonds	R0130	16,221,505
Government Bonds	R0140	7,743,369
Corporate Bonds	R0150	7,862,096
Structured notes	R0160	60,394
Collateralised securities	R0170	555,646
Collective Investments Undertakings	R0180	1,422,810
Derivatives	R0190	3,167,705
Deposits other than cash equivalents	R0200	877,314
Other investments	R0210	–
Assets held for index-linked and unit-linked contracts	R0220	44,359,685
Loans and mortgages	R0230	3,477
Loans on policies	R0240	3,130
Loans and mortgages to individuals	R0250	347
Other loans and mortgages	R0260	–
Reinsurance recoverables from:	R0270	4,720,953
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	4,733,572
Health similar to life	R0320	(12,620)
Life excluding health and index-linked and unit-linked	R0330	4,746,192
Life index-linked and unit-linked	R0340	(12,619)
Deposits to cedants	R0350	–
Insurance and intermediaries receivables	R0360	34,624
Reinsurance receivables	R0370	139,553
Receivables (trade, not insurance)	R0380	431,931
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	572,153
Any other assets, not elsewhere shown	R0420	1,000
Total assets	**R0500**	**90,739,972**

Liabilities		Solvency II value £000
		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	–
Technical provisions – life (excluding index-linked and unit-linked)	R0600	32,434,393
Technical provisions – health (similar to life)	R0610	(131,797)
TP calculated as a whole	R0620	–
Best Estimate	R0630	(135,533)
Risk margin	R0640	3,736
Technical provisions – life (excluding health and index-linked and unit-linked)	R0650	32,566,190
TP calculated as a whole	R0660	–
Best Estimate	R0670	32,455,687
Risk margin	R0680	110,503
Technical provisions – index-linked and unit-linked	R0690	42,728,381
TP calculated as a whole	R0700	44,221,385
Best Estimate	R0710	(1,604,050)
Risk margin	R0720	111,045
Contingent liabilities	R0740	–
Provisions other than technical provisions	R0750	117,969
Pension benefit obligations	R0760	–
Deposits from reinsurers	R0770	–
Deferred tax liabilities	R0780	145,313
Derivatives	R0790	1,374,631
Debts owed to credit institutions	R0800	558,415
Financial liabilities other than debts owed to credit institutions	R0810	–
Insurance & intermediaries payables	R0820	527,306
Reinsurance payables	R0830	2,796,201
Payables (trade, not insurance)	R0840	1,038,484
Subordinated liabilities	R0850	806,480
Subordinated liabilities not in BOF	R0860	–
Subordinated liabilities in BOF	R0870	806,480
Any other liabilities, not elsewhere shown	R0880	33
Total liabilities	**R0900**	**82,527,607**
Excess of assets over liabilities	**R1000**	**8,212,365**

1 Further detail on the 2018 SII balance sheet is presented in section D.1.1.

S.05.01.02 – Premiums, claims and expenses by line of business [unaudited]

		Line of Business for: **life insurance obligations**				**Life reinsurance obligations**		Total
£000		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Health reinsurance	Life reinsurance	
		C0210	C0220	C0230	C0240	C0270	C0290	C0300
Premiums written								
Gross	R1410	44,645	387,743	8,947,736	647,803	–	–	10,027,928
Reinsurers' share	R1420	13,013	601	(16,509)	260,033	–	–	257,138
Net	R1500	31,632	387,142	8,964,245	387,770	–	–	9,770,790
Premiums earned								
Gross	R1510	44,645	387,743	8,947,736	647,803	–	–	10,027,928
Reinsurers' share	R1520	13,013	601	(16,509)	260,033	–	–	257,138
Net	R1600	31,632	387,142	8,964,245	387,770	–	–	9,770,790
Claims incurred								
Gross	R1610	15,803	2,045,601	3,597,337	511,885	–	–	6,170,625
Reinsurers' share	R1620	9,009	49,005	23,042	431,976	–	–	513,032
Net	R1700	6,794	1,996,596	3,574,295	79,908	–	–	5,657,593
Changes in other technical provisions								
Gross	R1710	–	–	–	–	–	–	–
Reinsurers' share	R1720	–	–	–	–	–	–	–
Net	R1800	–	–	–	–	–	–	–
Expenses incurred	R1900	3,410	154,345	203,022	263,304	–	–	624,081
Other expenses	R2500							38,013
Total expenses	R2600							662,094
Total amount of surrenders	R2700	–	904,028	2,461,046	5,824	–	–	3,370,898

S.05.02.01 – Premiums, claims and expenses by country [unaudited]

Life £000	R1400	Home country	Top 5 countries (by amount of gross premiums written) – life obligations					Total Top 5 and home country
			IE[1]	DE[2]				
		C0220	C0230	C0240	C0250	C0260	C0270	C0280
Premiums written								
Gross	R1410	9,958,345	69,582	–	–	–	–	10,027,928
Reinsurers' share	R1420	231,348	25,790	–	–	–	–	257,138
Net	R1500	9,726,997	43,793	–	–	–	–	9,770,790
Premiums earned								
Gross	R1510	9,958,345	69,582	–	–	–	–	10,027,928
Reinsurers' share	R1520	231,348	25,790	–	–	–	–	257,138
Net	R1600	9,726,997	43,793	–	–	–	–	9,770,790
Claims incurred								
Gross	R1610	6,046,088	112,696	11,841	–	–	–	6,170,625
Reinsurers' share	R1620	493,064	19,968	–	–	–	–	513,032
Net	R1700	5,553,024	92,728	11,841	–	–	–	5,657,593
Changes in other technical provisions								
Gross	R1710	–	–	–	–	–	–	–
Reinsurers' share	R1720	–	–	–	–	–	–	–
Net	R1800	–	–	–	–	–	–	–
Expenses incurred	R1900	593,039	29,992	1,049	–	–	–	624,081
Other expenses	R2500							38,013
Total expenses	R2600							662,094

[1] IE refers to the Republic of Ireland, and is the prescribed country code in SII rules.
[2] DE refers to Germany, and is the prescribed country code in SII rules.

S.12.01.02 – Life and health SLT technical provisions [audited]

£000		Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance
				Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees		
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100
Technical provisions calculated as a whole	R0010	–	**44,221,385**			–			–	–
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	R0020	–	15,495			–			–	–
Technical provisions calculated as a sum of BE and RM										
Best Estimate										
Gross Best Estimate	R0030	**27,919,836**		–	**(1,576,045)**		**5,051,276**	**14,313**	–	–
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080	1,203,079		–	(28,114)		3,543,760	(646)	–	–
Best estimate minus recoverables from reinsurance/SPV and Finite Re - total	R0090	26,716,757		–	(1,547,931)		1,507,516	14,959	–	–
Risk margin	R0100	**1,071,217**	**575,226**			**259,830**			–	–
Amount of the transitional on Technical Provisions										
Technical provisions calculated as a whole – unaudited	R0110	–	–			–			–	–
Best estimate – unaudited	R0120	(492,252)		–	(28,005)		(34,444)	(3,042)	–	–
Risk margin – unaudited	R0130	(1,008,903)	(464,181)			(211,640)			–	–
Technical provisions - total	R0200	**27,489,897**	**42,728,381**			**5,076,293**			–	–

S.12.01.02 – Life and health SLT technical provisions [audited] (continued)

£000		Total (Life, other than health insurance, incl Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted	Total (Health, similar to life insurance)
				Contracts without options and guarantees	Contracts with options or guarantees			
		C0150	C0160	C0170	C0180	C0190	C0200	C0210
Technical provisions calculated as a whole	R0010	44,221,385	–			–	–	–
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	R0020	15,495	–			–	–	–
Technical provisions calculated as a sum of BE and RM								
Best estimate								
Gross Best Estimate	R0030	31,409,380		(135,454)	–	–	–	(135,454)
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080	4,718,078		(12,621)	–	–	–	(12,621)
Best estimate minus recoverables from reinsurance/SPV and Finite Re - total	R0090	26,691,302		(122,833)	–	–	–	(122,833)
Risk margin	R0100	1,906,272	19,527			–	–	19,527
Amount of the transitional on Technical Provisions								
Technical provisions calculated as a whole – unaudited	R0110	–	–			–	–	–
Best estimate – unaudited	R0120	(557,744)		(79)	–	–	–	(79)
Risk margin – unaudited	R0130	(1,684,724)	(15,791)			–	–	(15,791)
Technical provisions - total	R0200	75,294,571	(131,797)			–	–	(131,797)

S.22.01.21 – Impact of long-term guarantees and transitional measures [audited]

£000		Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions - unaudited	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	75,162,774	2,258,338	–	544,086	–
Basic own funds	R0020	6,368,023	(767,393)	–	(97,397)	–
Eligible own funds to meet Solvency Capital Requirement	R0050	6,368,023	(767,393)	–	(97,397)	–
Solvency Capital Requirement	R0090	4,476,782	2,384	–	(16,001)	–
Eligible own funds to meet Minimum Capital Requirement	R0100	5,785,382	(767,274)	–	(98,197)	–
Minimum Capital Requirement	R0110	1,119,195	596	–	(4,000)	–

S.23.01.01 – Own funds [audited]

£000		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 2015/35						
Ordinary share capital (gross of own shares)	R0010	–	–		–	
Share premium account related to ordinary share capital	R0030	–	–		–	
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	8,284,157	8,284,157			
Preference shares	R0090	–		–	–	–
Share premium account related to preference shares	R0110	–		–	–	–
Reconciliation reserve	R0130	(2,722,614)	(2,722,614)			
Subordinated liabilities	R0140	806,480		–	806,480	–
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**	**6,368,023**	**5,561,543**	**–**	**806,480**	**–**
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	–			–	

£000		Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
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	6,368,023	5,561,543	–	806,480	–
Total available own funds to meet the MCR	R0510	6,368,023	5,561,543	–	806,480	
Total eligible own funds to meet the SCR	R0540	6,368,023	5,561,543	–	806,480	–
Total eligible own funds to meet the MCR	R0550	5,785,382	5,561,543	–	223,839	
SCR	R0580	**4,476,782**				
MCR	R0600	**1,119,195**				
Ratio of Eligible own funds to SCR	R0620	**142%**				
Ratio of Eligible own funds to MCR	R0640	**517%**				

		C0060	
Reconciliation reserve			
Excess of assets over liabilities	R0700	8,212,365	
Own shares (held directly and indirectly)	R0710	–	
Foreseeable dividends, distributions and charges	R0720	–	
Other basic own fund items	R0730	8,284,157	
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring-fenced funds	R0740	2,650,822	
Reconciliation reserve	R0760	**(2,722,614)**	
Expected profits			
Expected profits included in future premiums (EPIFP) - Life business	R0770	1,415,762	
Expected profits included in future premiums (EPIFP) - Non-life business	R0780	–	
Total Expected profits included in future premiums (EPIFP)	R0790	**1,415,762**	

S.25.01.21 – Solvency Capital Requirement – for undertakings on Standard Formula [audited]

£000		Gross solvency requirement	USP	Simplifications
		C0110	C0090	C0100
Market risk	R0010	6,255,508		–
Counterparty default risk	R0020	312,492		
Life underwriting risk	R0030	1,406,961	None	–
Health underwriting risk	R0040	64,910	None	–
Non-life underwriting risk	R0050	–	None	–
Diversification	R0060	(1,179,152)		
Intangible asset risk	R0070	–		
Basic Solvency Capital Requirement	**R0100**	**6,860,719**		

Calculation of Solvency Capital Requirement		**C0100**
Operational risk	R0130	203,128
Loss-absorbing capacity of technical provisions	R0140	(3,905,962)
Loss-absorbing capacity of deferred taxes	R0150	(132,103)
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	R0160	–
Solvency Capital Requirement excluding capital add-on	R0200	3,025,782
Capital add-ons already set	R0210	1,451,000
Solvency Capital Requirement	R0220	**4,476,782**
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	2,227,675
Total amount of Notional Solvency Capital Requirements for ring fenced funds	R0420	2,249,106
Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	R0430	–
Diversification effects due to RFF nSCR aggregation for article 304	R0440	–

S.28.01.01 – Minimum Capital Requirement – Only life or only non-life insurance or reinsurance activity [audited]

£000		
		C0010
Linear formula component for non-life insurance and reinsurance obligations		
MCR_{NL} Result	R0010	–
Linear formula component for life insurance and reinsurance obligations		C0040
MCR_{L} Result	R0200	181,421

£000		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	13,372,970	
Obligations with profit participation - future discretionary benefits	R0220	12,851,534	
Index-linked and unit-linked insurance obligations	R0230	42,629,954	
Other life (re)insurance and health (re)insurance obligations	R0240	1,373,418	
Total capital at risk for all life (re)insurance obligations	R0250		39,499,494

Overall MCR calculation		C0070
Linear MCR	R0300	181,421
SCR	R0310	4,476,782
MCR cap	R0320	2,014,552
MCR floor	R0330	1,119,195
Combined MCR	R0340	1,119,195
Absolute floor of the MCR	R0350	3,288
Minimum Capital Requirement	R0400	**1,119,195**