Equitable Life Assurance Society

Solvency and Financial Condition Report (SFCR)

31 December 2018

Index

Glossary

Abbreviation or Technical Term	Long Form / Explanation
ALCo	Asset and Liability Committee
AMC(s)	Annual Management Charge(s)
APS X2	Review of Actuarial Work
ARC	Audit and Risk Committee
ASI	Aberdeen Standard Investments Limited
BACS	Bankers Automated Clearing Services run by Payments Schemes Limited
BAU	Business As Usual
CEF	Claims Enhancement Factor
CEO	Chief Executive Officer
CIUs	Collective Investment Undertakings
CMI	Continuous Mortality Investigation
COLL	Collective Investment Schemes Sourcebook
CRA	Credit Risk Adjustment
DDM	Dynamic Distribution Model
DFA	Dynamic Financial Analysis
EA	Excess Assets
EC	Economic Capital
ECAI	External Credit Assessment Institutions
ECD	Earliest Contractual Date
EIOPA	European Insurance and Occupational Pension Authority
ESG	Economic Scenario Generator
EU	European Union
EUC	End User Computing
ExCo	Executive Committee

FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FRS102	Financial Reporting Standard – applicable in the UK and Republic of Ireland
Gilts	Gilt-edged securities are bonds issued by the British Government
GIR(s)	Guaranteed Investment Return(s)
KPI(s)	Key Performance Indicator(s)
KRD	Key Rate Duration
KRI(s)	Key Risk Indicator(s)
LBG	Lloyds Banking Group
LPI	Limited Price Indexation (relates to annuity products)
MCR	Minimum Capital Requirement
MI	Management Information
MLRO	Money Laundering Reporting Officer
NED	Non-Executive Director
OEIC	Open Ended Investment Company
ORSA	Own Risk and Solvency Assessment
Pa	per annum
PRA	Prudential Regulatory Authority
RCSA	Risk and Control Self-Assessment
RIDCo	Regulatory and Industry Developments Committee
RM	Risk Margin
RSP	Recurrent Single Premium
SCR	Solvency Capital Requirement
Solvency II	European Union law that codifies and harmonises the EU insurance regulation. Primarily it concerns the amount of capital that EU insurance companies must hold to reduce the risk of insolvency. Came into effect from 1 January 2016.
TMTP	Transitional Measure on Technical Provisions

TRS	Total Return Swap
UKCGC	United Kingdom Corporate Governance Code C.1: Accountability - Financial And Business Reporting C.2: Accountability - Risk Management and Internal Control C.3: Accountability - Audit Committee and Auditors

Directors' Certificate

EQUITABLE LIFE ASSURANCE SOCIETY

Approval by the Board of Directors of the Solvency and Finance Condition Report for the period ending 31 December 2018

We certify that:

1. The Solvency and Financial Condition Report (SFCR) has been properly prepared in all material respects in accordance with the PRA rules and Solvency II Regulations; and

2. We are satisfied that:

    - Throughout the financial year in question, the Society has complied in all material respects with the requirements of the PRA rules and Solvency II Regulations as applicable; and

    - It is reasonable to believe that, at the date of the publication of the SFCR, the Society has continued so to comply, and will continue so to comply in future.

On behalf of the Board of the Equitable Life Assurance Society

Martin Sinkinson
Chief Actuary

Solvency and financial condition report: Structure and contents

Structure

1. The solvency and financial condition report shall follow the structure set out in Annex XX and disclose the information referred to in Articles 292 to 298 of this Regulation.
2. The report shall contain narrative information in quantitative and qualitative form supplemented, where appropriate, with quantitative templates.

Materiality

For the purposes of this Chapter, the information to be disclosed in the solvency and financial condition report shall be considered as material if its omission or misstatement could influence the decision-making or the judgement of the users of that document, including the supervisory authorities.

Summary

1. The solvency and financial condition report shall include a clear and concise summary. The summary of the report shall be understandable to policyholders and beneficiaries.
2. The summary of the report shall highlight any material changes to the insurance or reinsurance undertaking's business and performance, system of governance, risk profile, valuation for solvency purposes and capital management over the reporting period.

Summary

The Equitable Life Assurance Society is a mutual company owned by its Members. The Society no longer writes new business. We manage some £6bn of assets on behalf of approximately 126,000 individual with-profits policyholders; 126,000 with-profits policyholders in company pension schemes; and 108,000 unit-linked policyholders.

The Society’s business model is a simple one: to exclusively serve the best interests of our existing policyholders.

The Society’s aim is to recreate policyholder value by distributing all of the assets among with-profits policyholders as fairly and as soon as possible.

The new strategy

While it would be possible for the Society to continue in a viable run-off, the Board has concluded, following a feasibility study, that a new strategy would most likely deliver a better outcome for policyholders.

We considered a range of alternative strategies, and in June 2018 announced our proposal to distribute all of the available capital to with-profits policyholders.

The new strategy consists of four pillars. First, allocating all available assets in the with-profits fund fully to with-profits policyholders. Second, with-profits policies would be converted to unit-linked policies with a choice of investment funds. Third, in order to achieve this, investment guarantees and any guaranteed annual increases would be removed. Finally, all of the Society’s policies would be transferred to Utmost Life and Pensions (formerly Reliance Life).

Brexit

As a result of the outcome of the Brexit referendum, we have set up a subsidiary company in Ireland, Equitable Life Ireland DAC. Should it be necessary, this company will enable us to provide continuity of service to our Irish and German policies during this period of change.

Business and Performance in 2018

Capital Distribution

The Board is clear that, when policyholders leave, they should leave with a fair share of capital.

Whilst in run-off, the Society aims to ensure proper balance between those policyholders who leave now and those who would remain into the future. So long as there is sufficient capital to support the latter, earlier leavers should not be denied a fair capital distribution for the sake of higher investment returns to those policyholders who remain.

Every year, the Board assesses the risks and decides whether an adjustment in capital distribution is warranted. To help inform the Board, extensive reviews of the capital required under a wide range of possible future economic conditions are undertaken.

However, over recent years, we have seen policyholders choosing to retire later and so remain with the Society past the retirement date we had been assuming. In a low interest rate environment, this increases the capital strain of the guarantees.

The potential for this trend to continue represents the most significant risk faced by the Society in run-off and is a profound impediment to returning capital to with-profits policyholders “as fairly and as soon as possible”. As a result, taking all matters into consideration, the Board has decided that it is prudent and fair to maintain the current capital distribution of 35%.

Investment Strategy

To help maintain solvency in run-off, the Society’s investment strategy is largely determined by our policy of matching policy payments to cash flows from assets. This means that, as interest rates rise or fall, the Society’s ability to pay policy benefits is much less affected.

In order to assess when policy payments will occur, judgement is required regarding future policyholder behaviour. This strategy necessarily leads to a relatively conservative investment approach. The Society’s portfolio during the year has consisted primarily of British government securities (gilts), corporate bonds, and cash.

The Board has also been mindful of the benefit of being able to secure the current high values of our assets, as an uplift to capital distribution should the new strategy be implemented. In order to achieve this, the Board has entered into derivative transactions to help protect the asset values and hence the size of the uplift available under the new strategy, should interest rates change and in the event that gilt yields move differently to swap yields. Although the value of the uplift will not be certain until the proposal is implemented, the derivative transactions provide the Board with a high degree of certainty that the amount available to be distributed will not change materially.

Should the proposal be approved, the with-profits assets will need to be converted to cash to provide the uplift to policy values. As a first step towards this, the Board decided to sell the vast majority of the corporate bonds converting them into gilts of the same duration. This maintains the underlying matching position should the proposal not be agreed and we need to continue in run-off. If we were to continue in run-off, the investment strategy would likely include the repurchase of corporate bonds.

Investment return

The investment return needs to be seen in context of our conservative investment approach, as described above.

The return on investments in 2018 was 0.5%. As a result of our matching policy and continuing low interest rates, the Society's assets have risen by an equivalent amount to the increase in liabilities that arise from policy guarantees. Our matching policy requires us to hold the assets until maturity, to provide the necessary funds when policyholders decide to take their benefits. Consequently, the part of the return arising from the change in asset values caused by movements in interest rates cannot be passed on to policyholders. Therefore, it has been added back (0.7%) in order to arrive at the fund performance, which, in 2018, was 1.2% before charges of 1.5%.

In considering an appropriate increase to policy values, we are informed more by the underlying long-term sustainable rate of return, secured when contributions were originally invested, than by the in-year performance. The Board has decided therefore that, for 2018, policy values will increase at 2% pa for UK with-profits pension policies (1.6% pa for life assurance policies where tax is deducted).

Providing the best value-for-money cost base

We consider value for money to be where administrative expenses reduce in line with the run-off of policies as policyholders take their benefits. During 2018, the reduction in policies was approximately 20,000; a 6% fall from 2017. Administrative expenses also fell by c6% from £22m to £21m.

Project costs have increased in 2018, reflecting the significant activity associated with delivering the strategy. If the Scheme is approved by with-profits policyholders and the Court, the benefit will be reaped through being able to fully distribute the assets of the with-profits fund to with-profits policyholders.

We have also incurred significant costs to ensure that we were fully prepared and able to continue servicing all our policyholders in the event of any potential Brexit scenario.

Total costs in 2018 were £49m, up from £37m in 2017.

Key performance indicators

Key performance indicators are used by the Board to show the extent to which the strategies designed to recreate policyholder value are achieving the desired outcome. The most important indicators are shown in the table below.

% of policy value	2015-19	2014	2011-13
Capital distribution	35	25	12.5
Policy value increase	2	2	2
Financial Adjustment	0	0	5

System of Governance

There have been no material changes to the Society's System of Governance in 2018.

The Board had two executive Directors throughout 2018. Up to 24 July 2018, these were Chris Wiscarson, Chief Executive, and Simon Small, Deputy Chief Executive and Finance Director. From 25 July 2018, Simon Small continued as an executive Director in his new role as Chief Executive, and Martin Sinkinson, Chief Actuary, was appointed to the Board. There are six non-executive Directors on the Board.

Risk Profile

The Society operates a comprehensive Risk Management Framework through which it identifies, monitors and reports on the principal risks to its strategic objectives. They are managed within a risk appetite set by the Board, who ensure that adequate capital is then held against these risks.

The main risks relevant to the new strategy are as follows:

- Financial conditions deteriorate to a point which reduces the size of the uplift and makes the proposal unattractive
- Policyholders do not vote in favour of the proposal
- The Regulators or the Court objects.

Continuing in run-off has longer-term risks. Policyholders deferring taking their benefits in a low interest rate environment is a particularly onerous combination.

Our assets are invested so that we can pay policyholder guarantees based on when we estimate that policyholders will retire. When policyholders stay longer than expected, we have to reinvest the assets at a time when we cannot rely on being able to achieve a 3.5% return. As a result, in run-off, we will have to hold back capital to provide for this risk.

The other main risks in run-off are:

- Insurance risk
- Liquidity risk
- Credit risk
- Market risk

- Operational risk
- Regulatory risk

There were no material changes to these risks in 2018, apart from the deduction in credit risk due to the disposal of corporate bonds. Further details of this and other risks in run off are covered in section C.

Capital requirements and solvency coverage

The Society's Solvency II valuation has been undertaken to value Own Funds. This reflects:

- The Society's Board's decision in September 2018 to approve the removal of the Volatility Adjustment, following the sale of the Society's corporate bond holdings; and
- The recalculation of Transitional Measure on Technical Provisions (TMTP), which were £65m at 31 December 2018 (2017: £100m).

The valuation of Own Funds and capital requirements for the Society, are summarised in the table below:

£m	Position including TMTP	Position excluding TMTP	Position including TMTP & VA	Position excluding TMTP & VA
	2018	2018	2017	2017
Assets	6,155	6,155	6,613	6,613
Technical Provisions	5,497	5,562	5,851	5,991
Own Funds	658	592	762	622
Solvency Capital Requirement (SCR)	413	413	455	476
SCR coverage %	159%	143%	167%	131%
Minimum Capital Requirement (MCR)	124	124	129	131

The Society complied with all Solvency II capital requirements throughout the current and prior year.

A. Business and Performance

A.1 Business

1. The solvency and financial condition report shall include all of the following information regarding the business of the insurance or reinsurance undertaking:

(a) the name and legal form of the undertaking;

(b) the name and contact details of the supervisory authority responsible for financial supervision of the undertaking and, where applicable, the name and contact details of the group supervisor of the group to which the undertaking belongs;

(c) the name and contact details of the external auditor of the undertaking;

(d) a description of the holders of qualifying holdings in the undertaking;

(e) where the undertaking belongs to a group, details of the undertaking's position within the legal structure of the group;

(f) the undertaking's material lines of business and material geographical areas where it carries out business;

(g) any significant business or other events that have occurred over the reporting period that have had a material impact on the undertaking.

Guideline 1 - Business

1.13. Under section "A.1 Business" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should describe at least the following information regarding their business:

a) The name and location of the legal or the natural persons that are direct and indirect holders of qualifying holdings in the undertaking (including the immediate and ultimate parent entity or natural person), the proportion of ownership interest held and, if different, the proportion of voting rights held;

b) A list of material related undertakings including the name, legal form, country, proportion of ownership interest held and, if different, proportion of voting rights held;

c) A simplified group structure.

A.1 Business

(a)

The Equitable Life Assurance Society is a mutual society registered in England No. 37038. Registered office and administrative Office: Walton Street, Aylesbury, Buckinghamshire, HP21 7QW.

(b)

The Society is authorised and regulated by the Prudential Regulation Authority (PRA) as a Category 3 firm and regulated for conduct by the Financial Conduct Authority (FCA) as a "flexible portfolio" firm. The Society complies with all relevant requirements of PRA and FCA as set out in their respective Rulebook and Handbook.

The Society’s PRA contact is:

Senior Supervisor
Prudential Regulation Authority
Bank of England
20 Moorgate
London
EC2R 6DA
Phone - 020 3461 3414

The Society’s FCA contact is

Pensions & Retirement Income Department
Supervision – Investment, Wholesale and Specialists Division
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN
Phone - 020 7066 6758

(c)
Auditors: PricewaterhouseCoopers LLP, 7 More London Riverside, London, SE1 2RT

(d)
The Society is a mutual organisation owned by its Members, with only one tier of capital, namely policyholders’ funds. No other sources of additional capital are currently available.

(e)
The Society has two nil value subsidiary companies:

Lydiard Fields Management Company (LFMC) holds the Society’s residual freehold interest in common areas of an office and industrial development in Swindon. LFMC is held at nil value.

A new subsidiary, Equitable Life Ireland DAC, has been created in preparation for Brexit, and is held at nil value.

(f)
The principal activity of the Society during 2018 remained the transaction of life assurance and pension business in the form of guaranteed, participating and unit-linked contracts, predominantly in the UK. The Society closed to new business on 8 December 2000.

Operations are focused on the administration of c185,000 individual policies and c145,000 Members of company pension schemes, comprising c£6bn of policyholder liabilities. During 2017, the number of policies reduced by c25, 000. Following the announcement of the Society’s new strategy, the level of policy run-off has reduced as policyholders chose to defer taking benefits in anticipation of with-profits policy values being uplifted following completion of the strategy. The vast majority of Members are expected to take their benefits over the next 20 years.

(g) The Equitable Life has entered into an agreement to transfer the Society and all its policies to Utmost Life and Pensions (previously Reliance Life), part of the Utmost group of companies. The Society expects to be able to increase the current 35% capital distribution on with-profits policies to between 60% and 70%, the extent of such increase made possible by the transfer to Utmost Life and Pensions. For with-profits fund values to be enhanced eligible policyholders will be asked to vote in favour of removing investment guarantees as well as on the arrangements to transfer to Utmost Life and Pensions.

Voting is expected to take place and, with the approval of the High Court, the enhancement to with-profits policy values taking place around the end of 2019.

A.2 Underwriting Performance
The solvency and financial condition report shall include qualitative and quantitative information on the insurance or reinsurance undertaking's underwriting performance, at an aggregate level and by material line of business and material geographical areas where it carries out business over the reporting period, together with a comparison of the information with that reported on the previous reporting period, as shown in the undertaking's financial statements.

A.2 Underwriting Performance

The Society closed to new business in December 2000. Therefore underwriting performance is no longer considered of material relevance to the Society.

Movement in Excess Assets

The principal movements in the Excess Assets during the year, as per the Society's financial statements are shown in the following table.

	2018 £m	**2017 £m**	**2018 Key movements**
Opening Excess Assets	901	1,005	
Investment performance net of changes in policy values	(32)	(22)	Loss of Swaptions reflects increase in swap rates, reduction in interest rate volatility and erosion of time value
Variance in expenses experience and assumptions	(26)	(31)	Reflects further work on strategic plans and future running cost of new Irish subsidiary
Changes in valuation experience and assumptions	(1)	2	
Capital distribution within claims payments	(25)	(61)	
Other movements	(3)	8	
Closing Excess Assets	**814**	**901**	

The values of premium and claims, as per the Society's financial statements are shown in the following table.

	2018 £m	2017 £m
Earned premiums, net of reinsurance		
Gross premiums written	11	11
Other outward reinsurance premiums	(6)	(7)
	5	**4**
Claims incurred, net of reinsurance		
Claims paid – gross amount	200	364
Reinsurers' share	(22)	(21)
	178	**343**

A.3	Investment Performance
	The solvency and financial condition report shall include all of the following qualitative and quantitative information regarding the performance of the investments of the insurance or reinsurance undertaking over the reporting period together with a comparison of the information with that reported on the previous reporting period, as shown in that undertaking's financial statements:
(a)	information on income and expenses arising from investments by asset class and, where necessary for a proper understanding of the income and expenses, the components of such income and expenses;
(b)	information about any gains and losses recognised directly in equity;
(c)	information about any investments in securitisation.

A.3 Investment Performance

a)
The table below shows Investment performance during the year ended 31 December 2018

INVESTMENT PERFORMANCE

	At 31 December 2018 £m				
	Realised gains /(losses)	Unrealised gains / (losses)	Investment income	Investment expenses	**Total return**
Fixed income securities					
Government bonds	0.4	(37.7)	70.7		**33.4**
Index linked	3.4	0.3	3.9		**7.6**
Other fixed interest	(13.6)	(12.3)	25.6		**(0.3)**
	(9.8)	**(49.7)**	**100.2**		**40.7**
Other Investments					
Property & Equity	(3.2)	4.0	-		**0.8**
Derivatives	(11.5)	3.2	(15.8)		**(24.1)**
	(14.7)	**7.2**	**(15.8)**		**(23.3)**
Unit linked funds					
Property & Equity	7.2	(9.3)	2.2		**0.1**
Collective Invt Undertakings	21.7	(172.9)	41.0		**(110.2)**
Derivatives	(1.3)	0.2	-		**(1.1)**
	27.6	**(182.0)**	**43.2**		**(111.2)**
Interest	-	-	5.2		**5.2**
Other	-	0.4	(0.8)	(4.3)	**(4.7)**
TOTAL ASSETS	**3.1**	**(224.1)**	**132.0**	**(4.3)**	**(93.3)**

	At 31 December 2017 £m				
	Realised gains /(losses)	Unrealised gains / (losses)	Investment income	Investment expenses	**Total return**
Fixed income securities					
Government bonds	43.1	(53.4)	68.1		**57.8**
Index linked	24.4	(18.3)	3.8		**9.9**
Other fixed interest	(5.5)	(15.7)	40.9		**19.7**
	62.0	**(87.4)**	**112.8**		**87.4**
Other Investments					
Property & Equity	(11.9)	11.7	-		**(0.2)**
Derivatives	(7.0)	(38.7)	-		**(45.7)**
	(18.9)	**(27.0)**	**-**		**(45.9)**
Unit linked funds					
Property & Equity	4.6	6.5	0.9		**12.0**
Collective Invt Undertakings	31.0	137.5	39.1		**207.6**
Derivatives	3.2	(1.0)	-		**2.2**
	38.8	**143.0**	**40.0**		**221.8**
Interest	0.3	(0.4)	1.9		**1.8**
Other	1.8	(2.1)	(0.2)	(4.8)	**(5.3)**
TOTAL ASSETS	**84.0**	**26.1**	**154.5**	**(4.8)**	**259.8**

Investment returns were lower in 2018 than in 2017. Investment income reduced, reflecting the disinvestment from relatively higher yielding corporate bonds in the year. Unrealised losses in 2018 reflect: the fall in value of UK equity-based collective investment undertakings (CIU) that form the majority of linked assets; a fall in the value of the payer and receiver swaptions held throughout the year, as a result of increases in swap rates and reductions in interest rate volatility; and a small increase in gilt yields reducing the value of non-linked gilt holdings.

(b) The Society does not recognise any gains or losses directly in equity

(c) The Society does not hold investments in securitisation (for example, asset backed securities).

A.4 Performance of other activities
The solvency and financial condition report shall describe the other material income and expenses of the insurance or reinsurance undertaking incurred over the reporting period together with a comparison of the information with that reported on the previous reporting period, as shown in that undertaking's financial statements.
Guideline 2 – Performance of other activities
1.14. Under section A.4. "Performance of other activities" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should describe in general the leasing arrangements in relation to each material leasing arrangement, separately for financial and operating leases.

A.4 Performance of other activities

Net operating expenses

	2018 £m	2017 £m
Administration expenses	21	22
Costs of strategic initiatives	22	9
Redundancies	1	0
Total net operating expenses	**44**	**31**
Investment management expenses	4	5
Claims handling expenses	1	1
Total costs	**49**	**37**

Administration expenses have fallen in 2018 as a result of efficiency savings from fewer staff. Administration expenses include lease costs of less than £1m (2017: <£1m). Costs of strategic initiatives include those associated with the execution of the new strategy outlined within this report and preparatory costs for the UK's exit from the European Union. Investment management costs have fallen in 2018 due to policy run-off.

Other technical income

Other technical income of £5m (2017: £4m) includes rebates received from unit-linked Open Ended Investment Company (OEIC) fund managers of £3m (2017: £3m)

A.5 Any other information
The solvency and financial condition report shall include in a separate section any other material information regarding their business and performance of the insurance or reinsurance undertaking.

A.5 Any other information

At this time there is no other material information to disclose.

B. System of Governance

B.1 General Information on the system of governance

The solvency and financial condition report shall include all of the following information regarding the system of governance of the insurance or reinsurance undertaking:

(a) the structure of the undertaking's administrative, management or supervisory body, providing a description of its main roles and responsibilities and a brief description of the segregation of responsibilities within these bodies, in particular whether relevant committees exist within them, as well as a description of the main roles and responsibilities of key functions;

(b) any material changes in the system of governance that have taken place over the reporting period;

(c) information on the remuneration policy and practices regarding administrative, management or supervisory body and, unless otherwise stated, employees, including:

(i) principles of the remuneration policy, with an explanation of the relative importance of the fixed and variable components of remuneration;

(ii) information on the individual and collective performance criteria on which any entitlement to share options, shares or variable components of remuneration is based;

(iii) a description of the main characteristics of supplementary pension or early retirement schemes for the members of the administrative, management or supervisory body and other key function holders;

(d) information about material transactions during the reporting period with shareholders, with persons who exercise a significant influence on the undertaking, and with members of the administrative, management or supervisory body.

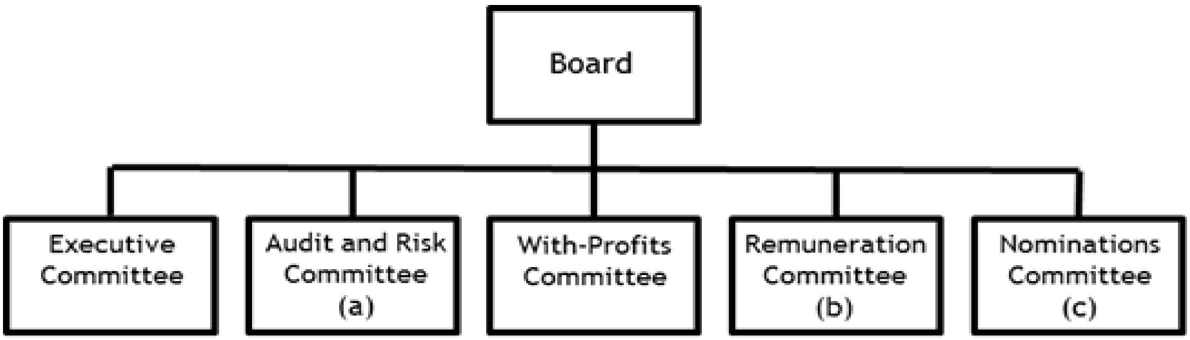
Guideline 3 - Governance Structure

1.15. Under section "B.1. General information on the system of governance" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should explain how the key functions have the necessary authority, resources and operational independence to carry out their tasks and how they report to and advise the administrative, management or supervisory body of the insurance or reinsurance undertaking (hereinafter "AMSB").

B.1 General Information on the system of governance

(a)

The Society aims to meet the highest standards in corporate governance and voluntarily adopts the relevant provisions of the 2016 UK Corporate Governance Code (UKCGC). The Board is responsible to the Society's Members for good corporate governance and applies high standards to ensure that this is achieved.



The Board of Directors

Ian Brimecome (b) (c) - Chairman
Keith Nicholson (a) (b) (c) - Deputy Chair and Senior Independent Director
Simon Small –Chief Executive Officer (CEO)
Martin Sinkinson - Chief Actuary
Penny Avis (a)
Lord Finkelstein (b)
Ian Gibson (a)
Cathryn Riley (a) (b) (c)

Key to membership of principal Board Committees

(a) Audit and Risk
(b) Remuneration
(c) Nominations

In 2018 there were ten Board meetings, nine With-Profits Committee, five Audit and Risk Committee (ARC), two Nominations Committee and five Remuneration Committee meetings held. In addition to the seven regular Board meetings, there were a further three meetings attended by Directors to consider strategic proposals and seven further meetings of the With-Profits sub-Committee.

The Board

The Board meets regularly to lead, control and monitor the overall performance of the Society. The Board's principal functions are: to determine the strategy and policies of the Society; to set out guidelines within which the business is managed; and to review business performance. The Board considers and decides on all major matters of Society corporate strategy and ensures that the strategy is consistent with its appetite for risk. There is a formal schedule of matters reserved for the Board's decision. Members of senior management supply the Board with appropriate and timely information and are available to attend meetings and answer questions. Authority is delegated to the CEO for implementing strategy and managing the Society.

The roles of Chairman and CEO are separated and the Chairman has primary responsibility for the effective functioning of the Board.

Management of the Society

The Executive team meets weekly to manage business activities. Papers are prepared and presented to the Board and its Committees by the Executive team. The Executive team comprises: the Chief Executive; the Chief Actuary; the Risk Director; the Chief Financial Officer; the Customer Service Director; and the Company Secretary.

The Chief Actuary, Martin Sinkinson advises on the Society's ability to meet obligations to policyholders. He identifies and assesses the risks that could have a material impact on meeting these objectives as well as the capital needed to support the business. He also advises the Board on the methods and assumptions to be used for the assessment of the value of the Society's liabilities, and reports on the results. The Society is also required to appoint a With-Profits Actuary, who advises the Board on key aspects of the discretion to be exercised affecting with-profits business, including the fair treatment of and communication with with-profits policyholders, and advice on bonus rates.

The Board has responsibility for investment strategy, investment policy and appointing investment managers. These responsibilities are discharged through the Society's Asset and Liability Committee (ALCo), which is chaired by the Chief Actuary. The Committee takes advice from the Chief Investment Officer, and regularly liaises with the investment advisers to oversee day-to-day investment matters.

The Chief Financial Officer is responsible for: the Society's Finance and IT Change functions, and for overseeing delivery of the Society's strategy by ensuring that appropriate infrastructure and resources are in place while complying with regulatory and legislative requirements.

Monthly management information (MI) in respect of financial performance, fair treatment of policyholders, complaints handling, risk management, compliance and investment performance is prepared and reviewed by senior management, the Executive team and the Board.

Each year, the Society prepares a business plan and budget to assist in the monitoring of results, assets, liabilities and investment performance. Actual performance against these plans is actively monitored and, where appropriate, corrective action is agreed and implemented.

The Customer Service Director is responsible for ensuring that we meet the day-to-day needs of the policyholders.

The Risk Director is responsible for: providing the framework of risk policies; processes and approaches to be followed by staff; support and challenge to line management in regard to the management of risks; and reporting to the ARC and the Board on the key risks facing the Society and how those risks are controlled and managed.

The Company Secretary is responsible for the proper functioning of Board, Board Committees and Executive Committees; overseeing the Society's governance arrangements; advising the Board on corporate governance matters.

Board Committees

The Board formally delegates certain specific responsibilities to the four Board Committees.

Audit and Risk Committee (ARC)

The objectives of the Committee are to assist the Board in ensuring that:

With regard to audit matters:

- The accounting systems provide accurate and up to date information on the financial position of the Society, and that the published Annual Report and Accounts represents a true and fair reflection of this position and that regulatory information is on a properly prepared basis.
- Appropriate accounting policies and systems of internal control are in place for the Society, taking account of those internal controls and other activities carried out by third parties in relation to their provision of services to the Society.
- The Society meets, in all material respects, the provisions relating to Principles C1, C2 and C3 of The UK Corporate Governance Code appended to the Listing Rules of the Financial Conduct Authority and the Guidance on Audit Committees, except

where the Board does not consider that the guidance is appropriate or relevant to the Society.

- The Society complies with the Financial Services and Markets Act 2000 and Money Laundering Regulations.

With regard to risk matters:

- The risk appetite is appropriate for the Society's needs.
- Key risks are identified and managed.

NOMINATIONS COMMITTEE

The objectives of the Committee are:

- To assist the Board in ensuring that the Board has a mix of Directors with the necessary skills, experience and independence to govern the Society effectively;
- To assist the Board in ensuring that suitable candidates are identified to fill vacancies or to add to the strength of the Society's Board;
- To review, on an ongoing basis, the appropriateness and suitability of each Director for continuing membership of the Board taking into account regulatory requirements and good corporate governance practices; and
- To assist the Board to meet, wherever possible, the standards set out in the UK Corporate Governance Code published by the Financial Reporting Council (FRC), in relation to membership of the Board.

REMUNERATION COMMITTEE

The objectives of the Committee are to assist the Board in ensuring that:

- The overall terms and conditions of employment of all Directors (including Executive Directors) are satisfactory; and
- Remuneration policy and practice for the Society complies with the remuneration requirements of Articles 275 of the Solvency II regulations and with the European Insurance and Occupational Pensions Authority (EIOPA) 'Guidance on system of governance' finalised on 14 September 2015, and wherever possible, meets the standards set out in the UK Corporate Governance Code published by the FRC.

WITH PROFITS COMMITTEE

The Committee considers matters affecting with-profits policyholders such that the interests of all, or, where relevant, specific groups of, policyholders are appropriately considered. Its primary objective is to ensure the fair treatment of with-profits policies, having due regard to:

- Appropriate risk and capital management
- Fair pay-outs when benefits are taken
- Appropriate investment strategies for the Society's fund
- Clear and timely policyholder communications

The Committee works closely with and obtains the opinion and advice of the With-Profits Actuary as appropriate.

B.1 (b)

On behalf of the Board, the ARC has reviewed the effectiveness of the risk management and internal control systems for the year ended 31 December 2018, both in regard to the execution of the Society's strategy and the delivery of business-as-usual activities.

The review demonstrated that the Society has in place a comprehensive set of risk management and internal control arrangements. These include the identification, assessment, measurement, monitoring, reporting and management of risks. The review also confirmed that the Society is compliant with the System of Governance requirements under Solvency II. There have been no material changes to the Society's System of Governance in 2018.

B.1 (c) (i)

The purpose of the Remuneration Policy is to ensure that staff are appropriately incentivised to meet the objectives of the business. The Remuneration Committee is responsible for reviewing and making recommendations to the Board in respect of the Remuneration Policy and, within policy, overseeing all the elements of remuneration payable to the Executive Directors. The Committee also reviews and, if thought fit, approves recommendations from the Chief Executive regarding remuneration of the Executive Committee (ExCo) and Solvency II Identified Staff.

The ExCo is responsible, within policy, for reviewing and approving the approach to remuneration of all other staff.

As well as salary, pension and other benefits, staff have the opportunity to receive a discretionary annual bonus.

Bonus payments depend on the Society achieving target performance against the Society's scorecard. Individual performance at an exceeded level against personal objectives leads to a higher level of bonus payment, while a 'not met' rating results in no bonus being payable.

The maximum bonus payable, for exceeded performance, does not exceed 40% of any individual's total pay. Accordingly, a fully flexible policy can be operated including the payment of no bonus in a particular year, should that be an appropriate course of action.

It is a clear priority of the Committee to ensure successful final completion of the Society's plans by retaining the executive Directors and paying them appropriately.

The Remuneration Policy approved by Members at the 2016 AGM allowed for the introduction of a retention bonus arrangement. In 2017, a retention bonus arrangement was put in place, as disclosed in the Annual Report and Accounts.

To meet the Society's strategic needs, individual retention arrangements are in place for members of ExCo. The Chief Executive has a retention payment in the fixed sum of £620,000; the Chief Actuary has a retention payment in the fixed sum of £518,766.

All staff benefit from life assurance cover. The Society pays other insurance premiums on behalf of certain staff. Eligible staff are automatically enrolled into a workplace pension scheme, the Equitable Life Grouped Personal Pension Plan with Legal & General.

Non-executive Directors (NEDs) receive only fees and are not eligible to receive benefits, pension or any annual or long-term incentives.

B.1 (c) (ii)

Bonus payments depend on the Society achieving target performance against the Society's scorecard. The Society's scorecard and the scorecards of the Executive Directors are approved by the Remuneration Committee.

The Society's 2019 balanced scorecard is as follows:

Objective	Measure	Performance required
Policyholders	Payments to policyholder Vote regarding Scheme of Arrangement and EGM	Policyholders recognise value in strategy Vote in favour
Financial	Solvency ratios Expense levels	Ratios to be within agreed limits Not to exceed budget
Risk	Manage risk within agreed appetite and strong control environment maintained	Detailed operational risk indicators in place, monitored and action taken
Strategy	Key indicators delivered	Base uplift satisfies set criteria Scheme and Part VII executed to plan Operationally ready for transition on Day 1
People	Staff survey	Staff say that they are properly communicated with

Objectives set down in the scorecards are cascaded through the Society to ensure that employee objectives are consistent with the Society's strategy, support delivery of the required performance and effective risk management.

B.1 (c) (iii)

As previously mentioned NEDs receive only fees and are not eligible to receive benefits, pension or any annual or long-term incentives.

The Society does not provide an occupational pension scheme for Directors. A cash allowance is provided in lieu.

Eligible staff are automatically enrolled into a workplace pension scheme, the Equitable Life Grouped Personal Pension Plan with Legal & General. Under the contribution structure until 31 March 2019, the Society makes a minimum contribution of 6% of basic salary, notwithstanding whether the individual makes a contribution into the Plan. From 1 April 2019, the Society's minimum contribution increases to 7.5% and individuals are required to contribute a minimum of 1.5%. The Society further matches contributions by individuals up to a maximum of 10% of basic salary.

B.1(d)

There were no material related party transactions during 2018. (2017: £nil)

B.2	**Fit and proper requirements**
The solvency and financial condition report shall include all of the following information regarding the 'fit and proper' policy of the insurance or reinsurance undertaking:	
(a)	a description of the undertaking's specific requirements concerning skills, knowledge and expertise applicable to the persons who effectively run the undertaking or have other key functions;
(b)	a description of the undertaking's process for assessing the fitness and the propriety of the persons who effectively run the undertaking or have other key functions.

B.2 Fit and proper requirements

B.2 (a)

The Society recognises that the operation of an effective system of governance is fundamental to its success. That system is in turn dependent on the fitness and propriety of its Senior Management Function Holders, Notified Non-Executive Directors and Certification Function Holders. An appropriate Fit and Proper Policy is therefore imperative for ensuring that the Society has the right people in place to enable the sound and prudent management of the business.

The Society seeks to recruit and appoint Senior Management Function Holders, Notified Non-Executive Directors and Certification Function Holders who meet and continue to meet requirements in relation to the following:

- Appropriate personal characteristics (including being of good repute and integrity)
- Training
- Creditworthiness
- Experience, knowledge and skills
- Qualifications
- Conduct standards
- Criminal records (barring driving convictions)
- Past business conduct.

B.2 (b)

The Policy specifically requires that;

- Board be satisfied that the fitness and propriety of any Senior Management Function Holder or Notified Non-Executive Director has been established before they are appointed into role.
- ExCo be satisfied that the fitness and propriety of any Certification Function Holder has been established before they are appointed into the role.

Compliance and HR procedures set out requirements for the recruitment and ongoing assessment of Senior Manager Function Holders and Certification Function Holders. These procedures cover the checks that must be undertaken, references to be obtained, arrangements for ongoing performance management, and requirements for annual review of fitness and propriety.

There are a range of checks that should normally be performed for individuals seeking approval. The regulators' guidance is that firms must perform an appropriate level of due diligence for a candidate they wish to appoint, which must be carried out before submitting an application. The types of checks will be determined in part by the nature of the role to be undertaken.

Checks will normally include:

- References from current/previous employers covering the last 6 years: these must be regulatory references where appropriate
- Verification of qualifications
- Appropriate personal characteristics (including being of good repute and integrity)
- Creditworthiness
- Criminal records (barring driving convictions)
- Experience, knowledge and skills
- Past business conduct

The Financial Conduct Authority (FCA) and PRA require that where an individual is or was employed by a regulated firm, that the employer must provide a regulatory reference and 'all relevant information'. The firm may not always provide a regulatory reference where the individual did not perform a regulated role while employed by the firm. In this instance, referral should be made to the Head of Compliance. Regulatory references are also required from organisations where the individual is, or was during the last six years, a Non-Executive Director.

A competency assessment will normally be performed by:

- The CEO for Senior Management Function Holders (except NEDs);
- The Chairman for NEDs; or
- Hiring manager in other cases such as the Money Laundering Reporting Officer (MLRO)

The Risk Director will decide who performs the competency assessment for Certification Function Holders. The assessment needs to be sufficiently detailed to evidence the relevant competencies and development areas for the individual. A skills analysis is completed and a development plan must be produced to address any gaps, including timeframe for completion of the plan. The plan should include sufficient detail to demonstrate how the gaps will be addressed and who will undertake the training.

The annual Fitness and Priority assessments for Non-Executive and Executive Directors is embedded into the annual Board evaluation of performance and annual reviews of Directors' performance. The Chairman's performance review is led by the Society's Senior Independent Director. Formal review is recorded at the Society's Nominations Committee.

For all other staff captured by the new requirements, the annual fitness and propriety assessments are embedded within the Society's performance management process and staff complete an annual declaration and self-assessment form. The Risk Director reviews the evidence of the annual fitness and propriety checks, seeking satisfactory explanation of (or, if necessary, investigating) any apparent irregularities. He reports to the CEO on the outcome of the assessments of fitness and propriety.

B.3.1 Risk management system

The solvency and financial condition report shall include all of the following information regarding the risk management system of the insurance or reinsurance undertaking:

(a) a description of the undertaking's risk management system comprising strategies, processes and reporting procedures, and how it is able to effectively identify, measure, monitor, manage and report, on a continuous basis, the risks on an individual and aggregated level, to which the undertaking is or could be exposed;

(b) a description of how the risk management system including the risk management function are implemented and integrated into the organisational structure and decision-making processes of the undertaking.

Guideline 4 - Risk management system for internal model users

1.16. Under section "B.3 Risk management system including the own risk and solvency assessment" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings using a partial or a full internal model to calculate the SCR, should describe at least the following information addressing the governance of the internal model:

a) The responsible roles and specific committees if any, their main tasks, position and scope of responsibilities;

b) How existing committees interact with the AMSB in order to meet the requirements of Article 116 of Solvency II Directive;

c) Any material changes to the internal model governance during the reporting period;

d) A description of the validation process (used to monitor the performance and on-going appropriateness of the internal model).

B.3 Risk management system including the own risk and solvency assessment

B.3.1 Risk management system

B.3.1 (a)

The Society's Risk Management Policy sets out the minimum standards for Equitable Life's arrangements for ensuring it has robust structures, roles and responsibilities and processes in place to identify and assess, measure, monitor, report and manage the key risks to which the Society's business is exposed. The Policy states that the Society is committed to:

- Maintaining a strong culture of risk management and controls throughout our business;
- Managing risk in a proportionate and cost effective manner, whilst ensuring compliance with applicable laws and regulations; and
- Having risk management arrangements that support the achievement of our strategic objectives.

The Risk Management Policy states that the ultimate responsibility for the oversight of the management of risk rests with the Board.

The Society follows the widely recognised 'three lines of defence' approach to governance, under which primary responsibility for day-to-day risk management and compliance rests with business areas. Oversight and challenge is provided by the Risk and Compliance function as the second line of defence, and independent assurance is provided by Internal Audit as the third line of defence.

The ARC has delegated authority from the Board for reviewing the Society's internal control and risk management systems, and for monitoring performance against the Board's risk appetite.

The Risk Director is responsible for ensuring that there is an effective and well-documented Enterprise-wide Risk Management Framework, including:

- A risk and control self-assessment process (RCSA), performed quarterly, which requires senior management to attest to the risks and associated controls in place within their area of the business;
- Risk management policies for all principal risk categories. Material changes to these policies are approved by the Board;
- The setting by the Board of risk appetite statements which are closely linked to the achievement of the Society's strategic objectives, and key risk indicators for monitoring against risk appetite;
- A robust and consistent approach across the Society for risk identification and risk assessment; and
- Detailed monitoring, review and reporting on material risks, including to the principal management and risk committees.

The Risk Management Framework is designed to meet the requirements and standards set by the PRA and the FCA, and the Solvency II requirements.

Aggregate Risks

Top Risks are those material risks, or aggregation of a number of related material risks:

- Which would have the greatest impact on the delivery of the Society's strategy, irrespective of their likelihood, or
- Which are currently at 'front of mind'. For example due to their potential impact on the delivery of the Society's strategy or some temporary phenomena which increases their likelihood.

Any member of ExCo, ARC or Board can propose a Top Risk, as can the Risk Function. The Risk Director and ExCo must agree that a particular risk be treated as a Top Risk, before it is put to ARC and Board for review and approval. Top Risks are reported monthly to ExCo and the Board, and reviewed quarterly by ARC.

Given the potential for Top Risks to have an adverse impact on the delivery of our strategy, ExCo, ARC and the Board focus attention on ensuring that these risks have been identified and are being properly assessed and managed.

While individual risks are important, the Board also considers certain combinations of risks. For example in run-off, falling interest rates combined with policyholders deferring benefits is a particularly onerous combination.

B.3.1 (b)

The Society calculates the Solvency Capital Requirement (SCR) following Standard Formula and does not use an internal model.

The Risk Director is a member of the ExCo which ensures that the Risk function is well informed about the strategy and business plans of the Society and the manner in which these are being implemented.

ExCo also has a key role in providing oversight over the adequacy of risk management arrangements in respect of all risk categories.

The risk management function itself is carried out by a team located within the Risk and Compliance Department reporting to the Risk Director.

The roles and responsibilities of the teams within Risk & Compliance are as follows:

- Develop and maintain the ERM Framework and Risk Management policies
- Develop and distribute a set of risk management tools, techniques, methodologies, analysis and reporting to support the embedding of the ERM Framework
- Ensure that risk management arrangements for the Society are, and continue to be, suitable, proportionate and effective, and that they are consistent with regulatory requirements and expectations
- Support business units in implementing risk policies, tools and mitigants including through provision of suitable communications and training to ensure that the ERM framework is embedded and effective
- Challenge risk registers and other information received from business units
- Consider the relevant category, area and potential accumulation and interactions of risks, including the indirect effect of risks that can occur
- Review regular attestations provided by Strategic third party providers and ensure that they are operating within the boundaries of the Society's Risk Management Policies and that any issues identified within the attestations are remediated in a timely manner
- Provide expert advice and guidance to Board, ARC and ExCo on risk management and regulatory compliance matters to inform strategy setting, decision making and the determination of appetite for risk
- Lead the production of the Own Risk and Solvency Assessment Report
- Facilitate risk assessment workshops on key areas of risk and provide templates, training and guidance to support Core Process Risk Assessments
- Produce timely and relevant risk reporting, including reporting on risk events, mitigating and corrective actions proposed/taken, and on emerging risks
- Review the basis for assessment of capital attributable to operational risk at least annually, for recommendation to ExCo and Board
- Monitor the Society's approach to Conduct Risk, providing advice, guidance and challenge as appropriate; including review and challenge of the Conduct Report
- Provide oversight of the design, development, testing and use of the Own Risk and Solvency Assessment (ORSA) and Solvency Capital Requirement (SCR) capital models
- Review and challenge the Solvency II, ORSA and other financial reporting assumptions and methodologies
- Create and update the scenarios to be included in the Society's sensitivity analysis and reverse stress testing, and review the results
- Consider as part of the annual review the continued appropriateness of the Standard Formula approach, having regard to the risk profile of the Society
- Review ongoing compliance with the Solvency II Directive, delegated regulations and the System of Governance Guidelines
- Responsible for day to day relationship with the PRA and FCA, including leading the Society's response to regulatory developments and initiatives, and reporting any matters of significance, including reportable breaches

Methods through which the Risk function implement their risk strategy

The Society has a documented Enterprise-wide Risk Management Framework which describes the processes that are in place to deliver effective risk management and meet the requirements set out in the Risk Management Policy. Core elements of the Framework are explained below.

Risk appetite

Risk appetite is the amount and type of risk that the Board is willing to accept in pursuit of our business objectives.

The Society's risk appetite is set annually as part of the Board strategy and business planning process and reviewed half yearly (or more frequently if required), as documented in the Corporate Planning Framework. More detailed granular risk appetites, which flow from and are aligned with Board risk appetite are set from time to time by ExCo and ALCo. All risks must be managed in accordance with the risk appetite set by the Board and in line with Key Risk Indicators (KRI).

As per the Risk Management Policy, the Risk Director is responsible for ensuring that there is a process in place to enable the Board's risk appetite to be set and reviewed regularly. The Risk Director and Chief Actuary are jointly responsible for the recommendation of risk appetite to ExCo and then to the Board.

The risk appetite of the Society is cascaded throughout the Society via Policies and Frameworks. ExCo and ALCo maintain separate lists of risk appetites and associated Key Risk Indicators in respect of the particular risks managed by those committees. Risk appetite is critical because it acts as the ultimate constraint on our activities and so it needs to be embedded into everything we do.

Risk strategy and plans

The Society's Risk Management Strategy is to:

- Maintain a strong culture of risk management and controls throughout our business;
- Manage risk in a proportionate and cost effective manner, whilst ensuring compliance with applicable laws and regulations; and
- Have risk management arrangements that support the achievement of our strategic objectives.

The Risk function's strategy and functional operating model are reviewed annually by ExCo in the context of the annual planning cycle.

Risk Identification and Assessment

The key tool for risk identification and assessment is the Society's quarterly Risk and Control Self-Assessment process (RCSA), which is the process used by management to identify their functions' risks and controls, and assess the impact and likelihood of each of these. Through the RCSA process, functions and projects will highlight those risks that are material (those with Society level impact). Emerging risks will also be highlighted.

The Risk function provides challenge to management to ensure that both function and project risks have been identified and that effective controls are in place. Risk reporting is then provided to risk committees, ExCo, ARC and Board for discussion and challenge.

Risk Measurement

The Society employs a range of risk measures, metrics and tools to assist in assessing risk exposures and deciding on suitable mitigating actions.

Further, detailed Stress and Scenario analysis and sensitivity testing, including the analysis of a combination of events are used to inform management and the Board about the robustness of the Society's strategy to adverse foreseeable events.

Risk monitoring

The ongoing cycle of risk monitoring includes the maintaining and regular review of risk-registers, the risk event reporting process and trend analysis of Key Risk Indicators (KRIs) by management and committees.

A range of tools and processes are deployed to manage and mitigate risks. These are dependent upon the nature of the risk and the appetite of the Society for that risk. Specific actions to mitigate material risks are discussed at the relevant governance forum(s) to ensure that they provide sufficient mitigation and that they do not expose the Society to other types of risk for which there is no appetite.

Risk reviews and 'deep dives' are used to enable more intensive review of particular risks at the relevant Committee. These are used where management wants to understand a risk in more detail and/or validate the appropriateness of the impact and likelihood scores or mitigating actions.

B.3.2 Own Risk and Solvency Assessment

The solvency and financial condition report shall include all of the following information regarding the process the insurance or reinsurance undertaking has adopted to fulfil its obligation to conduct an own risk and solvency assessment:

(a) a description of the process undertaken by the undertaking to fulfil its obligation to conduct an own risk and solvency assessment as part of its risk management system including how the own risk and solvency assessment is integrated into the organisational structure and decision making processes of the undertaking;

(b) a statement detailing how often the own risk and solvency assessment is reviewed and approved by the undertaking's administrative, management or supervisory body;

(c) a statement explaining how the undertaking has determined its own solvency needs given its risk profile and how its capital management activities and its risk management system interact with each other.

B.3.2 Own Risk and Solvency Assessment (ORSA)

B.3.2 (a)

The ORSA is the Society's own assessment of the capital that it needs to hold in view of its particular risk exposures, business and strategic plans and risk appetite.

ORSA is an ongoing process throughout the year to evaluate the Society's view of risks and capital.

The ORSA Report summarises the risks faced by the Society, and how they are managed and mitigated. It explains how, having regard to these risks, capital is assessed to ensure that it is adequate for a 1 in 200 year event. The Report is intended to provide assurance to the ExCo and Board that the Society's overall risk-based capital requirements are met, both over the three year business planning horizon, and in projections over the longer-term.

ORSA Framework

The main components of the Framework are:
Ongoing processes which are part of Business as usual (BAU) risk management, including risk identification, management and governance, continuous monitoring of the Society's solvency position and data quality and governance;

Other relevant processes or activities conducted annually, or infrequently, which are not specifically completed for the ORSA, but which provide important input to the ORSA process;

Core ORSA processes, which consist of:

- Running the ORSA model to produce the ORSA capital requirements, and the Dynamic Distribution Model (DDM) to provide projections of capital and solvency needs over the business planning period;
- Collating records of all processes involved in the ORSA;
- Producing the ORSA Report, and appendices;
- Quality assurance/audit/independent review of the ORSA process.

The above components lead to an ORSA Report that is used by the Society's Board to take strategic decisions as part of the strategy-setting and business planning process. The report is also a source of information for certain key staff on the risks within the business and the approach to risk management in the context of the Society's business strategy and risk appetite.

Preparation of the ORSA Report

The ORSA Report preparation typically commences in August.

The Risk function leads the preparation of the ORSA Report, coordinating inputs from across the business and ensuring a coherent end-product. The report is presented to December Board for discussion and approval.

The Risk Director provides PRA with a copy of the Society's Business Plan and ORSA Report once approved by Board, and informs FCA that these documents have been produced.

Throughout the year, ExCo reviews the Society's risk profile, making reference to the ORSA Report to assess that the actions envisaged are being carried out. The Society's ExCo and ALCo also pay specific regard to the risks described under ORSA, to ensure that they are being appropriately managed.

Consideration of the ORSA process is a fundamental part of the Society's annual strategy process. This is to ensure that business planning is consistent with risk appetite, with due consideration given to the current and future risks, including how these will be addressed. Its drafting is supervised through the ExCo strategy meetings in October and November, ARC in December, and formally adopted alongside the Business Plan at the December Board Meeting.

Board, supported by ARC, formally reviews the ORSA Report at its mid-year meeting. At this stage, Board considers whether the approach to the risks as described in the ORSA Report remain appropriate, or whether additional or different actions should be taken. Board also consider whether there have been any emerging risks that merit attention alongside those set down in the ORSA Report. While there have been changes to the Society's Top Risks in 2018, Board confirmed in July 2018 that it was content that the conclusions of the 2017 ORSA Report remain valid.

Should the risk profile of the company materially change, an out of cycle ORSA Report would be prepared.

The ORSA Report is used by Board and ExCo as an input into the Society's strategic decision making for the forthcoming period, and the setting of appropriate risk appetite statements. The ORSA Report is considered before the Society makes major decisions.

The ORSA Report is one of the key sources of information used to produce the Solvency and Financial Condition Report and Regular Supervisory Report, required under Solvency II.

During 2018, the Society undertook the following activities in relation to solvency measurement:

- Calculation of the ORSA and SCR capital requirements.
- Projection of the solvency capital over the business planning period.
- Stress and scenario testing, including reverse stress testing.
- Monthly reporting of the ORSA and SCR solvency position.

B.3.2 (b)

The Board are accountable for reviewing and approving, at least annually, the ORSA Policy and the ORSA process results and Report.

The Risk Function are responsible for providing the ORSA Report to PRA.

B.3.2 (c)

Unlike Standard Formula where many assumptions are specified by EIOPA, the assumptions and methodologies under the ORSA Solvency basis best reflect the Society's view of its risks.

The Society is required by the regulator to hold solvency capital. It is our strategic intention to distribute all of the assets amongst the with-profits policies as fairly and as soon as possible. Capital Management is a fundamental element of the Society's risk management system as it aims to meet these two objectives.

The Society's strategic objectives related to capital management are to:

- Carefully manage solvency to enable capital distribution and, only then, seeking to maximise return; and
- Distribute all of the assets amongst with-profits policyholders as fairly and as soon as possible.

The Board has made the following Key Risk Appetite Statement:

- Sufficient capital to meet economic and regulatory requirements

KRIs have been set for this statement in terms of the probability of ORSA or SCR coverage falling below certain levels.

The Society's principal risks are:

- Insurance Risk (Underwriting Risk)
- Liquidity Risk
- Credit Risk
- Market Risk
- Operational Risk
- Regulatory Risk

B.4	**Internal control system.**
The solvency and financial condition report shall include all of the following information regarding the internal control system of the insurance or reinsurance undertaking:	
(a)	a description of the undertaking's internal control system;
(b)	a description of how the compliance function is implemented.

B.4 Internal control system.

B.4 (a)

The Directors are ultimately responsible for the Society's system of internal control and for reviewing management's arrangements for ensuring its effectiveness, including the effectiveness of controls over outsourced activities. This system is designed to manage rather than eliminate the risk of failure to achieve business objectives. The system can only provide reasonable, rather than absolute, assurance against material loss or misstatement. The Directors seek to ensure that the Society mitigates its exposure to risks consistent with its strategy. They also take into consideration the materiality of the risks to be managed and the cost-effectiveness of the relevant aspects of internal control.

As previously mentioned in B.3.1(a) the Society has adopted the widely recognised 'three lines of defence' approach to governance.

An appropriate organisational structure for planning, executing, controlling and monitoring business operations is in place in order to achieve the Society's objectives. The structure is reviewed and updated on a regular basis, taking into account the different priorities of the Society's business, to ensure that it provides clear responsibilities and control for key areas. Separate functions have been established for Risk Management, Compliance and Internal Audit.

B.4 (b)

Primary responsibility for day-to-day compliance rests with business areas. Oversight and challenge is provided by the Compliance function as the second line of defence.

The role and responsibilities of Compliance are:

- Maintaining and developing the Regulatory Risk & Compliance Framework;

- Providing guidance and advice on regulatory matters;

- Reporting regularly on regulatory risks and mitigating actions;

- Maintaining a breach log and monitoring breaches and actions to resolve these, consider root causes and undertake investigations where required, reporting breaches to the PRA/FCA as required under Fundamental Rule 7/Principle 11;

- Preparing management for interactions with the Regulators;

- Providing Senior Management Function Holders, Notified Non-Executive Directors and Certification Function Holders with training on regulatory matters;

- Managing the relations with PRA and FCA, together with other regulators, including co-ordinating responses to information and other requests;

- Ensuring those undertaking Senior Management Functions have been approved by PRA and FCA, and briefing them on their responsibilities (at approval and at least annually thereafter) ;

- Ensuring that procedures are in place to assess the fitness and propriety of Senior Management Function Holders, Notified Non-Executive Directors and Certification Function Holders, during recruitment and on an annual basis;

- Monitoring analyse and report on regulatory developments;

- Review and advise on policyholder communications, providing sign off in line with the client output sign off process

- Producing an annual Compliance Plan setting out priorities for the coming year; and

- Maintaining an up to date set of Compliance Procedures.

B.5 Internal Audit function

The solvency and financial condition report shall include all of the following information regarding the internal audit function of the insurance or reinsurance undertaking:

(a) a description of how the undertaking's internal audit function is implemented;

(b) a description of how the undertaking's internal audit function maintains its independence and objectivity from the activities it reviews.

B.5 Internal Audit function

a) The Internal Audit function

The Society's Internal Audit team provides assurance over the operation of governance, risk management and the system of internal control. This team draws on technical audit support from a specialist third party.

The programme of Internal Audit reviews is based on the Society's risk profile, independently assessed by Internal Audit and reviewed by the ARC. The delivery of the Internal Audit plan and the activities to report and track audit findings are reported to, and reviewed by, the ExCo and the ARC.

b) Organisational Independence

Independence is the freedom from conditions that threaten the ability of Internal Audit to carry out its responsibilities in an unbiased manner. To achieve this independence the Head of Internal Audit does not perform any operational functions and has direct and unrestricted access to senior management and the Board.

The scope of Internal Audit Assurance activity covers all areas of the Society and includes the review of 2nd line Risk and Compliance functions and services.

The Risk Director has certain responsibilities for both 2nd line and administrative responsibilities for 3rd line activities. Risks of reduced independence are mitigated by:

- A clearly articulated and understood dual reporting line for the Head of Internal Audit to the Risk Director and the Chairman of the ARC
- Regular one to one meetings between the Head of Internal Audit and the Chief Executive Officer (CEO)
- Ensuring that the CEO is the accountable Executive for audits on areas under the responsibility of Risk Director, and that the Chairman of the ARC agrees the scope of such audits;
- Continued use of third party Internal Audit co-sourced services, who also have direct access to the Chairman of the ARC and CEO
- Co-sourced Internal Audit resource is used to perform any reviews of 2nd line of defence activities that report to the Risk Director
- ARC annual assessment of the effectiveness of Internal Audit

Objectivity

Assurance must be delivered in an impartial, unbiased manner and avoid any conflict of interest.

Internal auditors must not perform any operational functions or assess specific operations for which they were previously responsible within the last year or, if longer, within the timeframe covered by the audit.

The Head of Internal Audit has the right of attendance at executive and risk committees, but does not make business decisions as part of this attendance and is not a member of any decision making committees.

B.6 Actuarial function
The solvency and financial condition report shall include a description of how the actuarial function of the insurance or reinsurance undertaking is implemented.

B.6 Actuarial function

The Society's Actuarial Function provides effective actuarial control which allows identification, modelling and control of Financial, Insurance, Operational and Regulatory risks, and supports sound decision-making, capital management and regulatory compliance.

Competence

The Chief Actuary is responsible for ensuring that the Actuarial function has the right mix and level of skills and expertise and meets appropriate standards. This is achieved by:

- Work being carried out by appropriately qualified actuaries, technical staff and other individuals under supervision of actuaries who, themselves, are meeting professional standards;
- Actuarial tasks being planned to ensure there is skilled resource with sufficient time to carry out the right level of internal controls in line with the Materiality and Proportionality Policy. This includes ensuring that there are sufficient and appropriate resources available to ensure that the do/check/review processes are independent;
- Any conflicts (resources, professional or otherwise) being identified, documented and communicated in a timely manner to ExCo and, if appropriate, to other committees or the Board.
- Work meeting the standards set out by the actuarial profession. Requirements are set out in the Institute of Actuaries' Actuarial Code (including the specific requirements of the Chief Actuary and the With-Profits Actuary). The minimum standards for actuaries are set out by the FRC in a series of Technical Actuarial Standards covering modelling, data, insurance specific work and reporting. These are referred to as TAS 100 and TAS 200 respectively. Internal Checklists provide evidence of compliance with professional standards for all actuarial material referred to the Board and its committees.

The Actuarial function is currently structured as follows:

- Reporting team specialising in stochastic valuations, Solvency II SCR results, ORSA results;

- Actuarial Services team providing data analysis and experience analysis; and

- Actuarial Improvements team providing a controlled and separate area for model, and other, developments.

- Project team providing actuarial support and modelling to the new strategy.

Teams are led by managers with detailed knowledge of the regulatory environment and the theory and practice of the relevant work. Managers are supported by actuaries, trainee actuaries and other technical specialists (e.g. data analysts, valuation experts) to ensure continuity of knowledge and skills and enable appropriate succession plans to be produced.

The Actuarial function supports external actuaries in providing assurance at the request of the Technical Review Committee or ExCo for material actuarial work used to support the Society's strategy.

Evidence of appropriate levels of internal control is documented for all actuarial tasks. For smaller tasks, a Project Control Document is used. For actuarial models and their usage, more detailed standard documents are produced, reviewed, challenged and maintained.

Models

Much of the work performed by the Actuarial function for calculating technical provisions and assessing capital requirements is carried out using models.

The key models, together with a brief description of their purpose, are:

- End Of Year System
  Extracts policy valuation data from the administration systems.
- Model Point Creation System
  Puts policy data into a format suitable for valuation models.
- Solvency II SCR Model
  Values the Society's business in accordance with Solvency II Standard Formula regulations.
- ORSA Model
  Values the Society's business in accordance with its own views of its risks.
- Dynamic Distribution Model (DDM)
  Projects ORSA and SCR capital requirements and is used in the assessment of the Claims Enhancement Factor (CEF).
- Monthly Management Information (MI) Models
  Produce estimated month-end liability values.

The Society has governance arrangements and controls for models used for material, strategic and business decision-making.

IT resources are sufficient to enable calculations to be performed at the required level of homogeneous risk group and within the prescribed reporting timescales. Adequacy of these resources will be reassessed if they risk compromising the level of detail, level of accuracy (numbers of model points, number of stochastic simulations) or reporting timescales.

Appropriateness of the methodology and assumptions used in calculations of technical provisions and capital requirement is achieved by appropriate internal and independent external review and challenge.

Quality assurance

Actuarial control over the quality of calculations and reports is achieved through the following:

- Maintaining a do / check/ review process for all key calculations. All reports to ExCo, Board and its committees are reviewed by the Chief Actuary;

- Review of Actuarial work is considered as directed by APS X2, issued by The Institute and Faculty of Actuaries;

- Production of Project Control Documents;

- Completion of Checklists to ensure Technical Actuarial Standards and regulatory compliance of reports and calculations;

- Risk assessment of calculation processes;

- Maintenance of a standard spreadsheet template and design protocol to ensure spreadsheets are clear to understand and are subject to change control;

- Production of standard documentation where appropriate to ensure processes carried out correctly and completely: Process diagrams, risk assessments, checklists and procedure notes; and

- Key models built in accordance with agreed specifications. If it is necessary to deviate from the agreed specification, relevant documentation must be amended and re-presented to the appropriate authority for approval and appropriate testing must be carried out subsequently.

- Regular Internal Audit reviews

Data

The closed book and stable systems lead to data consistency and accuracy over time due to the absence of change. Data quality, sufficiency and completeness are achieved by:

- Maintaining data dictionary specifying names of data items, meaning, usage, origin and importance enabling all data items to be identified and understood, used correctly and changes to the data items assessed and understood.
- Extracting policy data at benefit level with validation and reconciliation procedures on key fields in the data production process.
- Reconciling asset data between source and model
- Documenting policy and asset data extraction processes demonstrating source, use and quality of data.
- Complying with Technical Actuarial Standards and documenting any approximations or assumptions applied.
- Completing regular data quality questionnaires and reporting any data quality issues to the Data Quality Manager

Experience Analysis

Best estimates of key valuation assumptions are compared with actual experience and presented to Board on persistency, mortality, expenses and analysis of change in capital resources.

Risk Assessment

As required under the RCSA Process, the Actuarial Function has its own risk register which is reviewed every two months by the function to identify, categorise and document key risks. The register supports the quarterly RCSA submission.

B.7 Outsourcing
The solvency and financial condition report shall include a description of the outsourcing policy of the insurance or reinsurance undertaking, that undertaking's outsourcing of any critical or important operational functions or activities and the jurisdiction in which the service providers of such functions or activities are located.

B.7 Outsourcing

The Society uses outsourcers where, due to our lack of scale or areas of expertise, we do not have the ability to provide the service in-house. In these instances, we will go out to the external market and source the provision of these services from the most appropriate Third party service provider who meets our business needs. We manage these third party service providers in accordance with minimum standards for engagement and management of contractual agreements.

All contracts are with UK companies or UK offices of overseas companies.

The Society needs to ensure that contracts with third party providers are only entered into where:

- A clear business need and business benefits have been demonstrated
- An appropriate third party has been selected based on a good understanding of the market for the activity and a robust selection process
- The financial implications have been assessed and shown to be acceptable
- It has been demonstrated that adequate governance has supported the decision to enter into the contract
- An appropriate level of due diligence has been undertaken, and the associated risks fully assessed.

The Society needs to ensure that, once a contract is entered into, the contract and the ongoing relationship with the third party are appropriately managed over the course of the contract.

The Board and Management are committed to ensuring that:

- All outsourcing arrangements, relating to activities for which the Society remains liable as an authorised entity, are assessed regularly in light of regulatory considerations, and:
- Written agreements are sufficiently robust to manage not only counterparty risk, but also to minimise exposure to service, regulatory, compliance and reputational risks.

B.8 Any other information
The solvency and financial condition report shall include an assessment of the adequacy of the system of governance of the insurance or reinsurance undertaking to the nature, scale and complexity of the risks inherent in its business. The solvency and financial condition report shall include in a separate section any other material information regarding the system of governance of the insurance or reinsurance undertaking.

B.8 Any other information

On behalf of the Board, the ARC has reviewed the effectiveness of the risk management and internal control systems for the year ended 31 December 2018, taking into account matters arising up to the end of March 2019.

The review demonstrated that the Society has in place a comprehensive set of risk management and internal control arrangements. These include the identification, assessment, measurement, monitoring, reporting and management of risks. The review also confirmed that the Society is compliant with the Systems of Governance requirements under Solvency II. There have been no material changes to the Society's System of Governance in 2018.

A programme of internal audits and compliance monitoring takes place to provide assurance that the Society's controls are fit for purpose and that regulatory requirements are being met. No material control issues arose in 2018 and there were no material risk events or breaches during the year. If significant failings or control deficiencies were to be identified, the Committee would confirm whether or not appropriate remedial action had been taken. The review concluded that the Society's risk management and internal control systems are operating effectively.

C. Risk Profile

C Risk Profile

The solvency and financial condition report shall include qualitative and quantitative information regarding the risk profile of the insurance or reinsurance undertaking, in accordance with paragraphs 2 to 7, separately for the following categories of risk:

(1) underwriting risk;

(2) market risk;

(3) credit risk;

(4) liquidity risk;

(5) operational risk;

(6) other material risks.

The Society operates a comprehensive Risk Management Framework through which it identifies, monitors and reports on the principal risks to its strategic objectives. They are managed within a risk appetite set by the Board, who ensures that adequate capital is held against these risks.

The main risks relevant to the Society are:

- Insurance risk (Underwriting risk)
- Market risk
- Credit risk
- Liquidity risk
- Operational risk
- Regulatory and Strategic risk

C1 Underwriting Risk

2

The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the 'prudent person principle' set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

3

With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed

4

With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

5

With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

6

With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

7

The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

Guideline 5 - Underwriting risk

1.17. Under section "C.1 Underwriting risk" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, regarding the use special purpose vehicles, describe if they were authorised under Article 211 of Solvency II Directive, identify the risks that are transferred to it and explain how the fully funded principle is assessed on an ongoing basis.

C.1 Underwriting risk

Underwriting, or Insurance risk is the risk that the actual timing, frequency and severity of insured events differ from that assumed in policy valuations.

For the Society, insurance risk consists of expense risk and the following elements relating to the timing of insured events:

- Persistency risk
- Longevity risk; and
- Mortality risk

C1. 2(a)

The Enterprise-wide Risk Management Framework describes the measures used to assess the Society's risks. Further details are set out in section B3.

The Society is closed to new business and does not take on new insurance risk. The Society reviews its recent claims experience and combines it with industry-wide data (standard tables of mortality rates) and industry standard models of future annuitant mortality improvement rates in order to derive expectations about future timing of policyholder claims.

The key insurance risks are measured using Key Risk Indicators (KRI).

The Society's approach to measuring persistency experience is by reviewing the rate at which policies are going off the books against Earliest Contractual Date (ECD), split by contractual and non-contractual exits.

KRIs are maintained by the Actuarial function. Exceptions are reported to the Executive Committee (ExCo) and Board.
As part of the Society's assessment of the adequacy of its financial resources, Insurance Risks are subject to stress and scenario testing.

There have been no material changes to the measures used to assess these risks over the reporting period.

C1. 2(b)

Persistency Risk

The most material insurance risk is in regard to retirements and transfers not being in line with estimates in a low interest rate environment.
Persistency risk is the risk that the timing at which policyholders choose to take their benefits differs from the timing expected. If future experience is different than expected, it can lead to an increase in the cost of the guarantees within policies.

Expense Risk

The second material insurance risk is in regard to expenses not reducing in line with policyholder run-off.

The Balance Sheet includes amounts representing the expected value of all future expenses of administration and investment management net of charges made to policy values to pay for these costs. Expense risk is the risk that expenses are higher than those assumed.

The main sources of risks are:

- The assumed future cost base of the business is higher than expected;
- Future inflation of expenses is higher than anticipated; and
- The value of future charges deducted from unit-linked policies is lower than expected.

Risks relating to future expenses are monitored by:

- Comparing actual expenses against plan; and,
- Reviewing business plans and strategic projects against run off assumptions.

Expense risk associated with investment management is monitored against levels set within the Investment Guidelines on a daily basis by the With-profits Investment Manager. The appropriateness of the benchmark in relation to the actual expense liabilities is reviewed on an annual basis by Asset and Liability Committee (ALCo).

We consider that the main mitigation to this risk is the execution of the strategy, as the transfer to Utmost Life and Pensions will enable expenses to be more effectively managed.

Longevity Risk

Longevity risk is the risk that policyholders live longer than currently expected, giving rise to the payment of more benefits than currently reserved for.

The Society's existing exposures to longevity risk have been all but eliminated through reinsurance. The taking-on of additional longevity risk has been eliminated by providing retiring pension policyholders with a Canada Life annuity illustration and emphasising their option to seek annuities in the open market.

Mortality Risk

Mortality risk is the risk that policyholders die sooner than currently expected, giving rise to the payment of more death benefits than currently reserved for. A further exposure to mortality risk exists on conventional with-profits policies, but these represent only 2% of with-profits policy values.

C1. 2(c)

PRA's Prudent Person Principle means firms are expected to exercise prudence in relation to the acquisition and holding of assets and to ensure that assets are appropriate to the nature and duration of liabilities.

The Society's risk management policies, together with the Asset Management Policy and the Investment Guidelines enable us to identify, measure, monitor, manage, control and report on the risks inherent in the Society's assets and investments.

These arrangements include requirements relating to the security of assets, their quality and liquidity, and duration, all of which are monitored by the Asset & Liability Management Committee through monthly reporting received from our investment managers, BlackRock and, for unit linked funds, Aberdeen Standard Investments Limited (ASI). The Committee monitors the performance of the investment managers against the Investment Guidelines and objectives set for each portfolio. BlackRock and ASI are also required to report to the Committee on any breaches of the Guidelines, as well as compliance with the Prudent Person Principle and on the actions they have taken, or are taking to rectify such breaches.

C1. 3

One important risk for the Society is that policyholders defer retirement in a low interest rate environment. Some 76% of the Society's with-profits policies have a built-in guarantee that they will grow at 3.5% p.a. Our assets are invested so that we can pay the guarantees based on when we estimate that policyholders will retire. When policyholders stay longer than expected, we have to re-invest the assets, and in the current climate we cannot possibly hope to achieve a 3.5% return.

C1. 4

The methods used to manage and monitor the Society's risks are set out in section B3. Those specific to insurance risks are described below:

Expense risk

The Society actively manages its costs down, so that business-as-usual costs fall in line with policy run-off. Furthermore, the Society maintains, and regularly reviews, a set of actions it can take to directly control expenses in severe business scenarios.

Most of the Society's expenses are expected to be linked in some way to UK price inflation. To mitigate the risk of higher than expected rates of inflation, the Society holds a portfolio of index-linked assets in order to match the inflation-linked nature of expenses.

Timing of insured events risk: persistency, longevity and mortality risks

The Society is closed to new business and does not take on new insurance risk.

The Society's existing exposures to longevity and mortality risk have been all but eliminated through reinsurance. As set out in C1. 2b.

The Society reviews its recent claims experience and combines it with industry-wide data (standard tables of mortality rates) and industry standard models of future annuitant mortality improvement rates in order to derive expectations about future timing of policyholder claims.

To mitigate the impact of with-profits policyholders with a 3.5% pa Guaranteed Investment Return (GIR) deferring retirement when interest rates fall, the Society holds a series of derivatives called 'receiver swaptions'. These increase in value when interest rates fall or interest rate volatility increases.

The effectiveness of the swaption portfolio is reviewed periodically to ensure that it provides adequate protection against a fall in interest rates.

Continued monitoring

Insurance risks are monitored and escalated. Routine monitoring is conducted through the quarterly Risk, Control and Self-Assessment process and regular risk reporting.

C1. 6

Stress tests comprise movements in a single risk, such as shifts in interest rates.

Scenario tests comprise simultaneous movements in different risks, such as changes to retirement rates, credit spreads, interest rates and expenses.

Both the excess of assets over liabilities and the regulatory capital that would be required under each test are calculated, assuming that the changes occur instantaneously. Reverse stress tests are also performed to determine which event or combinations of events would lead to failure of the business model.

For the purposes of the sensitivities below, the SCR has been adjusted to take account of management actions that could be taken to mitigate the impact of the SCR stress events.

Expense

The table below shows the sensitivity to reasonably possible scenarios on the ratios of Own Funds (the excess of assets over liabilities) to the SCR, including the underlying assumptions:

	Net impact on solvency coverage ratio	
Sensitivity scenario	**2018 %**	**2017 %**
10% increase in assumed level of expenses	(4)	(4)
0.5% increase in assumed rate of UK expense inflation	(3)	(1)

Timing of Insured Events

The following table shows the sensitivities to possible changes in the timing of when policyholders choose to take their benefits.

	Net impact on solvency coverage ratio	
Sensitivity scenario	**2018 %**	**2017 %**
With-profits retirement rates Decrease[1]	(3)	(2)
With-profits retirement rates Increase[2]	-	-

Note:
[1] A change in retirement rates in respect of policies with a guaranteed return of 3.5% pa that is approximately equal to those policyholders delaying retirement by an average of 1 year.
[2] A change in retirement rates in respect of policies with a guaranteed return of 0% pa that is approximately equal to those policyholders retiring on average one year earlier.

While individual risks are important, the Board also considers certain combinations of risks. For example, in run-off, falling interest rates combined with policyholders deferring benefits is a particularly onerous combination.

C.2 Market risk

2

The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the 'prudent person principle' set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

3

With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

4

With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

5

With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

6

With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

7

The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C.2 Market risk

Market risk is the risk of adverse changes in asset values or values of future cash flows of investments. This can arise from fluctuations in interest rates, equity, property and corporate bond prices, and foreign currency exchange rates. The exposure to property and equity risk is immaterial and arises solely through the impact of changes in property and equity values on unit-linked fund charges.

The main responsibility for monitoring these risks lies with the Society's ALCo.

C2. 2(a)

Interest rate risk

The Society measures its exposure to interest rate risk by the duration mismatch between assets and the liabilities. This is monitored by the Investment Manager and reported every other month to ALCo. Also reported is the breakdown of the duration into Key Rate Durations (KRD). These measures allow the Society to understand the sensitivity to general interest rate market movements and to movements of specific parts of the yield curve.

The market value of the receiver and payer swaptions, and in turn the risk from interest rate volatility, is measured by the Investment Manager and reported to ALCo monthly.

The receiver swaption portfolio is reviewed at least annually to determine whether it is still appropriate as a mitigant against the negative consequences of agreed stress scenarios and falling interest rates.

The exposure to corporate bond spread risk was almost entirely eliminated in 2018 through the sale of the Society's corporate bonds. The remaining holdings will mature in 2019.

Liability matching risk

Overall cash flow matching risk is monitored monthly by ALCo through:

- Year-by-year matching reports;
- Cumulative matching schedules;
- KRD active duration (years) tables; and
- KRD monetary impact exposures.

There have been no material changes to the measures used to assess these risks over the reporting period.

C2. 2(b)

Market risk is considered further by looking at its three elements:

i) Interest rate risk;
ii) Corporate bond spread risk; and
iii) Currency risk.

(i) Interest rate risk

Long-term liabilities fluctuate in value because of changes in interest rates. Interest rate risk is the risk that these fluctuations are not fully matched by changes in investment values.

As mentioned under insurance risk C1.3, there is a further risk for the Society in respect of the guaranteed investment return on with-profits policies, which are typically 3.5% pa. In the current low interest rate environment, the cost of providing these guarantees would increase if interest rates fall further, if policyholders defer their retirement beyond the dates assumed, or if both scenarios occurred together.

The Society is exposed to the risk that increases in interest rates result in a fall in the capital available to distribute to policyholders.

Interest rate volatility is a measure of the likelihood that interest rates will change in the future. This would impact the value of our payer and receiver swaptions, and spread-locks. See section C7 for further details.

(ii) Corporate bond spread risk

The capital requirement for credit spread risk has decreased significantly over the year, due to the sale of bond holdings.

(iii) Currency risk

The capital requirement for currency risk remained unchanged during the year.

C2. 2(c)

This is described in further detail within section C3 – Credit risk.

C2. 3

The Society's approach to the management of market risk is to set limits for specific market risks, and exposure to those risks, to enable effective management of the Society's solvency level.

The Society's detailed risk appetite statements, supporting KRIs for market risk are set by ALCo and monitored on a monthly basis.

C2. 4

Interest rate risk

The Society operates an investment policy so that assets and liabilities are matched. Specifically, the Society holds fixed-interest assets to produce income and redemption proceeds that closely match the expected outgoings from with-profits policies and non-profit policies each year. Index linked gilts are held to match the expected outgoings from regular expenses. The Society monitors the exposure to changes in interest rates through periodic reviews of the asset and liability matching position.

To mitigate the impact of increasing interest rates on asset values, payer swaptions were purchased in 2017 and a gilt-swap spread-lock was executed in 2018. Together they lock into the market value of the underlying gilts, helping to secure the potential uplift for policyholders under the new strategy, while maintaining the matching of with-profit liabilities required for run-off.

To mitigate the impact of with-profits policyholders with a 3.5% pa GIR deferring retirement when interest rates fall, the Society holds a series of derivatives called 'receiver swaptions'. These increase in value when interest rates fall or interest rate volatility increases.

The effectiveness of the swaption and spread-lock portfolios are reviewed periodically to ensure that it provides adequate protection against the impact of potential changes in interest rates.

The Society monitors the interest rate volatility risk arising from the Swaptions and spread-locks.

The table below illustrates how with-profits investments are mainly in fixed–interest securities:

UK with-profits assets mix	**2018** %	**2017** %
Gilts	76	51
Corporate bonds	2	26
Short-term gilts and cash	19	20
Other	3	3
	100	100

In adverse investment conditions, the Society could make appropriate reductions to with-profits policy values and apply financial adjustments to surrenders. These actions mitigate market risk, but do not remove the risk entirely for with-profits policies because the value of assets could still fall short of the value of guarantees within policies.

Corporate bond spread risk

As previously stated, the exposure to corporate bond spread risk was almost entirely eliminated in 2018 through the sale of the majority of the Society's corporate bonds. The remaining holdings will mature in 2019.

Currency risk

The Society's principal liabilities are defined in pounds sterling, and its exposure to the risk of movements in foreign exchange rates is limited.

The Society's financial assets are primarily denominated in the same currencies as its liabilities, which mitigates the foreign exchange rate risk for any overseas operations. The main foreign exchange risk arises from recognised assets denominated in currencies other than those in which insurance and investment liabilities are expected to be settled. The Society invests in a US dollar forward exchange contract to mitigate the most significant exposure to currency risk, and so has very low sensitivity to currency risk.

Monitoring

Market risks are monitored and escalated in accordance with the Enterprise-wide Risk Management Framework. Routine monitoring is conducted through:

- The quarterly Risk, Control and Self-Assessment Process.
- Bi–monthly reporting of Insurance and financial risks to ALCo
- ALCo also receives monthly reporting from the Investment Managers against the Investment Guidelines.

C2. 6

Sensitivities

Please refer to the previous section - Insurance Risk C1. 6, for further understanding of the methodology underlying stress testing.

Interest rate risk

The following table shows the sensitivity of solvency coverage to reasonably possible changes in interest rates.

Scenario	**Impact on solvency coverage ratio**	**Impact on solvency coverage ratio**
Interest rates, at all terms	**2018**	**2017**
	%	%
Fall by 0.5% pa	(13)	(12)
Rise by 1.25% pa	76	74

The Society monitors the interest rate volatility risk arising from the swaptions and spread-locks.

The following table shows the sensitivity to interest rate volatility. Volatility decreased over the year.

Scenario	**Impact on Excess Assets**	**Impact on Excess Assets**
	2018	2017
	£m	£m
10% increase in interest rate volatility	12	17
10% decrease in interest rate volatility	(12)	(17)

Corporate bond spreads

The exposure to corporate bond spread risk was almost entirely eliminated in 2018 through the sale of the majority of the Society's corporate bonds.

The following table shows the sensitivity to reasonably possible scenarios.

Scenario	**Impact on Excess assets**	**Impact on Excess assets**
Change in corporate bond spreads	**2018** %	**2017** %
Rise 0.5% pa	-	(19)
Fall 0.5% pa	-	20

Currency risk

The Society is exposed to the risk that movements in foreign exchange rates reduce the value of charges levied on unit-linked business.

The impact of a change of 10% in foreign exchange rates at the reporting date would have reduced Excess Assets by £4m (2017: £4m) after allowing for the mitigating impact of the US dollar forward exchange contract.

C.3 **Credit risk**
2
The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:
(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;
(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.
(c) a description of how assets have been invested in accordance with the 'prudent person principle' set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.
3
With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed
4
With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.
5
With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).
6
With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.
7
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C.3 Credit risk

C3. 2(a)

The key measure of credit risk arising from counterparties is the credit ratings sourced from rating agencies registered as External Credit Assessment Institutions (ECAIs) under European Union (EU) regulations. The Society relies upon the Investment Manager to assess the ratings, to provide ratings where they are not available from ECAIs and monitor any movements.

The Investment Manager uses the credit ratings in conjunction with the actual exposures to monitor the aggregate portfolio against a series of risk limits, recorded in the Investment Guidelines. The Investment Guidelines govern allocation to different credit rating bands, minimum credit ratings and issuer concentration. Breaches of the Investment Guidelines are reported to the Investment function and ALCo as they occur.

A further credit risk measure is the level of solvency capital held by the Society against the credit risk associated with investing in corporate bonds. This measure was reported monthly by the With-profits Investment Manager. It was also calculated by the Actuarial function and was monitored against limits provided in the Investment Guidelines. The sale of the majority of corporate bonds means this measure is no longer relevant.

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

C3. 2(b)

Credit risk is the risk that a counterparty will fail to pay amounts in full when due. The main credit risks faced by the Society are:

- The risk of default on its portfolio of fixed-interest investments, especially corporate bonds;
- The risk of default by derivative contract counterparties; and
- The risk of default by any of its reinsurers.

The change to the Society's exposure to credit risk in 2018 reflects the disposal of the majority of the Society's corporate bonds and investment of the proceeds in gilts.

The potential credit risk exposure from default of the gilt Total Return Swap (TRS) counterparties, and by both payer and receiver counterparties, is mitigated by the receiving of collateral.

The potential credit risk exposure from default by future counterparties is mitigated by daily settlement of variation payments and through trading on a regulated futures exchange. None of the changes in the value of derivatives has been driven by changes in the credit rating of counterparties.

C3. 2(c)

This is described in further detail within section C1. **2**(c).

C3. 3

The Society's exposure to credit risk associated with all the Society's financial assets is summarised below, according to the middle rating of the external credit ratings supplied by Moody's, Standard & Poor's, and Fitch.

2018 **Credit ratings**	**AAA** **£m**	**AA** **£m**	**A** **£m**	**BBB** **£m**	**Other** **£m**	**Total** **£m**
Debt and other fixed-income securities	109	3,199	14	34	-	3,356
Deposits and other investments	803	-	17	-	-	820
Cash at bank and in hand	-	-	-	6	-	6
Other financial assets	2	20		1	5	28
Reinsurers' share of technical provisions and liabilities[1]	-	-	366	-	-	366
	914	3,219	397	41	5	4,576

2017 Credit ratings	AAA £m	AA £m	A £m	BBB £m	Other £m	Total £m
Debt and other fixed-income securities	132	2,314	445	547	17	3,455
Deposits and other investments	866	-	14	-	-	880
Cash at bank and in hand	-	-	-	5	-	5
Other financial assets	2	12	6	11	11	42
Reinsurers' share of technical provisions and liabilities	-	-	402	-	-	402
	1,000	2,326	867	563	28	4,784

(1) The amount of reinsurers' share of technical provisions in the table above is based on technical provisions in the 2018 financial statements.

The largest single credit risk exposure amounts to £364m for business reinsured with Scottish Widows. (2017:£398m) In the event of the insolvency of the reinsurer, if not honoured by the Lloyds Banking Group (LBG) parent company, the Society would be liable for any shortfall between the obligations under the policies and the amounts recovered. The Society does not hold any investments with LBG. (2017: £26m of investments credit rating A).

After LBG, the next largest single credit exposure is £14m, relating to an investment in Daimler International Finance, a regulated financial company. In 2017 the largest single credit exposure was £35m, relating to an investment in Bayerische Motoren Werke AG (BMW) (2018: £nil).

C3. 4

Management of risk:

Credit risk is monitored by the Society's ALCo. The Society manages its exposure to default on its portfolio of fixed-interest investments through:

- Its policy of only investing in assets of high credit quality;
- Carefully selecting individual investments; and
- Limiting concentrations with any one counterparty.

As previously mentioned, the potential credit risk exposure from default of the gilt TRS counterparties, and by both payer and receiver swaption counterparties is mitigated by the receiving of collateral. Collateral of £123m (2017: £139m) has been received in cash and has been invested in pooled deposit funds. The value of these assets at the year-end was £123m.

The potential credit risk exposure from default by futures counterparties is mitigated by daily settlement of variation payments and through trading on a regulated futures exchange. None of the changes in the value of derivatives has been driven by changes in the credit rating of counterparties.

At the reporting date, no material financial assets were past due nor impaired. (2017: £nil) The Society has not experienced nor expects any significant losses from non-performance by any counterparties.

With regard to reinsurance, steps are taken wherever possible, to limit counterparty risk. The major reinsurance treaties are with Scottish Widows. Because reinsurance does not remove the primary liability of the Society to its policyholders, the credit rating of Scottish Widows is monitored closely in order to manage the risk.

Monitoring

ALCo is the key decision making body responsible for credit risk mitigation/management. Following review of reporting (as above), actions required to mitigate the risk are devised and responsibilities allotted. This may result in adjustments to policy, strategy or Investment Guidelines.

Implementation of strategy to mitigate/manage credit risk is carried out by BlackRock, ASI and Northern Trust to whom the investment management and custody services of the Society have been outsourced. Oversight mechanisms to provide the Society with the required reassurance over the systems and controls operated by third parties are set out in the Asset Management Policy.

Reporting on the embeddedness of this risk policy is delivered through reports submitted by the Risk function to the ExCo and ALCo.

Daily monitoring to ensure that the exposure to individual counterparties remains within the limits set by the Society is the responsibility of the Investment Managers. Significant events are reported to the Society monthly.

As part of the Society's assessment of the adequacy of its financial resources, credit risk exposures are subject to stress testing and scenario analysis. The results of these are reported to the Board, Audit and Risk Committee (ARC) and ALCo.

ALCo also receives a monthly Investment Report from the With-profits Investment Managers and a detailed Stock Lending Report from Northern Trust (the Stock Lending Agent). Unit linked Pricing Committee (UPCo) receives a monthly Investment Report from the Unit-Linked Investment Managers.

Monitoring processes are used by management to identify their functions' risks and controls, and assess the impact and likelihood of each of these.

C3. 6

Sensitivities

The Society undertakes stress and scenario testing, including reverse stress testing. Stresses and scenarios are used to inform the Executive and Board on the risks faced by the Society from the macro environment.

Market risk tests take account of changes in nominal and real interest rates, changes in credit spreads, the gilt-swap spread and the Credit Risk Adjustment (CRA).

Sensitivity to corporate bond spreads are covered in section C2. 2(b).

C.4 Liquidity risk 2 The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles: (a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period; (b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period. (c) a description of how assets have been invested in accordance with the 'prudent person principle' set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description. 3 With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed 4 With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques. 5 With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2). 6 With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events. 7 The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C.4 Liquidity risk

Liquidity risk

This is the risk that the Society is unable to meet short-term cash flow requirements, particularly those in respect of policyholders taking their benefits.

C4. 2 (a)

Analysis of the Society's activities and its associated sources of liquidity risk is carried out as appropriate by the Finance and Actuarial functions and the Chief Investment Officer. ALCo reviews the investment policy in the light of any internal or external changes and considers the liquidity risk implications of any material changes. UPCo reviews and approves unit-linked fund mandates to ensure appropriate levels of liquidity are maintained.

The level of liquid assets is measured, and monitored against the amount required to meet a potential mass lapse.

The main mitigant for liquidity risk is the cautious investment policy. Assets are selected in terms of their nature, duration and liquidity in order to meet claims as they fall due. This addresses both short-term and long-term liquidity risk.

Other processes impacting on liquidity risk are the banking and treasury functions ensuring the availability of cleared funds for each day's payments (including BACS).

There were no material changes to the Society exposure to liquidity risk over the prior year.

C4. 2(b)

The main source of liquidity risk for the Society is the potential for with-profits policyholder claims to diverge from assumptions requiring forced sale of the Society's assets. A significant increase in the level of claims, without a sufficient buffer of liquid assets, might give rise to the need to sell illiquid assets on a forced sale basis.

Claims payments as a result of high levels of unit-linked claims would be met by sales of units. There could be a short-period where claims payments need to be made but money from the sale of units has not been received. The impact is not expected to be significant.

C4. 2(c)

This is described in further detail within section **C1. 2**(c)**.**

C4. 3

As per section **C4. 2**(b) above.

C4. 4

The Society holds highly liquid assets in excess of short-term cash flow requirements and so has a very low exposure to short-term liquidity risk.

The Society has held high levels of liquid assets in order to provide protection against the scenario of policyholders who have passed their earliest contractual date (ECD) deciding to take their benefits immediately. The impact of such an event would be immediate claims of approximately £1.3bn, and liquid assets significantly in excess of this amount are held in mitigation.

Assets backing linked liabilities are mostly invested in UK listed Open Ended Investment Companies (OEICs). In the unlikely event that OEIC fund managers suspend trading, the Society would be exposed to liquidity risk. The Society has sufficient liquid assets to meet cash flow requirements on linked policies. In extreme scenarios, the Society can defer paying unit-linked claims for up to one month and, in respect of property linked funds, up to six months.

Over the longer term, the Society monitors its forecast liquidity position for with-profits business by estimating the expected cash outflows and purchasing assets with similar durations to meet these obligations. The sensitivity of these outflows to changes in policyholder behaviour is also monitored. Large volumes of surrenders or policyholders taking their benefits earlier than expected can cause the forced sale of illiquid assets at impaired values. If this disadvantages continuing customers, the Financial Adjustment to policy values can be varied to maintain fairness.

Monitoring

ExCo and ALCo are provided a Liquidity and Cash Flow Monitoring Report within the monthly MI pack. Adverse trends and any areas of concern are highlighted.

Liquidity risks are monitored and escalated in accordance with the Enterprise-wise Risk Management Framework. Routine monitoring will be conducted through the quarterly risk and control self-assessment process, regular risk reporting and through ExCo.

This monitoring process is used by management to identify their functions' risks and controls, and assess the impact and likelihood of each of these.

C4. 5

The Society closed to new business on 8 December 2000.

No credit is taken for expected profits that might arise from premiums in existing policies.

C4. 6

Sensitivity

The Society's investment strategy and reinsurance arrangements mean that it has a very low exposure to liquidity risk. The sale of corporate bonds in 2018 reduced exposure even further. After allowing for collateral associated with derivative positions, some 93% of invested assets backing insurance and investment liabilities are held in liquid assets such as gilts and cash, which can normally be quickly realised.

Unit-linked contracts can be terminated at any time. The value of unit-linked polices, net of reinsurance, that could be terminated at 31 December 2018 is £1.6bn. (2017: £1.9bn). The Society has sufficient liquid assets to meet cash flow requirements on linked policies.

With-profits policies with a contractual payment date prior to 31 December 2018 have a contractual value no lower than total guaranteed benefits, and equalled £1.3bn at 31 December 2018. (2017: £1.3bn). The liquid assets previously referred to include £4.0bn to back with-profits policies. (2017:£3.0bn). This is more than sufficient to meet the value of these guaranteed with-profits benefits.

C.5 Operational risk

2

The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the 'prudent person principle' set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

3

With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

4

With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

5

With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

6

With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

7

The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking

C.5 Operational risk

C5. 2(a)

Operational risk is the potential for loss to result from inadequate or failed internal processes and systems, human error or from external events.

The Society uses a scenario modelling approach to quantify the amount of capital required. Using this approach, the business identifies plausible, but severe, scenarios for the event types based on operational risk data and management experience. These scenarios are used as inputs to an operational risk model, which calculates the operational risk capital required to survive a one in 200 year event.

Further details regarding the measures used to assess the Society's risks are set out in section B3.

The Board requires that the Society maintains a strong control environment as the Society's cost base reduces. In support of this Board risk appetite statement, the Society has a series of triggers in place which define its limited appetite. These measures are reviewed at least annually in the context of the Society's strategy setting process.

More detailed operational risk appetite statements and associated KRIs are set from time to time by the Risk Team, who will review performance against these appetites.

C5. 2(b)

The main sources of operational risk for the Society are:

- Those related to delivery of services to our policyholders;
- The delivery of services to the Society by significant third party suppliers; and
- Risks in executing strategic projects.

The Board is particularly aware that cyber-attacks on companies are a growing threat and could lead to loss of policyholder data, operational disruption, and reputational damage. Working closely with suppliers, the Board regularly assesses the threat level in the UK, along with the Society's defences against various potential attacks. Management also conducts simulations to ensure the Society is as prepared as it can be.

The management controls designed to mitigate these risks have succeeded in keeping losses to a bare minimum.

There have been no material changes to operational risk in the year.

On behalf of the Board, the ARC has reviewed the effectiveness of the risk management and internal control systems for the year ended 31 December 2018, taking into account matters arising up to the date of this report.

C5. 2(c)

This is described in further detail within section C1. **2**(c) and C1. **6**.

C5. 3

This is described in section C5. **2**(b).

C5. 4

The key systems and controls used to manage the Society's operational risk exposure are described below:

People

- An organisational structure chart for the business, supported by roles and responsibilities/job descriptions for key roles including those undertaken by Approved persons
- An annual programme of computer based training modules to be completed by all staff
- Mid and full year performance reviews for all staff
- Policies and procedures to support recruitment, remuneration and performance management
- Training and Competence framework
- Regular staff communications

Processes

- Documented procedures for core processes, including Core Process Risk Assessments where required
- Policies and/or Frameworks for key areas of operational risk such as Third Party Management, Internal Controls, Financial Crime, Complaint Handling, Conflicts of Interest, Data Protection and Whistleblowing

Systems

- An IT strategy which is approved annually by the ExCo and the Board
- An Information Security Policy, Framework and related guidance
- Information Security Cyber Action plan

- An End User Computing (EUC) guidelines
- Identification and assessment of emerging risks, including annual review of global risks by the ARC.

Business Continuity

- Documented arrangements for Business Continuity and IT Disaster Recovery
- Documented and agreed test plans and procedures
- Execution of an annual programme of testing including crisis management scenario tests.
- Periodic crisis management scenario tests.

Monitoring

Routine monitoring will be conducted by management and via the Risk Team and ExCo, based on regular Operational Risk Reporting produced by the Risk team (including reporting on the outcomes of the quarterly RCSA process).

This monitoring process is used by management to identify their functions' risks and controls, and assess the impact and likelihood of each of these.

C5. 6

The Society uses a scenario based approach as the basis for assessment of capital attributable to operational risk. The Society does not perform stress testing for operational risks; as such, risks are typically independent of market conditions.

C.6 Other material risks

2

The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the 'prudent person principle' set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

3

With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

4

With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

5

With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

6

With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events. 7 The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C.6 Other material risks: regulatory risks

C6. 2(a)

Regulatory risk is the risk to capital and reputation associated with a failure to identify or comply with regulatory requirements and expectations.

Further details regarding the measures used to assess the Society's risks are set out in section B.3.

Function Holders are responsible for ensuring that all relevant regulatory risks are captured on risk registers which will be reviewed and attested to quarterly. Risk shall be responsible for reviewing areas of concern highlighted as a result of this process and bringing any regulatory matters to the attention of Compliance.

The Society's Regulatory and Industry Developments Committee (RIDCo) identifies areas of regulatory change and tracks the approach taken by the Society to implement the required changes.

Compliance provides regular reporting on regulatory matters, including the Society's arrangements for compliance, to various governance forums (ARC, ExCo, and RIDCo).

C6. 2(b) **/ C6. 3**

The main regulatory risk facing the Society is the risk of regulatory sanctions, financial loss or loss of reputation as a result of failure to comply with the laws, regulations, rules and codes of conduct applicable to the Society's activities.

C6. 4

Monitoring

The Society has a dedicated Compliance function whose role is to provide advice, guidance and challenge to business areas to assist them in ensuring compliance.

The Compliance function will perform compliance monitoring in accordance with the annual compliance Plan.

Function Heads are responsible for ensuring that all relevant regulatory risks are captured on the Society's risk register. These shall be reviewed and attested to quarterly in accordance with the RCSA Guide. Risk shall be responsible for reviewing areas of concern highlighted as a result of this process and bringing any regulatory matters to the attention of Compliance.

This monitoring process is used by management to identify their functions' risks and controls, and assess the impact and likelihood of each of these.

C6. 6

The Society does not perform sensitivity tests for regulatory risks. The potential impact of regulatory risks are not reflected in the Balance Sheet, nor do we hold capital against these risks.

The Society considers that any such capital requirements for these are included within the capital requirements for operational risk.

C.7	**Any other information**
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.	

C.7 Any other information

The following sets out the key risks that the Society is exposed to, both in regard to execution of the new strategy and on the basis of run-off.

Risks associated with execution of the new strategy

The main risks relevant to the new strategy are as follows:

- Financial conditions deteriorate to a point which reduces the size of the uplift and makes the proposal unattractive.

  The 2017 purchase of payer swaptions provides protection for the uplift from rising interest rates. Further to this, the majority of the Society's corporate bond portfolio was sold in August and September 2018 and was replaced by gilts. This improves certainty of the amount available for uplift by removing credit risk. The key residual risk was that associated with gilt yields moving differently from swap yields. For example, if gilt yields rise by more than swap yields, the value of assets will decrease by more than the protection provided by the payer swaptions, thereby creating a financial impact on the assets available to distribute via the uplift. To mitigate this risk, the Board purchased derivatives called spread-locks in November 2018, helping to mitigate the risk of future significant changes in the uplift.

  Spread-locks are a derivative contract that lock in the difference, i.e. the spread, between the price of an interest rate swap and the price of the underlying gilt. This allows us to mitigate the risk that the value of gilts reduces by more than the rise in payer swaptions.

- Policyholders do not vote in favour of the proposal.

  The Board considers the proposition to be compelling, and plans to mitigate this risk by presenting clear, balanced and impartial communications and guidance, engaging eligible policyholders and encouraging them to vote in their own best interests.

- The Regulators or the Court objects.

  Both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) are required to consider the Scheme and Transfer and to provide their opinions on them to the Court. A key requirement for the Society is that Regulators do not object to the strategic proposal. The Society has, therefore, since late 2016, been engaging regularly with both the FCA and the PRA to discuss and share the strategic proposal as it has developed.

If the strategy does not succeed, the material issues associated with run-off would continue and the Society would need to take action to address those issues. The risks are the ones to which the Society is currently exposed.

D. Valuation for Solvency Purposes

D.1 Assets

The solvency and financial condition report shall include all of the following information regarding the valuation of the assets of the insurance or reinsurance undertaking for solvency purposes:

(a) separately for each material class of assets, the value of the assets, as well as a description of the bases, methods and main assumptions used for valuation for solvency purposes;

(b) separately for each material class of assets, a quantitative and qualitative explanation of any material differences between the bases, methods and main assumptions used by that undertaking for the valuation for solvency purposes and those used for its valuation in financial statements.

Guideline 6 – Assets – Information on aggregation by class

1.18. Under section "D.1 Assets" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, when aggregating assets into material classes to describe the valuation basis that has been applied to them, consider the nature, function, risk and materiality of those assets.

1.19. Classes other than those used in the Solvency II balance sheet template as defined in the Implementing Technical Standard with regard to the procedures, formats and templates of the solvency and financial condition report should only be used if the undertaking is able to demonstrate to the supervisory authority that another presentation is clearer and more relevant.

Guideline 7 – Content by material classes of assets

1.20. Under section "D.1 Assets" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, in relation to each material class of asset, describe at least the following quantitative and qualitative information:

a) The recognition and valuation basis applied, including methods and inputs used, as well as judgements made other than estimations which would materially affect the amounts recognised, in particular:

i. For material intangible assets: nature of the assets and information on the evidence and criteria used to conclude that an active market exists for those assets;

ii. For material financial assets: information on the criteria used to assess whether markets are active and, if the markets are inactive, a description of the valuation model used;

iii. For financial and operating leasings: describe in general the leasing arrangements in relation to each material class of assets subject to leasing arrangement, separately for financial and operating leases;

iv. For material deferred tax assets: information on the origin of the recognition of deferred tax assets and the amount and expiry date, if applicable, of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the balance sheet;

v. For related undertakings: where related undertakings were not valued using quoted market prices in an active markets or using the adjusted equity method, provide an explanation why the use of these methods was not possible or practical.

b) Any changes made to the recognition and valuation bases used or to estimations during the reporting period;

c) Assumptions and judgements including those about the future and other major sources of estimation uncertainty.

D.1 Assets

D.1(a) and **D.1(b)**

The Society's invested assets are recognised and measured according to UK accounting standards, which are consistent with international accounting standards. Assets are measured at Fair Value, mostly at market (bid) price. Judgement is applied in valuing only a small number of securities (approximately 3%), namely the spread-lock, interest rate swaptions and private equity investments. The spread-lock involves valuation of the Gilt Total Return Swap (TRS), a new area of judgement in 2018.

Asset values by category

	Solvency II 31/12/18 £m	Accrued Income £m	Reclass (Notes) £m	**R&A 31/12/18 £m**	R&A 31/12/17 £m
Fixed income securities					
Government bonds (incl index linked)	**3,310**	(21)	9[1]	**3,298**	2,325
Corporate bonds	**69**	(2)	(9)[1]	**58**	1,130
	3,379	**(23)**	**-**	**3,356**	**3,455**
Other Investments					
Derivatives	**162**		(34)[3]	**128**	130
Collective Investments Undertakings	**809**		(803)[2]	**6**	7
	971	**-**	**(837)**	**134**	**137**
Assets held for index-linked and unit linked funds					
Collective Investments Undertakings	**1,625**			**1,625**	1,872
Cash & equivalents	**3**			**3**	3
Other assets including current liabilities	**(2)**		4[4]	**2**	(5)
	1,626	-	4	**1,630**	**1,870**
Cash & equivalents	**17**		**803**	**820**	**880**
Total invested assets	**5,993**	**(23)**	**(30)**	**5,940**	**6,342**
Corporate cash	**6**			**6**	5
Other current assets	**5**	23		**28**	42
	11	**23**	**-**	**34**	**47**
TOTAL ASSETS	**6,004**	**-**	**(30)**	**5,974**	**6,389**

Notes:

(1) KFW, a German government backed stock, is classified differently for Solvency II and statutory reporting (£9m)

(2) Most non-unit linked collective investments undertakings (CIUs) are cash funds and are classified as 'cash & equivalents' in the Report & Accounts (£803m)

(3) Pairs of swaptions are reported at the net asset value in the statutory accounts, whereas the two legs of each pair are reported separately in asset and liabilities for Solvency II reporting

(4) Liability positions held for unit-linked funds are classified as current liabilities in statutory accounts and as invested assets for Solvency II reporting

The table above is as per S.02.01 Solvency II balance sheet quantitative reporting template in Appendix 1 (excluding reinsurance recoverables).

Recognition of assets

The Society recognises a financial asset or a financial liability only when it becomes a party to the contractual provisions of the instrument. Most of the Society's assets are simple in structure and nature with no ownership issues. However, where assets are being sold or liquidated, special consideration is given to possible derecognition. At 31 December there were no liquidations or disposals requiring special consideration.

There have been no changes to the recognition and valuation bases used, or to estimations, during the reporting period, other than the new methods required to value Gilt TRS.

Valuation bases, methods and main assumptions

Fixed income securities

Most of the Society's investments are fixed income securities. These securities are valued at market price based on a number of types of price source:

- Vendor quoted price
- FTSE Index quoted price
- Broker quoted price
- Model / Internal price
- Cost

Each price source is reviewed on a regular basis, with support from the Society's fund manager, to ensure that it continues to represent fair value for the asset class being valued. Independent prices are sought where values are subjective, including any securities identified as 'illiquid'.

No assets have defaulted or been written down in value in the year.

Collective Investments Undertakings (CIUs)

Non-linked Collective Investments Undertakings (CIUs) comprise mostly cash funds, while those within unit-linked assets are 'retail mutual funds'. These are all regulated in accordance with the Financial Conduct Authority (FCA) Collective Investment Schemes Sourcebook (COLL) and are available to other investment clients. In all cases the prices are published daily and the funds are actively traded on an exchange daily. In such circumstances the published price is considered to be the fair value of the asset.

There are no significant CIUs that are not retail mutual funds or cash funds.

Alternative methods of valuation

Mark to model techniques are used to value:

Participations and private equity (£6m)

The Society has two nil value subsidiary companies. Lydiard Fields Management Company (LFMC) holds the Society's residual freehold interest in common areas of an office and industrial development in Swindon. LFMC is held at nil value.

A new subsidiary, Equitable Life Ireland DAC, has been created in preparation for Brexit, and is held at nil value.

Other investments are mostly private equity and so reported as CIUs. Valuation is at net asset value, being a simple, industry standard model that reflects the recoverable amount of the investment. Valuations are reviewed in discussion with the fund manager and significant disposals are compared against carrying value, to confirm that such valuation represents fair value.

The implementation of the new strategy may result in a requirement to dispose of private equity holdings in 2019. Other options are being explored, including seeking Regulatory permission for the private equity holdings can be transferred into the pension managed fund. If the assets are held in run-off we are confident that fair value will be realised, and therefore, the valuation basis for these assets for year-end 2018 is the same as used in previous years.

Derivatives: Payer and receiver interest rate swaptions (pre November 2018) (£99m)

Valued using an industry standard model. While most inputs to the valuation model are market observable, there is also some subjectivity. Significant inputs to the model include interest rate curves and interest rate volatility. The model produces mid-level valuation results which are compared against those supplied by the swaption counterparties (Morgan Stanley, Goldman Sachs, JP Morgan and Citigroup) to confirm that an alternative set of independently chosen assumptions would not result in a significantly different valuation. All mid valuation differences during the period, and at the period end, have been within normal tolerance levels.

The bid value of each asset is determined from the mid value, based on BlackRock's assessment of market conditions.

Derivatives: Spread-locks

The spread-locks were effected through a combination of Gilt TRS (asset positions £3.5m, liability positions £18.0m) and pairs of sold payer and purchased receiver swaptions (asset positions £59.5m, liability positions £30.3m).

The Gilt TRS valuation comprises two components; a performance leg and a funding leg. The mid value of the performance leg is based on the difference between the price of each underlying gilt at the valuation date and the forward sale price agreed at outset. The funding leg represents interest earned on the initial market value of each underlying gilt and so accrues daily. The amount of interest is calculated using the coupon rates written into each contract, which are based on repo rates at outset. To derive the bid value, BlackRock supply an adjustment based on transaction costs they observe in the market to close out the contracts immediately. The mid-bid adjustment at 31 December 2018 was c£6m. This adjustment is expected to reduce to zero as we approach the expiry dates.

The pairs of payer and receiver swaptions were valued using the same model as that used to value the Society's other swaptions holding, to produce a mid-level value. The swaptions within the spread-locks would only ever be sold in pairs, and so the assessment of the mid-to-bid adjustment takes account of this.

Other Assets

- Forward exchange contracts are small in value and held to hedge currency exposures
- Cash & cash equivalents represent cash at bank and trading balances held at the custodian
- Other current assets represent a portfolio of loans held against policies, tax recoverables and amounts due from policyholders, reassurers and investment brokers and other receivables, valued at recoverable amount.
- The Society has no material intangible assets, leases or deferred tax assets

Assumptions and Uncertainties

Aside from assumptions used for valuation models, as noted above, there are no significant assumptions or uncertainties regarding the valuation of assets.

Active Markets

For fixed income securities, a market is considered to be 'active' if trades occur regularly and daily pricing is available. Where there are few, or no, trades or daily pricing is not available, a security is considered 'stale' and additional price information sought – generally a second vendor or broker price – to confirm the validity of the price used. The market for all UK government bonds was assessed as active at the year end.

For equity and investment funds, including most of the assets held for unit-linked funds, a market is considered 'active' if there are trades on a daily basis. Where the market is not active, securities are valued at net asset value, or expected recoverable amount (if lower).

Valuation of assets in the Financial Statements

There are no differences between the bases, methods and main assumptions used in the valuation for solvency purposes and those used for valuation in the Financial Statements.

Asset values in the Solvency II Balance Sheet are shown including accrued interest thereon. In the Financial Statements, the accrued interest is shown separately. This is a difference in presentation and not a valuation difference.

Deferred taxation

In 2017, there were unrealised gains of £13m, on which a provision for future tax of £3m had been recognised in the Balance sheet. In 2018, £11m of the gains reversed, resulting in the release of the £2m of the provision for deferred tax, leaving a provision for deferred tax in the Balance sheet of £0.3m.

D.2 Technical provisions

The solvency and financial condition report shall include all of the following information regarding the valuation of the technical provisions of the insurance or reinsurance undertaking for solvency purposes:

(a) separately for each material line of business the value of technical provisions, including the amount of the best estimate and the risk margin, as well as a description of the bases, methods and main assumptions used for its valuation for solvency purposes;

(b) a description of the level of uncertainty associated with the value of technical provisions;

(c) separately for each material line of business, a quantitative and qualitative explanation of any material differences between the bases, methods and main assumptions used by that undertaking for the valuation for solvency purposes and those used for their valuation in financial statements;

(d) where the matching adjustment referred to in Article 77b of Directive 2009/138/EC is applied, a description of the matching adjustment and of the portfolio of obligations and assigned assets to which the matching adjustment is applied, as well as a quantification of the impact of a change to zero of the matching adjustment on that undertaking's financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(e) a statement on whether the volatility adjustment referred to in Article 77d of Directive 2009/138/EC is used by the undertaking and quantification of the impact of a change to zero of the volatility adjustment on that undertaking's financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(f) a statement on whether the transitional risk-free interest rate-term structure referred to Article 308c of Directive 2009/138/EC is applied and a quantification of the impact of not applying the transitional measure on the undertaking's financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(g) a statement on whether the transitional deduction referred to in Article 308d of Directive 2009/138/EC is applied and a quantification of the impact of not applying the deduction measure on the undertaking's financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement.

(h) a description of the following:

(i) the recoverables from reinsurance contracts and special purpose vehicles;

(ii) any material changes in the relevant assumptions made in the calculation of technical provisions compared to the previous reporting period.

Guideline 8 – Valuation of technical provisions

1.21. Under section "D.2 Technical provisions" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should describe the significant simplified methods used to calculate technical provisions, including those used for calculating the risk margin.

D.2 Technical provisions

D.2 (a) Technical Provisions for each line of business

Technical Provisions are the sum of the Best Estimate Liabilities and the Risk Margin. Solvency II uses a best-estimate basis for all assumptions for the calculation of Best Estimate Liabilities. A best estimate basis is one where there is an equal chance of over-estimating the actual experience and under-estimating the actual experience. Best Estimate Liabilities are split between the main lines of business and between reassured and non-reassured liabilities, together with a split of the Risk Margin between business types as per **S.12.01.02** (Appendix 1).

December 2018:

£m	With-profit participation	Unit-linked insurance	Other life insurance	Accepted Reinsurance	Total
Technical provisions calculated as a whole	-	1,634	-	-	1,634
Best estimate liabilities (gross)	3,295	44	398	1	3,738
Risk Margin	144	31	15	-	191
Transitional measures on technical provisions (TMTP)	(42)	(23)	(1)	-	(65)
Technical Provisions	3,398	1,686	412	1	5,497
Reinsured Liabilities	(-)	(8)	(362)	-	(371)
Technical provisions net of Reinsured Liabilities	3,398	1,678	51	1	5,126

Methodology for with-profits business

Technical provisions for recurrent single premium business have been calculated by projecting policy values and guaranteed values, allowing for death rates, surrender (non-contractual termination) rates and retirement rates. For contractual terminations, i.e. deaths and retirements, the amount paid is based on the higher of the projected policy value and the projected guaranteed value. For surrenders, the amount paid is the projected policy value, less any financial adjustment.

After discounting to the valuation date, values are summed across all possible claim dates for all benefit groupings. No allowance is made for capital distribution.

For the purpose of these calculations, investment returns and deflators are based on the risk-free curve defined by European Insurance and Occupational Pension Authority (EIOPA), i.e. swap yields less the Credit Risk Adjustment (CRA).

This calculation is repeated across 5,000 stochastic simulations i.e. different possible financial outcomes, and the average liability across these outcomes calculated. This methodology captures the "time value" of the underlying guarantees. In order to reduce model run times, the final model runs are performed using two blocks of 500 simulations that produce the closest match to the cost of guarantees produced by 5,000 simulations. These 1,000 simulations are then used in the calculation of liabilities.

A similar methodology is used for conventional with-profits business i.e. endowments and whole of life policies. The sum assured and declared bonus on each policy is first converted into a notional policy value, using final bonus rates and a bonus reserve valuation. Expenses are implicitly allowed for in the premiums valued. No allowance for surrenders is made. Future reversionary bonuses are assumed to be zero.

Methodology for unit-linked business

The unit liability under linked contracts is valued by taking the number of units deemed to attach to policies multiplied by the valuation price per unit as provided by State Street.

At 31 December 2018, all unit liabilities were non-reassured except for c£8m reassured with Scottish Widows.

No future premiums are assumed for unit-linked pension policies, only contractual premiums are included for unit-linked life policies.

As at 31 December 2018, the weighted average of the Society's Annual Management Charge (AMC) across all funds was 0.72% pa.

The present value of unit-linked charges is calculated by applying this charge to the projected value of liabilities, using a cash-flow approach i.e. rolling forward and discounting using the risk-free interest term structure, allowing for terminations using a multiple decrement approach.

Based on the ratio of the average Aberdeen Standard Investments Limited (ASI) fund management charge to the average AMC, a proportion of the resultant value of charges is attributed to unit-linked business and included within the expense reserve.

The non-unit liability is calculated using a per-policy projected cash flow methodology. The only non-linked liabilities are in respect of expenses and mortality.

Methodology for non-profit business (other life insurance)

Non-profit best estimate liabilities are calculated on a projected cash flow basis, allowing for any escalation in payment or deferment, spouse's benefits, any minimum or maximum payment term and any change to the level of annuity at a particular age, for example State Pension Age. For index-linked annuities, benefits are first increased by inflation which is implied from nominal and real gilt yields at the valuation date. The resultant cash-flows are discounted at the EIOPA risk-free curve.

For Limited Price Indexation (LPI) annuities i.e. index-linked annuities with a specified maximum increase rate. The average liability across 1,000 stochastic simulations is used, with inflation capped at 5% p.a. in each simulation for each year of the projection.

Methodology for expense reserves

Expense reserves are derived by considering the run-off total expenses rather than building up a picture of the future cost of administering each policy.

The expense model takes the budget for regular expenses in the next year; and a forecast of annual expenses in the years in which: the total number of benefits in force has reduced by half; by three quarters; and the year in which the total number of policies in force has reduced to c1, 000. Customer service costs are modelled separately from other administration and support costs.

The budget for customer service costs in the next year is split by product based on the results of an activity cost analysis. Future customer service costs for each product are assumed to run off at a proportion of the reduction in the number of benefits each year. The same proportion is used across all products and in all future years. The proportion is set such that modelled total customer service costs are in line with the forecast of customer service costs in the three years described above.

A similar method is used to model other administration and support costs. They are modelled in aggregate based on the run off of the total number of benefits.

For reporting purposes, customer service costs attributed to each product type are split between non-profit, with-profits and unit-linked business in proportion to the number of benefits. Other administration and support costs are allocated in proportion to policy administration expenses.

Expenses are increased in line with expected inflation, as implied by the difference between nominal and index-linked yield curves at the valuation date.

Allowance is made for the charges made to Scottish Widows for administering the reinsured business, which is based on a set of agreed per policy costs for each line of business, applied to a projection of the number of policies and multiplied by the proportion of benefits reinsured at each future date. These costs are increased from the date of the 2009 agreement in line with an agreed sub-index of national average earnings as published by the Office for National Statistics, between July 2009 and the valuation date.

Allowance is also made for unit pricing and accounting charges payable to State Street.

The value of investment management fees payable to BlackRock is calculated by running off the current level of charges applicable to with-profits assets in line with policy values.

Charges applicable to assets underlying expense reserves are run-off in line with a projection of the regular expense reserve.

An additional provision is held for future project costs not allowed for in department budgets, e.g. for future regulatory change. Expected inflation is applied to future costs as described above.

The value of the unit-linked fund management charges described above is added to the total regular expense reserve.

Assumptions

In the calculations for with-profits business described above, charges of 2% p.a. of policy values have been allowed for, comprising the following:

- An expense charge of 1% p.a. deducted from policy values.

- A further charge of 1% p.a. deducted from policy values to make some allowance for the expected cost of guarantees and to act as a margin against risk and adverse experience.

Surrender (non-contractual termination) rates are based on recent experience, adjusted for future expected developments / trends. Surrender rates are determined by product type.

Retirement rates for pensions business are based on recent experience for each product type. An adjustment is applied to reflect expected future developments.

In the projection of assets and liabilities it has been assumed that Policy Values would be changed in line with the return on assets less charges.

Future declared reversionary bonus rates are assumed to be zero throughout the projection period, as has been the case since 1999.

The Society's valuation has been carried out using published mortality tables and an investigation into the Society's actual mortality experience. The Society continues to make allowance for future improvements in the longevity of annuitants.

Mortality Assumptions by class of business	Current Valuation	Previous Valuation
Pension and purchased life annuities	92.5% PNML08 cmi2017 (U=2018)* for males	92.5% PNML08 cmi2015 (U=2017)* for males
	90% PNFL08 cmi2017 (U=2018)* for females	90% PNFL08 cmi2015 (U=2017)* for females
Permanent assurances	75% AMC00 males	75% AMC00 males
	75% AFC00 for females	75% AFC00 for females
Temporary assurances	52.5% TMC00 for males	52.5% TMC00 for males
	65% TFC00 for females	65% TFC00 for females
Pensions in deferment	55% AMC00 for males	62.5% AMC00 for males
	62.5% AFC00 for females	67.5% AFC00 for females

* The allowance for mortality improvements is based on the CMI 2017 improvements model with a long-term rate of improvement of 1.5% p.a. for males and 1.25% p.a. for females.

Policy Administration expenses are assumed to run-off at a fixed percentage of the projection of the total number of benefits within a specified product grouping. This was set at 71% as at 31 December 2018 (80% December 2017).

Other administration and support costs are assumed to run-off at a fixed percentage of the average benefit run-off rate across all products. This was set at 56% as at 31 December 2018 (62% December 2017).

Future premiums for with-profits business (contract boundaries)

The Society is closed to new business and premiums into with-profits Recurrent Single Premium (RSP) policies are only permitted if premiums have been paid in each previous calendar year. This has resulted in very low premiums in respect of with-profits RSP business. Technical provisions have therefore been calculated assuming that the only premiums payable will be those contractually due, for example under conventional with-profits policies, term assurances and flexible protection plans.

Simplifications

No significant simplifications have been used in the valuation of best estimate liabilities.

Risk Margin

The Risk Margin is an addition to the liabilities and is designed to offer extra protection to policyholders against the risk of insurer insolvency. The Risk Margin increases the technical provisions to the amount that would have to be paid to another insurance company in order for them to take on the best estimate liability.

It therefore represents the theoretical compensation for the risk of future experience being worse than best estimate assumptions, and for the cost of holding regulatory capital against this.

The Risk Margin only covers unhedgeable risks. Risks that contribute to the Risk Margin are mortality, longevity, lapse, expense, operational and counterparty default. It is assumed that were another insurance company to take on the best estimate liability they would be able to select assets in such a way so as to remove market risk.

The method of calculating the Risk Margin and the degree of simplification used in its calculation is a matter of judgement. The Solvency II regulations included four alternative methods of varying complexity and accuracy. Our chosen methodology is Level 1 of the four level hierarchy. This is the most detailed and accurate of the available methodologies.

Individual risk capital requirements are generally assumed to run-off in line with their respective liability components. For example, lapse risk is assumed to run off in line with with-profits policy values. The actual average run-off of lapse risk in the Society's projection model, the Dynamic Distribution Model (DDM), is much closer to the run-off of policy values than to any other proxy such as with-profits liabilities.

The capital requirements in respect of mortality risk and operational risk is assumed to run off in line with the with-profits component of technical provisions. Mortality risk is largely proportionate to the amount of with-profits business on the books, whilst operational risk under Solvency II (using the Standard Formula) is expressed directly as a proportion of technical provisions excluding unit-linked business.

Expenses are assumed to run-off in line with the best estimates from the expense model (hence the expense reserve at future valuation dates in base and stress can be calculated by discounting expected cash-flows beyond the valuation date).

Counterparty risk is assumed to run-off in line with the reinsured component of best estimate liabilities. The capital requirement for counterparty risk is calculated based on credit rating and the amount recoverable from the counterparty, which is proportionate to the reinsured liabilities. Note that the credit ratings of the counterparties are assumed not to change over time.

The capital requirement for life underwriting risks in the reference undertaking is assumed to be the same (at time zero) as in the original undertaking because it is difficult to eliminate or hedge life underwriting risks.

The Risk Margin has been split between lines of business by first calculating the Risk Margin for each line of business on the assumption that other lines of business do not exist, and then splitting the total Risk Margin in proportion to these amounts.

Economic Scenario Generator

For the Society's with-profits business, an additional cost is generated when policyholders take benefits on contractual terms where their guaranteed fund is in excess of their policy value.

The cost of the guarantee in an individual simulation is the discounted value of the difference between the policy value at retirement and the guaranteed value at retirement, if the guaranteed value is higher than the policy value.

A deterministic calculation using current risk-free yields to derive expected future returns, and hence future policy values, will capture the expected, or 'intrinsic,' value of these guarantees. However, there is a wide range of possible outcomes for future investment returns, and hence future policy values and the cost of guarantees. This additional cost of guarantees arising from the uncertainty of future returns, known as the 'time value' is not captured in the intrinsic value. This can apply even if today a policy has a policy value well in excess of the guarantees.

In order to calculate the cost of the guarantees applying to our with-profits business properly, including the time value described above, the Society is required to undertake a stochastic valuation using a wide range of future investment scenarios. The stochastic simulations are produced by the Economic Scenario Generator (ESG).

The Moody's Analytics ESG, with nominal interest rates fitted to market swap rates, is used to produce the stochastic simulation file used in the calculation of technical provisions. An adjustment is made within Prophet Life Dynamic Financial Analysis (DFA) to calibrate the results to the EIOPA risk-free curve. This methodology means that future interest rate paths in the simulations are dispersed either side of the risk-free curve.

In order to reduce model run times, the final model runs are performed using two blocks of 500 simulations that produce the closest match to the cost of guarantees produced by 5,000 simulations.

D.2(b) Level of uncertainty associated with technical provisions

The main uncertainties in technical provisions are in respect of:

Policyholder behaviour:

- Decreasing retirement rates on average by one year would decrease Excess Assets by c£31m (2017: c£31m);

Future expenses:

- Increasing assumed level of future expenses by 5% would decrease Excess Assets by c£19m (2017: c£21m)
- Increasing future inflation of expenses by 1% would decrease Excess Assets by c£39m (2017: c£43m)

D.2(c) Material differences to financial statements

Assets other than the reinsurer's share of technical provisions are valued consistently for solvency purposes and in the statutory financial statements. Therefore, differences arise solely from differences in the valuation of technical provisions. The material differences between the bases, methods and main assumptions used have been set out with reference to the difference between Excess of Assets over liabilities in the financial statements and Own Funds being the equivalent measure under Solvency II. This is a key measure of capital management for the Society.

The following table shows a breakdown of the material differences to the financial statements.

Description	Amount 2018 £m	Amount 2017 £m
Excess of Assets over liabilities in financial statements	814	901
Difference in valuation assumptions for with-profits business (1)	(17)	(43)
Difference in valuation assumptions for non-profit business (net of reinsurance)(1)	-	-
Other valuation differences on expense reserve (1)	(7)	(12)
Adjustment for expected counterparty default rates (2)	(6)	(7)
Risk Margin (3)	(191)	(217)
Transitional Measures to Technical Provisions (TMTP)(3)	65	100
Own Funds	658	723

(1) In the financial statements, liabilities are discounted using a gilt yield curve. This is based on the gross redemption yields of government fixed interest securities. Under Solvency II, however, the "risk-free" curve used to discount liabilities is based on swap yields less a CRA. The difference in discount rates is the main reason for the difference in the value placed on liabilities.

(2) This is the material difference arising from the prescribed methods used to value reinsured assets under Solvency II, primarily for non-profit business.

(3) The Risk Margin and Transitional Measures are not included in technical provisions in the financial statements and therefore have a direct impact on the difference between Excess of Assets in the financial statements and Own Funds. A further split of these items by line of business can be found in section D.2 (a).

D.2(d) Matching Adjustment

The Society does not apply a Matching Adjustment in the calculation of Technical Provisions.

D.2(e) Volatility Adjustment

In September 2018, the Society's Board approved the removal of the Volatility Adjustment following the sale of the majority of the Society's corporate bond holdings.

D.2(f) Transitional measure on risk-free interest rates

The Society does not apply the transitional measure on risk-free interest rates.

D.2(g) Transitional measure on technical provisions (TMTP)

The purpose of the Transitional Deduction is to smooth the transition between Solvency I and Solvency II capital requirements by helping to mitigate the impact of the Risk Margin. The Society has approval for the use of a transitional deduction to SII technical provisions based on the solvency position as at 31 December 2015. The PRA gave permission for the recalculation of the transitional deduction, which were £65m as at 31 December 2018 (2017: £100m).

The amount of transitional deduction applied as at 31 December 2018 was £65m. If transitional deductions were not applied, total technical provisions would be £65m higher than stated in section D.2 (a) and correspondingly Own Funds would be £65m lower. The Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) are unaffected by the application of transitional deductions to technical provisions as at 31 December 2016. TMTPs of £65m reduce linearly every year until 2031, with the next reduction on 1 January 2019.

D.2(h),(i) Reinsurance recoverables

Recoverables from reinsurance contracts are treated as an asset in Solvency II. The value of the reinsurance asset is calculated to be the value of reinsured liabilities less an adjustment to allow for default risk. This adjustment means that the Solvency II balance sheet does not include the full benefit of reinsurance contracts. The adjustment is dependent upon the credit rating of the counterparty and the term of the reassurance agreement.

The amount of reinsurance recoverables is set to the value of best estimate liabilities, less an adjustment for expected counterparty default risk (around 0.25% of technical provisions). This adjustment is calculated allowing for the likelihood of default of each counterparty, in particular using a credit rating of “A” for the main counterparty, Scottish Widows. A recovery rate of 50% is used, as per the simplification set out in Article 61 of the Delegated Acts.

Further detail on the valuation methodology for non-profit business can be found in section D.2 (a). All deferred annuities and most assurances are reinsured to mitigate longevity and mortality risk as per section C.1 2b of this report.

D.2(h),(ii) Material Changes in Relevant Assumptions

Retirements

An investigation of the actual retirement ages for the Society’s with-profits policyholders, analysed by type of contract, has been carried out based on experience between 2014 and 2017 and used to set underlying retirement assumptions. A separate review of retirement experience in 2018 showed a deferral of claims by policyholders, following communication about the Society’s new strategy. Were the Society to continue in run-off, the deferral would be expected to persist through 2019 and then reverse in 2020, such that, the combined effect of the three years together is consistent with the longer-term assumptions adopted. The underlying retirement assumptions and temporary deferral have been converted to best estimate retirement rates using judgement about future retirement patterns.

The effect of the temporary decrease in retirement and surrender assumptions in 2019, and the reversion in 2020 has resulted in a decrease in Excess Assets of £6m (2017: change in retirement assumptions resulted in a decrease in Excess Assets of £16m; change in surrender assumptions resulted in an increase in Excess assets of £26m).

As at 31 December 2018 assumed future expenses were updated to reflect business forecasts, resulting in a decrease in the value of liabilities of c£8m (Increase in the value of liabilities of c£31m in 2017).

D.3 Other liabilities

The solvency and financial condition report shall include all of the following information regarding the valuation of the other liabilities of the insurance or reinsurance undertaking for solvency purposes:

(a) separately for each material class of other liabilities the value of other liabilities as well as a description of the bases, methods and main assumptions used for their valuation for solvency purposes;

(b) separately for each material class of other liabilities, a quantitative and qualitative explanation of any material differences with the valuation bases, methods and main assumptions used by the undertaking for the valuation for solvency purposes and those used for their valuation in financial statements.

Guideline 9 – Liabilities other than technical provisions – information on aggregation by class

1.22. Under section "D.3 Other liabilities" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, when aggregating liabilities other than technical provisions into material classes to describe the valuation basis that has been applied to them consider the nature, function, risk and materiality of those liabilities.

1.23. Classes other than those used in the Solvency II balance sheet template as defined in the Technical Standard on the templates for the submission of information to the supervisory authorities should only be used if the undertaking is able to demonstrate to the supervisory authority that another presentation is clearer and more relevant.

Guideline 10 – Content by material classes of liabilities other than technical provisions

1.24. Under section "D.3 Other liabilities" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, in relation to each material class of liability other than technical provisions, describe at least the following quantitative and qualitative information:

a) Recognition and valuation basis applied, including methods and inputs used, in particular:

i. describe in general the material liabilities arising as a result of leasing arrangements, separately disclosing information on financial and operating leases;

ii. the origin of the recognition of deferred tax liabilities and the amount and expiry date if applicable, of taxable temporary differences;

iii. the nature of the obligation and, if known, expected timing of any outflows of economic benefits and an indication of uncertainties surrounding the amount or timing of the outflows of economic benefits and how deviation risk was taken into account in the valuation;

iv. The nature of the liabilities for employee benefits and a breakdown of the amounts by nature of the liability and the nature of the defined benefit plan assets, the amount of each class of assets, the percentage of each class of assets with respect to the total defined benefit plan assets, including reimbursement rights.

b) Any changes made to the recognition and valuation bases used or on estimations during the reporting period;

c) Assumptions and judgements including those about the future and other major sources of estimation uncertainty.

D.3 Other liabilities

OTHER LIABILITIES

	At 31 December 2018 £m	At 31 December 2017 £m
Other provisions (deferred tax)	0.3	2.5
Debts owed to credit institutions	1.4	2.5
Insurance & intermediaries payables	21.3	24.2
Derivatives	48.3	-
Payables (trade, not insurance)	142.5	151.7
TOTAL OTHER LIABILITIES	**213.8**	**180.9**

In 2017 we recognised a deferred tax liability arising from increases on assets in the year which will become taxable in future years. This was offset by losses arising from decreases in unit-linked asset values in 2018.

Other liabilities are valued at the amount payable and recognised when the obligation to pay arises.

Derivatives with negative values at the balance sheet date include:

- Gilt TRS contracts that form part of the spread-locks (negative £18m)
- Payer Swaptions that form part of the spread-locks (negative £30.3m)

Payables include £123m obligation to repay amounts received as collateral held against the swaption contracts.

The Society has no material liabilities arising as a result of leasing arrangements. There are also no significant uncertainties regarding the timing or amounts of other liabilities.

There have been no changes made to the recognition and valuations bases, or estimates used, of other liabilities during the reporting period.

There are no differences between the bases, methods and main assumptions used in the valuation for solvency purposes and those used for valuation in the Financial Statements.

Aside from assumptions used for valuation models, as noted above, there are no significant assumptions or uncertainties regarding the valuation of assets.

D.4 Alternative methods for valuation
The solvency and financial condition report shall include information on the areas set out in Article 263 in complying with the disclosure requirements of the insurance or reinsurance undertaking as laid down in paragraphs 1 and 3 of this Article.

D.4 Alternative methods for valuation

There are no differences between the bases, methods and main assumptions used in the valuation for solvency purposes and those used for valuation in the Financial Statements.

Please see section D1 for detail of alternative valuation methods. There are no liabilities valued using alternative valuation methods.

D.5 Any other information
The solvency and financial condition report shall include in a separate section any other material information regarding the valuation of assets and liabilities for solvency purposes.

D.5 Any other information

The PRA has given permission for the recalculation of TMTPs, which were £65m at December 2018 (2017: £100m). These are a transitional reduction in technical provisions, helping to mitigate the impact of the Risk Margin on available capital. TMTPs reduce annually until 2031.

E. Article 297 - Capital Management

E.1 Own funds

The solvency and financial condition report shall include all of the following information regarding the own funds of the insurance or reinsurance undertaking:

(a) information on the objectives, policies and processes employed by the undertaking for managing its own funds, including information on the time horizon used for business planning and on any material changes over the reporting period;

(b) separately for each tier, information on the structure, amount and quality of own funds at the end of the reporting period and at the end of the previous reporting period, including an analysis of the significant changes in each tier over the reporting period;

(c) the eligible amount of own funds to cover the Solvency Capital Requirement, classified by tiers;

(d) the eligible amount of basic own funds to cover the Minimum Capital Requirement, classified by tiers;

(e) a quantitative and qualitative explanation of any material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes;

(f) for each basic own-fund item that is subject to the transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC, a description of the nature of the item and its amount;

(g) for each material item of ancillary own funds, a description of the item, the amount of the ancillary own-fund item and, where a method by which to determine the amount of the ancillary own-fund item has been approved, that method as well as the nature and the names of the counterparty or group of counterparties for the items referred to in points (a), (b) and (c) of Article 89(1) of Directive 2009/138/EC;

(h) a description of any item deducted from own funds and a brief description of any significant restriction affecting the availability and transferability of own funds within the undertaking. For the purposes of paragraph (g), the names of the counterparties shall not be disclosed where such disclosure is legally not possible or impracticable or where the counterparties concerned are not material.

Guideline 11 - Own funds – Additional solvency ratios

1.25. Under section "E.1 Own funds" of the SFCR as defined in Annex XX of the Delegated Regulation, where undertakings disclose additional ratios to the ones included in template S.23.01, the SFCR should also include an explanation on the calculation and meaning of the additional ratios.

Guideline 12 - Own funds – Information on the structure, amount, quality and eligibility of own funds

1.26. Under section "E.1 Own funds" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, regarding their own funds, describe at least the following information:

a) for each material own fund item set out in Article 69, Article 72, Article 74, Article 76 and Article 78, as well as for items that received supervisory approval as per Article 79 of the Delegated Regulation the information required in Article 297 (1) of the Delegated Regulation, distinguishing between basic and ancillary own fund items;

b) for each material own fund item, the extent to which it is available, subordinated, as well as its duration and any other features that are relevant for assessing its quality;

c) an analysis of significant changes in own funds during the reporting period, including the value of own fund items issued during the year, the value of instruments redeemed during the year, and the extent to which the issuance has been used to fund redemption;

d) in relation to subordinated debt, an explanation of the changes to its/ their value;

e) when disclosing the information required in Article 297 (1) (c) of the Delegated Regulation, an explanation of any restrictions to available own funds and the impact of limits on eligible Tier 2 capital, Tier 3 capital and restricted Tier 1 capital;

f) details of the principal loss absorbency mechanism used to comply with Article 71 (1)(e) of the Delegated Regulation , including the trigger point, and its effects;

g) an explanation of the key elements of the reconciliation reserve;

h) for each basic own fund item subject to the transitional arrangements:

i.		the tier into which each basic own fund item has been classified and why;
ii.		the date of the next call and the regularity of any subsequent call dates, or the fact that no call dates fall until after the end of the transitional period.
i)	when disclosing the information required in Article 297(1)(g) of the Delegated Regulation, information on the type of arrangement and the nature of the basic own funds item which each ancillary own fund item would become on being called up or satisfied, including the tier, as well as when the item was approved by the supervisory authority and, where a method was approved, for how long;	
j)	where a method has been used to determine the amount of a material ancillary own fund item, undertakings should describe:	
i.		how the valuation provided by the method has varied over time;
ii.		which inputs to the methodology have been the principal drivers for this movement;
iii.		the extent to which the amount calculated is affected by past experience, including the outcome of past calls.
k)	Regarding items deducted from own funds:	
i.		the total excess of assets over liabilities within ring-fenced funds and matching adjustment portfolios, identifying the amount for which an adjustment is made in determining available own funds;
ii.		the extent of and reasons for significant restrictions on, deductions from or encumbrances of own funds.

E.1 Own Funds

Assets other than the reinsurer's share of technical provisions are valued consistently for solvency purposes and in the statutory financial statements. Therefore, all differences in the value of Own Funds arise from differences in the valuation of technical provisions.

Own Funds consists entirely of the excess of assets over liabilities and is entirely Tier 1. The Society does not have any ordinary share capital, ancillary Own Funds or any other own fund items other than the reconciliation reserve.

The Society's approach to capital distribution and capital management is set out in the respective sections of the introduction to this report.

Section D.2 (c) sets out the material differences between Own Funds and Excess Assets in the financial statements.

The Society does not apply any transitional measures in respect of own fund items, only in respect of the Transitional Measures on Technical Provisions. The amount of eligible Own Funds (Tier 1) to cover the Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) as at 31 December 2018 is £658m (31 Dec17: £762m) as per **S.23.01.** Details of Own Funds can be found in **S.23.01.01**. (Appendix1).

E.2	**Solvency Capital Requirement and Minimum Capital Requirement**
The solvency and financial condition report shall include all of the following information regarding the Solvency Capital Requirement and the Minimum Capital Requirement of the insurance or reinsurance undertaking:	
(a)	the amounts of the undertaking's Solvency Capital Requirement and the Minimum Capital Requirement at the end of the reporting period, accompanied, where applicable, by an indication that the final amount of the Solvency Capital Requirement is still subject to supervisory assessment;
(b)	the amount of the undertaking's Solvency Capital Requirement split by risk modules where that undertaking applies the standard formula, and by risk categories where the undertaking applies an internal model;

(c)	information on whether and for which risk modules and sub-modules of the standard formula that undertaking is using simplified calculations;
(d)	information on whether and for which parameters of the standard formula that undertaking is using undertaking specific parameters pursuant to Article 104(7) of Directive 2009/138/EC;
(e)	where applicable, a statement that the undertaking's Member State has made use of the option provided for in the third subparagraph of Article 51(2) of Directive 2009/138/EC;
(f)	unless the undertaking's Member State has made use of the option provided for in the third subparagraph of Article 51(2) of Directive 2009/138/EC, the impact of any undertaking-specific parameters that undertaking is required to use in accordance with Article 110 of that Directive and the amount of any capital add-on applied to the Solvency Capital Requirement, together with concise information on its justification by the supervisory authority concerned;
(g)	information on the inputs used by the undertaking to calculate the Minimum Capital Requirement;
(h)	any material change to the Solvency Capital Requirement and to the Minimum Capital Requirement over the reporting period, and the reasons for any such change.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The Society calculates the SCR following Standard Formula and does not use an internal model.

Details of the SCR can be found in **S.25.01** and details of the MCR in **S.28.01**. (Appendix 1) There are no undertaking specific parameters or capital add-ons to report.

Details of the SCR can be found in **S.25.01** and details of the MCR in **S.28.01**. (Appendix 1)

Simplifications

The impact of the catastrophe stress has been estimated based on the sums at risk as per Article 96 of the Delegated Acts.

The impact of the lapse stress has been calculated based on homogenous risk groups rather than policy by policy, an adjustment has been made to allow for the potential increased capital requirement when performing a more granular approach.

Changes to the SCR over the reporting period

The SCR has decreased by £42m over the reporting period, as shown in the table below.

Change in SCR	£m
Change in individual risks	
Credit spread Risk	(73)
Interest rate risk	14
Lapse risk	(12)
Equity Risk	(5)
Expense Risk	(3)
Other Risks	(6)
	(85)
Change in Diversification Benefits	43
Change in SCR in the year	(42)

The main reasons for the decrease in SCR of £42m are:

- A £73m decrease in the capital requirement for credit risk due to the sale of corporate bonds
- A £12m decrease in the capital requirement for lapse risk. This was largely due to a rise in swap yields
- As a result of these decreases and other changes in individual risks there was a reduction of £43m in diversified benefits

E.3	**Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement**
The solvency and financial condition report shall include all of the following information regarding the option set out in Article 304 of Directive 2009/138/EC:	
(a)	an indication that that undertaking is using the duration-based equity risk sub-module set out in that Article for the calculation of its Solvency Capital Requirement, after approval from its supervisory authority;
(b)	the amount of the capital requirement for the duration-based equity risk sub-module resulting from such use.

E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement

The Society does not use the duration based equity sub-module.

E.4	**Differences between the standard formula and any internal model used**
Where an internal model is used to calculate the Solvency Capital Requirement, the solvency and financial condition report shall also include all of the following information:	
(a)	a description of the various purposes for which that undertaking is using its internal model;
(b)	a description of the scope of the internal model in terms of business units and risk categories;
(c)	where a partial internal model is used, a description of the technique which has been used to integrate any partial internal model into the standard formula including, where relevant, a description of alternative techniques used;
(d)	a description of the methods used in the internal model for the calculation of the probability distribution forecast and the Solvency Capital Requirement;
(e)	an explanation, by risk module, of the main differences in the methodologies and underlying assumptions used in the standard formula and in the internal model;
(f)	the risk measure and time period used in the internal model, and where they are not the same as those set out in Article 101(3) of Directive 2009/138/EC, an explanation of why the Solvency Capital Requirement calculated using the internal model provides policyholders and beneficiaries with a level of protection equivalent to that set out in Article 101 of that Directive;
(g)	a description of the nature and appropriateness of the data used in the internal model.
Guideline 13 - Differences between the standard formula and internal models used	
1.27.	Under section "E.4 Differences between the standard formula and any internal model used" of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, when disclosing the main differences in methodologies and underlying assumptions used in the standard formula and in the internal model, describe at least the following:
a)	Structure of the internal model;
b)	Aggregation methodologies and diversification effects;
c)	Risks not covered by the standard formula but covered by the internal model.

E.4 Differences between the Standard Formula and any internal model used

The Society calculates the SCR following Standard Formula and does not use an internal model.

E.5	**Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement**
The solvency and financial condition report shall include all of the following information regarding any non-compliance with the Minimum Capital Requirement or significant non-compliance with the Solvency Capital Requirement of the insurance or reinsurance undertaking:	
(a)	regarding any non-compliance with that undertaking's Minimum Capital Requirement: the period and maximum amount of each non-compliance during the reporting period, an explanation of its origin and consequences, any remedial measures taken, as provided for under Article 51(1)(e)(v) of Directive 2009/138/EC and an explanation of the effects of such remedial measures;
(b)	where non-compliance with the undertaking's Minimum Capital Requirement has not been subsequently resolved: the amount of the non-compliance at the reporting date;
(c)	regarding any significant non-compliance with the undertaking's Solvency Capital Requirement during the reporting period: the period and maximum amount of each significant non-compliance and, in addition to the explanation of its origin and consequences as well as any remedial measures taken, as provided for under Article 51(1)(e)(v) of Directive 2009/138/EC and an explanation of the effects of such remedial measures;
(d)	where a significant non-compliance with the undertaking's Solvency Capital Requirement has not been subsequently resolved: the amount of the non-compliance at the reporting date.

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

There was no non-compliance with either the MCR or SCR over the reporting period.

E.6	**Any other information**
The solvency and financial condition report shall include in a separate section any other material information regarding the capital management of the insurance or reinsurance undertaking	

E.6 Any other information

At this time there is no other material information to disclose

Additional voluntary information
Where insurance and reinsurance undertakings disclose publicly, in accordance with Article 54(2) of Directive 2009/138/EC, any information or explanation related to their solvency and financial condition whose public disclosure is not legally required these undertakings shall ensure that such additional information is consistent with any information provided to the supervisory authorities pursuant to Article 35 of that Directive.

At this time there is no other material information to disclose.

APPENDIX 1: Quantitative Reporting Template Disclosures

General information

Undertaking name	Equitable Life Assurance Society
Undertaking identification code	549300WH4MO7YSR34G34
Type of code of undertaking	LEI
Type of undertaking	Life undertakings
Country of authorisation	GB
Language of reporting	en
Reporting reference date	31 December 2018
Currency used for reporting	GBP
Accounting standards	Local GAAP
Method of Calculation of the SCR	Standard formula
Matching adjustment	No use of matching adjustment
Volatility adjustment	No use of volatility adjustment
Transitional measure on the risk-free interest rate	No use of transitional measure on the risk-free interest rate
Transitional measure on technical provisions	Use of transitional measure on technical provisions

List of reported templates

S.02.01.02 - Balance sheet
S.05.01.02 - Premiums, claims and expenses by line of business
S.12.01.02 - Life and Health SLT Technical Provisions
S.22.01.21 - Impact of long term guarantees measures and transitionals
S.23.01.01 - Own Funds
S.25.01.21 - Solvency Capital Requirement - for undertakings on Standard Formula
S.28.01.01 - Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

S.02.01.02

Balance sheet

		Solvency II value
	Assets	C0010
R0030	Intangible assets	0
R0040	Deferred tax assets	0
R0050	Pension benefit surplus	0
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	4,350,212
R0080	*Property (other than for own use)*	0
R0090	*Holdings in related undertakings, including participations*	0
R0100	*Equities*	0
R0110	*Equities - listed*	0
R0120	*Equities - unlisted*	0
R0130	*Bonds*	3,379,403
R0140	*Government Bonds*	3,310,222
R0150	*Corporate Bonds*	69,181
R0160	*Structured notes*	0
R0170	*Collateralised securities*	0
R0180	*Collective Investments Undertakings*	808,621
R0190	*Derivatives*	162,187
R0200	*Deposits other than cash equivalents*	0
R0210	*Other investments*	0
R0220	Assets held for index-linked and unit-linked contracts	1,625,670
R0230	Loans and mortgages	151
R0240	*Loans on policies*	0
R0250	*Loans and mortgages to individuals*	151
R0260	*Other loans and mortgages*	0
R0270	Reinsurance recoverables from:	364,772
R0280	*Non-life and health similar to non-life*	0
R0290	*Non-life excluding health*	0
R0300	*Health similar to non-life*	0
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	356,469
R0320	*Health similar to life*	0
R0330	*Life excluding health and index-linked and unit-linked*	356,469
R0340	*Life index-linked and unit-linked*	8,303
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	985
R0370	Reinsurance receivables	446
R0380	Receivables (trade, not insurance)	2,961
R0390	Own shares (held directly)	0
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	22,761
R0420	Any other assets, not elsewhere shown	753
R0500	**Total assets**	6,368,712

S.02.01.02

Balance sheet

		Solvency II value
	Liabilities	C0010
R0510	Technical provisions - non-life	0
R0520	*Technical provisions - non-life (excluding health)*	0
R0530	*TP calculated as a whole*	0
R0540	*Best Estimate*	0
R0550	*Risk margin*	0
R0560	*Technical provisions - health (similar to non-life)*	0
R0570	*TP calculated as a whole*	0
R0580	*Best Estimate*	0
R0590	*Risk margin*	0
R0600	Technical provisions - life (excluding index-linked and unit-linked)	3,811,218
R0610	*Technical provisions - health (similar to life)*	0
R0620	*TP calculated as a whole*	0
R0630	*Best Estimate*	0
R0640	*Risk margin*	0
R0650	*Technical provisions - life (excluding health and index-linked and unit-linked)*	3,811,218
R0660	*TP calculated as a whole*	0
R0670	*Best Estimate*	3,693,750
R0680	*Risk margin*	117,467
R0690	Technical provisions - index-linked and unit-linked	1,685,960
R0700	*TP calculated as a whole*	1,633,692
R0710	*Best Estimate*	44,264
R0720	*Risk margin*	8,004
R0740	Contingent liabilities	0
R0750	Provisions other than technical provisions	0
R0760	Pension benefit obligations	0
R0770	Deposits from reinsurers	0
R0780	Deferred tax liabilities	256
R0790	Derivatives	48,336
R0800	Debts owed to credit institutions	1,409
R0810	Financial liabilities other than debts owed to credit institutions	0
R0820	Insurance & intermediaries payables	21,357
R0830	Reinsurance payables	0
R0840	Payables (trade, not insurance)	142,455
R0850	Subordinated liabilities	0
R0860	*Subordinated liabilities not in BOF*	0
R0870	*Subordinated liabilities in BOF*	0
R0880	Any other liabilities, not elsewhere shown	0
R0900	**Total liabilities**	5,710,991
R1000	**Excess of assets over liabilities**	657,720

S.05.01.02

Premiums, claims and expenses by line of business

Life

		Line of Business for: life insurance obligations						Life reinsurance obligations		Total
		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life reinsurance	
		C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
	Premiums written									
R1410	Gross		6,066	7,348	4,265				193	17,871
R1420	Reinsurers' share		1,618	108	4,351				0	6,077
R1500	Net		4,448	7,240	-87				193	11,794
	Premiums earned									
R1510	Gross		6,066	7,348	4,265				193	17,871
R1520	Reinsurers' share		1,618	108	4,351				0	6,077
R1600	Net		4,448	7,240	-87				193	11,794
	Claims incurred									
R1610	Gross		163,781	137,949	20,820				228	322,778
R1620	Reinsurers' share		934	1,460	21,195				0	23,590
R1700	Net		162,846	136,489	-375				228	299,189
	Changes in other technical provisions									
R1710	Gross		0	0	0				0	0
R1720	Reinsurers' share		0	0	0				0	0
R1800	Net		0	0	0				0	0
R1900	**Expenses incurred**		16,375	7,246	2,259				0	25,880
R2500	**Other expenses**									23,880
R2600	**Total expenses**									49,760

S.12.01.02

Life and Health SLT Technical Provisions

		Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
				Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0150	C0160	C0170	C0180	C0190	C0200	C0210
R0010	**Technical provisions calculated as a whole**		1,633,692							0	1,633,692						
R0020	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole		8,022							0	8,022						
	Technical provisions calculated as a sum of BE and RM																
	Best estimate																
R0030	**Gross Best Estimate**	3,295,055		43,742	522		397,380	711		604	3,738,015						
R0080	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	271		281	0		355,488	711		0	356,750						
R0090	Best estimate minus recoverables from reinsurance/SPV and Finite Re	3,294,784		43,461	522		41,893	0		604	3,381,264						
R0100	**Risk margin**	144,403	31,017			15,303				23	190,746						
	Amount of the transitional on Technical Provisions																
R0110	Technical Provisions calculated as a whole	0	0			0				0	0						
R0120	Best estimate	0		0	0		0	0		0	0						
R0130	Risk margin	-41,563	-23,013			-700				0	-65,275						
R0200	**Technical provisions - total**	3,397,896	1,685,960			412,694				628	5,497,178						

S.22.01.21

Impact of long term guarantees measures and transitionals

		Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions	Impact of transitional on interest rate	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
		C0010	C0030	C0050	C0070	C0090
R0010	**Technical provisions**	5,497,178	65,275	0	0	0
R0020	**Basic own funds**	657,720	-65,275	0	0	0
R0050	**Eligible own funds to meet Solvency Capital Requirement**	657,720	-65,275	0	0	0
R0090	**Solvency Capital Requirement**	413,319	0	0	0	0
R0100	**Eligible own funds to meet Minimum Capital Requirement**	657,720	-65,275	0	0	0
R0110	**Minimum Capital Requirement**	124,489	0	0	0	0

S.23.01.01

Own Funds

	Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	**Total**	**Tier 1 unrestricted**	**Tier 1 restricted**	**Tier 2**	**Tier 3**
		C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	0	0		0	
R0030	Share premium account related to ordinary share capital	0	0		0	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
R0050	Subordinated mutual member accounts	0		0	0	0
R0070	Surplus funds	0	0			
R0090	Preference shares	0		0	0	0
R0110	Share premium account related to preference shares	0		0	0	0
R0130	Reconciliation reserve	657,720	657,720			
R0140	Subordinated liabilities	0		0	0	0
R0160	An amount equal to the value of net deferred tax assets	0				0
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	0	0	0	0	0
R0220	**Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds**	0				
R0230	**Deductions for participations in financial and credit institutions**	0	0	0	0	
R0290	**Total basic own funds after deductions**	657,720	657,720	0	0	0
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	0				
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0				
R0320	Unpaid and uncalled preference shares callable on demand	0				
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0390	Other ancillary own funds	0				
R0400	**Total ancillary own funds**	0			0	0
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	657,720	657,720	0	0	0
R0510	Total available own funds to meet the MCR	657,720	657,720	0	0	
R0540	Total eligible own funds to meet the SCR	657,720	657,720	0	0	0
R0550	Total eligible own funds to meet the MCR	657,720	657,720	0	0	
R0580	**SCR**	413,319				
R0600	**MCR**	124,489				
R0620	**Ratio of Eligible own funds to SCR**	159.13%				
R0640	**Ratio of Eligible own funds to MCR**	528.34%				

	Reconcilliation reserve	C0060
R0700	Excess of assets over liabilities	657,720
R0710	Own shares (held directly and indirectly)	0
R0720	Foreseeable dividends, distributions and charges	
R0730	Other basic own fund items	0
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0
R0760	**Reconciliation reserve**	657,720
	Expected profits	
R0770	Expected profits included in future premiums (EPIFP) - Life business	0
R0780	Expected profits included in future premiums (EPIFP) - Non- life business	0
R0790	**Total Expected profits included in future premiums (EPIFP)**	0

S.25.01.21

Solvency Capital Requirement - for undertakings on Standard Formula

		Gross solvency capital requirement	USP	Simplifications
		C0110	C0090	C0120
R0010	Market risk	26,503		
R0020	Counterparty default risk	13,957		
R0030	Life underwriting risk	383,528		133223.4595
R0040	Health underwriting risk	0		
R0050	Non-life underwriting risk	0		
R0060	Diversification	-29,103		
R0070	Intangible asset risk	0		
R0100	**Basic Solvency Capital Requirement**	394,886		

	Calculation of Solvency Capital Requirement	C0100
R0130	Operational risk	18,433
R0140	Loss-absorbing capacity of technical provisions	0
R0150	Loss-absorbing capacity of deferred taxes	0
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0
R0200	**Solvency Capital Requirement excluding capital add-on**	413,319
R0210	Capital add-ons already set	0
R0220	**Solvency capital requirement**	413,319
	Other information on SCR	
R0400	Capital requirement for duration-based equity risk sub-module	0
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	0
R0420	Total amount of Notional Solvency Capital Requirements for ring fenced funds	0
R0430	Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios	0
R0440	Diversification effects due to RFF nSCR aggregation for article 304	0

USP Key

For life underwriting risk:
1- Increase in the amount of annuity benefits
9 - None

For health underwriting risk:
1- Increase in the amount of annuity benefits
2 - Standard deviation for NSLT health premium risk
3 - Standard deviation for NSLT health gross premium risk
4 - Adjustment factor for non-proportional reinsurance
5 - Standard deviation for NSLT health reserve risk
9 - None

For non-life underwriting risk:
4 - Adjustment factor for non-proportional reinsurance
6 - Standard deviation for non-life premium risk
7 - Standard deviation for non-life gross premium risk
8 - Standard deviation for non-life reserve risk
9 - None

S.28.01.01

Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

	Linear formula component for non-life insurance and reinsurance obligations	C0010
R0010	MCR_{NL} Result	0

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
		C0020	C0030
R0020	Medical expense insurance and proportional reinsurance		
R0030	Income protection insurance and proportional reinsurance		
R0040	Workers' compensation insurance and proportional reinsurance		
R0050	Motor vehicle liability insurance and proportional reinsurance		
R0060	Other motor insurance and proportional reinsurance		
R0070	Marine, aviation and transport insurance and proportional reinsurance		
R0080	Fire and other damage to property insurance and proportional reinsurance		
R0090	General liability insurance and proportional reinsurance		
R0100	Credit and suretyship insurance and proportional reinsurance		
R0110	Legal expenses insurance and proportional reinsurance		
R0120	Assistance and proportional reinsurance		
R0130	Miscellaneous financial loss insurance and proportional reinsurance		
R0140	Non-proportional health reinsurance		
R0150	Non-proportional casualty reinsurance		
R0160	Non-proportional marine, aviation and transport reinsurance		
R0170	Non-proportional property reinsurance		

	Linear formula component for life insurance and reinsurance obligations	C0040
R0200	MCR_{L} Result	124,489

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0050	C0060
R0210	Obligations with profit participation - guaranteed benefits	3,181,032	
R0220	Obligations with profit participation - future discretionary benefits	114,985	
R0230	Index-linked and unit-linked insurance obligations	1,669,653	
R0240	Other life (re)insurance and health (re)insurance obligations	42,497	
R0250	Total capital at risk for all life (re)insurance obligations		271,059

	Overall MCR calculation	C0070
R0300	Linear MCR	124,489
R0310	SCR	413,319
R0320	MCR cap	185,993
R0330	MCR floor	103,330
R0340	Combined MCR	124,489
R0350	Absolute floor of the MCR	3,288
R0400	**Minimum Capital Requirement**	124,489