Sanlam Life and Pensions UK Limited
Solvency and Financial Condition Report
2019

Wealth

SANLAM LIFE AND PENSIONS UK LIMITED
SOLVENCY AND FINANCIAL CONDITION REPORT

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INTRODUCTION

This is the Solvency and Financial Condition Report for Sanlam Life and Pensions UK Limited (the Company) based on the financial position as at 31 December 2019.

BUSINESS AND PERFORMANCE SUMMARY

The Company forms part of the Sanlam UK group whose vision is to be a leader in advice led wealth management within the UK market. This includes ensuring that policyholders continue to receive the promised benefits from their existing policies.

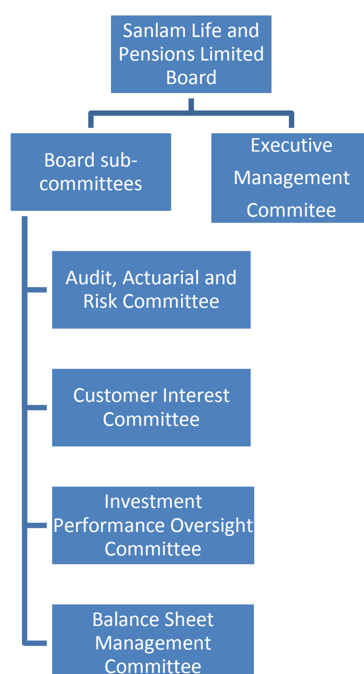
Sanlam UK is part of Sanlam Limited, an international financial services group headquartered in South Africa. Sanlam Limited has a presence in 18 countries and is rated AA- by Standard and Poor's in South Africa. It has a market capitalisation of £10.4bn.

The Company's main role within Sanlam UK is that of life insurance and investment administrative services provider. To deliver this the Company focuses on the provision of specialist investment wrappers to affluent and high net worth clients through offering open architecture and self-investment choice and the provision of 'vanilla' investment wrappers to affluent clients through Sanlam multi-asset funds and model portfolios combined with its own investment platform, Sanlam Platform. Ongoing investment continues to be made in enhancing the Company's products, systems and service.

The Company's underwriting and investment performance can be found in sections A.2 and A.3 respectively.

SYSTEM OF GOVERNANCE SUMMARY

Overview of the Board and Sub Committees



The Company uses the 'three lines of defence' governance model. This model separates out the tasks of risk management, risk oversight and risk assurance, calling them respectively the first, second and third lines of defence.

First line of defence: Risk management

This is the primary responsibility of front line managers and the Executive Committee rather than the Risk Function. Front line managers are responsible for identifying and evaluating risks to the business and the customer and for designing and operating suitable controls in line with the agreed risk limits set by senior management.

Second line of defence: Risk oversight

Risk oversight is performed by the Risk Function, which provides oversight for business and operational risks, and the Compliance Function, which provides oversight for regulatory and conduct risks.

Risk and Compliance are independent of the first line.

Third line of defence: Risk assurance

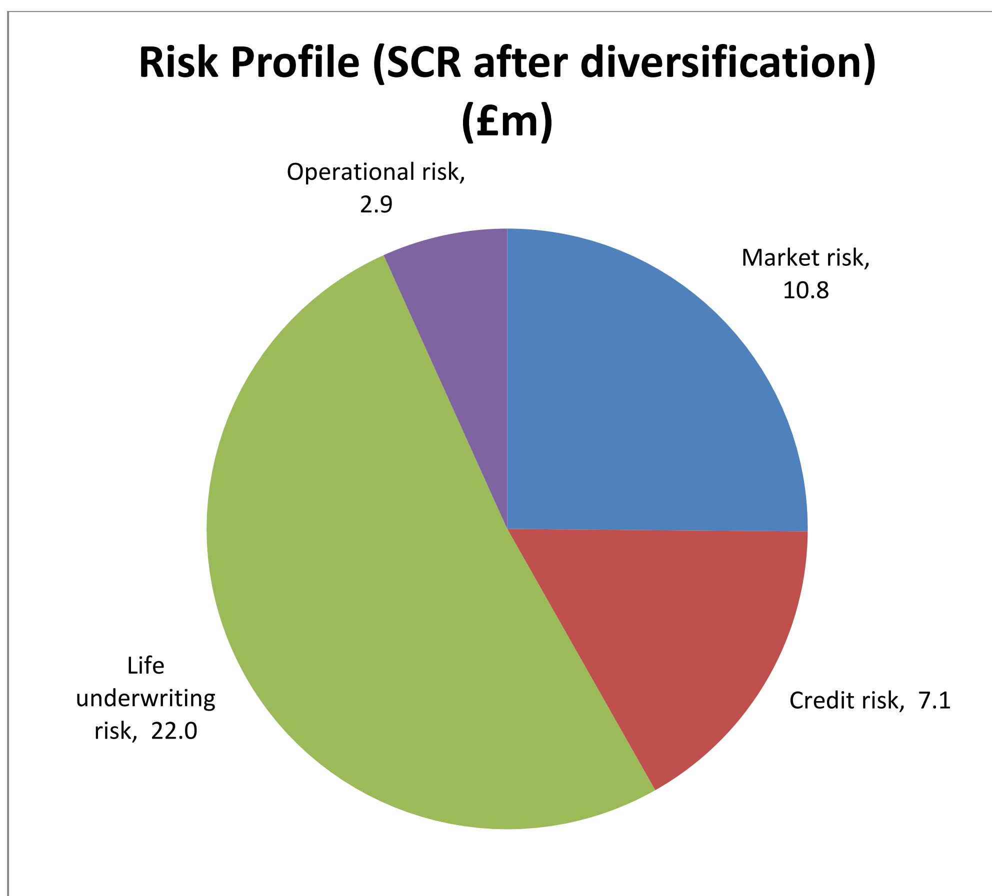
This is the independent assurance from 'neutral' parties that the risk management framework is operating effectively. This is provided by the Board, and its sub-committees, assisted by internal audit.

The Company's key risks can be found in section C.

RISK PROFILE SUMMARY

The Company currently uses the Standard Formula to calculate its solvency capital requirement (SCR).

The components of the Company's SCR as at 31 December 2019 are illustrated in the following chart.



Note: credit risk is made up of the standard formula spread risk and counterparty default risk sub-modules.

VALUATION FOR SOLVENCY PURPOSES SUMMARY

An analysis of the valuation of assets and liabilities per the Solvency II balance sheet [S.02.01.02.C0010] are provided in the report in sections D.1 and D.3 respectively. A comparison between IFRS and Solvency II valuation methodologies and results is included in section D.

There have been no significant changes to the valuation methodologies applied under IFRS or Solvency II during 2019.

Section D.2 provides a detailed explanation of the methodology for calculating technical provisions for the Company's various lines of business, including the key assumptions used in these calculations. Please note that no matching adjustment or volatility adjustment has been used in the calculation of the Company's technical provisions. No transitional measures are applied in the calculation of the Company's technical provisions and SCR.

CAPITAL MANAGEMENT SUMMARY

As at 31 December 2019, the Company's SCR is £42.8m while the Minimum Capital Requirement (MCR) is £19.3m. The Company's own funds stand at £62.6m all of which is classified as unrestricted Tier 1 capital. This gives a SCR coverage ratio of 146.3%.

The objectives of the own funds management are set out in the Company's capital management policy. The Company aims to maintain, at all times, sufficient own funds to cover the SCR and MCR together with an appropriate buffer.

The acceptable target range for the Pillar 1 CAR (ratio of eligible own funds over SCR) is 120% to 140%. The Company regularly monitors the Pillar 1 CAR and the capital management policy sets out the process to follow to restore the CAR if it falls outside the target range.

The Company has complied with both the SCR and MCR throughout 2019.

ADDITIONAL INFORMATION

The Prudential Regulation Authority issued a statement on March 23, 2020 confirming that COVID-19 should be treated as a "major development" as per Article 54 (1) of the Solvency II Directive. The valuations reported within this report are based on information up to 31 December 2019. Therefore, based on the Company's interpretation of Article 77 (2) of the Solvency II Directive, the valuations and technical provisions including the premium provision do not reflect the impact of COVID-19. Further information relating to the COVID-19 pandemic is included within section F.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

We acknowledge our responsibility for preparing the SFCR in all material respects in accordance with the PRA Rules and the Solvency II Regulations. We are satisfied that:

a) Throughout the financial year in question, the insurer has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable and;
b) It is reasonable to believe that, at the date of the publication of the SFCR, the insurer continues so to comply, and will continue so to comply in future.

Nick Parry
Chief Executive Officer

2 June 2020

A. BUSINESS AND PERFORMANCE

A.1 Business

The principal activity of the Company is the transaction of life assurance and pensions business.

The Company forms part of the Sanlam UK group whose vision is to be a leader in advice led wealth management within the UK market.

The Company's main role within Sanlam UK is that of life insurance and investment administrative services provider. To deliver this, the Company focuses on:

- the provision of specialist investment wrappers to affluent and high net worth clients through offering open architecture and self-investment choice
- the provision of 'vanilla' investment wrappers to affluent clients through Sanlam multi-asset funds and model portfolios combined with the Sanlam Platform. Investment continues to be made in enhancing the Company's products, systems and service.

The Company is incorporated in the United Kingdom and is a company limited by shares. The address of the registered office is:

Monument Place
24 Monument Street
London
EC3R

REGULATOR

The Group supervisor can be contacted as follows:

Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA
0207 601 4878

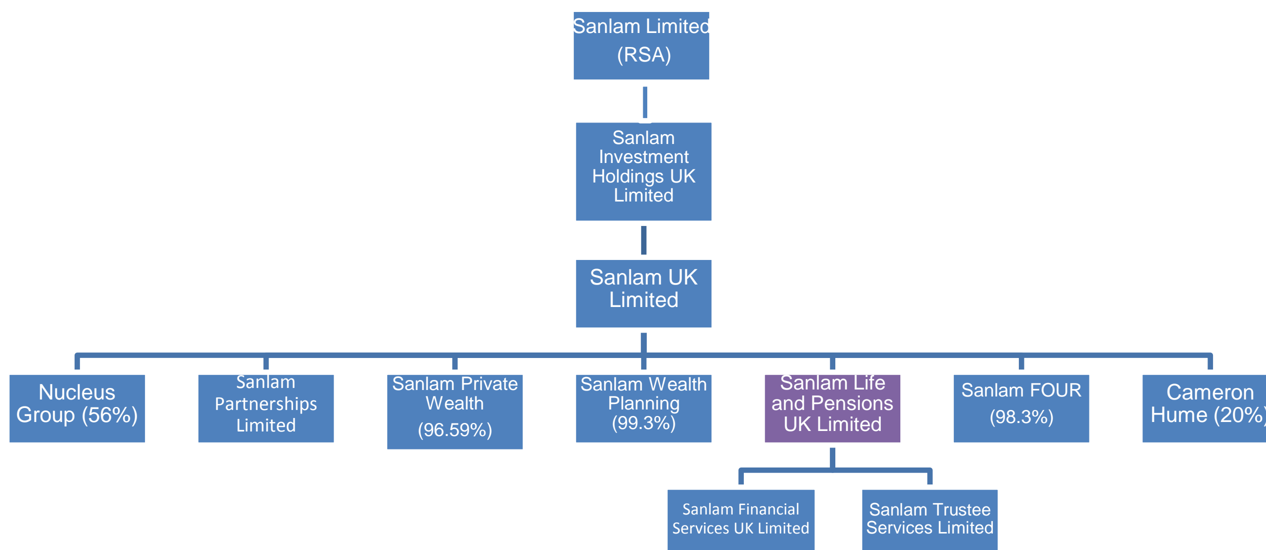
AUDITORS

The External Auditor for Sanlam Life & Pensions UK Limited for the reporting period was Richard Page, Senior Statutory Auditor, for and on behalf of Ernst & Young LLP, The Paragon, Counterslip, Bristol, BS1 6BX, United Kingdom.

The SFCR has not been audited for the year ended 31 December 2019 as it is below the threshold which requires an external audit.

GROUP STRUCTURE

The company is wholly owned by Sanlam UK Limited. Its ultimate controlling party is Sanlam Limited, a company registered in the Republic of South Africa. A simplified organisational structure chart is shown below.



For the purposes of this document, "the Group" is defined as Sanlam Investment Holdings UK Limited (SIH) and its subsidiaries.

Since the Group operates a vertically integrated business model, there are many areas in which the activities of the Company are impacted by other entities within the Group.

The entity's proposition is distributed through two structures.

1. Sanlam Wealth Planning incorporating Sanlam Wealth Planning UK Limited, English Mutual Limited, and two investments acquired during 2019 – a 100% holding in Blackett Walker Limited, and a 55% stake in Avidus Scott Lang Group Limited. This is a focused, advice-led, vertically integrated Wealth Management business in retail financial services. It operates a Sanlam restricted proposition in respect of investment and product solutions to retail clients in the United Kingdom subject to client suitability and focussing on positive client outcomes.

2. Sanlam UK distribution, which sits within the Sanlam UK Limited entity, is an appointed representative of the Company and engages with third party advisory and wealth management businesses including the network of IFA firms within Sanlam Partnerships Limited.

Management of the Company's assets is carried out by Sanlam Asset Management Ireland (a wholly owned subsidiary of Sanlam Investment Holdings UK Limited) and Sanlam Investments for the linked asset portfolio and Cameron Hume for the non-linked and shareholder portfolio.

From December 2012, the Company has been providing a version of its onshore bond product to the Nucleus Group, a wrap platform specialist in which the Group has a controlling interest. The distribution and administration of this bond has been outsourced to Nucleus Financial Services Limited which in turn has outsourced the administration of the bond to GenPact.

In addition, there are transactions between the Company and other entities within the Group in respect of shared expenses. Administration, Internal Audit and Compliance monitoring are undertaken by Group functions on behalf of the Company.

Subsidiary undertakings

The Company owns 100% of the shares in Sanlam Financial Services UK Limited (SFS) and Sanlam Trustee Services Limited (STS).

SFS

The principal activity of SFS is the provision of administration and client money handling services to the Company, as well as other companies the Group. It also acts as the scheme administrator of the Sanlam Personal Retirement Scheme, a personal retirement scheme established under a trust deed in 1988.

STS

STS acts as trustees to pension schemes provided by the Company. This includes being the custodian for certain assets of the current portfolio of trust based self-invested personal pensions.

A.2 Underwriting Performance

Since the Company prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), the performance information recognised in the statutory accounts recognises premiums and claims only on insurance business as defined under IFRS. The vast majority of the business written by the Company is investment business as defined by IFRS. As required under Solvency II, the underwriting performance information below recognises premiums and claims for both insurance and investment business.

	Index-linked and unit-linked insurance		Other life insurance		Total	
	2019 £'000	2018 £'000	2019 £'000	2018 £'000	2019 £'000	2018 £'000
Gross premiums written	197,426	203,913	401	430	197,827	204,343
Premiums ceded to reinsurers	766	965	1	3	767	967
Net premiums written	196,660	202,948	400	427	197,060	203,375
Net claims incurred	30,485	22,446	5,167	5,434	35,652	27,880
Direct expenses incurred	28,368	24,160	555	574	28,923	24,735
Surrenders	211,728	196,993	0	0	211,728	196,993

A.3 Investment Performance

	2019 £'000	2018 £'000
Investment income	37,221	38,194
Net gains on assets and liabilities at fair value through profit or loss	274,036	(124,900)
Investment management fees	(35,928)	(33,249)

Investment income is made up of dividends, interest income, and rental income from investment properties.

The net gains on assets and liabilities at fair value through profit or loss is due to the rise in equity markets in 2019. Unit linked assets accounted for the majority of this gain, and this is therefore offset by a movement in unit linked liabilities.

A.3.1 Information about any gains and losses recognised directly in equity

This is not applicable – all gains and losses are recognised in the income statement.

A.3.2 Information about investments in securitisations

The Company did not invest directly in securitised investments during the year ended 31 December 2019.

A.4 Performance of other activities

`	2019 £'000	2018 £'000
Fees and commission income	18,506	18,561
Operating expenses	(16,639)	(16,621)
Finance costs	(339)	(210)
Taxation	(16,284)	6,412
Re-measurement of the net pension scheme liability	1,903	209

The 2019 total tax charge is primarily a reflection of the charge on profits whereas the 2018 credit was driven by market downturn experienced during 2019 given that the company's tax profile is driven by its investment assets' performance.

The main reasons for the movement in the pension scheme's other comprehensive income are higher than expected asset returns, a change in demographic assumptions and better than expected membership experience which have been slightly offset by a fall in AA corporate bond yields.

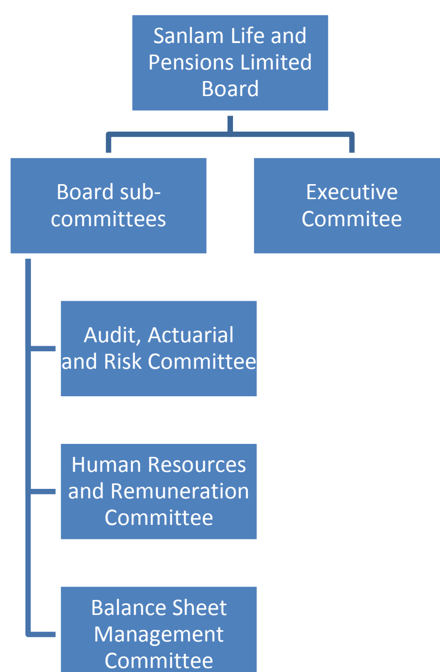
A.5 Any other information

There is no further information to be disclosed in relation to business and performance.

B. SYSTEM OF GOVERNANCE

B.1 General information on the system of governance

The Company is governed by a Board, which currently comprises 3 non-executive directors and 3 executive directors, is responsible to the shareholders for the governance of the Company including financial, operational and compliance controls and risk management processes. To support the Board in meeting that responsibility, a governance structure has been established with clear operating procedures, lines of responsibility and authority.



Board sub-committees

1. Audit, Actuarial and Risk Committee (AARC)

The Committee is chaired by a non-executive director. It meets on a quarterly basis and comprises 3 non-executive directors and management by invitation. Its purpose, with the assistance of management where required, is to assist the Board in fulfilling its oversight responsibilities by:-

- Setting and overseeing the overall standards for financial and actuarial reporting, compliance, risk management, internal controls and ethical conduct within the company;
- Monitoring the effectiveness of compliance and business risk management processes in the Company, and monitoring that Conduct Risk principles and processes are embedded throughout the company;
- Reviewing and assessing the quality of the work done by the professionals responsible for financial and actuarial reporting, compliance and internal control;
- Engaging with the external and internal auditors on the quality and acceptability of the control environment and reporting structures;

- Recommending appropriate follow-up action to the Board and

- Reviewing and assessing the quality of the work done by the professionals responsible for financial and actuarial reporting, compliance, Client Assets (CASS) and internal control.

2. Human Resources and Remuneration Committee

The Committee satisfied its requirements as part of the group level Sanlam UK Human Resources and Remuneration Committee, is chaired by a non-executive director and is responsible for the Company's intellectual human capital and maintaining an effective management team. The committee is also responsible for the remuneration strategy of the Company and determines the remuneration packages for members of the Executive Management team.

3. Balance Sheet Management Committee

The Balance Sheet Management Committee meets on a quarterly basis with the aim to develop and recommend a strategic framework for the management of the Company's balance sheet. A dedicated balance sheet management Actuary is employed to facilitate this forum.

This includes the following activities:

- Oversight of the management of assets in the shareholder portfolios and the policyholder portfolios where the Company carries all the investment risks;
- Oversight of capital efficiency within the Company. This includes the management of required capital
  within the boundaries of risk appetite; and the utilization and optimisation of returns on discretionary capital;
- Oversight over Liability Driven Investment (LDI) portfolios, in particular Asset Liability Management (ALM) over the non-participating policy holder portfolios;
- Working capital and liquidity management;
- The Company's 'estate' portfolios i.e. portfolios where the shareholder carries all the investment risk. This includes all shareholder capital portfolios as well as any policyholder liability portfolios where the shareholder carries all investment risk;
- Oversight of the investment strategy of the defined benefit pension scheme of which the Company is the sponsor (in conjunction with the Scheme's trustees); and
- Carry out certain business relating to personal and private funds.

4. Executive Management Committee

The Executive Management Committee, chaired by the Chief Executive Officer, meets on a monthly basis to consider strategic, operational, projects and human resources issues. Significant projects are also reviewed by the Group Executive Management Committee. The Executive Management Committee also encompasses the previous Finance, Risk and Compliance Committee for the purpose of reviewing monthly management information, monitoring new and existing risks, and considering any compliance, prudential, legal and regulatory issues with appropriate support from the Assurance Committee.

5. Investment Performance Oversight Committee

The Investment Performance Oversight Committee is a sub-committee of the SIH Board. It meets quarterly, is chaired by a Non-Executive Director and includes the Chief Executive Officer and the Group Finance Director. The Committee monitors the investment activities of the Company's insured funds, assists the Company to achieve its investment objectives and to fulfil its responsibilities to customers through monitoring all applicable parties compliance with investment management agreements, monitoring the competitiveness of the funds and model portfolios, reviewing mandates and appointments and removals of investment managers, custodians and administrators.

The Company also meets periodically with its distribution partners, Sanlam UK Distribution and Sanlam Wealth, to assess the performance of its distribution and marketing activities.

This activity is further supported by a monthly meeting of the Sanlam UK Proposition and Client Interest Committee which is a sub-committee of the Sanlam UK Executive Committee, and the Customer Interest Committee, a sub-committee of the SIH Board.

A Statement of Business Principles is in place to provide guidance as to the standards expected when acting on behalf of the Company. These aim to ensure that the Company conducts its business in full compliance with the law and its regulatory obligations and adheres to the highest professional and ethical standards.

Remuneration policy

Principles

- There is a balance between fixed and variable remuneration which allows the Company to operate a flexible bonus policy.
- Variable remuneration should contain a substantial deferred component with a deferral period of at least three years. However, there is a de minimis limit below which deferral is not required and no Company executives have breached this minimum level;
- Performance metrics include both financial and non-financial performance measures, as well as a downwards adjustment for exposure to current and future risks; and
- Variable remuneration for control functions (Risk, Compliance, Internal Audit and Actuarial functions) is independent from the performance of the operational units and areas that are submitted to their control.

Fixed remuneration

Base salaries plus add-on benefits are reviewed annually, at the start of each year. Any annual salary increase is determined by factors such as Company performance, rate of inflation, prevailing local marketplace trends, changes in responsibilities and individual performance. Under certain circumstances an increase to base salary may occur during the year, usually due to promotion.

Variable remuneration

Variable remuneration is determined with the support of a robust performance management framework. This is based on 'What' employees do (Objectives) as well as 'How' they do it (Behaviours). Employees' performance is measured against the achievement of objectives in line with the expected Sanlam Behaviours.

The Company's variable remuneration is made up of both long and short term incentives.

i) Short term

The Company implements discretionary bonuses. All such bonuses are based on two elements, Personal Performance and Company Performance. The Personal Performance element is multiplied with the overall Company Performance weighting achieved during the year to determine the bonus award.

The Personal Performance element is based on an employee's personal performance which is reflected in a year-end performance rating, measured on delivery against objectives and behaviours. Company performance is based on a set of KPIs that includes both financial and non-financial elements.

ii) Long term

Growth Shares: Selected members are offered the opportunity to subscribe for Growth Shares in Sanlam UK Limited. The ownership of the Growth Shares will give them the opportunity to participate

in the value of the Company above a set threshold. Shares are eligible for participation subject to achievement of KPI's.

Supplementary pension or early retirement schemes for the members of the administrative, management or supervisory body and other key function holders

The Company offers all staff the choice of making contributions into a defined contribution pension scheme, which the company will match up to a limit. The Company has £57.8m of defined benefit pension scheme liabilities. The scheme has been closed to new accruals since 2013.

B.2 Fit and proper requirements

The Approved Persons Guide is available to all staff on the intranet. The procedure for appointing a new approved person includes undertaking a fit and proper person test and seeking approval from the Board and Regulator. No individual can undertake such responsibilities without first obtaining approval and passing this test.

Before appointing an individual, the Company must be satisfied that the person has the personal characteristics (including being of good repute and integrity), possesses the required level of competence, knowledge and experience, has the relevant qualifications, and has undergone, or is undergoing, training required in order for them to perform their key function effectively and in accordance with any relevant regulatory requirements.

The ongoing fitness and propriety of Approved Persons is assessed through the Company's Performance Management structure, with progress reviews being carried out no less than annually.

Progress reviews for all executive Approved Persons other than the Chief Executive will be carried out by the Chief Executive. The Chairman will carry out a progress review in respect of the Chief Executive. The performance of the Board will be reviewed annually on a self-assessment basis and this will be facilitated by the Company Secretary in conjunction with the Chairman and the Chief Executive.

The Approved Persons are also required to complete an annual self-certification to confirm that they remain fit and proper to carry out their role.

Once an individual is an Approved Person they are made aware that they must abide by strict standards of conduct – and that they become personally accountable to the regulator.

B.3 Risk Management System including the Own Risk and Solvency Assessment

The Company uses the Standard Formula without Undertaking-Specific Parameters to assess the solvency capital requirements. The Company does not have approval for a full or partial internal model.

The Company's risk universe summarises the key risks that have been identified to date as potentially capable of impacting the customer and the company. For the more material of these risks, risk policies have been produced which document at a more granular level how risks are identified, assessed, managed, controlled, monitored and reported.

In addition, risk policies cover the relevant risk appetite, risk tolerance and risk strategy as well as the associated risk limits set by management. As such, risk policies also help to provide a bridge between the 'top down' view of risk appetite set by the Board and the 'bottom up' risk limits used by risk managers to manage risks on a day to day basis.

The risk policies are either at a Group level which all business entities are to adhere to or there are policies which only apply specifically to the Company.

All risk policies are reviewed on a rolling basis throughout the year in line with the Policy Review Log by the policy owner with any proposed changes being subject to the approval of the Group Executive Management Committee.

Risk Management Roles and Responsibilities

The Group's risk management framework uses the 'three lines of defence' model. This model separates out the tasks of risk management, risk oversight and risk assurance, calling them respectively the first, second and third lines of defence.

Risk management (the First Line of Defence)

Risk management is the primary responsibility of front line managers and senior management. Front line managers are responsible for identifying and evaluating risks posed to the business and its customers within their areas of responsibility, and for designing and operating suitable controls in-line with the agreed risk limits set by senior management.

In the execution of this responsibility, the Company must comply with all requirements set by Sanlam Group. In particular, escalation of risks must comply with the Group Risk Escalation Matrix.

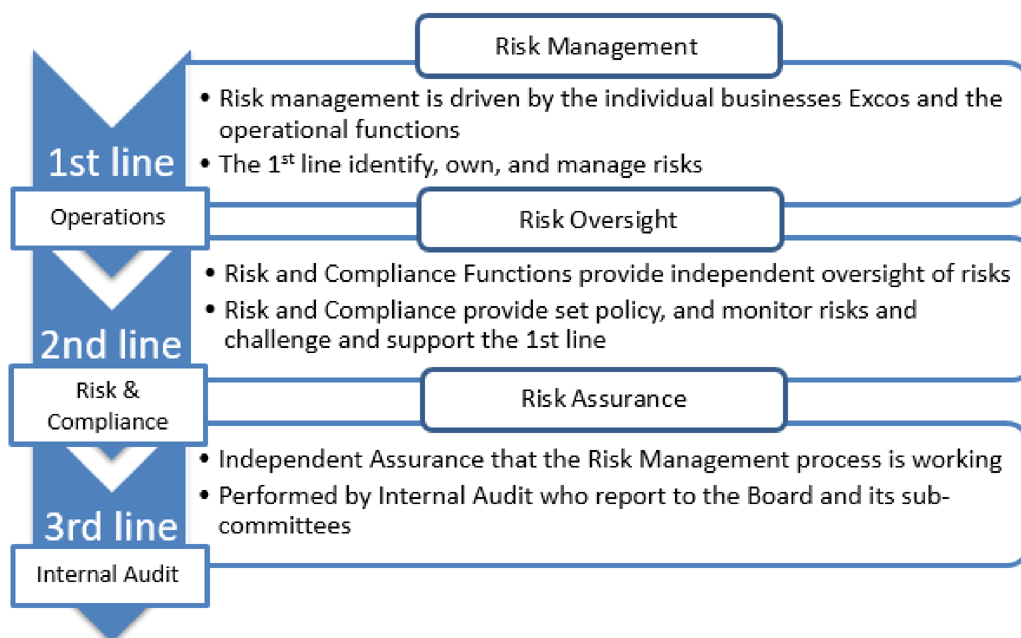
Risk oversight (the Second Line of Defence)

Risk oversight is performed by independent, specialist functions that are responsible for oversight of the risks (for example, examining how well they are being managed). They achieve this by setting policy, monitoring the systems and controls the first line has in place to manage the risks and by challenging the first line on the effectiveness of controls. The Risk Function provide oversight for business and operational risks and the Compliance Function provide oversight for regulatory and conduct risks.

Whilst Risk and Compliance are independent from the first line, they can provide advice and support to the first line to help them develop effective controls. The second line functions however, are not involved in operating the controls; first line remains the owner of the risks in question and designing and operating suitable controls.

Risk assurance (the Third Line of Defence)

Risk assurance is the independent assurance provided by 'neutral' parties that the risk management framework is operating effectively. This is provided by the Internal Audit Function and by external auditors, who undertake reviews on the control environment and report to the Board, and its sub-committees.



The Company uses the Standard Formula without Undertaking-Specific Parameters to assess the solvency capital requirements. The Company does not have approval for a full or partial internal model.

The Company has an effective and documented risk management process. The risk management process entails the planning, arranging and controlling of activities and resources to minimise the impacts of all risks to levels within the risk appetite. As the management of risk is integral to how the company is run, the risk management process is embedded in the normal management processes of the company; for example, risk and its impact on risk capital should be considered whenever key business decisions are made.

There are a number of quite distinct stages involved in the risk management process that can be summarised as follows. Within each stage there are a number of sequential steps that should be covered as part of a comprehensive process.

a) **Identification** - identify inherent vulnerabilities, exposures and sources of risk.

b) **Assessment** - assess/measure the identified risks from a severity and probability perspective to determine their priority for remedial action and the need for further quantification.

b) **Response** - determine the appropriate course of action to address the risks identified – this may be to avoid the risk (e.g. by exiting certain activities); reduce the risk through changes to every-day business activities; transfer the risk (e.g. through reinsurance), or acceptance (no action taken). Implement the actions identified through policies and procedures. This will involve assessing the effectiveness of existing controls and improving them accordingly and/or implementing new policies/procedures.

c) **Monitoring** - monitor the effectiveness of control activities through various techniques including variance analysis and stress testing.

d) **Reporting** - report at each of the four sequential stages as it is a core part of driving decision making in effective risk management.

All risks identified are recorded on the BWise risk software system and a full risk assessment undertaken.

e) Own Risk Solvency Assessment (ORSA)

The Company produces a 'solo' ORSA report to inform the Board of the outcome of the own risk and solvency assessment and is prepared in line with the Prudential Regulatory Authority (PRA) ORSA requirements. An ORSA is also produced for the Group. Information is gathered from the Company's ORSA and the corresponding ICAAP's and fed in appropriately providing overarching assurance to the Group.

The ORSA process for the Company is an assessment which considers and links a number of key risk and capital processes, functions and activities operated throughout the Company. The Group Risk Function produces an ORSA update report for the Board every quarter in line with the Board meeting cycle. This report is designed to provide an update and assessment of the key risks that the business is exposed to within the context of the stated risk appetite, and the current (and likely future) solvency positions given these exposures to risk.

The ORSA is conducted in such a way that it supports and complements the Group and company's risk management and capital allocation activities in an efficient manner, by providing feedback loops between the risk assessment, risk measurement and capital and business planning activities. The ORSA describes how the capital management activities take into account its risk management activities.

The following activities form part of the regular ORSA activity cycle:

- Annual review of risk management processes and results presented to the May Board meeting;
- Quarterly quantitative assessment of current and forward looking risk and capital positions;
- Interim capital calculations as part of regular management information in June. Results used to align risk management and capital calculations so that suitable up to date link exists for budget process (September to November);
- Confirmation that risk management and capital calculations are still appropriate (or have been appropriately adjusted) for business planning results flowing from the budget process in November each year; and
- Main ORSA capital calculations (for reporting purposes) based on 31 December calibrations and assumptions, in line with the annual process for updating assumptions for calculations of technical provisions.

The annual cycle is thus aligned with the budgeting process so as to support the use test. The yearly cycle will, however, have to be supported by further on-going monitoring.

Any change in the risk profile or capitalisation of the Company will be tested for significance against the detail of relevant documented stress testing / scenario analysis.

A significant change in risk profile or capitalisation at business or entity may trigger an out-of-cycle ORSA for the specific business or entity but may not require an out-of-cycle ORSA, provided there is not a significant change in the overall SLP group risk profile.

Activities or events that may trigger an out-of-cycle ORSA include:

- macro-economic shocks
- a significant shift in investment markets;
- significant M&A activity;
- significant changes to reinsurance programs;
- major changes to the risk appetite or tolerances; and
- natural/man-made disasters.

In addition to the full ORSA and ORSA Reports to be performed on an annual and "out-of-cycle" basis, the Company performs a selection of ORSA activities on a quarterly basis (partial ORSA). This is required for purposes of interim reporting, management information, decision making, etc. for ensuring on-going regulatory compliance. This includes;

- Review and update of risks faced by the Company;
- High level review of appropriateness of ORSA capital requirement calculations; and
- ORSA capital requirement calculations (technical provisions, SCR, MCR, ECR, whether detailed calculations or estimations) and continuous compliance with the requirements of regulatory capital and technical provisions, and the risks arising from these calculations.

Such activities will not include the completion and submission of an external ORSA Report to the regulatory authorities, but will include those activities required to produce the necessary internal ORSA management information, as required by the Board.

The ORSA process is designed so that it reveals potential areas for improvement so as to:

- Support the optimisation of risk and capital management processes; and
- Ensure that the intended level of comfort with regard to ongoing solvency is provided.

The annual ORSA report is owned by the Board and reviewed by the AARC. The ORSA report is reviewed and approved at least annually by the Board and the latest ORSA report was submitted to the PRA in November 2019.

Review:

Independent review of the ORSA is carried out. The independent review principles have been developed specifically to meet the EIOPA requirements, but also to take into account the Sanlam Group requirements, where the Sanlam Group is subject to South Africa's SAM regime. The SAM regime includes a similar requirement for an independent review of the ORSA.

The review of the ORSA needs to be performed by party/parties independent of those responsible for management and execution of the ORSA processes.

Therefore the independent review of the ORSA is performed by some or a combination of the following parties (consistent with the Sanlam Group's Combined Assurance Model):

- Risk Management
- Compliance
- Internal Audit
- External Audit
- External Service Provider

Further detail is contained in the Sanlam Investment Holdings UK Limited ORSA policy.

B.4 Internal Control System

The Company's internal control system is designed to provide reasonable assurance over the effectiveness and efficiency of operation, the reliability of financial reporting and compliance with laws and regulations. The Board is ultimately responsible for overseeing and maintaining the adequacy and effectiveness of the risk management and internal control systems.

There are various policies in place that provide details of the procedures to be followed to ensure that internal controls are sufficient to allow the Company to operate within its defined risk appetite. These include the Group Risk Policy and its sub policies, Internal Audit Policy, Compliance Function Risk

Management Policy, Outsourcing Policy, Capital Management Policy, and the Corporate Governance Manual. All policies are reviewed at least annually.

The Company has a Data Quality Policy that sets out the principles around data quality and the processes to be applied in order to ensure that this is maintained. These processes include regular analysis of the financial results to ensure that these are well understood, reconciliation of data sources with other internal and external data and the investigation of any discrepancies and review of the financial results on a regular basis by the Executive Committee. All of these activities are carried out as part of business as usual processing.

The Company has a Combined Assurance Model in place. This aims to optimise the assurance coverage obtained from management, internal assurance providers and external assurance providers on the risk areas affecting the company.

The AARC is responsible for monitoring the appropriateness of the company's combined assurance model and ensuring that significant risks facing the company are adequately addressed.

The combined assurance provided by internal and external assurance providers and management should be sufficient to satisfy the AARC that significant risk areas within the company have been adequately addressed and suitable controls exist to mitigate and reduce these risks.

External assurance providers may include the external auditor, regulators or any other external assurance providers. The relationship between the external assurance providers and the company is monitored by the AARC.

By providing an effective counterbalance to the executive management, the ARC upholds the independence of internal and external assurance providers, thus helping to ensure that these functions are carried out effectively.

The IFRS financial statements are also subject to rigorous controls in the production and review leading up to publishing. The actuarial liabilities are produced using best practice actuarial practices. The statements are also subject to internal review and external audit review. They are presented to the Board for sign-off prior to publishing.
The ARC annually reviews and approves the overall risk assurance coverage of high risk areas of the business by considering the plans of the Risk Management Function, Internal Audit, external audit and Compliance.

Operation of the Compliance function

The Compliance Function is an independent function within the Company which is responsible for ensuring that compliance with the appropriate financial services regulatory bodies' regulations and requirements is achieved. Due to the scope of regulation and the potential consequences of non-compliance, the Compliance Function provides the second line of defence for the primary compliance and conduct risks that the Company is exposed to.

The Compliance Function's role is:

- to provide guidance to the business on regulatory changes so that the business can build appropriate controls
- to monitor the design and operational effectiveness of the controls put in place by the business.

The Compliance Function is responsible to the Board for ensuring compliance risks are identified, assessed, monitored, and reported.

To this end, the Compliance Function assesses the appropriateness of the Company's compliance procedures, processes, guidelines systems and controls, follows up identified deficiencies promptly and makes appropriate recommendations for improvement as necessary.

The Compliance Function is responsible for producing and delivering against an annual compliance monitoring plan (requiring Board approval) that ensures compliance and conduct aspects of the Company's activities are appropriately assessed in a manner that is proportionate to the risk exposure, the ramifications of non–compliance, and commensurate with the regulatory risk appetite.

The Compliance Function Holder is the Group Head of Compliance, who reports to the Sanlam UK CEO and is a member of Sanlam UK Executive Management Committee and attends meetings of the AARC and Board. This ensures that the Compliance Function is independent from the rest of the business and can therefore provide an objective view on Compliance matters, without the risk of outside influence.

The Compliance Function provides monthly reports to the Sanlam UK Assurance Committee on regulatory issues that have arisen (both internally to the relevant firms and externally to the regulatory structure) and progress against the Compliance plan. Similarly the Compliance Function also produces a quarterly report to the ARC covering material issues.

B.5 Internal Audit Function

The internal audit function is an independent function within the Company which examines and evaluates the functioning of the internal controls and all other elements of the system of governance (including risk management), as it relates to the compliance of activities with internal strategies, policies, processes and reporting procedures. As such, Internal Audit forms a key element of the 'third line of defence' in the risk management framework.

Internal Audit prepares an audit plan setting out the audit work to be undertaken in the upcoming business year(s). The audit plan is based on a methodical risk analysis, with consideration of historical audit conclusions, business projects, regulatory and industry developments, business strategy and Compliance and Risk Management activities. The result of this risk analysis is assessed and subsequently an annual plan is established which reflects the scale and complexity of business activities. As part of the planning process, Internal Audit ensures that all high impact business processes are reviewed within a reasonable period of time (usually a three-year cycle).

The findings and recommendations of any internal audit reviews performed are reported to management and to the ARC who then determine what actions are to be taken with respect to each of the findings/recommendations and ensure that those actions are subsequently carried out within a reasonable time period. Internal audit activities are complemented by a follow-up procedure designed to keep track of remedial actions taken by management in areas where control deficiencies have been identified. Quarterly summarised reports are issued to the ARC and Senior Management.

Internal Audit is independent from the organisational activities that it reviews and carries out its assignments with impartiality. The principle of independence requires that Internal Audit only operates under the functional oversight of the ARC and reports to this body.

B.6 Actuarial Function

The Actuarial Function within the Company supports the Chief Actuary in the provision of actuarial advice to key stakeholders in the business. The role performed by the Company's Actuarial Function is set out in the Actuarial Function Terms of Reference document.

The Chief Actuary reports directly through to the CEO and sits on the Executive Management Committee and attends the AARC. This ensures that the Chief Actuary is independent from the rest of the business and can provide an independent view on actuarial matters, free from outside influence.

The Chief Actuary has strong experience in the UK Life Insurance industry, having been Chief Actuary of the Company since 2018 and being the Actuarial Manager since 2010. Prior to joining the

Company the Chief Actuary gained over 12 years' experience through various technical actuarial and financial reporting roles. He is a Fellow of the Institute and Faculty of Actuaries and has continuously complied with the applicable professional obligations this requires. He holds a Practicing Certificate and is an Approved Person (SIMF20) under the Senior Managers and Certification Regime.

The Company's Actuarial Function is made up of three qualified actuaries who are Fellows of the Institute and Faculty of Actuaries. All actuaries at the Company keep their knowledge up-to-date by meeting the continuous professional development requirements. The actuaries are supported by four Actuarial Analysts, a Unit Pricing Manager and a Technical Analyst.

The key areas of responsibility of the Actuarial Function are:

- Coordinate the calculation of the technical provisions
- Assess the sufficiency and quality of the data used in the calculation of technical provisions
- Express an opinion on the overall underwriting policy and reinsurance arrangements
- Contribute to the effective implementation of the risk management system
- Experience investigations (expenses, mortality, morbidity, and persistency)

The Chief Actuary submits an annual report to the Board that includes:

- Documentation of all tasks that have been undertaken by the Actuarial Function and their results
- Details of any deficiencies identified
- Recommendations as to how such deficiencies should be remedied.

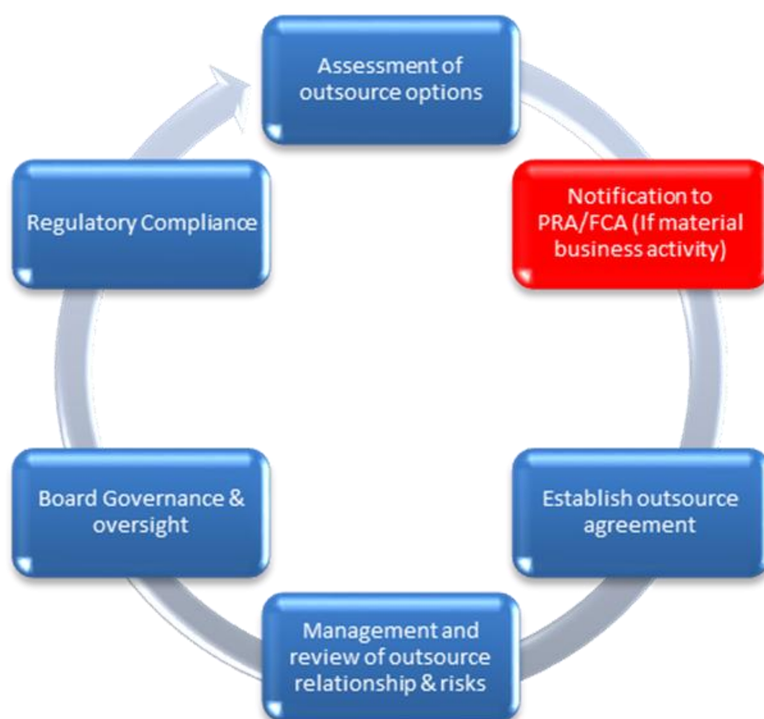
In addition to those listed above the Actuarial Department has the following responsibilities:

- Contribute to the production of the ORSA
- Stress and scenario testing
- Financial projections for business planning
- Asset/liability matching
- Capital management
- Solvency monitoring
- Production of daily unit prices
- Variations in charges for benefits and expenses
- Embedded value reporting

B.7 Outsourcing

The Group has adopted an Outsourcing Policy which is intended to establish a prudent risk management framework in relation to the management of the outsourcing arrangements and ensure compliance with the relevant regulatory requirements.

Outsourcing is only implemented following an outsourcing control cycle that contains the following steps.



B.7.1 Roles and responsibilities

Both senior management and the Board remain fully responsible and accountable for the discharge of all of their obligations when a new outsourcing arrangement is entered into and/ or existing outsourcing arrangement is managed or renewed.

The Sanlam Investment Holdings Ltd (SIH) Board

The SIH Board delegates authority and accountability of the SUK Outsourcing Policy and Framework to the Group Executive Committee.

The Group Executive Committee

Group Executive Management Committee is ultimately accountable for:

- Deciding on business activities of a material nature to be outsourced and approving such arrangements.
- Proposing outsourcing strategies to the Board to support the business strategy, mitigating risks where appropriate and deciding on business activities of a material nature to be outsourced.
- Communicating information pertaining to material outsourcing risks to the SIH Board in a timely manner;
- Periodically reviewing the original business rationale for the outsourcing agreement.
- The Outsourcing Policy;
- Approval of the Outsourcing Risk Management framework;

The Board

Outsourcing arrangements may not impair the prudent management of SUK's business and the SIH Board and the Business Subsidiary boards retain ultimate responsibility and accountability for all regulatory obligations in respect of outsourced obligations. This includes the responsibility to ensure that all prescribed regulatory standards are observed and that this Policy is complied with.

The Board where appropriate is responsible inter alia for:

- Undertaking regular reviews of outsourcing strategies and arrangements, including and assessment of their continued relevance, safety and soundness.
- Laying down appropriate approval authorities for significant outsourcing arrangements depending on risks and materiality.
- Evaluating the risks and materiality of all existing and prospective outsourcing arrangements along with the governance and oversight that applies to such arrangements within their business.
- Receiving reports from Executive Management to evaluate the risks of all significant existing and prospective outsourcing and the contracts that apply to such arrangements.
- Evaluating the annual feedback on the management of material outsource business activities which should include reporting on any outsourced business activities considered significant from a regulatory perspective.

Risks inclusive of mitigation plans and progress thereon pertaining to the outsource agreement must be reported regularly to the Boards of SUK and the SIH Assurance Committee.

The Board must satisfy itself prior to the outsourcing of any control function that the outsourcing will not interfere with the function's independence, objectivity or effectiveness.

The SIH Assurance Committee

The SIH Assurance committee where appropriate is responsible inter alia for:

- Evaluating the risks and significance of all material existing and prospective outsourcing, based on the Outsourcing Policy approved by Group Ex-Co.
- Developing and implementing sound and prudent outsourcing procedures based on the principles contained in the SUK Outsourcing Policy commensurate with the nature, scope and complexity of the outsourcing.
- Obtaining the required regulatory approvals and reporting with regards to outsourcing.
- Reviewing annually the effectiveness of policies and procedures related to outsourcing and updating them as necessary.
- Ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested.
- Ensuring that there is independent review and audit for compliance with set policies where appropriate based on the nature scale and complexity of the outsource agreement and associated risks.
- Undertaking periodic reviews of outsourcing arrangements to identify new material outsourcing risks, as they arise. The business must retain the necessary expertise to supervise the outsourced functions effectively and manage the risks associated with the outsourcing.
- Taking appropriate action in terms of the outsourcing agreement if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable

laws and regulatory requirements.

- Ensuring procedures are in place to manage the outsourcing agreement with regards to finances as well as deliverables. This includes reviewing the financial strength and service delivery of the service provider on a continuous basis.
- Communicating information pertaining to significant outsourcing risks to the Group Ex-Co in a timely manner.

Business Owner

The Business head (or an appropriate deputy)/ Relationship Manager (if appointed) has overall responsibility of the relationship on behalf of the Company. They are responsible for ensuring the following tasks are undertaken:

- Ensures that a detailed examination is performed to ensure that the potential service provider has the ability, the capacity and any authorisation required by law to deliver the required functions or activities satisfactorily, taking into account the undertaking's objectives and needs.
- Ensures that the service provider has adopted all means to ensure that no explicit or potential conflict of interests jeopardize the fulfilment of the needs of the outsourcing undertaking;
- Engages with Legal to ensure that a written agreement is entered into between the Company and the service provider which clearly defines the respective rights and obligations of the Company and the service provider
- Ensures that the general terms and conditions of the outsourcing agreement are clearly explained to the Board and authorised by them;
- Ongoing governance of the service provider in accordance with the service provider management framework.

Control Functions and Assurance Providers

The Board and Group Executive Management Committee require the most appropriate control function(s) to review any proposed outsourcing of a material business activity and the risk function must regularly review and report to the Boards, SIH Audit & Risk committee and the SIH Assurance committee on compliance with this Policy or the Outsourcing & Service Provider procedures.

The auditor of SUK must provide assurance to the Group Executive Committee and Board and any relevant regulator, if requested, that the Business Subsidiary complies with the prescribed requirements.

An overview of the outsourcing of important operational functions for the Company is provided below.

Name of organisation	Services provided	Location	Group company
Curo	Fund administration and unit pricing of certain insured funds	South Africa	N
Genus	Legacy microfiche scanning and storage services	United Kingdom	N
Hubwise	Platform Management and Software	United Kingdom	N
Iron Mountain	Secure storage of paper files offsite, off-site electronic back-up services	United Kingdom	N
JP Morgan	Custody services in respect of equities and bonds held in the main insured funds and certain personal funds.	United Kingdom	N

Nucleus	Policy administration related activities for the white labelled Nucleus onshore bond. In turn, Nucleus outsources this to Genpact.	United Kingdom	N
Sanlam Asset Management Ireland	Investment management of certain insured funds and asset-liability matching advice on the Company's non-linked assets fund	Ireland	Y
Sanlam Investments	Investment management of certain insured funds	United Kingdom	Y
SPI	Management of SFS CASS arrangements	United Kingdom	Y
Cameron Hume	Asset liability matching advice on the Company's non-linked assets fund	United Kingdom	Y

B.8 Any other information

The system of governance is considered to be appropriate for the Company, taking into account the nature, scale and complexity of the risks inherent in the business.

There is no further information to be disclosed in respect of the system of governance.

There have been no material changes to the system of governance over the reporting period.

C. RISK PROFILE

The purpose of this section is to describe the material risks to which the Company is exposed and the techniques used to monitor and manage them.

There have been no material changes to measures used to assess the risks to which the Company is exposed over the reporting period.

C.1 Underwriting risk

Underwriting risk as at 31 December 2019 represents around 53% of the Company's undiversified basic SCR. The material underwriting risks are described below.

Persistency risk

Persistency risk relates to all the Company's business apart from annuities and represents around 31% of the Company's undiversified basic SCR. Persistency risk relates to the loss of future charges as a result of unfavourable persistency, potentially resulting in a significant reduction in the value of future profits and therefore the Company's own funds. However, in the event of unfavourable persistency, the impact on solvency would be largely offset by a reduction in the capital requirement (as evidenced by the sensitivity test results later in this section).

Adverse persistency will affect the solvency of the company. Lower than expected persistency on policies with realistic reserves which are lower than their surrender values (i.e. policies which are expected to produce future profits) will negatively impact the solvency of the company. Conversely lower than expected persistency on policies with realistic reserves that are higher than their surrender values will positively impact the solvency of the company.

Mitigation

Mitigants include proactive monitoring of emerging experience; on-going persistency initiatives; product design and distributor relationship management. That said, persistency risk is by its nature largely outside management's control and therefore comes with a sizeable residual risk.

Longevity risk

Longevity risk represents around 12% of the Company's undiversified basic SCR. If clients holding annuities survive longer than anticipated in the reserving calculations, reserves will need to be strengthened, which could significantly impact the Company's solvency position.

Mitigation

A proof of existence exercise is carried out on an ongoing basis by monitoring death registrations to ensure only genuine claims are paid. Emerging experience is regularly monitored at Board level.

Mortality risk

Mortality risk is a material risk for some legacy products with a material sum at risk, however it is largely all mitigated by reinsurance arrangements that have been in place for many years. Therefore, mortality risk only represents around 2% of the Company's undiversified basic SCR after allowing for reinsurance.

Mitigation

The reinsurance arrangements remain effective for these legacy products and these products are gradually going off the books. The ongoing effectiveness of these reinsurance arrangements is monitored by the Company's Actuarial Function. If the Company decided to take on new mortality exposures by selling new protection business, the possibility of mitigating the new mortality risk using new reinsurance arrangements would be assessed.

Mortality charges on protection business are variable, so the Company could consider increasing mortality charges if mortality experience were to worsen significantly.

Expense risk

Expense risk represents around 8% of the Company's undiversified basic SCR. The Company has a good record of keeping its expenses within budget. However, a number of factors (such as the need to recruit external consultants or increased statutory obligations) could force the Company to incur additional expenses over the next twelve months.

While expenses by themselves are unlikely to cause a threat to solvency, since the expected surplus over the next year is likely to be sufficient to meet any expense demands, they could contribute to the insolvency of the Company if other adverse events occurred at the same time.

If the Company closed to new business, or was unable to continue to expand new business, there is a risk that its solvency would be eroded over time by an expense overrun. An expense overrun occurs when the actual expenses incurred exceed the expenses assumed in the reserving bases, and as a result the surplus that emerges from the business is either reduced or becomes negative.

There is also a risk that expense inflation could be higher than expected in the reserving basis, although such a rise could to some extent be met by an increase in charges, subject to TCF considerations.

Mitigation

The key mitigating factor is proactive expense management through the budget setting and monitoring processes together with the approval framework and authority guide.

Material underwriting risk concentrations

The Company has a reasonably diverse pool of underwriting risks which reduces its exposure to underwriting risk concentrations. The Company makes use of reinsurance to reduce exposures to certain risks.

C.2 Market risk

The Company's investment management policy is to follow the Prudent Person Principle (PPP) as specified in Article 132 of the Solvency II EU Directive. That is, with respect to the whole portfolio of assets, the Company's investment risk appetite is to only invest in assets and instruments whose risks the company can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs,

The Company manages assets on behalf of unit-linked customers as well as assets backing non-linked business and shareholder assets. The Investment Committee is responsible for ensuring that the Company follows PPP with regard to the unit-linked investments while the Balance Sheet Management Committee is responsible for the non-linked assets. The Balance Sheet Management Committee sets the concentration risk policy which ensures that the Company is not exposed to any material market risk concentrations.

Market risk as at 31 December 2019 represents around 32% of the Company's undiversified basic SCR. The key market risks for the Company are equity risk, currency risk and interest rate risk. These risks are described below.

Equity risk

Equity risk represents around 18% of the Company's undiversified basic SCR. A fall in equity markets would have a detrimental effect on the value of future annual administration charges.

The Company is not exposed to any material investment guarantees that would be directly affected by a fall in equity values. However, a fall in equity values would damage the Company's solvency because the resulting lower future expected fund administration charges would increase the realistic technical provisions and therefore immediately worsen the Company's solvency position. Following a fall in equity values, there would also be a reduction in the capital requirement due to the symmetric adjustment, helping to smooth the impact on the solvency position in the short term.

A fall in equity values may also increase the likelihood of other risks occurring such as reduced new business or worse persistency. For example, mis-selling reserves are more likely to be inadequate following a fall in equity values since policy values will be reduced, potentially leading to higher compensation costs.

Mitigation

The Company has a detailed set of processes and procedures in place to manage and mitigate any impact of equity risk. Unit linked assets and liabilities are matched on a daily basis, with some minimal residual exposure permitted within detailed limits for the sake of operational efficiency.

Currency risk

Currency risk represents around 9% of the Company's undiversified basic SCR. Some of the Company's unit linked funds are invested in overseas linked assets and as such an increase in the value of sterling compared to other currencies will lead to a reduction in the value of capital resources through lower future fund administration charges. Note that the assets held to match the Company's other non-linked liabilities are all sterling denominated.

Mitigation

As with equity risk, unit linked assets and liabilities are matched on a daily basis, with some minimal residual exposure permitted within detailed limits for the sake of operational efficiency.

Interest rate risk

Interest rate risk is currently low, representing less than 2% of the Company's undiversified basic SCR. The non-linked liabilities are matched by a portfolio of fixed coupon and index linked securities of relevant outstanding term. All liabilities and assets are denominated in sterling and the matching

position is reviewed monthly. Consequently the losses that could arise from mismatching within the Company are unlikely to have a significant impact on the overall solvency position.

Although changes during 2019 to the defined benefit pension scheme's investment strategy have reduced the level of interest rate mismatching of the Scheme's assets and liabilities, a material amount of interest rate risk still remains within the Scheme.

The Company's solvency position is sensitive to interest rate risk. This is partly due to the level of the risk margin being sensitive to the level of interest rates.

Mitigation

The Company has in place a detailed investment mandate for non-linked matching with another Group company, Cameron Hume, to mitigate any potential impact. The mandate has clear rules over what constitutes an acceptable level of matching and these are reviewed on a regular basis. Performance is reviewed on a monthly basis.

For pension scheme matching, the Scheme's Trustees have in place an investment strategy together with a set of detailed investment limits which are set out in the Scheme's Statement of Investment Principles. Performance against the Scheme's Statement of Investment Principles by the investment manager is reviewed on a regular basis. There is however a sizeable amount of residual risk given the nature of the benefit guarantees that have been granted.

C.3 Credit risk

Credit risk as at 31 December 2019 represents around 15% of the Company's undiversified basic SCR. The key credit risks for the Company are downgrade risk and default risk. These risks are described below:

- Asset default on assets backing non-linked liabilities. The impact would be a straight hit to the Company's solvency position.
- Asset default on assets backing final salary pension scheme. The impact would be a worsening in the scheme's solvency and funding position which would require the Company to increase contributions.
- Reinsurer default. If a default did occur the Company would need to hold gross rather than net reserves for the policies affected, and the previously reinsured mortality and morbidity profits or losses would be retained by the Company.
- The failure of the mis-selling indemnity provider to pay amounts due. The impact would be that the Company could no longer take credit for the expected recovery under the pecuniary loss insurance contract with Allianz Cornhill and this would adversely impact the Company's solvency.

Mitigation

Credit risk is managed in the following ways:

- Asset default (non-linked liabilities). The Company has in place an investment management mandate with Cameron Hume to mitigate any potential impact. The mandate has clear rules over the quality and type of asset that can be used to match non-linked liabilities as well as limits on maximum counterparty exposure. These are reviewed on a regular basis and the investment manager's performance against these guidelines is monitored regularly at Balance Sheet Management Committee meetings. No credit default swaps have been purchased.

  The Company has to date not suffered a default on any of its non-linked assets and the practice is not to seek excessive returns because of the inherent default dangers.

- Asset default (pension scheme). Limits agreed with the Trustees over the maximum percentage of the assets that can be invested in corporate bonds, investing in corporate bonds via a collective scheme which improves diversification and ensures professional management.

- Reinsurers. The risk of reassurer default is kept low by only dealing with a good quality reinsurance company, proactive account management and the right to offset. No use has yet been made of deposit backs.

- Indemnity provider. Dealing with a good quality counterparty, Allianz Cornhill, together with account management keeps the risk of the failure of this indemnity low.

C.4 Liquidity risk

In addition to considering whether the Company has an adequate amount of capital, we also need to consider whether the assets held by the Company are sufficiently liquid, that is whether there is a cost associated with having to realise the assets at an unfavourable time. The Company has limited liquidity risk.

A large amount of surrenders on a single day could potentially impact the Company's liquid resources. If the amount of surrender was greater than the cash in the unit fund, assets in that fund would need to be sold. However, since the Company operates a next day pricing policy and fund accounts receive daily unit movement reports on the day that a surrender is keyed, assets in the fund can be sold before the price is calculated. The cost of selling assets will therefore be incurred by those surrendering rather than the Company itself.

The Company monitors the level of liquid assets held and reports this to the Executive Committee on a monthly basis.

The expected profit included in future premiums (EPIFP) as at 31 December 2019 is £1.8m. Although EPIFP contributes to the Company's own funds, it only represents around 3% of the total own funds. Therefore, the highly illiquid nature of EPIFP isn't an issue given the Company's other highly liquid investments.

C.5 Operational risk

Based on the standard formula's formulaic approach, operational risk as at 31 December 2019 represents around 4% of the Company's undiversified SCR. For Pillar 2, the Company has a separate calculation for operational risk which attempts to be more appropriate to the Company specifically. The Company's internal operational risk model aggregates all the company's operational risk impacts and likelihoods as assessed by the various department heads using correlation matrices.

Operational risk is considered separately for each risk category of the Company's risk universe in terms of the loss caused if a process were to fail or, alternatively, the impact on the business if an adverse external event were to hit the Company.

<u>Mitigation</u>

Mitigants include the following:

- Risk reduction – where possible, the Company takes action to reduce the impact of a risk. The required actions vary by risk.
- Risk avoidance – where risks are outside risk appetite and there are no commercially viable means of reducing the risk, the Company may avoid the risk.
- Risk acceptance – in some cases, after assessment it is decided that a risk that is outside tolerance should be accepted. In this case, the risk is monitored closely and included in the monthly risk reporting.

- Transfer – in some cases action is taken to reduce the probability or severity by transferring or sharing a portion of the risk

C.6 Other material risks

There are no other material risks.

There have been no material changes to the risk profile over the reporting period.

Sensitivities

The Company carries out stress and scenario testing as part of the ORSA process which includes sensitivity testing for the material risks. Sensitivity tests have been selected to give an indication of how sensitive the Company's solvency position is to these material risks. The results of the sensitivity tests on a Pillar 1 basis as at 31 December 2019 are shown in the table below.

Pillar 1 December 2019	Own Funds £'000	Capital requirement £'000	Capital adequacy ratio
Base	62,606	42,780	146%
10% reduction in annuitant mortality (inc. pension scheme)	58,114	42,942	135%
1% fall in interest rates	61,076	45,184	135%
1% increase in credit spreads	55,775	41,995	133%
30% fall in equity values (Changed Symmetric Adjustment)	55,459	36,692	151%
10% increase in renewal expenses	58,164	42,546	137%
10% mass lapse event	55,540	40,085	139%

The 30% fall in equity values sensitivity shows a big impact on own funds. However, the capital requirement would also fall in this scenario, because the market risk and mass lapse risk would be lower. Therefore the capital adequacy ratio is expected to increase in this scenario.

C.7 Any other information

There is no other information to be disclosed regarding the risk profile of the Company.

D. VALUATION FOR SOLVENCY PURPOSES

D.1 ASSETS

	Solvency II value £000	Statutory accounts value £000	Variance £000	Note
Property, plant & equipment held for own use	292	292	0	D.1.2
Holdings in related undertakings, including participations	5,387	0	(5,387)	D.1.3
Government Bonds	26,310	25,884	(426)	D.1.4
Corporate Bonds	75,318	74,374	(943)	D.1.4
Deposits other than cash equivalents	4,284	4,284	0	D.1.5
Assets held for index-linked and unit-linked contracts	2,727,967	2,727,967	0	D.1.6
Loans on policies	263	263	0	D.1.7
Reinsurance recoverables: Life excluding health and index-linked and unit-linked	694	1,028	334	D.1.8
Reinsurance recoverables: Life index-linked and unit-linked	(4,709)	452	5,161	D.1.8
Reinsurance receivables	7	7	0	D.1.9
Receivables (trade, not insurance)	12,170	13,540	1,370	D.1.10
Cash and cash equivalents	8,903	8,903	0	D.1.11
Total assets	**2,856,885**	**2,856,992**	**108**	`

All assets and liabilities in the IFRS financial statements are valued in accordance with IFRS. All assets and liabilities are included in the Solvency II balance sheet at fair value.

The best evidence of fair value is quoted market information or observable active market data at the balance sheet date. For quoted investments where this is not available, the fair value is determined by reference to prices for similar assets in active markets. For transactions in less active markets an alternative valuation method is used. This occurs when the nature of the asset means there is no quoted price available e.g. investment property.

It is not possible to tie the figures in the statutory accounts column directly in to the financial statement balance sheet due to the requirement to show linked assets in a single line for Solvency II purposes.

There have been no material changes to the approach to valuing assets for solvency purposes over the reporting period.

D.1.1 Deferred tax

There is no deferred tax asset in the IFRS and Solvency II balance sheets.

D.1.2 Property, plant and equipment held for own use

The value of property, plant and equipment held for own use is £0.3m as at 31 December 2019 [S.02.01.01 C0010 R0060].

This is valued at cost less depreciation in both the IFRS financial statements and the Solvency II balance sheet. Given the magnitude of this balance, it is deemed that there is no material difference between this treatment and fair value as required in Solvency II.

D.1.3 Holdings in related undertakings, including participations

The value of holdings in related undertakings is £5.4m as at 31 December 2019 [S.02.01.01 C0010 R0090]. The balance represents the value of SFS (the value of STS is not material). This is held at cost in the IFRS financial statements and fair value for Solvency II. The fair value of SFS is calculated using the embedded value approach

D.1.4 Bonds

The total value of bonds in the non-linked funds was £101.6m as at 31 December 2019 [S.02.01.01 C0010 R0130]. This value is made up of corporate bonds and government securities.

All bonds are marked to market for both the IFRS financial statements and the Solvency II balance sheet.

There is a difference between the Solvency II balance sheet value and IFRS financial statement value in respect of listed securities, which is the value of interest accrued on these bonds as at 31 December 2019. This amount is included in the Solvency II value, but excluded from the IFRS financial statement value, where convention dictates that bonds are included at clean market value with accrued interest shown as a separate line within current assets.

D.1.5 Deposits other than cash equivalents

The value of deposits was £4.3m as at 31 December 2019 [S.02.01.01 C0010 R0200]. These are valued at fair value in both the IFRS financial statements and the Solvency II balance sheet.

D.1.6 Assets held for unit linked and index linked contracts

The total value of assets held for unit and index linked contracts was £2,728m as at 31 December 2019 [S.02.01.01 C0010 R0220]. This value is comprised of the following types of asset:

- Investment property
- Corporate bonds
- Government securities
- Equity
- Investment funds
- Cash

Investment property

The Company owns two types of investment properties – property fund properties, and properties within the self-invested funds of some clients.

<u>Property fund properties</u>

These properties are valued on a monthly basis by Jones Lang LaSalle (JLL), an independent property valuer, on an open-market basis. Their valuation is prepared in accordance with the Practice Statements in the RICS Appraisal and Valuation Standards (5th Edition).

Market value is measured as the most probable price reasonably obtainable in the market at the date of valuation between a willing buyer and a willing seller in an arm's-length transaction. Therefore it is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer.

<u>Self-invested properties</u>

These properties are valued prior to purchase and then triennially, by an independent professional valuer acceptable to the Company, and with knowledge of the local market, on an open market basis.
It is determined that all investment properties are fair valued for both the IFRS financial statements and the Solvency II balance sheet.

Corporate bonds and government securities

These are marked to market for both the IFRS financial statements and Solvency II balance sheet.

Equities

These are marked to market for both the IFRS financial statements and Solvency II balance sheet.

Investment funds

These are marked to market for both the IFRS financial statements and Solvency II balance sheet.

Cash

This is held at fair value for both the IFRS financial statements and Solvency II balance sheet.

D.1.7 Loans on policies

The value of loans on policies is £0.3m as at 31 December 2019 [S.02.01.01 C0010 R0230]. These are valued at cost in both the IFRS financial statements and the Solvency II balance sheet. Given the magnitude of this balance, it is deemed that there is no material difference between this treatment and fair value as required by Solvency II.

D.1.8 Reinsurance recoverables

The total value of reinsurance recoverables is £(4.0m) as at 31 December 2019 [S.02.01.01 C0010 R0270]. On the realistic basis used under Solvency II, reinsurance liabilities exceed the reinsurance assets and therefore reinsurance increases the technical provisions. This is because for unit linked business, reinsurance premiums are fixed and therefore do not reduce on a realistic basis. Reinsurance recoverables reduce on a realistic basis compared to the more prudent IFRS valuation basis.

D.1.9 Reinsurance receivables

The total value of reinsurance receivables is £0.0m at 31 December 2019 [S.02.01.01 C0010 R0370]. The balance is made of claims due in the normal course of business. These are valued at fair value for both IFRS financial statements and Solvency II purposes.

D.1.10 Receivables (trade, not insurance)

The total value of trade receivables is £12.2m at 31 December 2019 [S.02.01.01 C0010 R0380]. These are valued at fair value for both the IFRS financial statements and Solvency II balance sheet, and include £4.2m due from Allianz Cornhill in respect of mis-selling claims. The difference in the value between IFRS financial statements and Solvency II is due to the different treatment of accrued interest on fixed income securities under the different bases. For the IFRS financial statements, this is included in this balance (i.e. assets are held at the clean market value) whereas under Solvency II accrued interest is part of the overall asset value (i.e. assets are held at dirty market value).

D.1.11 Cash and cash equivalents

The value of cash and cash equivalents is £8.9m as at 31 December 2019 [S.02.01 C0010 R0410]. These are fair valued for both the IFRS financial statements and Solvency II balance sheet.

There are no differences between the valuation methods used by the Company as outlined above and those used by other companies in the Group.

D.2 Technical Provisions

The table below shows the technical provisions as at 31 December 2019 split by material line of business.

	Index-linked and unit-linked £'000	Life (excluding health and index-linked and unit-linked) £'000	Total £'000
Gross Best Estimate Liabilities (BEL)	(43,651)	74,649	30,998
less Reinsurance recoverables	(4,709)	694	(4,015)
BEL after recoverables	**(38,942)**	**73,955**	**35,013**
Technical provision calculated as a whole	**2,711,382**	**-**	**2,711,382**
Risk Margin	10,506	5,596	16,102
Technical Provisions after recoverables	**2,682,945**	**79,551**	**2,762,496**

Technical provision calculation methodology

The Company uses a deterministic policy-by-policy cash-flow projection approach to the calculation of the technical provisions.

Future cash flows are to be discounted at the risk free rate as specified by regulation.

In certain specific circumstances, the best estimate element of technical provisions may be negative (e.g. for some individual contracts). These profitable contracts can be recognized on the Solvency II balance sheet and so the value of the best estimate with respect to those individual contracts should not be set to zero. No implicit or explicit surrender value floor should be assumed for the amount of the market consistent value of liabilities for a contract. This means that if the sum of a best estimate and a risk margin of a contract are lower than the surrender value of that contract there is no regulatory requirement to increase the value of insurance liabilities to the surrender value of the contract.

The Best Estimate Liabilities are calculated gross, without deduction of the amounts recoverable from reinsurance contracts or the premiums payable to reinsurers.

The Company has existing reinsurance contracts with Munich Re that cover business written around 1990. The Company has no special purpose vehicles or finite reinsurance.

Recoverables from these reinsurance contracts are valued separately but using consistent assumptions and methodologies to the underlying insurance contracts including applying consistent contract boundaries (see the “Future Premiums” section under “Technical provisions assumptions”). This means separate reinsurance assets and liabilities are shown on the balance sheet.

There have been no material changes to this approach over the reporting period.

Technical provisions assumptions

The key assumptions are as follows:

Interest rates

The investment return assumptions and the discount rate are based on the GBP risk-free interest rate term structure as specified in the Solvency II regulations. The Company uses the risk free yield curve supplied by EIOPA:

- No matching adjustment or volatility adjustment is added to the risk-free rate.

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

Mortality

The following mortality assumptions were used as at 31 December 2019 and 31 December 2018.

	Aggregate	Non-Smoker	Smoker
Males	33% A67/70 sel	29% A67/70 sel	43% A67/70 sel
Females	37% FA75/78 sel	32% FA75/78 sel	48%FA75/78 sel

Annuitant mortality

For annuities, the following mortality assumptions were used as at 31 December 2019:

	Base Table	Age Rating	Improvement Factors
Conventional annuities			
Males	118% PCMA00	None	CMI 2018, 1.25% LTI
Females	118% PCFA00	None	CMI 2018, 1.25% LTI
Unit linked annuities			
Males	101% PCMA00	-2	CMI 2018, 1.25% LTI
Females	101% PCFA00	-2	CMI 2018, 1.25% LTI

The following mortality assumptions were used as at 31 December 2018:

	Base Table	Age rating	Improvement Factors
Conventional annuities			
Males	118% PCMA00	None	CMI 2017, 1.25% LTI
Females	118% PCFA00	None	CMI 2017, 1.25% LTI
Unit linked annuities			
Males	102% PCMA00	-2	CMI 2017, 1.25% LTI
Females	102% PCFA00	-2	CMI 2017, 1.25% LTI

The CMI tables used in the annuitant mortality investigation for future mortality improvement factors have been updated to reflect more current mortality experience. This has led to a decrease in technical provisions.

Expenses

The following expenses per policy were used as at 31 December 2019:

Class	31 Dec 2019		31 Dec 2018	
	Live	Paid up	Live	Paid up
UL Bond	-	£45.54	-	£40.06
UL Savings Endowment	£47.92	£45.54	£42.12	£40.06
UL Target Cash Endowment	£47.92	£45.54	£42.12	£40.06
UL Regular Premium Pension	£62.63	£50.46	£56.70	£44.68
UL Single Premium Pension	-	£50.46	-	£44.68
Conventional annuities	-	£40.25	-	£35.89
Unit linked annuities	-	£147.24	-	£197.86

The assumptions have been increased over the reporting period to reflect the latest expense experience. This has led to an increase in technical provisions.

Inflation

Renewal expenses and monthly expense charges were assumed to increase at 3.45% p.a. The 31 December 2018 assumption was 3.70%.

Persistency

Discontinuance rates are based on the company's recent experience.

Risk Margin

The risk margin is an addition to the Best Estimate Liabilities to ensure that the total technical provisions are sufficient to cover the amount that a third party would require to take over and meet the insurance obligations.

The risk margin is calculated by determining the cost of providing an amount of eligible own funds equal to the SCR necessary to support the insurance and reinsurance obligations over the lifetime thereof.

The rate used in the determination of the cost of providing that amount of eligible own funds is the Cost-of-Capital rate. The Cost-of-Capital rate is the annual rate to be applied to the capital requirement in each period. The Cost-of-Capital rate is set by EIOPA and currently equals 6%.

Therefore the Cost of Capital at time t equals the SCR at time t (excluding avoidable market risk) multiplied by the Cost-of-Capital rate. The risk margin equals the sum of the present value of the cost of capital for each future year.

The main risks that make up the SCR used in the calculation of the risk margin are calculated at each time t.

Future Premiums

Where certain requirements are met, the Solvency II specifications allow contract boundaries to be set into the future for protection business. This allows future cash flows relating to future regular premiums to be treated as existing business and therefore included in the best estimate. The impact of this is quantified by calculating the expected profits arising from future premiums (EPIFP). The EPIFP form part of the reconciliation reserve and are included in the own funds.

Uncertainty associated with the level of technical provisions

Uncertainty primarily relates to how future actual experience will differ from the best estimate assumptions used in the technical provision calculations. The key assumptions are interest rates, persistency rates, mortality rates and expense assumptions. The Company performs experience investigations on an annual basis to compare actual experience against the best estimate assumptions. The results of these investigations are used in the assumption setting process to help ensure the level of uncertainty is well understood.

The sensitivity test results at the end of Section C show how sensitive the Company's solvency position is to the key assumptions.

Solvency II and IFRS valuation differences

The table on the following page gives a build up from the IFRS valuation to the Solvency II technical provisions as at 31 December 2019.

£'000	Index-linked and unit-linked	Life (excluding health and index-linked and unit-linked)	Total
IFRS liabilities	2,712,398	77,221	2,789,620
Adjustments for Solvency II	(44,648)	(2,572)	(47,240)
Best Estimate Liabilities (BEL)	**2,667,731**	**74,649**	**2,742,380**
Add Risk Margin	10,506	5,596	16,102
Technical Provisions	**2,678,236**	**80,245**	**2,758,481**

The main differences between the Solvency II technical provisions and IFRS liabilities arise from:

- In certain specific circumstances, Solvency II allows the best estimate element of technical provisions to be negative. However, under IFRS, for investment business, the liability is determined by the value of the corresponding units allocated to the policyholders; the unit liability is tested to ensure that it is not less than the unit surrender value.
- Solvency II uses best estimate assumptions whereas the IFRS valuation assumptions include margins for adverse future experience. The IFRS expense assumptions contain a 10.0% margin. For persistency, the IFRS assumptions contain a 30% margin. For annuitant mortality, the IFRS assumptions include a margin over the best estimate assumptions. This is achieved by applying a 10% margin to the table percentage and a 0.5% margin to mortality improvements in the IFRS basis compared to the best estimate basis.
- Solvency II uses risk-free discount rates based on the relevant risk-free interest rate curve supplied by EIOPA. IFRS uses discount rates based on the risk adjusted yield of the backing assets.
- The risk margin is included in Solvency II technical provisions.

D.3 Other Liabilities

	Solvency II value £'000	Statutory accounts value £'000	Variance £'000	Note
Technical provisions - life (excluding index-linked and unit-linked)	80,245	77,221	(3,024)	D.2
Technical provisions - index-linked and unit-linked	2,678,236	2,712,398	34,162	D.2
Provisions other than technical provisions	4,202	4,202	0	D.3.1
Pension benefit obligations	0	0	0	D.3.2
Deferred tax liabilities	9,980	10,532	553	D.3.3
Debts owed to credit institutions	5,204	5,204	0	D.3.4
Financial liabilities other than debts owed to credit institutions	2,997	2,997	0	D.3.5
Payables (trade, not insurance)	13,416	13,416	0	D.3.6
Total liabilities	**2,794,280**	**2,825,971**	**31,691**	

The approach used for each item in the table is described in the relevant note. There have been no material changes to the approaches used to value other liabilities over the reporting period.

D.3.1 Provisions other than technical provisions

The value of other provisions is £4.2m as at 31 December 2019 [S.02.01.01 C0010 R0750]. This is the balance recognised in respect of pensions mis-selling and dilapidations. This is valued at fair value for both the IFRS financial statements and the Solvency II balance sheet.

D.3.2 Pension benefit obligations

The value of pension benefit obligations is £0.0m as at 31 December 2019 [S.02.01.01 C0010 R0760]. This is valued at fair value in both the IFRS financial statements and the Solvency II balance sheet.

D.3.3 Deferred tax liabilities

The deferred tax liability is £10.0m as at 31 December 2019 [S.02.01.01 C0010 R0780].

International Accounting Standard (IAS) 12 prescribes the accounting treatment for income taxes. In the IFRS financial statements, deferred tax liabilities are provided for in full on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

A tax asset is recognised for tax loss carry forwards to the extent that it is probable at the reporting date that future taxable profits will be available against which the unused tax losses can be utilised. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and legislation enacted or substantively enacted at the reporting date. Where tax law allows set off of current tax assets and liabilities, deferred tax assets and liabilities are netted off on the statement of financial position.

The Solvency II methodology for the calculation of deferred tax also follows the provisions of IAS 12. Deferred tax for Solvency II valuation purposes is determined by identifying temporary differences between the fair value of assets or liabilities on the Solvency II balance sheet and their equivalent tax base. The Solvency II technical provisions valued in accordance with the Solvency II Directive are calculated to be at a lower level than our present IFRS liabilities which are used to calculate the company's tax position. As a result of this temporary difference a deferred tax liability needs to be recognised on the Solvency II balance sheet. The other differences between the Solvency II and IFRS balance sheets do not result in any deferred tax changes.

For non-BLAGAB (basic life assurance and general annuity business) business the recognition of this larger deferred tax liability allows the recognition of a larger deferred tax asset related to the non-BLAGAB brought forward losses.

D.3.4 Debts owed to credit institutions

The total value of debts owed to credit institutions is £5.2m as at 31 December 2019 [S.02.01.01 C0010 R0800]. This value represents mortgages on properties held by a number of the Company's clients within their Self-Invested Personal Pension (SIPP) portfolios. These are valued at amortised cost in the IFRS financial statements. A discounted cash flow approach has been taken to value the liabilities for the Solvency II balance sheet, since this is representative of fair value.

D.3.5 Financial liabilities other than debts owed to credit institutions

The value of other financial liabilities is £3.0m as at 31 December 2019 [S.02.01.01 C0010 R0810]. This balance represents accruals for expenses. This is valued at fair value for both the IFRS financial statements and the Solvency II balance sheet.

D.3.6 Payables

The value of payables is £13.4m as at 31 December 2019 [S.02.01.01 C0010 R0840]. This balance is made up of trade creditors, intercompany creditors, the overall tax creditor and claims outstanding. These are fair valued for both the IFRS financial statements and the Solvency II balance sheet.

D.4 Alternative methods for valuation

Other than those described in sections D1.3, D1.6 and D3.4 there were no other alternative methods for valuation to be disclosed.

D.5 Any other information

The Company has related party transactions with Sanlam Wealth Planning UK Limited that is not a wholly owned subsidiary within the Sanlam group. The transactions are all on an arm’s length basis.

Sanlam Wealth Planning UK Limited receives adviser fees payments and gets recharged for operating expenses.

The Company also has related party transactions with Nucleus and Cameron Hume, two associates of the Sanlam group. The transactions are all on an arm’s length basis.

E. CAPITAL MANAGEMENT

E.1 Own Funds

The objectives of the own funds management are set out in the Company's capital management policy. The Company aims to maintain, at all times, sufficient own funds to cover the SCR and MCR together with an appropriate buffer.

The acceptable target range for the Pillar 1 CAR (ratio of eligible own funds over SCR) is 120% to 140%. The Company regularly monitors the Pillar 1 CAR and the capital management policy sets out the process to follow to restore the CAR if it falls outside the target range.

The business plan contains a three year projection of the Pillar 1 solvency position and this helps identify any required actions for future own funds management

The table below shows a breakdown of the Company's own funds:

	Tier 1 31 Dec 2019 £'000	Tier 1 31 Dec 2018 £'000
Ordinary share capital	25,000	25,000
Reconciliation reserve	37,606	34,843
Total Basic own funds after deductions	**62,606**	**59,843**

The eligible amount of own funds to cover the SCR and the MCR is £62.6m. The Company's ordinary share capital, surplus funds and reconciliation reserve are all available as unrestricted tier 1 own funds.

The table below gives an analysis of the significant movements in own funds over the reporting period:

£'000	Tier 1 Own funds	Note
Opening position	**59,856**	
Impact of new business	(1,743)	1
Expected return	1,918	2
Pension scheme contributions	(1,905)	3
Expense assumptions	(3,301)	4
Market movements	5,259	5
Credit spread movements	1,872	6
Other	650	
Closing position	**62,606**	

1. **Impact of new business**
   The value of new business written during the year on a Solvency II basis has resulted in a fall in Own Funds. This includes a £0.8m increase in risk margin due to new business written during the year.

2. **Expected return**
This increase is driven by the decrease in the risk margin due to the unwinding of the cost of capital calculation.

3. **Pension scheme contributions**
As part of the change in investment strategy in the staff defined benefit pension scheme, the company paid an additional one-off contribution of £1m to compensate for the lower investment returns expected as a result of disinvesting from equities. In combination with the company's regular contributions into the scheme, this has reduced the Own Funds by £1.9m. This is due to the fact any surpluses in the staff pension scheme are excluded from the Own Funds calculation.

4. **Expense assumptions**
Assumptions for expenses have been updated to reflect the latest experience, this change led to an increase in the technical provisions and a fall in Own Funds.

5. **Market movements**
The closing stock market position at year end was higher than expected, resulting in an increase the value of future administration charges.

6. **Credit spread movements**
The fall in credit spreads over the year has resulted in higher corporate bond values, which has increased Basic Own Funds.

Various sensitivities are shown in a table in section C.6 which give an indication of how exposed the Company's solvency position is to various stresses.

The following table reconciles differences (reconciliation reserve) between the equity in the IFRS financial statements and the excess of the assets over the liabilities on a Solvency II basis.

£'000	31 Dec 2019
Ordinary share capital	25,000
Equity - financial reporting basis	**25,000**
Retained earnings in IFRS financial statements	13,416
Valuation differences	(2,005)
Adjustment for realistic reserves	41,744
Risk Margin	(16,102)
Change to deferred tax liability	553
Reconciliation reserve	**37,606**
Solvency II - Basic Own Funds	**62,606**

Valuation differences include the fair value of Sanlam Financial Services. SFS is treated as a strategic participation for Solvency II purposes.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The amount of the Company's Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) at the 31 December 2019 are £42.8m and £19.3m respectively.

The table below shows the risk modules that make up the Company's SCR at 31 December 2019.

£'000	31 Dec 2019	31 Dec 2018	Difference
Market risk	22,924	24,697	(1,773)
Counterparty risk	1,753	2,138	(384)
Life underwriting risk	26,707	24,066	2,641
Undiversified Basic SCR	**51,384**	**50,901**	**484**
Diversification	(11,491)	(11,620)	129
Basic SCR	**39,893**	**39,281**	**613**
Loss absorbency capacity of deferred taxes	-	-	-
Operational risk	2,887	2,912	(25)
SCR	**42,780**	**42,193**	**587**

The increase in SCR is mainly due to an increase in life underwriting risk, which was driven by persistency risk. This was partially offset by a fall in market risk, largely due to the change in investment strategy of the pension scheme assets.

The Company uses EIOPA's Solvency II Standard Formula. It does not use undertaking specific parameters.

The MCR represents the absolute minimum level of capital that the Company must hold to avoid regulatory action. The MCR as at 31 December 2019 is £19.3m which is the minimum calculated from the formula specified in the Solvency II regulation. The table below shows the results of the MCR calculation:

£'000	31 Dec 2019	31 Dec 2018	Difference
Linear MCR	20,349	18,859	1,411
SCR	42,780	42,193	587
MCR cap	19,251	18,987	264
MCR floor	10,695	10,548	147
Combined MCR	19,251	18,859	392
Absolute floor of the MCR	3,288	3,288	-
Minimum Capital Requirement	**19,251**	**18,859**	**392**

In the Company's case the MCR is equal to the MCR cap, as the linear MCR exceeds the MCR cap (45% of the SCR).

The MCR at 31 December 2018 was equal to the Linear MCR. The calculation of the linear MCR is based on the best estimate liabilities (BEL) after recoverables:

- 0.7% of the BEL after recoveries for index linked and unit linked obligations (see the table at the beginning of D.2)
- Plus 2.1% of the BEL after recoveries for other life (excluding health and index linked and unit linked) (see section D.2)
- Plus 0.07% of the total capital at risk.

Details of the calculation of the MCR are shown on S.28.01 QRT included in the appendix to this document.

The SCR is subject to supervisory review which could result in a capital add-on. There is currently no capital add-on for the Company.

E.3 Use of the duration-based Equity Risk Sub-Module in the calculation of the Solvency Capital Requirement

The Company does not apply the duration-based equity sub-module.

E.4 Differences between the standard formula and any internal model used

The Company uses the Standard formula and does not use an internal model to calculate the Solvency Capital Requirement.

E.5 Non-Compliance with the Minimum Capital Requirement and Non-Compliance with the Solvency Capital Requirement

There was no breach of the SCR (and therefore the MCR) over the reporting period.

E.6 Any other information

There is no further information to be disclosed in respect of capital management.

There have been no material changes to capital management over the reporting period.

F. ADDITIONAL INFORMATION ON THE COVID-19 PANDEMIC

On 11 March 2020, the World Health Organization declared the outbreak of a strain of a novel coronavirus, COVID-19, a global pandemic. COVID-19 has caused significant disruption across the globe, with governments in affected areas imposing a number of measures designed to contain the outbreak, including business closures, travel restrictions, stay at home orders and cancellations of gatherings and events. This has resulted in an economic downturn in the UK and the global economy more widely, as well as causing increased volatility in financial markets. If the pandemic is prolonged the adverse impact on the global economy could be deepened and result in further declines in financial markets.

The following summarises the impact of COVID-19 on the information contained within sections A to E of the SFCR where this is considered relevant.

Business and performance

Information presented in Section A of this report represents the performance of the business as reported in the Company's financial statements for the 12-month period to 31 December 2019. As the situation is rapidly evolving it is not practicable to quantify the potential financial impact of the outbreak on the Company at this stage. Figures presented in the SFCR and the associated Quantitative Reporting Templates (QRTs) have been prepared based on conditions and best estimate assumptions at 31 December 2019 and have therefore not been adjusted for any impacts of COVID-19.

System of governance

The Company's risk management and internal control system is responding well to the challenges of the COVID-19 outbreak and remains intact. Government travel restrictions and social distancing measures have required changes to some of our operational processes to ensure continued uninterrupted service to customers, while minimising the impact on the quality of service provided. This involves most of the staff working from home. The changes to operational processes that have been implemented have been designed to ensure customer service, data protection and staff well-being risks are at a level acceptable to Management.

Risk profile

The COVID-19 pandemic has the potential to have significant impacts on each of the main risk categories covered above (Underwriting, Market, Credit, Liquidity and Operational). Taking each of these in turn:

- **Underwriting risk**
  The principal life underwriting risks impacted by the COVID-19 pandemic are mortality and morbidity risks. Going forward, there is also uncertainty over the impact the pandemic will have on future policyholder behaviour (e.g. persistency). The claim frequency impacts from COVID-19 are being actively monitored by the Actuarial function across all lines of business.

- **Market risk**
  Market risk will be impacted by the widening of corporate bond spreads and the reduction in equity market valuations. SLP's solvency position is being monitored on a regular basis, using the latest market valuation data and taking into account the impacts on the pension scheme.

- **Credit risk**
  Credit risk could be impacted by increased frequencies of downgrades and defaults.

- **Liquidity risk**
  The Company's liquidity position could be affected by reduced liquidity in its investments, and also through the inability of customers to keep up with premium payments.

- **Operational risk**
  COVID-19 is resulting in an increased level of operational risk through enforced remote working, staff absences for sickness and childcare, and through market volatility. The Company is adjusting processes and controls to ensure operational risks remain at an acceptable level.

Valuation for solvency purposes

The COVID-19 pandemic has resulted in declines in global financial markets with a corresponding impact on the valuation of certain financial assets held at fair value within the Company's balance sheet. Technical provisions have been prepared based on conditions and best estimate assumptions at 31 December 2019 and have therefore not been adjusted for any impacts of COVID-19. Life insurance technical provisions will be impacted through life protection products as a result of increased mortality, and through income protection and critical illness products as a result of increased morbidity. These impacts may be offset by a potential reduction in future annuity payments. We review the best-estimate assumptions used in the calculation of technical provisions on an ongoing basis and will update them accordingly for the expected impacts of COVID-19. However, given the rapidly evolving nature of the situation, it is not practicable at this stage to quantify the potential valuation impact of the pandemic and related financial market impacts on the financial assets and technical provisions of the Company.

Capital management

The capital of the Company is monitored on an ongoing basis and the Company and expects to continue to meet its Solvency Capital Requirements. However, the negative impact of the COVID-19 pandemic on the economy and the associated volatility in financial markets will most likely have an adverse impact on the Company's own funds and solvency ratio. The Company's balance sheet exposure and solvency position is being reviewed on an ongoing basis and actions are being taken to protect the solvency position and further reduce the sensitivity to economic shocks and mitigate insurance risk.