Zurich Assurance Ltd

ZURICH

Solvency and Financial Condition Report 2018

Zurich Assurance Ltd
Solvency II – SFCR 2018

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Overview

Business profile

Zurich Assurance Ltd is a provider of long term insurance in the UK and is part of the Zurich Insurance Group

Zurich Assurance Ltd (ZAL) is a limited company domiciled and incorporated in the United Kingdom. ZAL also has overseas branches in Hong Kong and the Isle of Man and a run-off portfolio in Malta, which are no longer open to new business.

GBP 8,556 m

Gross Customer Claims (2018)

OVER 99%

Death Claims paid out (in 2018)

System of governance

Zurich Assurance Ltd operates a mature and well established system of governance

Ultimate accountability is shared by the Board and its shareholder, which are supported by the Risk, Audit, Nomination and Investment Committees.

ZAL documents its system of governance within its governance map, which sets out the key functions in the firm and the relevant individuals in control of these functions, along with their lines of accountability and responsibility.

Risk profile

Zurich Assurance Ltd holds appropriate capital for the risks its business faces and has robust controls and mitigants in place

ZAL's business model results in it being subject to a range of risks associated with the activity of issuing insurance and investment contracts and the use of financial instruments. These include risks for which ZAL holds capital, including underwriting, market, credit and operational risks as well as risks for which other mitigation is applied.

Regulatory capital, assessed on the Solvency II standard formula basis, is held to cover the risks associated with ZAL's balance sheet position, specifically for underwriting, market, credit and operational risks. Capital is also held for staff pension scheme risk not covered by the standard formula.

Financial condition

Zurich Assurance Ltd is strongly capitalised

As of 31 December 2018, ZAL's SCR ratio was above the requirement of 100%.

137%

Solvency II SCR ratio (as of 31 December 2018)

GBP 1,642 m

Own funds under Solvency II (as of 31 December 2018)

1 Summary

Zurich Assurance Ltd (ZAL or 'the Company') presents its results as a standalone entity and this Solvency and Financial Condition Report (SFCR) should be read in that context. ZAL is part of the Zurich Insurance Group (ZIG or 'the Group'). In addition to the capital and liquidity held by ZAL, the Group holds substantial capital and liquidity centrally. This centrally held capital and liquidity can be deployed into subsidiaries if needed, and thus provides further support for ZAL to absorb potential losses which could arise from the occurrence of extreme adverse events. The Group itself is regulated by the Swiss Financial Markets Supervisory Authority. As of 1 January 2018, the Group had a solvency ratio of 216% as measured by the Swiss Solvency Test, which has equivalence with the Solvency II regulatory regime applicable to ZAL. The Group manages its capital at an AA level according to its internal economic capital model. The financial strength of Zurich Insurance Company Ltd, which is the main insurance carrier of the Group, is rated AA-/stable by Standard and Poor's. More information on the Group's risk and capital management is provided in its annual report, which is available at www.zurich.com.

A. Business and performance

ZAL is a limited company domiciled and incorporated in the United Kingdom. The principal activity of ZAL is the provision of long term insurance business carried out in the United Kingdom. ZAL has overseas branches in Hong Kong and the Isle of Man and a run-off portfolio in Malta. The branches and run-off portfolio are no longer open to new business.

At 31 December 2018 ZAL had total assets under management (AuM) in excess of £46.6bn and 3.4m policyholders and scheme members. ZAL's UK GAAP profit for the year before taxation was £190m (2017: £94m loss), which in addition to underlying trading profit, includes a gain of £44m on derivative contracts from falling equity markets (2017: £71m loss) and an £83m profit from a reduction in Technical Provisions resulting from demographic basis updates (2017: £17m loss). In addition, 2017 included a one-off loss of £60m as a result of increased Technical Provisions related to the change in capital gains indexation relief announced in the 2017 budget.

ZAL's total annual premium equivalent was £208m. In 2018 gross claims were £10.5bn, this differs from the number in the overview due to platform movements, which is explained below. ZAL paid over 90% of critical illness claims, over 99% of death claims and 95% of income protection claims. ZAL is committed to paying valid claims as they make a real difference to the lives of its customers at a time when they are most vulnerable.

The UK economy has struggled to pick up pace in the last couple of years, but has maintained stability despite the ongoing uncertainty with Brexit. As an open economy, the UK has benefitted despite a reduction in growth in the global economy, in part due to a significantly weaker currency, which drives increased exports. GDP grew at an annual rate of 1.5% in the third quarter of 2018, up from 1.1% in the first quarter. As the global outlook weakens, a result of tighter financial conditions and uncertainty with Brexit, economic momentum in the UK is likely to soften.

Following its August rate rise, the weakening economic environment and the uncertainty around the final Brexit process makes it very unlikely that the Bank of England would increase rates further before summer 2019. The future path of economic activity and monetary policy crucially depends on the outcome of the Brexit process. While the short-term impact of a disorderly Brexit would be substantial the longer-term effects are less clear and would significantly depend on fiscal and monetary policy reactions.

Market highlights include equity markets falling sharply in 2018, leading to large equity losses. Following a year of volatility within Global stock markets, the FTSE 100, which mostly represents large, multinational companies has suffered. Whilst the domestic situation regarding Brexit is a headwind for earnings of smaller domestic firms, firms listed in the FTSE 100 earn the majority of their revenues abroad and are thus much less vulnerable to domestic issues than often perceived. Despite this, the FTSE 100 has underperformed mainly due to the US market's strong performance relative to most other regions, but also due to concerns around global trade, particularly between the US and China. However, near-term performance will be driven by political developments around Brexit with significant volatility to be expected until a deal between the UK and EU is agreed. The Gilt market has been relatively stable in the period, with yields continuing to rise seeing a small drop in values, although this was partially reversed in Q418.

In spite of the economic uncertainty caused by Brexit, the fundamentals of the UK financial services market remain sound. The role of the State continues to be reassessed by the Government as it seeks to close the UK's budget deficit and fund its social protection policy agenda. There are significant opportunities for innovative companies to help consumers address the savings and protection gaps from the reduced reliance on the State and greater dependence upon private provision which characterise today's financial services marketplace. The directors recognise the economic conditions and changing market landscape and the opportunities these bring to ensure that the Company remains at the forefront of meeting customer needs.

The Company is well positioned to succeed in an uncertain business environment, with a strong risk management and governance framework in place and benefits from the financial security provided from being a member of the Group.

Technical provisions have decreased primarily due to market movements and the continued run off of the with-profits business.

On 12 October 2017 the UK business announced the sale of its workplace pensions and Zurich Corporate Savings (ZCS) business to the Lloyds Banking Group. Part of this business is operated by ZAL. The announcement included a multi-year, exclusive distribution partnership for ZAL to provide group life protection solutions to certain corporate clients of Lloyds Banking Group's Commercial Banking Services. The transaction is expected to complete in mid 2019.

In September 2018 the UK business launched a new end to end digital platform, the Life Protection Proposition (LPP), for the sale of Retail Protection business, replacing an aging legacy suite of systems. The new digital first capability will transform the way protection customers and advisers engage with Zurich, making it easier for them to buy (through an improved application experience), easier to recommend Zurich (with market leading products and propositions) and easier to service (through online customer and adviser portals). LPP positions the UK to deliver significant profitable growth in Retail Protection business.

The UK Life business's strategic decision to move corporate pensions business onto the ZCS platform, which sits outside of ZAL but with funds invested in ZAL, generated large movements in premiums and claims in 2017 and this has continued in 2018. The headline Gross Customer Claims number in the above overview (£8,556m) does not include these ZCS platform movements due to this being a strategic move, rather than actual customer claims.

No other material changes than the ones mentioned above have occurred during the reporting period.

B. System of governance

ZAL operates a mature and well established system of governance. The Board derives its collective authority by direct delegation from its shareholders, and is supported by its Risk, Audit, Nomination and Investment Committees. On a day to day basis ZAL is managed by the UK Executive team.

ZAL is part of the UK country segment of the Zurich Group, led by the UK Executive team. On a day to day basis ZAL is run by the individuals approved under the Senior Manager and Certification Regime (SMCR). ZAL is managed as part of the wider Zurich UK with specific functions of Life Manufacturing, Retail Management and UK Distribution supported by pan-UK functions.

ZAL's system of governance is well established and aligned to the wider governance principles of ZIG, as well as the requirements of Solvency II and the Senior Manager and Certification Regime (SMCR), which came into effect on 9 December 2018. The system of governance ensures that there are clear roles and responsibilities throughout the governance structure including the role of the Board, its Committees and the use of non-executive directors, with the effectiveness of the Board and its Committees being reviewed on an annual basis.

ZAL's system of governance and oversight changed during the year with the formation of a Nomination Committee, which has responsibility to provide oversight and to lead the process for board appointments. In addition, the Nomination Committee will consider and make recommendations to the Board on the appointment and removal of any regulatory key function holder with responsibilities that are material to ZAL.

The system of governance is considered appropriate for the nature and scale of ZAL's business.

C. Risk profile

ZAL's business model results in it being subject to a range of risks associated with the activity of issuing insurance and investment contracts and the use of financial instruments.

These include risks for which ZAL holds capital - underwriting risk, market risk, credit risk, operational risk and pension scheme risk - and also risks, such as liquidity risk, for which other mitigation techniques are applied.

Regulatory capital, assessed on the Solvency II standard formula basis, is held to cover the risks associated with ZAL's balance sheet position where the value depends on financial markets, best estimate assumptions being different to expected, operational risks and failures of counterparties. Capital is held for staff pension scheme risk, which is not covered by the standard formula where the scheme is not directly held on the balance sheet, as is the case for ZAL.

Throughout the reporting period ZAL's risk profile has not materially changed with respect to the sources and nature of risks that the business is exposed to.

D. Valuation for solvency purposes

With the aforementioned sale of the workplace pensions and ZCS business an additional asset valuation category ('Assets Held for Sale') has been used. The majority of the value of this asset category is held under 'Assets held for index-linked and unit-linked contracts'.

Total Assets have been valued at £48.1bn (UK GAAP: £48.9bn), with valuation differences in Deferred Acquisition Costs and Reinsurance Recoverables making up the majority of this difference.

Technical Provision liabilities have been valued at £45.6bn (UK GAAP: £47.3bn), with valuation differences in the calculation of technical provisions, including the difference in the underlying valuation of assets making up the majority of this difference.

Other Liabilities have been valued at £789m (UK GAAP: £696m), with valuation differences in Deferred Tax, Deferred Origination Fees and Fund for Future Appropriations making up the majority of this difference.

The numbers above have led to an 'Excess assets over liabilities' value of £1.8bn (UK GAAP: £880m).

No material changes to the valuation methods of the assets and liabilities have occurred during the reporting period, other than those mentioned above.

E. Capital Management

ZAL ensures it has excess money so that it can withstand any uncertainties in future experience. Under Solvency II the Solvency Capital Requirement (SCR) is the capital required to ensure that ZAL will be able to meet its obligations over the next 12 months with a probability of at least 99.5%.

ZAL manages its capital to ensure that regulatory requirements are met at all times. There were no material changes to ZAL's capital management processes during 2018.

As at 31 December 2018, the total eligible Own Funds to meet the SCR was £1,642m, of which £1,641m was classified as tier one and the rest as tier three. The Company's SCR, calculated using a Standard Formula approach, at 31 December was £1,202m. The surplus of eligible Own Funds above the SCR gives a cover ratio of 137%. This is a reduction from the 2017 cover ratio of 160%, which is explained below.

The key changes over the period causing the reduction in the coverage ratio are:

- Changes in Own Funds: There have been reductions in own funds primarily due to the payment of two dividends totalling £250m in the year. This decision was taken to reduce the overall ratio towards a level in line with our target range.

- Changes in SCR: An increase of £39m from the capital add-on in respect of the staff pension scheme risk.

2 Statement of directors responsibility

The ZAL Board of Directors acknowledges its responsibility for preparing the Solvency and Financial Condition Report (SFCR) in all material respects in accordance with the rules issued by the Prudential Regulation Authority (PRA) and the Solvency II regulations.

The ZAL Board is satisfied:

a) Throughout the 2018 financial year, ZAL complied in all material respects with the applicable requirements of the PRA Rules and the Solvency II regulations; and

b) It is reasonable to believe ZAL has continued to comply subsequently and that it will continue to comply in future.

On behalf of the ZAL Board

Jim Sykes

Chief Executive Officer

09 April 2019

3 Independent auditors report

Report of Report of the external independent auditors to the Directors of Zurich Assurance Ltd ('the Company') pursuant to Rule 4.1 (2) of the External Audit Part of the PRA Rulebook applicable to Solvency II firms

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

Opinion

We have audited the following documents prepared by the Company as at 31 December 2018:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2018, ('**the Narrative Disclosures subject to audit**'); and
- Company templates S.02.01.02, S.12.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 ('**the Templates subject to audit**').

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

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

- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S.05.01.02 and S.05.02.01;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report ('**the Responsibility Statement**').

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

Basis for opinion

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

Conclusions relating to going concern

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

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

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

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

Emphasis of Matter - Basis of Accounting

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

Other Information

The Directors are responsible for the Other Information.

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

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

Responsibilities of Directors for the Solvency and Financial Condition Report

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been supplemented by the determination of a capital add-on made by the PRA under the PRA Rules and Solvency II regulations on which they are based.

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

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

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

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

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

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

Report on Other Legal and Regulatory Requirements

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

PricewaterhouseCoopers LLP

Chartered Accountants

Bristol

April 2019

A. Business and performance

This section provides information on ZAL's business structure and operations, as well as its financial performance over the reporting period.

A.1 Business

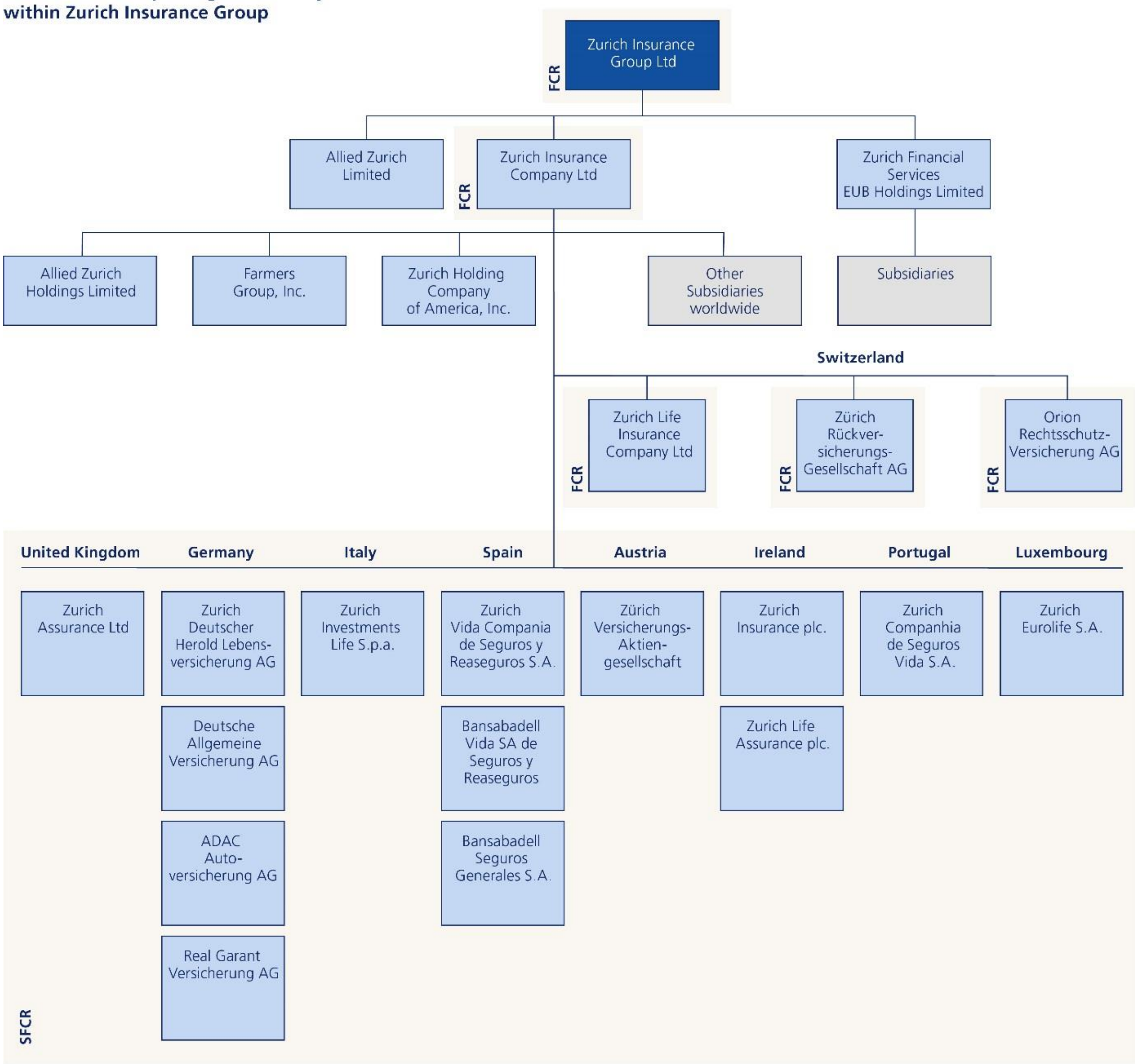
Business profile

Name, Location and legal form of the undertaking	ZAL is a limited company domiciled and incorporated in the UK. The registered office is The Grange, Bishops Cleeve, Cheltenham, Gloucestershire, GL52 8XX. The principal activity of the Company is the provision of long term insurance business carried out in the United Kingdom and overseas. This includes its primary branch situated in Hong Kong, one small branch in the Isle of Man and a run-off portfolio in Malta. These overseas branches and run-off portfolio are no longer open to new business. ZAL is registered in England and Wales under company number 02456671 as a private company limited by shares.
Name and contact details of the supervisory authority responsible for financial supervision and, where applicable, name and contact details of the group supervisor	ZAL is authorised by the Prudential Regulation Authority (PRA) and regulated by the PRA and the Financial Conduct Authority (FCA). The PRA can be contacted at 20 Moorgate, London EC2R 6DA. The FCA can be contacted at 25 The North Colonnade, London E14 5HS. The Zurich Insurance Group is subject to insurance group supervision by the Swiss Financial Market Supervisory Authority (FINMA). FINMA can be contacted at Laupenstrasse 27, CH-3003 Bern, Switzerland.
Name and contact details of the external auditor of the undertaking	PricewaterhouseCoopers LLP 2 Glass Wharf, Bristol, BS2 0FR.
List of material related undertakings including the name, legal form, country, proportion of ownership interest held and, if different, proportion of voting rights held	A list of material related undertakings can be found in Appendix 1.
Description of the holders of qualifying holding in the undertaking	ZAL is a member of the Zurich Insurance Group. Zurich Insurance Group is a leading multi-line insurer that serves its customers in global and local markets. The Group is headquartered in Zurich, Switzerland. Zurich Insurance Group ('the Group') consists of Zurich Insurance Group Ltd (ZIG Ltd) holding entity and its subsidiaries. Zurich Insurance Company Ltd (ZIC) is the principal operating insurance company of ZIG. ZIC and its subsidiaries are collectively referred to as 'Zurich Insurance Company Group' or 'ZIC Group'. The main subsidiaries of ZIC include Allied Zurich Holdings Limited (AZH), Farmers Group, Inc, Zurich Life Insurance Company Ltd and Zurich Holding Company of America, Inc.

	The Company's immediate parent company is Eagle Star Holdings Limited (ESH) owned by Zurich Financial Services (UKISA) Limited (UKISA), itself a subsidiary of AZH.
Proportion of ownership interest held and, if different, the proportion of voting rights held	ZIG Ltd has a 100% shareholding and voting power in ZIC. ZIC has a 100% shareholding and voting power in AZH. AZH has a 100% shareholding and voting power in UKISA. UKISA has a 100% shareholding and voting power in ESH. ESH has a 100% shareholding and voting power in ZAL.
Where the undertaking belongs to a group, details of the undertaking's position within the legal structure of the group	ZAL is a fully-owned subsidiary of ZIC, which is part of the Zurich Insurance Group. See description of ownership above and simplified structure chart in Appendix 1. The Company operates in the UK business unit as part of the Group, and was part of the UK business unit during 2018. ZIG Ltd and ZIC are both incorporated in Switzerland. AZH is incorporated in Jersey. UKISA and ESH are both incorporated in England.
Undertaking's material lines of business – Health insurance	Insurance contracts providing benefits in the event of illness, accident or disability.
Undertaking's material lines of business – Insurance with-profits participation	Contracts which are eligible to participate in discretionary distributions based on profits arising in part of the business. ZAL has two ring-fenced with-profits funds, the 90:10 With-Profits Fund and the 100:0 With-Profits Fund, where policyholders participate in the profits.
Undertaking's material lines of business – Index-linked and unit-linked insurance	Contracts where the benefits are wholly or partly determined by reference to a unit or index value. This excludes any linked contracts already classified under health.
Undertaking's material lines of business – Other life insurance	Any other directly written insurance contract not classified as health, with-profits or linked insurance.
Undertaking's material lines of business – Non material Lines of Business (LoB)	These represent the accepted reinsurance treaties. These lines of business are immaterial.
Undertaking's material geographical areas where it carries out business – United Kingdom	This is the primary geographical area. For presentation purposes this also includes the non-branch business sold in the rest of Europe, which is not material.
Undertaking's material geographical areas where it carries out business – Rest of Europe	The business sold in Europe includes Jersey, Guernsey, Isle of Man and Malta. The Malta business and some of the Isle of Man business has been written through branches which are now closed to new business. The Malta business is a run-off portfolio rather than a branch.
Undertaking's material geographical areas where it carries out business – Asia	The business carried out in Asia is through the Hong Kong branch which is closed to new business.
Business planning period	For business planning purposes ZAL operates a three year planning period.

Public reporting on solvency and financial condition within Zurich Insurance Group

Chart 1: Public reporting on solvency and financial condition within Zurich Insurance Group



SFCR: Solvency and Financial Condition Report (Solvency II; from 2016) **FCR:** Financial Condition Report (Swiss regulation; from 2017)

☐ Subsidiary ☐ Group of subsidiaries

Note: The purpose of the chart above is to provide a simplified overview of the Group's major subsidiaries (as reported at December 31, 2018), with special focus on the public reporting of their solvency and financial condition. Please note that this is a simplified representation showing entities that must publish such a report and therefore it may not comprehensively reflect the detailed legal ownership structure of the entities included in the overview. The ordering of the legal entities under each country is not indicative of ownership; these are independent legal entities.

Significant business or other events that have occurred over the reporting period

On 12 October 2017 the UK business announced the sale of its workplace pensions and ZCS business to the Lloyds Banking Group, part of which is operated by the Company. The announcement included a multi-year, exclusive distribution partnership for the Company to provide group life protection solutions to certain corporate clients of Lloyds Banking Group's Commercial Banking Services. This transaction will provide clear strategic benefits and aligns with the Company's plan to remove corporate pensions business from its balance sheet. The transaction is expected to complete mid 2019.

In September 2018 the UK business launched a new end to end digital platform, the Life Protection Proposition (LPP), for the sale of Retail Protection business, replacing an aging legacy suite of systems. The new digital first capability will transform the way protection customers and advisers engage with Zurich, making it easier for them to buy (through an improved application experience), easier to recommend Zurich (with market leading products and propositions) and easier to service (through online customer and adviser portals). LPP positions the UK to deliver significant profitable growth in Retail Protection business.

Two dividends have been paid in the period totalling £250m. Our solvency ratio has been above our solvency risk appetite. These dividends bring the solvency ratio closer to our solvency risk appetite.

A Bank of England August interest rate rise, the weakening economic environment and the uncertainty around the final Brexit process has led to volatility in Global stock markets, in particular the FTSE 100. The future path of economic activity and monetary policy crucially depends on the outcome of the Brexit process. While the short-term impact of a disorderly Brexit would be substantial the longer-term effects are less clear and would significantly depend on fiscal and monetary policy reactions.

A.2 Underwriting performance

ZAL prepares its statutory financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP) in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101), which results in recognition and measurement in accordance with EU adopted International Financial Reporting Standards (IFRS). Consequently, the information included in this section is presented on a UK GAAP basis plus deposit accounted investment contracts as required under Solvency II.

The UK GAAP profit for the year before taxation was £190m (2017: Loss £94m). As well as underlying trading profit, this includes a gain of £44m on derivative contracts held to mitigate equity risk on unit-linked business, as part of ZAL's capital management objectives, see section C.2 'Market risk'. This also includes an £83m profit from a reduction in Technical Provisions resulting from demographic basis updates. From a solvency perspective the derivative gain is offset by expected lower future profits from policies, whereas in the profit before tax under UKGAAP there is no recognition of the expected lower future profits.

The significant lines of business contributing to the profit for the year were unit-linked insurance, health insurance and other life insurance. There was some with-profits business where the contribution to the result was the shareholder's share of any bonuses paid.

The table below shows ZAL's premiums, claims and expenses split by Solvency II lines of business for the period ended 31 December 2018 (the numbers in this table correspond to the numbers presented in the QRT S.05.01.02 under Appendix 2):

Premiums, Claims and Expenses by Line of Business	In £'000		Health insurance	Insurance with-profit participation	Index-linked and unit-linked insurance	Other life insurance	Non material LoBs	TOTAL
	Gross Premiums	2018	212,078	9,599	5,371,128	646,132	2,551	6,241,488
		2017	203,311	12,868	5,922,763	533,932	2,669	6,675,543
	Reinsurers' share of premiums	2018	(98,295)	(342)	(8,914)	(462,167)	-	(569,718)
		2017	(89,157)	(415)	(9,092)	(384,852)	-	(483,516)
	Gross Claims	2018	(119,699)	(203,792)	(9,724,752)	(452,683)	(2,201)	(10,503,127)
		2017	(108,267)	(232,089)	(6,833,420)	(381,922)	(1,442)	(7,557,140)
	Reinsurers' share of claims	2018	58,445	103	4,098	413,506	-	476,152
		2017	43,781	63	4,614	352,473	-	400,931
	Gross changes in technical provisions (TP)	2018	(6,817)	192,485	6,580,144	127,593	441	6,893,846
		2017	(50,594)	170,501	(3,808,950)	1,167,251	190	(2,521,602)
	Reinsurers' share of changes in TP	2018	22,266	-	(3,627)	(113,718)	-	(95,079)
		2017	43,020	-	2,841	(1,263,928)	-	(1,218,067)
	Expenses	2018	(74,713)	(10,497)	(210,116)	(151,627)	(630)	(447,583)
		2017	(65,279)	(9,531)	(256,762)	(111,003)	(814)	(443,389)

UK Life business's strategic decision to move corporate pension business onto the Zurich UK platform has continued to contribute to the large Premiums and Claims numbers. The removal of the scheme from ZAL to the separate platform creates a one off claim in ZAL. On investment in the platform there is then a corresponding premium to ZAL when the schemes assets are invested into ZAL's insured funds. This accounted for £1,953m of premium and claims in 2018 (2017: £2,148m). The movement of schemes onto the platform has continued after the announced sale of the corporate pension business.

Within the year three large schemes have left and this has contributed to the larger than normal claims value being shown.

Of the remaining gross claims paid a large proportion were due to surrenders on products which are closed to new business. There is a corresponding offset to this through the movements in technical provisions.

ZAL had 3.4 million (2017: 3.3 million) policyholders or scheme members at 31 December 2018.

ZAL is committed to paying valid claims as they make a real difference to the lives of ZAL's customers at a time when they are most vulnerable. During 2018 ZAL's retail protection business paid out over 90% (2017: 95%) of critical illness claims, over 99% (2017: over 99%) of death claims and over 95% (2017: 87%) of income protection claims. For the minority of claims not paid, reasons include non-disclosure of medical information on applications and instances of income protection customers having returned to work before the policy's payment period started.

Gross premiums written during 2018 comprised regular premiums of £1,541m (2017: £1,522m) and single premiums of £4,706m (2017: £5,154m).

Technical provisions decreased in the year by £6.9bn. The material changes are:

- Index-linked and unit linked decreased by £6.6bn with the main movements being premiums of £5.4bn, claims of £9.7bn and investment income and gains/(losses) of £(2.1)bn, largely due to UK Life business's strategic decision to move corporate pension business onto the Zurich UK platform.

- Insurance with profit participation reduced by £194m mainly due to the run-off of the business.

- Other life insurance reduced by £127m, with reductions seen from demographic basis updates.

Reinsurance recoverables reduced in the year by £85m, with Other life insurance driving this movement.

Expenses in the year included acquisition costs, investment expenses and overhead expenses. There has been no significant movement compared to last year.

Total annual premium equivalent (APE) for the year was £208m (2017: £458m). The decrease largely reflects a lower level of single premiums from the ZCS business, which were no longer counted in APE following the announcement of the sale of ZCS on 12 October 2017. ZCS accounted for £324m of the 2017 APE. This remains a strong result in a challenging business environment, and reflects the strength of the Company's distribution strategy.

ZAL's primary market is the United Kingdom. The table below shows ZAL's premiums, claims and expenses split by material geographical area (the numbers in this table correspond to the numbers presented in the QRT S.05.02.01 under the Appendix 2):

Premiums, Claims and Expenses by Geographical Area

In £'000		Unit Kingdom	Asia	Other Europe	TOTAL
Gross Premiums	2018	6,214,635	26,385	468	6,241,488
	2017	6,645,392	29,553	598	6,675,543
Reinsurers' share of premiums	2018	(567,880)	(1,838)	-	(569,718)
	2017	(481,407)	(2,109)	-	(483,516)
Gross Claims	2018	(10,447,590)	(46,972)	(8,565)	(10,503,127)
	2017	(7,501,133)	(47,161)	(8,846)	(7,557,140)
Reinsurers' share of claims	2018	474,645	794	713	476,152
	2017	398,786	1,232	913	400,931
Gross changes in technical provisions (TP)	2018	6,884,433	5,251	4,162	6,893,846
	2017	(2,577,589)	53,397	2,590	(2,521,602)
Reinsurers' share of changes in TP	2018	(94,138)	-	(941)	(95,079)
	2017	(1,218,395)	-	328	(1,218,067)
Expenses	2018	(440,799)	(6,390)	(394)	(447,583)
	2017	(437,555)	(5,460)	(374)	(443,389)

The reconciliation from the Solvency II information reported in QRT S.05.01.02 in Appendix 2 to UK GAAP profit before taxation is as follows:

SII to UK GAAP reconciliation

In £'000	2018	2017
Gross Premiums (as per S.05, table above) *	6,241,488	6,675,543
Reinsurers' share of premiums (as per S.05, table above)	(569,718)	(483,516)
Gross Claims (as per S.05, table above) *	(10,503,127)	(7,557,140)
Reinsurers' share of claims (as per S.05, table above)	476,152	400,931
Gross Changes in Technical Provisions (as per S.05, table above) *	6,893,846	(2,521,602)
Reinsurers' share of Changes in TP (as per S.05, table above)	(95,079)	(1,218,067)
Expenses (as per S.05, table above)	(447,583)	(443,389)
Investment Performance (see Section A.3 below)	(2,019,393)	5,143,039
Other Technical Income, net of reinsurance *	18,621	21,150
Tax charge attributable to Long-Term Business	181,834	(107,056)
Transfers from / (to) Fund for Future Appropriations (FFA)	5,300	(7,162)
Non-Technical Income / Expenses (see Section A.4 below)	8,606	3,124
Other Activities	(387)	(221)
Total UK GAAP (Loss) / Profit before Taxation	**190,560**	**(94,366)**
Tax on (Loss) / Profit (see Section A.4 below)	(34,185)	18,976
Total UK GAAP (Loss) / Profit after Taxation	**156,375**	**(75,390)**

* The rows above shown with an asterisk are adjusted in the financial statements (UK GAAP) for deposit accounting (DA) by the amounts shown below (total impact on the result is nil):

DA adjustment for Gross Premiums	(5,228,893)	(5,734,811)
DA adjustment for Gross Claims	8,396,217	5,311,107
DA adjustment for Gross Changes in Technical Provisions	(3,286,078)	281,458
DA adjustment for Other Technical Income, net of reinsurance	118,754	142,246
Total deposit accounting adjustments (UK GAAP)	**-**	**-**

The UK GAAP figures above use the Solvency II presentation. For certain headings the reported figures above may differ from the presentation in the financial statements due to the deposit accounting requirements under UK GAAP. The deposit accounting adjustments are only presentational and have no impact on the results. These differences are shown in the bottom part of the table above.

Other Technical Income is the movement in Deferred Origination Fees (DOF) in the year. DOF relates to unit-linked investment contract holders. These fees are recognised in the period in which they are charged unless they relate to services to be provided in future periods, in which case they are deferred and recognised as income over the expected term of the contract as the services are provided.

The FFA represents the amounts in the participating ring-fenced funds for which the allocation to participating policyholders and shareholders has not been determined at the balance sheet date.

A.3 Investment performance

Net investment income represents income earned in the year, which is reported on an accruals basis and includes amortisation of premium (discount) on fixed interest securities. The investment result for the year was:

Investment Performance

In £'000	Net Investment Income		Net capital gains (losses)		Investment result	
	2018	2017	2018	2017	2018	2017
Cash and cash equivalents	1,119	249	(18)	765	1,101	1,014
Equity securities	7,787	8,826	(39,639)	12,724	(31,852)	21,550
Debt securities	75,206	75,253	(76,499)	25,558	(1,293)	100,811
Real estate held for investment	(73)	(24)	5,794	24,547	5,721	24,522
Mortgage loans	7	224	190	-	197	224
Other loans	1,586	2,679	-	-	1,586	2,679
Collective Investments Undertakings	1,594	1,207	9,787	32,535	11,381	33,742
Derivatives	-	-	47,100	(80,433)	47,100	(80,433)
Assets held for index-linked and unit-linked contracts	773,444	810,351	(2,861,105)	4,288,512	(2,087,661)	5,098,864
Other investments	(866)	(278)	35,193	(59,656)	34,327	(59,934)
Investment performance, gross	**859,804**	**898,487**	**(2,879,197)**	**4,244,552**	**(2,019,393)**	**5,143,039**
Investment expenses					(80,391)	(67,855)
Investment performance, net					**(2,099,784)**	**5,075,184**

Losses on equity securities during 2018 reflect a decline in equity markets over the period. The reduction on the FTSE all share index was 13% in 2018 (9% growth in 2017).

Losses on debt securities in 2018 reflect decreases in both government and corporate bond indices over the year.

Gains on Real estate in 2018 includes amounts realised on the disposal of assets.

The decrease in net capital gains on collective investment undertakings compared to prior year reflects the relative return on the underlying debt and equity assets held within the collectives.

Gains on derivatives of £47m (2017: loss of £80m) included a gain of £44m (2017: loss of £76m) on derivative contracts held to mitigate equity risk on unit-linked business, as part of ZAL's capital management objectives, see section A.2 'Underwriting performance' and C.2 'Market risk'. The remaining gain on derivatives of £3m (2017: loss of £4m) arose in the with-profits funds.

There were no gains or losses recognised directly in Equity in ZAL's financial statements.

All of the net gains and losses arising on investments during the year are in respect of financial investments classified at fair value through profit or loss.

Securitisation or repackaged loans

ZAL had exposure to securitisations and repackaged loan holdings of £24m at 31 December 2018 (2017: £28m). The net investment income is included in the 'debt securities' figures above.

A.4 Performance of other activities

ZAL reported net income from 'Other income and expenses' for the year 2018 of £8.6m (income of £9.7m minus expenses of £1.1m), which consisted of the following:

Other income and expenses	In £'000		Income		Expenses
		2018	2017	2018	2017
	Investment result in non-technical account *	4,000	4,300	(129)	(287)
	Other income and expenses in non-technical account *	5,735	111	(1,000)	(1,000)
	Other activities	-	-	-	(221)
	Tax on (Loss) / Profit	-	-	(34,185)	18,976
	Total of other income/ expenses	**9,735**	**4,411**	**(35,314)**	**17,468**

* The sum of the non-technical income and expenses in the two first rows of the table above corresponds to the amount of the row 'Non-Technical Income Net' in the table presenting the SII to UK GAAP reconciliation in section A.2 'Underwriting performance'.

The 'Investment result in non-technical account' represents dividend income from subsidiary undertakings.

'Other income and expenses in non-technical account' captures income streams earned by the shareholder fund and other shareholder expenses, including depreciation.

'Taxation' represents the impact of both current and deferred tax on the 'Underwriting performance' and the 'Other incomes and expenses'. UK corporation tax has been calculated at rates between 17% and 19% in accordance with the rates applicable to the long term business of a life insurance company.

Leasing arrangements

ZAL was not party to any finance lease arrangements.

ZAL has entered into certain operating lease contracts in relation to land and buildings where ZAL is lessor and has also entered into operating lease contracts with tenants where ZAL is the lessee. These consist of six agreements where ZAL is lessor and seven separate agreements where ZAL is lessee. No one lease is material in nature or in size.

A.5 Any other information

There is no other information to report.

B. System of governance

This section provides information on ZAL's system of governance. This includes roles and responsibilities of the ZAL Board and Executive Committees, and remuneration policies and transactions with members of the Board, as well as explaining the risk management system and the internal control system implemented by the company.

B.1 General information on the system of governance

Under Solvency II ZAL is required to maintain a comprehensive and up-to-date governance map. ZAL uses this to set out the key functions in the firm and the relevant individuals responsible for these functions, along with their lines of accountability and responsibility both within the firm and the wider group.

ZAL has to produce a Management Responsibilities Map in accordance with the Senior Manager and Certification Regime (SMCR), which came into effect on 9 December 2018. ZAL uses this to set out key functions in the firm and the relevant individuals responsible for these functions, along with their lines of accountability and responsibility both within the firm and the wider group.

ZAL's system of governance is well established and aligned to the wider governance principles of ZIG, as well as the requirements of Solvency II. The system of governance ensures that there are clear roles and responsibilities throughout the governance structure including the role of the Board, its Committees and the use of non-executive directors, with the effectiveness of the Board and its Committees being reviewed on an annual basis. The system of governance is considered appropriate for the nature and scale of ZAL's business.

ZAL is managed as part of the wider Zurich UK with specific functions of Life Manufacturing, Retail Management and UK Distribution supported by pan-UK functions.

ZAL's system of governance and oversight changed during the year with the formation of a Nomination Committee, which has responsibility to provide oversight and to lead the process for board appointments. In addition, the Nomination Committee will consider and make recommendations to the Board on the appointment and removal of any regulatory key function holder with responsibilities that are material to ZAL.

Zurich Assurance Ltd Board overview and role

ZAL is a wholly-owned subsidiary of a global insurance group ZIG and is aligned to the Group's internal organisational structure. The ZAL Board derives its collective authority by direct delegation from its shareholder. Its key purpose is to direct company affairs whilst meeting the appropriate interests of its key stakeholders, including its customers, employees and the shareholder.

The ZAL Board has two overarching responsibilities:

- To ensure the Company remains compliant with local law and meets the expectations of its regulators, paying due regard to jurisdictional best practice; and
- To maintain ZAL's business as a going concern in line with its strategic aims and targets or, if it was ever to be required, manage its orderly closure. In either respect, the directors should ensure full regard is paid to the interests and expectations of all of the Company's customers and other stakeholders.

Insofar as it is required to discharge these responsibilities, the remit of the ZAL Board comprises:

- Values and standards – The Board sets the values and standards for ZAL. This is achieved by adopting and adapting the Group code of conduct and other applicable group policies;
- Strategy – Executive management proposes its strategy for ZAL to the ZAL Board, to consider and adopt it as appropriate. As a part of its considerations, the Board takes into account the appropriateness of this strategy, ensuring it can be executed in a compliant manner. The Board ensures the strategy is within its stated risk appetite, and considers the extent to which it will enable ZAL to meet the interests and expectations of its stakeholders;
- Risk management – The Board has responsibility for setting ZAL's risk appetite and must ensure risks are appropriately identified and managed. Capital policy and plans (over the short, medium and long term) including capital buffers are reviewed by management and approvals are sought from the Board as and when appropriate;
- Systems and controls – The Board has responsibility for the effectiveness of an appropriate system of internal controls to ensure the ongoing compliance of the Company with all applicable regulation and legislation, to protect the interests of customers and to ensure that risks are mitigated to within the stated risk appetite. The control framework ensures that, where regulation or legislation requires Board notification or decision, matters are brought to the attention of the Board in a timely manner and the Board has accountability for ensuring the completion of remedial actions;
- Resources – The Board retains responsibility for ensuring the ongoing adequacy and efficient usage of the resource available to the Company to deliver its strategy and operational plan. Examples of resource-types include human, financial, physical or technological; and
- Audit, Risk, Nomination and Investment Committees – The Board is responsible for the operation of the Committees to assist the Board in meeting its obligations and the expectations of the regulators or other sources of jurisdictional best practice that may be applicable. The Board is responsible for approving the terms of reference for each of the Committees.

ZAL's Board is composed of executive directors and independent non-executive directors. There is no formal limit to the number of directors that can sit on the Board, however, appointment follows group governance principles for subsidiaries, although local statutory and regulatory requirements take precedence. The table below shows the composition of the ZAL Board during 2018:

Zurich Assurance Ltd Board of Directors

Individual	Role	Comments
J.T.G. Butler	Independent Non-executive Director	Chair of Audit Committee
C.S. Fairclough	Independent Non-executive Director	Chair of Risk Committee
T.R. Naidu	Executive Director	
G.P.J. Shaughnessy	Executive Director	
I.C.R. Stuart	Independent Non-executive Director	Chair of Board, Investment and Nomination Committee
P. Bishop	Independent Non-executive Director	Appointed to the Board on 08 March 2019
J.R. Sykes	Executive Director, CEO	CEO

Committees of the Board of Directors

The ZAL Board has four standing committees, which regularly report to the Board and submit proposals for resolution by the Board:

Risk Committee

The Risk Committee is authorised to assist the Board in carrying out its responsibilities in relation to the oversight of risk management in accordance with law and regulations by:

- Providing oversight and guidance to the Company and its management in relation to risk management and assisting in identifying issues requiring management's attention;
- Acting as a focal point for discussion and communication on matters regarding the oversight of risk management including monitoring adherence to the Board's defined risk appetite; and
- Determining which areas might require further review, additional attention and escalation.

Audit Committee

The Audit Committee is authorised to assist the Board in carrying out its responsibilities relating to financial reporting, internal control and governance, in accordance with regulation, legislation and acceptable ethical standards by:

- Providing oversight and guidance to the Company and its management with regard to the above matters and to assist in identifying issues requiring management's attention;
- Acting as a focal point for discussion and communication of matters regarding the oversight of financial reporting, internal control, compliance (including financial crime) and governance; and
- Giving sufficient attention to presented issues and information to determine areas for further review, additional attention and escalation.

The Audit Committee is also responsible for the oversight of the Company's external auditor, PwC.

Investment Committee

The Investment Committee is authorised to assist the Board in carrying out its responsibilities in relation to the oversight of investment management in accordance with law and regulations by:

- Providing oversight and guidance to the Company and its management in relation to investment management and assisting in identifying issues requiring management's attention;
- Acting as a focal point for discussion and communication of matters regarding the oversight of investment management; and
- Giving sufficient attention to presented issues and information to determine which areas might require further review, additional attention and escalation.

Nomination Committee

The Nomination Committee is authorised by the Board and its purpose is to assist the Board by providing oversight and to lead the process for board appointments. The Committee shall further:

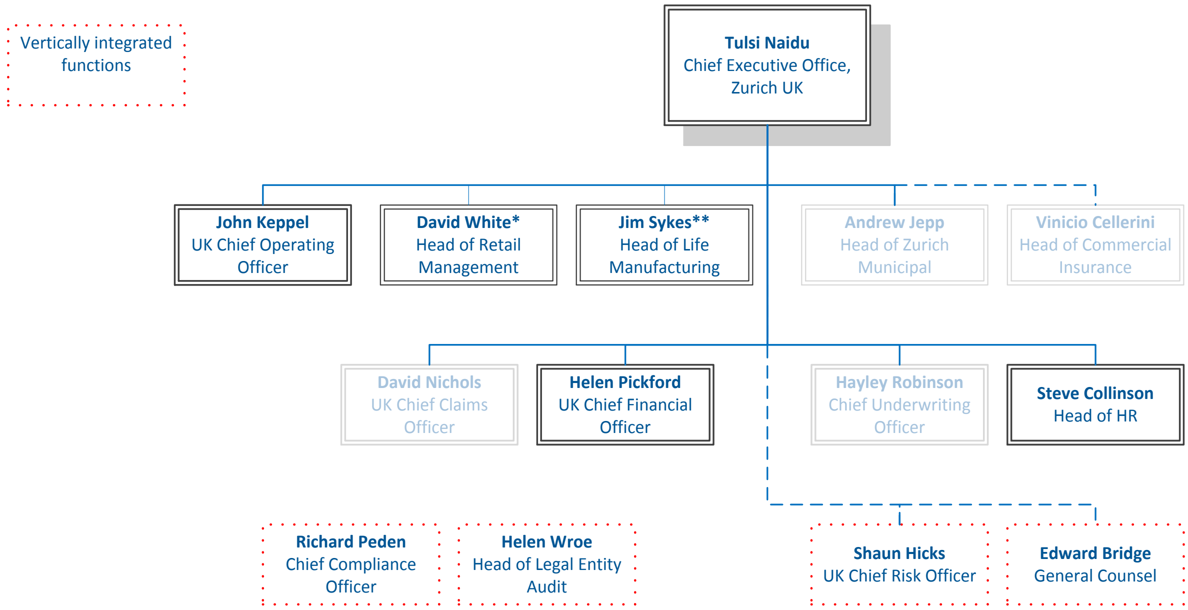
- Provide oversight and guidance in relation to the structure and composition of the Company's Board and assisting in identifying issues requiring Management's attention in relation to these matters;
- Monitoring the balance of skills, independence, knowledge, experience and diversity on the Board;
- Act as a focal point for discussion and communication of matters regarding succession planning for the Board and senior management;
- To consider, unless the matter has been raised separately at Board, any proposals for key function holder appointments with material responsibilities to the Company;
- Escalating matters that require the further attention of the Board.

Executive Committee

The Executive Management structure reflects the organization of Zurich's UK business of which ZAL is a part. The Executive Committee is made up of members of Executive Management from each area of the UK business and the supporting functions. ZAL is represented by three business roles, the Head of Life Manufacturing (also the CEO of ZAL) the Head of UK Distribution and the Head of Retail Management. In addition the Executive Committee includes the CEO of Zurich UK and the heads of Operations & IT, Finance, HR, Marketing and Risk.

The role of the Executive Committee is to support management and advise the CEO on the day to day management of the business, ensuring executive alignment on courses of action for the business through robust challenge and decision-making and identifying any decisions that may need to be taken to the ZAL Board.

The following diagram sets out the composition of the Executive Committee as at 31 December 2018, the roles that are relevant to the Life business and ZAL are highlighted, including vertically integrated functions that have reporting lines into a Group function:



* David White left his role as Head of Retail Management on 31 January 2019 to become CEO, EMEA for Cover More, with responsibilities passing to Jim Sykes.

** Jim Sykes is the CEO of ZAL, which although not represented in the above structure is set out in an earlier table.

Key functions within ZAL

The key functions relating to corporate governance and risk management identified by ZAL are shown in the table below. Each key function holder is either a standing ex officio attendee of, or has a right of access to, the ZAL Board outside of their own management reporting line. This gives the individual the operational independence to carry out their tasks and advise and inform the Board of any issues or concerns.

Key function holders

PRA Definition	ZAL Role Title	Individual in Role
The Risk Management Function	Chief Risk Officer	Shaun Hicks
The Compliance Function	Chief Compliance Officer	Richard Peden
The Internal Audit Function	Head of Legal Entity Audit	Helen Wroe
The Actuarial Function	Chief Life Actuary (CLA)	Keith Jennings*

* David King was appointed as ZAL's CLA ad interim until 31 December 2018. Keith Jennings appointment as ZAL's CLA was with effect from 31 December 2018.

Remuneration policy and guiding principles

ZAL is a subsidiary of ZIG and applies the Group's remuneration philosophy and agreed remuneration rules. The remuneration rules serve as a framework for the governance, design, implementation and monitoring of the Group's remuneration architecture globally. They are designed to support the business strategy, risk management framework and operational and financial plans for ZIG and its subsidiaries. Employees working on behalf of ZAL are predominantly employed by Zurich Employment Services Limited with the costs subsequently being recharged to ZAL. ZAL applies a remuneration policy in respect of these employees.

The ZIG Board is responsible for the design, implementation and monitoring of the Group's overall remuneration architecture. The ZIG Board has established a Remuneration Committee to oversee the design of the Group's remuneration architecture, the implementation of the remuneration rules and the respective monitoring process on behalf of the ZIG Board. The ZIG Board reviews the remuneration rules regularly, at least once a year. The rules are amended by the ZIG Board as necessary.

The ZAL Board is responsible for its own remuneration arrangements and has developed its own remuneration policy statement in the context of the Group remuneration rules. The ZAL Board has delegated responsibility for reviewing and monitoring implementation of this policy to its Risk Committee. The Risk Committee meets on at least an annual basis to review the remuneration policy statement and its implementation.

ZAL operates a balanced and effectively managed remuneration system providing competitive total remuneration opportunities designed to attract, retain, motivate and reward employees to deliver high performance. The link between pay and performance is supported by fixed pay (i.e. base salary and benefits) and performance-related pay (short and long term bonus schemes as applicable).

The remuneration system is an important element of the Group's risk management framework and is designed to discourage inappropriate risk taking through effective governance and a clearly defined performance management process which supports the Group's overall strategy, values and long term interests. Performance-related pay is designed to promote sound risk management and does so by ensuring an appropriate balance between fixed and performance based elements.

Total remuneration and its composition may be influenced by factors such as scope and complexity of the role, level of responsibility, risk exposure, business performance, individual performance, internal equity, and legal requirements.

The key design principles of ZAL's remuneration arrangements include:

- Aligning remuneration structures to the delivery of good customer outcomes and adherence to corporate values;
- Being simple, transparent and implementable;
- Oriented towards the long term for those individuals who might have a material impact on the Company's risk profile;
- Ensuring the structure and level of total remuneration are aligned with risk policies and risk-taking capacity;
- Promoting a high performance culture by differentiating total remuneration based on the relative performance of businesses and individuals;
- Defining the expected performance through a structured system of performance management and using this as the basis for remuneration decisions; and

- Linking variable remuneration awards to key performance factors which include the performance aspects of the wider Group's business and the Company as well as individual achievements.

Total remuneration for employees of ZAL can include the following elements:

Base salary

Base salary is the fixed pay for the role performed, determined by the scope and complexity of the role and is reviewed regularly. Overall base salary structures are positioned to manage salaries around the relevant market rates and take into account the individual's overall experience and performance. Employees may also participate in a defined contribution pension scheme.

Board members and key function holders are, where relevant, members of their respective country pension schemes and all arrangements are subject to the standard rules of those schemes.

Variable remuneration

ZAL operates variable short term and long term incentive plans aligned to the achievement of key financial objectives and the execution of the business strategy, risk management framework and operational plans.

Variable remuneration is structured such that typically there is a higher weighting towards the longer term sustainable performance for the most senior employees of the Group and those with the most impact on the Group's risk profile. This ensures that a significant portion of the variable pay for those employees is deferred. Variable remuneration includes both short term incentive plans for which all employees are eligible to join and long term incentives for selected employees.

Independent non-executive directors do not participate in the variable remuneration element or pension scheme arrangements described above and are entitled to base salary remuneration only.

In alignment with the Group's risk profile and business strategy, long term incentives are deferred taking into account material risks and the associated time horizon. Deferred bonuses vest after three years. The Vesting Level is proposed by the Group CEO to the Remuneration Committee and the Remuneration Committee makes a recommendation to the Board of Directors for final approval. In addition there are restrictions in place preventing the sales of half of the vested shares for a further three years.

Material transactions during the reporting period

There were no material transactions between ZAL and the members of its Board during the reporting period.

Material changes to the system of governance during the reporting period

There have been no material changes to ZAL's system of governance during the reporting period.

B.2 Fit and proper requirements

ZAL applies fit and proper requirements to its approved persons, senior managers (SMCR) and key function holders. Fitness means knowledge, professional qualifications and relevant experience are adequate to enable sound and prudent management, control and oversight of ZAL. The concept of fitness also extends to the assessment of collective fitness – the collective diversity of qualifications of the senior managers of ZAL. Propriety is defined as the evidence of good reputation and integrity (honesty and individual soundness).

ZAL operates a process for assessing the fitness and propriety of its senior managers and key function holders via background screening and pre-employment or pre-appointment checking, carried out internally and through an external screening partner. To ensure that these individuals remain fit and proper an annual self-certification exercise takes place, and furthermore each year the fitness and propriety of a third of all such employees is checked by a third party. This means that all in-scope employees are independently verified every three years.

The collective fitness of the senior managers of ZAL refers to the qualifications and experience with respect to:

- Insurance and financial markets – awareness and understanding of the wider business, economic and market environment in which ZAL operates;
- Business strategy and business model – appropriate detailed understanding of these aspects with regard to ZAL;
- System of governance – risk management and control, awareness of the risks ZAL is facing and capability to manage them and to assess the effectiveness of the measures to deliver effective governance, oversight and controls and changes;
- Financial and actuarial analysis – ability to interpret ZAL's financial and actuarial information, identify key issues and put in place appropriate controls and take necessary measures; and
- Regulatory framework and requirements – awareness and understanding of the regulatory framework in which ZAL operates, awareness and understanding of requirements and expectations and adaptation of changes without delay.

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

Risk management framework

Risk management is integral to ZAL's strategy and operations. ZAL operates a rigorous risk management framework designed to promptly identify, measure, manage, report and monitor all risk types and associated risks that affect the achievement of strategic, operational and financial objectives. This includes reviewing the Company's risk profile and monitoring risk exposures against ZAL's risk appetite as defined by the Board, so that ZAL is able to respond to new risks and opportunities and to support risk-based decision making.

The Board defines ZAL's risk strategy and appetite and oversight of the risk management framework is provided by the Risk Committee which is authorised by the Board and its purpose is to assist the Board by:

- Providing oversight and guidance to the Company and its management in relation to risk management and assisting in identifying matters requiring management's attention;
- Acting as a focal point for discussion and communication of matters regarding risk management; and
- Giving sufficient attention to presented issues and information to determine which areas might require further review, additional attention and escalation.

ZAL manages and mitigates the risks identified within the risk assessment process through specifically identified executive management actions which are tracked and reported.

Three lines of defence model

A 'three lines of defence' model is adopted and applied through the Group's risk governance structure to deliver integrated assurance and ensure risks are clearly identified, owned and managed so that:

- Business management takes risks and is responsible for day-to-day risk management;
- The risk management function oversees the overall risk management framework, and helps the business manage its risks. Other governance and key functions, such as Compliance, Legal, Actuarial and Finance help the business manage and control specific types of risks; and
- The audit function provides independent assurance regarding the effectiveness of the risk management framework and risk controls.

Risk management organisation

The Group Chief Risk Officer (CRO) leads the Group risk management function, which develops methods and processes for identifying, measuring, managing, monitoring and reporting risks throughout the Group. The Group sets out its risk management requirements through the 'Zurich Risk Policy' which specifies the Group's risk tolerance, risk limits and authorities, reporting requirements, procedures to approve any exceptions and procedures for referring risk issues to senior management and the Board of Directors.

ZAL's Chief Risk Officer reports to both the UK Chief Executive and the Group CRO. He also has confidential access to the Chairperson of the Board Risk Committee to maintain organisational independence.

The Own Risk and Solvency Assessment (ORSA)

The ORSA is the assessment of the current and future risk profile of ZAL and resultant capital requirements, including:

- The nature, scale and complexity of the current and likely future risks inherent to the business
- ZAL's solvency position under current and stressed conditions
- A forward-looking assessment of the solvency position over the planning horizon

The ORSA process addresses all material risk types that ZAL's business is exposed to and considers these over the short, medium and long term. The ORSA process is a continuous process made up of a combination of periodic and ongoing activities. It culminates in a formal ORSA report which is compiled on an annual basis as a minimum.

The ORSA is a key component of ZAL's risk framework with supporting processes integrated into the risk management system. The ORSA supports business planning and strategic decision making. It is the fundamental aim of the ORSA process to demonstrate ZAL's understanding of the relationship between risk taking, its solvency position and its capital base.

Risk reporting

The Chair of the Risk Committee provides a written or verbal update to the Board highlighting any matters for noting, escalation or approval. In addition, he or she will inform on a timely basis the Audit Committee and the Investment Committee of any risk-related matters considered relevant. The Chair of the Risk Committee can also, if necessary, escalate matters to the UK CEO with support from Group Risk. The Board retains responsibility for approving certain items, as specified in the Risk Committee Terms of Reference, and the ultimate responsibility for risk management rests with the Board.

B.4 Internal control system

Internal control framework

The ZAL Board has overall responsibility for risk management and internal controls. Primary risk management and internal control systems are established at a group level and applied, where appropriate, by ZAL, with additional controls applied to meet ZAL's specific control requirements.

ZAL's management is responsible for identifying, evaluating and addressing significant risks, and designing and maintaining internal controls. The internal control framework is reviewed and updated on a regular basis in response to business change to ensure controls are appropriate and proportionate to the risk exposure.

The internal control framework increases the reliability of ZAL's financial reporting and its operational effectiveness, and ensures legal and regulatory compliance is maintained.

Internal and external auditors regularly report conclusions, observations and recommendations that arise as a result of their independent reviews and testing of internal controls over financial reporting and operations.

Compliance Function

ZAL's compliance function provides policies and guidance, business advice, training and assurance over compliance controls. The compliance function also supports ZAL's management in maintaining and promoting a culture of compliance and ethics consistent with the Group's code of conduct.

The compliance framework relies on an ongoing compliance risk assessment to support a risk-based monitoring regime. The results of this assessment underpin the compliance function's strategic planning which is conducted in consultation with management. The compliance monitoring plan is presented annually to the Audit Committee and approved on behalf of the Board. Through this comprehensive monitoring program, the compliance function implements, embeds and monitors compliance with external regulation and internal policies and guidance.

Model Governance Committee

ZAL operates a Model Governance Committee (MGC) to support the CRO in performing effective model governance, by overseeing the design and development of capital models and ensuring that they continue to be fit for purpose and operate as intended. The key components and responsibilities of model governance which are overseen by the committee are:

- Model development, change and validation; and
- Data quality.

B.5 Internal audit function

The internal audit function of the Group (Group Audit) reports to the Chair of the ZAL Audit Committee and is tasked with providing independent and objective assurance to the ZAL Board, Audit Committee, CEO and management. This is accomplished by developing a risk-based audit plan which is updated in response to changes in ZAL's risk profile. The plan is based on the full spectrum of business risks as well as concerns and issues raised by the Audit Committee, management and other stakeholders. Group Audit executes the plan in accordance with defined operating standards, which incorporate and comply with the International Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors (IIA). Key issues raised by Group Audit are communicated to the responsible management function, the CEO and the Audit Committee using a suite of reporting tools.

The ZAL Audit Committee approves the audit plan annually, and reviews reports from the Internal Audit Director on significant risk, control and governance issues every quarter as a minimum. The Internal Audit Director reports functionally to the Audit Committee and administratively to the CEO, and meets regularly with the Chairperson of the Audit Committee. Group Audit has no operational responsibilities over the areas it reviews. To ensure independence, all Group Audit employees globally report through to the Head of Group Audit.

Important audit findings, including ineffective opinions, mitigation actions and management responses, are reported to the ZAL Audit Committee, Board and CEO. The ZAL Internal Audit Director is responsible for ensuring issues which could have an impact on ZAL's operations are brought to the attention of the Audit Committee and appropriate levels of management ensuring timely follow-up action occurs. This is supported by attendance at each meeting of the Audit Committee.

The Internal Audit Director is authorised to review all areas of ZAL and has unrestricted access to all of its activities, accounts, records, property and personnel necessary to fulfil its duties. In the course of its work, Group Audit takes into consideration the work of other assurance functions. In particular, Group Audit coordinates its activities with the external auditors, sharing risk assessments, work plans, audit reports and updates on audit actions.

The ZAL Audit Committee assesses the independence of Group Audit and reviews its activities, plans and organisation, the quality of its work and its co-operation with the external auditors. As required the Internal Audit function is quality-reviewed periodically, at least every five years, by an independent qualified body. This review was conducted most recently in 2016 and the results confirmed that Group Audit's practices conform to IIA standards.

B.6 Actuarial function

The UK Chief Life Actuary (CLA) heads ZAL's actuarial function which is responsible for:

- Coordinating the calculation of the technical provisions;
- Ensuring appropriateness of methodologies, models and assumptions used in the calculation of the technical provisions;
- Assessing sufficiency and quality of data used in the calculation of technical provisions;
- Comparing best estimate against experience;
- Reporting to the ZAL Board on the adequacy of technical provisions;
- Expressing an opinion on the underwriting policy and adequacy of reinsurance arrangements;
- Contributing to the effective implementation of ZAL's risk management system; and
- Ensuring the Group's reporting and governance standards are adhered to.

ZAL's actuarial function is made up of people within the Finance and Risk functions with sufficient knowledge of actuarial and financial mathematics. The Risk team is fully independent from the team calculating the technical provisions and from the underwriting and reinsurance areas. As a result the actuarial function is able to provide an independent viewpoint to the ZAL Board.

ZAL's CLA reports into the ZAL Chief Financial Officer (CFO), with direct access to the ZAL Board. The ZAL CLA is an approved person under SMCR.

B.7 Outsourcing

Outsourcing is an arrangement by which a business capability is performed by a service provider instead of being performed by ZAL. This enables ZAL to focus on its core business capabilities. Outsourcing poses risks, particularly operational, reputation and credit risks, which must be managed.

A service provider may be either a third party external to ZAL, or another Zurich unit or function other than ZAL (also called intra-group sourcing). ZAL makes use of service providers covering a range of services and has a comprehensive policy to manage the associated outsourcing risks. It is ZAL's policy to manage the risks in outsourcing by:

- Only outsourcing work such that ZAL retains effective control over its business;
- Assessing and mitigating potential risks before making the decision to outsource and during the life of the outsourcing arrangement;
- Standardising the selection and management of outsourcing arrangements in order to manage exposure to third parties;
- Making use of globally selected suppliers to more effectively oversee and manage risk in outsourcing, taking into account potential effects of concentration risk;
- Maintaining an inventory of service providers and outsourced work to detect potential areas of concentration;
- Establishing internal controls and monitoring them through the life of the outsourcing arrangement; and
- Developing and maintaining strategies to exit from outsourcing arrangements.

Applicable standards for managing outsourcing are set out in ZAL's risk policy supplemented by the Zurich Group's sourcing policy. These documents address key processes including: fair and unbiased supplier selection, due diligence requirements, contracting, managing service delivery, risk and issues management and exiting outsourcing arrangements.

These standards and processes are applicable to both external suppliers and intra-group arrangements and are applied on a risk-based and proportionate basis depending upon the materiality of the relationship. This is assessed using factors including the financial value and financial liability associated with the arrangement, the extent to which customer data is shared and the degree to which Zurich's business and reputation may be affected by a failure of that relationship.

Some activities have a higher level of oversight and specific requirements for how they are managed in an outsourcing arrangement. These critical activities are:

- Compliance with Zurich's policies and legal and regulatory requirements;
- Ongoing risk management;
- Internal audit, accounting and finance operations;
- Actuarial activities;
- Storing, retaining and transferring confidential and highly confidential data; and
- Maintaining and supporting IT systems.

Oversight of outsourced services is achieved through a framework of regular cross-business forums which cover: service delivery (against agreed service levels), financial management (against agreed forecasts), assurance, compliance, change and transformation.

All outsourcing activity within ZAL is overseen by the Chief Operating Officer (COO) who is the key function holder responsible for outsourcing.

During 2018 ZAL has entered in to a temporary arrangement for the provision of front and back office administration services across on-boarding, servicing, claims (including migration of schemes from Zurich DC Platform to Lloyds Banking Group) until completion of the Part VII in mid 2019.

ZAL has recently extended its relationship with Capita through the TUPE transfer of staff and processes relating to Underwriting, Complaint Handling, New Business and Adviser Remuneration of the Life Manufacturing business.

A list of ZAL's critical and important outsourcing arrangements is provided in the tables below. In addition to these external parties ZAL makes use of intra-group outsourcing to provide services including employment services, risk, audit and investment administration.

Outsourcers

Operational function	Outsourcer	Location
Operational Administration	Capita Life & Pensions	UK
Operational Administration	Lloyds Banking Group	UK
Investment Administration	State Street Corporation	UK
Investment Administration	Northern Trust Corporation	UK
IT Support & Delivery	DXC Technology	UK
Document Logistics	RR Donnelley	UK
Document Logistics	Swiss Post	UK

B.8 Any other information

With-profits business

ZAL operates two ring-fenced with-profits funds and has appointed a With-Profits Actuary who reports to the CRO. The role of the With-Profits Actuary is to provide ZAL management and the ZAL Board with actuarial advice for the with-profits funds. The With-Profits Actuary supports ZAL in maintaining compliance with regulatory requirements and ensuring an appropriate balance between fairness to policyholders and the mitigation of risks to the shareholder including the risk that with-profits funds may not be able to meet liabilities to policyholders as they fall due.

C. Risk profile

This section sets out and describes;

- The material risks in ZAL's risk profile;
- The processes used to identify and monitor these risks; and
- The mitigation techniques used to reduce risk exposures to within ZAL's risk tolerance and appetite.

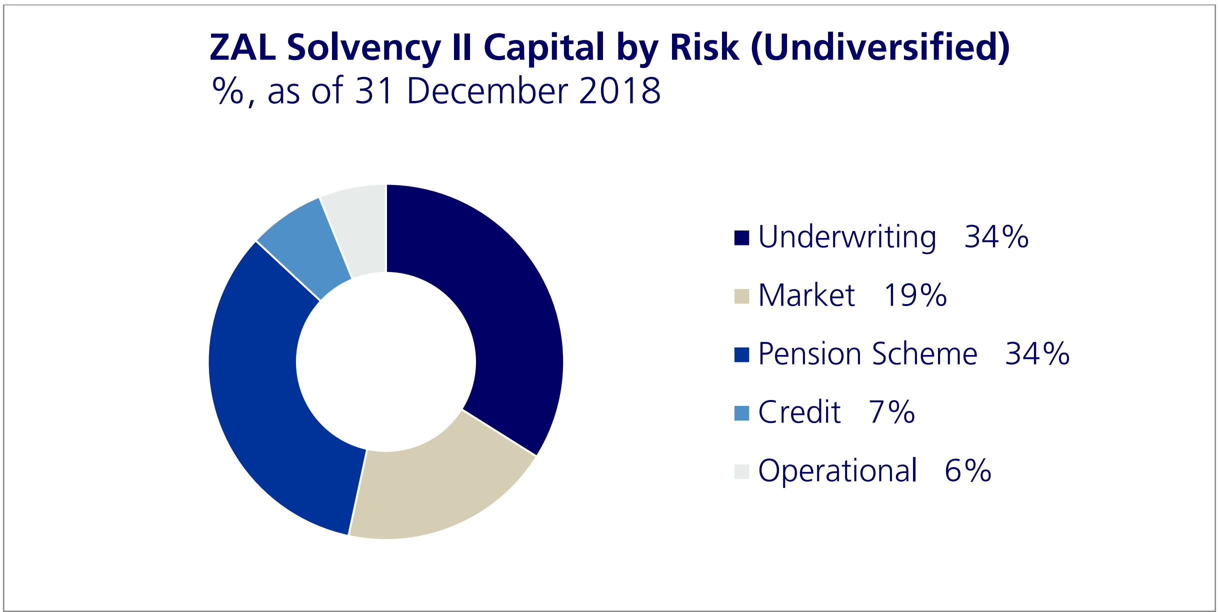
Any changes in ZAL's risk profile over the reporting period are also considered.

ZAL's business model results in it being subject to a range of risks associated with the activity of issuing insurance and investment contracts and the use of financial instruments.

These include risks for which ZAL holds capital - underwriting risk, market risk, credit risk, operational risk and pension scheme risk - and also risks, such as liquidity risk, for which other mitigation techniques are applied.

Regulatory capital, assessed on the Solvency II standard formula basis, is held to cover the risks associated with ZAL's balance sheet position where the value depends on financial markets, best estimate assumptions being different to expected, operational risks and failures of counterparties. Capital is held for staff pension scheme risk, which is not covered by the standard formula where the scheme is not directly held on the balance sheet, as is the case for ZAL. More detail of the pension scheme risk is provided in section C.6 'Other material risks'.

The capital held by ZAL is broken down in the figure below further detail is provided in section E2, which includes the amount of capital held for each risk:



Further information on each risk is provided in the sections below including sensitivity analysis where appropriate. To measure ZAL's sensitivity to its material risks, stresses are performed on each of the risk types and the impact on own funds calculated. Material risks are identified by analysing ZAL's Solvency II standard formula SCR as at 31 December 2018. The stresses performed are the Solvency II standard formula stresses recalibrated to the equivalent of a 1 in 10 year event. Where applicable the stress used is the most onerous one, as included in the SCR as per the standard formula methodology. The impact of own funds presented allows for movements in asset values, including reinsurance assets, as well as best estimate liabilities and risk margin.

ZAL mitigates its risks so that they are kept within its Board's stated risk appetite. Throughout 2018 ZAL remained within this appetite. A wide range of mitigation techniques are available to ZAL, and these are discussed below. At a high level the key mitigation techniques are:

- Reinsurance;
- Outsourcing;
- Robust system of governance and oversight arrangements; and
- Derivatives used for hedging purposes.

ZAL offers a wide range of product catering to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location. As such, ZAL has a diverse and balanced mix of business and risk exposures.

In addition, ZAL uses a variety of measures to limit any excess concentrations:

- investing in a range of assets governed by investment mandates and asset counterparty limits;
- using hedging to reduce market risk;
- managing counterparty risk through risk limits on exposure and concentration; and
- limiting excess concentrations of underwriting risk through a range of reinsurance strategies.

As ZAL has written the majority all of its business in the UK, results are sensitive to demographic and economic changes arising in the UK.

C.1 Underwriting risk

Underwriting risk is the inherent uncertainty regarding the occurrence, amount or timing of insurance liabilities. Capital is held in respect of the following risks:

- Mortality – actual policyholder death experience is higher than expected.
- Longevity – annuitants live longer than expected.
- Morbidity / disability – policyholder health-related claims are higher than expected.
- Lapse – policyholder behavior in discontinuing or reducing contributions or withdrawing benefits prior to the maturity of contracts is different to that expected.
- Expense – expenses incurred in acquiring and administering policies are higher than expected.
- Catastrophe – policyholder health and death related claims from a large scale event.

ZAL quantifies underwriting risk as part of its SCR. As well as holding capital, ZAL uses a variety of risk mitigation techniques which help it manage and reduce its exposure to underwriting risks.

ZAL has a system of regular monitoring which reports on the mortality, longevity, morbidity, lapse and expense experience of the business. This is used to help determine the rates at which new business is accepted and the value of ZAL's technical provisions. In addition to monitoring business experience ZAL regularly assesses whether its underwriting risk exposures are in line with its expectations and its risk appetite.

ZAL runs a longevity platform, which has transacted longevity insurance with a number of pension schemes since 2015. On these trades, ZAL has used reinsurance to manage an appropriate amount of longevity risk taken on, with a minority retained; ZAL has strong internal expertise, systems, processes and controls to price, execute and operate these contracts efficiently.

Risk mitigation techniques and their effectiveness

ZAL uses a number of techniques to mitigate underwriting risk as set out below:

Reinsurance

ZAL's principal mitigation technique for underwriting risk is reinsurance. ZAL effectively mitigates its morbidity, mortality, longevity and catastrophe risks by reinsuring a significant proportion of its underwriting risk both with other entities within the Zurich Group and with external reinsurers. The use of reinsurance reduces financial volatility in ZAL and the capital requirement for underwriting risk. ZAL retains risks in line with its risk appetite. ZAL's actuarial function and Risk department oversee the use and effectiveness of its reinsurance arrangements and review arrangements on a regular basis.

Underwriting discipline, product design and expense management

Alongside reinsurance, a number of other techniques are used to mitigate underwriting risk. Underwriting discipline is a fundamental part of managing underwriting risk and applies to product design and approval and the underwriting process. Product features such as reviewable charges are used on certain products which enables ZAL to charge an appropriate rate for the risks associated with these policies.

ZAL further mitigates underwriting risk by underwriting individual protection business at the point of application. The process involves reviewing appropriate policyholder medical information and if required seeking additional information to support the underwriting decision.

ZAL mitigates underwriting risk for group protection policies by both underwriting the scheme risk for cover below the automatic acceptance limit and underwriting individual benefit exposures that exceed this.

The continued suitability, and the potential risks, of existing life products are regularly reviewed.

The risk that administration expenses increase is mitigated through robust budgeting and expense management processes, by use of outsourcing where appropriate – including for policy administration on a fixed per policy basis– and the application of efficiency methodologies within ZAL's business.

Analysis of sensitivities for underwriting risk

The impact of ZAL's sensitivities to underwriting risks on the Basic Own Funds (BOF) after any Ring Fenced Fund (RFF) restrictions and on the ratio of eligible own funds to SCR are shown in the table below.

Impact of life insurance risk scenarios on basic own funds

Life insurance risk scenario results	Impact on BOF (in £'000)	Impact on SCR coverage (in %)
Lapse	(137,100)	-6.8%
Expenses	(69,830)	-6.7%
Longevity	(17,938)	-1.9%
Morbidity	(26,665)	-2.4%
Mortality	(9,747)	-0.8%

The Impact on SCR coverage shows how the ratio of Eligible Own Fund to SCR, as quoted in section E.1, would change under each sensitivity.

The impacts have been calculated using the following approximate 1 in 10 year stresses:

- Lapse: a mass lapse event of 20% on individual business and 35% on group business
- Expenses: a 5% increase in renewal expenses and a 0.5% increase in expense inflation
- Longevity: a 10% reduction in the number of deaths experienced at each age
- Morbidity: claim incidences increase by 17.5% in year 1 and 12.5% thereafter, with a 10% reduction in recovery rates
- Mortality: a 7.5% increase in the mortality rates

No sensitivities are provided for catastrophe risk as, due to reinsurance, this has an immaterial impact.

C.2 Market risk

Market risk is the risk associated with ZAL's assets and liabilities where their value or cash flow depends on financial markets; this includes the market value of ZAL's balance sheet positions and future earnings on contracts linked to the value of unit-linked assets.

The risks associated with market risk include:

- Equity price risk – risk of loss resulting from changes in equity prices;
- Property price risk – risk of loss resulting from changes in property prices;
- Interest rate risk – risk of loss resulting from changes in interest rates, including changes in the shape of yield curves;
- Credit spread risk – risk of loss resulting from widening of credit spreads; and
- Currency exchange rate risk – risk of loss resulting from currency exchange rate movements.

ZAL quantifies market risk as part of its Solvency Capital Requirements. ZAL uses a variety of risk mitigation techniques which helps it manage and reduce its exposure to market risks. ZAL monitors and controls exposures to market risk by aligning its strategic asset allocation to its risk appetite. Consideration is given to regulatory requirements, liability profiles and capital impacts. ZAL operates an Investment

Committee which has responsibility for the setting, implementation, monitoring and evaluation of this process and approves any changes to the strategic asset allocation, including within with-profits funds.

Monitoring includes regular review of actual exposures relative to targets set as well as risk assessments which include quantification of the contributions to financial market risk from major risk drivers. The economic effect of potential extreme market moves, including the potential impact of Brexit, is regularly examined and considered when setting the asset allocation.

Through the implementation of the risk management techniques and processes detailed in this section, ZAL also ensures that the management of assets is in line with that which would be expected of a prudent person managing such assets.

Risk mitigation techniques and their effectiveness

ZAL uses a variety of risk mitigation techniques to effectively manage market risks. The specific risk mitigation technique depends on the risk. For ZAL's material market risks the mitigation techniques used are outlined below.

Equity risk

ZAL uses a derivative strategy to mitigate equity risk within its unit-linked business. Derivatives are used to protect the value of expected future management charges less investment expenses against movements in equity prices, maintaining the economic value of the Company to the shareholder. ZAL is exposed to a low level of equity risk as the equity derivative strategy does not cover the equity exposure within ZAL's Hong Kong branch or the equity exposure within ZAL's with-profits funds. However the with-profits exposure is partially hedged.

Credit spread risk

Spread risk is mitigated by limiting ZAL's investment exposure to lower credit quality assets.

Interest rate risk

ZAL mitigates its interest rate risk by specifying fixed interest portfolio mandates which include target asset durations and range limits. The target asset durations are set to match with the liability durations so as to reduce net interest rate risk.

Analysis of market risk sensitivities

The impact of ZAL's sensitivities to market risk on the BOF after RFF restriction and on the ratio of eligible own funds to SCR are shown in the table below.

Consistent with ZAL's Solvency II standard formula SCR, ZAL is sensitive to credit spread risk and currency risk. Credit spread risk is driven by ZAL's holdings of corporate bonds which are used to back policyholder liabilities. Currency risk is primarily driven by unit-linked policyholders choosing assets in foreign denominations, which exposes ZAL to the fluctuations in future annual management charges on these assets.

For the interest rate risk the key driver of the impact on BOF is the change in the Risk Margin, see section D.2, due to the revised interest rate used in the calculation. The Risk Margin relates to the cost of holding capital and is not considered as part of the interest rate risk when determining the appropriate asset durations.

Property risk is not a material risk to ZAL and has not been shown.

Impact of market risk scenarios on basic own funds

Sensitivity Scenarios	Impact on BOF (in £'000)	Impact on SCR coverage (in %)
Interest rate up	20,760	5.0%
Interest rate down	(50,143)	-8.0%
Credit spreads widen	(41,246)	-3.3%
Credit spreads narrow	37,262	3.0%
Equity up	(5,418)	4.5%
Equity down	3,521	-4.3%
Currency	(44,054)	-1.8%

The Impact on SCR coverage shows how the ratio of Eligible Own Fund to SCR, as quoted in section E.1, would change under each sensitivity.

The impacts have been calculated using the following approximate 1 in 10 year stresses:

- Interest rate up: a 0.5% increase in the risk free interest rate
- Interest rate down: a 0.5% reduction in the risk free interest rate
- Credit spreads widen: a 0.5% increase in the yield on corporate bonds relative to government bonds
- Credit spreads narrow: a 0.5% reduction in the yield on corporate bonds relative to government bonds
- Equity up: a 25% increase in the market value of equities
- Equity down: a 25% reduction in the market value of equities
- Currency: a 12.5% strengthening of sterling relative to other currencies

The impact on the BOF is allowed for in the impact on the SCR coverage along with any changes to the SCR. For the equity sensitivities the impact of the derivative strategy used to mitigate equity risk is allowed for in the impact on BOF.

C.3 Credit risk

Counterparty default risk is the risk associated with a loss or potential loss from counterparties failing to fulfil their financial obligations. ZAL's exposure to counterparty default risk (as opposed to credit spread risk) is derived from the following main asset categories:

- Cash and cash equivalents
- Reinsurance assets
- Receivables
- Derivatives

ZAL is also exposed to counterparty default risk by the use of fund reinsurance to access external funds provided by other life insurers. Here the legal form is a reinsurance arrangement but in practice the fund operates in the same way as a collective investment arrangement. ZAL considers its exposure to the risks associated with these funds assessed under the best estimate of default to be very low however it does hold capital for these arrangements under its Solvency II standard formula SCR, which requires the same treatment as for other reinsurances.

ZAL quantifies counterparty default risk as part of its Solvency Capital Requirements. ZAL implements credit exposure limits and regularly monitors credit exposures to counterparties by aggregating exposures across various types of credit risk. The limits vary based on the underlying counterparty rating and appropriate benchmarks.

Risk mitigation techniques and their effectiveness

Note that changes in value of investment assets such as corporate bonds are covered by the market risk module, and this includes the risk of loss of value on default.

ZAL's credit risk exposures are monitored by its Investment Committee. ZAL controls credit risk primarily through implementation and adherence to policies for credit risk exposure and concentration limits, as well as through regular routine monitoring through its liquidity and reinsurance forums.

Cash and cash equivalents

In order to mitigate concentration, settlement and operational risks related to cash and cash equivalents, ZAL limits the maximum cash amount that can be deposited with a single counterparty and maintains an authorised list of acceptable cash counterparties based on current ratings and outlook.

Reinsurance Assets

ZAL typically cedes new business, both internally and externally, to authorised reinsurers with a minimum credit rating of 'A-'. ZAL maintains a list of authorised acceptable reinsurance counterparties based on current ratings and outlook, taking the analysis of fundamentals and market indicators into account. Another technique used in some instances to mitigate credit risk is requiring the reinsurers to place collateral of acceptable quality. ZAL's exposure to reinsurers is monitored via the Reinsurance Underwriting and Claims Forum, chaired by the ZAL CFO.

Receivables

ZAL monitors past due receivable balances and aims to keep the balance of past due positions as low as possible. ZAL has a small amount of exposure to intermediaries where commission is paid on policies which are later cancelled; this is managed via the commission claw-back process to further limit the size and duration of the exposure.

Derivatives

To limit credit risk, derivative financial instruments are typically executed with counterparties rated "A-" or better by an external rating agency. ZAL only transacts derivatives with counterparties where a credit support agreement is in place – this mitigates credit exposures from over-the-counter transactions due to close-out netting and requires the counterparty to post collateral when the derivative position is beyond an agreed threshold. Derivative valuation reconciliation and collateral assessments take place on a daily basis to ensure credit risk is appropriately mitigated.

Analysis of credit risk sensitivities

ZAL's sensitivity to counterparty credit risk is primarily driven by its exposure to fund and risk reinsurers. As the exposure to risk reinsurers is mitigated through the use of collateral arrangements where appropriate, ZAL's most material sensitivity is to fund reinsurers. ZAL is sensitive to both increases in the probability of default and the loss given default and increases in these will reduce own funds. In a 1 in 10 year stress calculation the probability of default is expected to be very small and as a result any impact on own funds would be immaterial.

C.4 Liquidity risk

Liquidity risk is the risk that ZAL may not have sufficient liquid financial resources to meet its obligations when they fall due, or would have to incur excessive costs to do so.

ZAL monitors operational liquidity risk by projecting expected future payments and holding cash and cash equivalents sufficient to cover these payments as they fall due. ZAL monitors the impact of financial market volatility on the level of policy surrenders, funds withdrawals and fund switches. In response ZAL holds appropriate levels of unencumbered liquidity to meet any potential increases in withdrawals, including those from unit-linked funds.

A liquidity governance framework is in place to monitor liquidity in the short, medium and long term. This ensures there are appropriate liquidity levels at all times. This framework monitors liquidity risk by taking into account the amount, availability and speed at which assets can be accessed and includes daily liquidity monitoring.

ZAL monitors unit-linked funds cash balances. The balances are managed separately for each unit-linked fund and are set at a level which aims to reflect the liquidity of the other investments in the fund.

Disclosure of expected profit included in future premiums

As at 31 December 2018 ZAL's expected profit included in future premiums (EPIFP) was £435m million. Note, this number is presented gross of any reinsurance arrangements currently in place and does not allow for any recovery of termination fees, in line with the EIOPA rules to calculate the EPIFP. Whilst this contributed to ZAL's own funds, it is not liquid and not taken into account when assessing ZAL's liquidity position.

Risk mitigation techniques and their effectiveness

Whilst operational liquidity risk is inherent to the nature of the business that ZAL operates, it is also in the nature of long term insurance that ZAL has large volumes of assets which are either liquid or generate steady liquidity. While small amounts of liquidity risk are unavoidable, the Board's requirement is for ZAL to ensure sufficient liquidity to meet all forecast cash outflows in the short and medium term.

Analysis of liquidity sensitivities

ZAL mitigates liquidity risk by ensuring it holds enough liquid assets under a range of scenarios. Given this approach the impact on ZAL's own funds from a liquidity sensitivity would be zero and a sensitivity analysis is not applicable.

C.5 Operational risk

Operational risk is 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'. This definition includes legal, compliance and customer conduct risks. ZAL quantifies its exposure to operational risk as part of its Solvency Capital Requirement.

Risk mitigation techniques and their effectiveness

Operational risk mitigation enables ZAL to manage the likelihood of operational risks occurring and to reduce the impact should they occur. To achieve this ZAL implements a robust and comprehensive framework for identifying, assessing, managing and reporting operational risk.

This framework ensures that material operational risks are fully understood and appropriately managed to within ZAL's risk appetite. ZAL makes use of a number of processes and tools to understand and manage its operational risk profile including risk and control assessments, loss event management, scenario analysis and reverse stress testing.

As part of the operational risk framework, ZAL operates a robust conduct risk framework in order to manage the risks to the delivery of customer outcomes in all its businesses. This approach allows ZAL to appropriately identify, analyse and prioritise conduct risk exposures from within its business models and strategies and equally evaluate the resultant impact on its conduct risk appetite.

ZAL's exposure to operational risk is mitigated by a system of internal controls, capital, corporate internal insurance programmes and its business continuity planning process. ZAL is putting in place additional mitigants and contingency planning to alleviate any potential increase in operational risk that could arise from Brexit.

Analysis of operational risk sensitivities

ZAL uses the Solvency II standard formula to calculate its capital requirement for operational risk. As a result, its sensitivity to operational risk is primarily driven by the level of expenses on unit-linked business. Due to the formulaic nature of the calculation no quantitative analysis is provided. As per the standard formula, operational risk has no dependencies on any of ZAL's other risks. However, ZAL further seeks to understand operational risk sensitivities through the use of operational risk scenarios and reverse stress tests. The methodology ZAL uses for this also allows for the consideration of the interaction between operational risk and other risk types. The results of this scenario and reverse stress test analysis are incorporated into ZAL's ORSA.

C.6 Other material risks

Off balance sheet risks

As ZAL does not transfer any risk to special purpose vehicles, it is not exposed to any risks arising from their use.

ZAL is exposed to pension scheme risk. This is the risk that ZAL may need to support its ultimate UK parent company UKISA in securing funding for the defined benefit staff pension scheme, following changes in the assets or liabilities of the scheme.

Employees in the UK working on behalf of ZAL are predominantly employed by Zurich Employment Services Limited (ZES), a wholly owned subsidiary of UKISA. The employees of ZES mainly participate in a pension scheme which contains both defined benefit and defined contribution sections. The defined benefit sections of the scheme were closed to new entrants in March 2007 and to further accruals from 1 January 2016. The financial position of the pension scheme is recognised in the ZES balance sheet. UKISA, as the pension scheme sponsoring company, is obliged under the scheme rules to procure payment of contributions that the participating employers, including ZES, are required to make into the scheme.

Although ZAL is not bound by any legal obligation to support the pension scheme, under extreme circumstances there remains a risk that ZAL may be required to assist its parent UKISA in securing the funding ZES may be required to make to the pension scheme. The Solvency II standard formula does not cover this off balance sheet pension scheme risk. To reflect this specific limitation of the standard formula when applied to ZAL's business, ZAL has agreed a capital add-on with the PRA. ZAL is in the process of developing a partial internal model to capture the pension scheme risk and replace the capital add-on in due course.

Other risks for which ZAL does not hold capital

In addition to the risks identified above ZAL is also exposed to a number of other risks for which ZAL does not hold capital as it is not the most appropriate mitigant. The most material of these risks are strategic risk, reputational risk and group risk. These risks are detailed below.

Strategic risk

Strategic risk is the unintended risk that can result as a by-product of planning or executing the strategy. Strategic risks can arise from:

- Inadequate assessment of strategic plans;
- Ineffective implementation of strategic plans; and
- Unexpected changes to assumptions underlying strategic plans.

ZAL works to reduce unintended risks of strategic business decisions through its risk assessment processes and tools, including its strategic level risk assessment process. As part of this regular process, ZAL's Executive Management identifies both current and future key strategic risks. The material strategic risks are mitigated through robust and diligent Board and Executive Management governance processes. These provide the means through which strategic plans are reviewed, challenged and refined. Through this comprehensive and iterative process strategic risk is mitigated.

Reputational risk

Reputational risk is the risk that an act or omission by ZAL, or the Group to which ZAL belongs, or any of its employees results in a loss of reputation or trust in ZAL among any of its stakeholders. ZAL accepts that exposure to these risks cannot be completely avoided and continues to take risk on a well informed and conscious basis.

Reputational risk is primarily a consequence of the crystallisation of other risks, most notably operational risk. Reputational risk is effectively managed through business controls, including but not restricted to appropriate recruitment and vetting procedures and a suitable business culture and ethos, supplemented by effective media relations and communications activity.

Group risk

Group risk is the risk of loss resulting from the failure of a group company as a going concern, or from the failure of a group company to provide key outsourced services as required by ZAL.

These can be broadly categorised as:

- Operational outsourcing risk – these are the risks associated with the failure of shared services or functions outsourced to other parts of the Group;
- Brand and reputational risk – this is the risk that an event occurs elsewhere in the group which generates negative publicity which adversely impacts ZAL's business; and
- Risks relating to intra-group reinsurance.

ZAL has intra-group agreements in place for all outsourcing placed with group companies that is categorised as critical or important. Monitoring of all outsourcing arrangements is undertaken by the designated outsourcing contract owners. The Board receive an annual update on the current list of critical and important outsourcing arrangements.

The Board recognises that there are significant advantages to being part of a well-capitalised international group and that these outweigh potential group risks and monitors its exposure to group risk through its risk appetite.

Given ZAL's business model, potential group risk exposures are largely unavoidable and the purchase of financial mitigation for this risk is not commercially realistic. In accordance with the Board's risk strategy, group risk will continue to be taken on a well informed and conscious basis. The Board recognises that the consequential risks arising from the failure of a Zurich Group entity to provide services are identified and considered both within Executive Management's functional oversight processes and within ZAL's approaches for operational risk, credit risk and stress testing.

C.7 Any other information

There is no other material information to report.

D. Valuation for solvency purposes

This chapter provides the value separately for each material class of assets, technical provisions and other liabilities and a description of the bases, methods and main assumptions used for their valuation for solvency purposes under the sections D.1, D.2 and D.3. It also provides a quantitative and qualitative explanation of any material differences between those bases, methods and main assumptions and those used for their valuation in the financial statements.

The table below presents a summarised balance sheet as at 31 December 2018 comparing the assets and liabilities as reported in the UK GAAP financial statements to the values reported under Solvency II and setting out the differences between the two. These differences are explained in sections D.1 to D.3.

	As at 31 December 2018 in £'000	Financial Statements (UK GAAP)	Reclassification within Assets / Liabilities	Reclassification between Assets and Liabilities	Restated UK GAAP	Valuation differences	Solvency II
D.1 Valuation of asset types for financial reporting and solvency purposes	**Total Assets split by material classes of assets**						
	Deferred acquisition costs	230,043	-	-	230,043	(230,043)	-
	Deferred tax assets	-	-	-	-	624	624
	Property, plant & equipment held for own use	2,984	-	-	2,984	-	2,984
	Investments (other than assets held for index-linked and unit-linked contracts)	3,309,532	27,119	-	3,336,651	-	3,336,651
	Assets held for index-linked and unit-linked contracts	42,930,697	(13,368,575)	-	29,562,122	-	29,562,122
	Loans and mortgages	55,238	-	-	55,238	-	55,238
	Reinsurance recoverables	1,678,077	13,355,687	-	15,033,764	(594,723)	14,439,041

	Insurance and intermediaries receivables	104,902	(341)	(2,621)	101,940	-	101,940
	Reinsurance receivables	227,952	375	-	228,327	-	228,327
	Receivables (trade, not insurance)	75,037	(14,518)	39,716	100,235	-	100,235
	Cash and cash equivalents	291,676	-	-	291,676	-	291,676
	Any other assets, not elsewhere shown	16,353	253	6,019	22,625	(7,628)	14,997
	Total assets	**48,922,491**	**-**	**43,114**	**48,965,605**	**(831,770)**	**48,133,835**
D.2 Valuation of technical provisions for financial reporting and solvency purposes	**Material lines of business of technical provisions**						
	Insurance with-profits participation	1,478,868	286	-	1,479,154	(202,424)	1,276,730
	Other life (excluding health and index-linked and unit-linked)	2,355,906	1,028	-	2,356,934	(845,336)	1,511,598
	Index-linked and unit-linked	42,792,264	-	-	42,792,264	(303,832)	42,488,432
	Health insurance (direct business)	526,036	-	-	526,036	(227,256)	298,780
	Health reinsurance (reinsurance accepted)	2,114	-	-	2,114	(625)	1,489
	Claims outstanding	191,462	(191,462)	-	-	-	-
	Total technical provisions	**47,346,650**	**(190,148)**	**-**	**47,156,502**	**(1,579,473)**	**45,577,029**
	Material classes of other liabilities						

D.3 Valuation of other liabilities for financial reporting and solvency purposes

Contingent liabilities	-	-	-	-	5,300	5,300
Provisions other than technical provisions	29,959	-	-	29,959	-	29,959
Deferred tax liabilities	47,816	-	-	47,816	(19,475)	28,341
Derivatives	18,914	-	-	18,914	-	18,914
Financial liabilities other than debts owed to credit institutions	23,119	-	-	23,119	(2)	23,117
Insurance & intermediaries payables	112,643	190,148	(2,621)	300,170	9	300,179
Reinsurance payables	246,574	-	-	246,574	-	246,574
Payables (trade, not insurance)	20,109	-	39,716	59,825	(19)	59,806
Any other liabilities, not elsewhere shown	196,993	-	6,019	203,012	(125,891)	77,121
Total other liabilities	**696,127**	**190,148**	**43,114**	**929,389**	**(140,078)**	**789,311**
Total liabilities	**48,042,777**	**(0)**	**43,114**	**48,085,891**	**(1,719,551)**	**46,366,340**
Excess of assets over liabilities	**879,714**	**0**	**-**	**879,714**	**887,781**	**1,767,495**

The UK GAAP figures above use the Solvency II balance sheet presentation. For certain balance sheet headings the reported figures above may differ from the presentation in the financial statements.

The Reclassification within Assets / Liabilities are due to the following reasons:

Solvency II requires the accrued interest on the Bonds to be included in the underlying asset type, whereas for UK GAAP reporting this is required to be included in the "Receivables (trade, not insurance)" line.

Solvency II requires the legal form to be followed and unit-linked funds reinsurance contracts are presented as reinsurance recoverables. Under UK GAAP unit-linked funds reinsurance contracts are treated as investment contracts as required by IFRS 4 and are therefore disclosed in 'Assets held for index-linked and unit-linked contracts'.

For Solvency II reporting some of the unit-linked related assets are disclosed in 'Receivables (trade, not insurance)' – including foreign withholding tax, and certain index-linked assets are disclosed in 'Government and Corporate Bonds'. Under UK GAAP all current assets and current liabilities for index-linked and unit-linked business are recorded under 'Assets held for index-linked and unit-linked contracts'.

Other reclassification differences exist due to there being a different presentation of asset categories for Solvency II and UK GAAP reporting.

The Reclassification between Assets and Liabilities are due to the following reasons:

Under UK GAAP participations are valued at their fair value, after adjusting for balances due to or due from ZAL. Under Solvency II participations are valued at their fair value, which is the amount that they could be sold for, before taking in to account balances due to and from ZAL. Although there is no significant difference in the valuations, the debtors and creditors between the participations and ZAL are presented differently.

In the Solvency II balance sheet certain balances between the ring-fenced funds and the remaining funds are presented gross. However for the UK GAAP presentation, there is no requirement to show ring-fenced funds separately, therefore where there is a right of set off, these balances are shown net. Therefore there are offsetting differences, as shown in the section 'Other Liabilities'.

D.1 Assets

This section sets out the principles of valuation that ZAL uses to calculate its assets for solvency reporting and explains the differences compared to the valuation used in ZAL's financial statements which are prepared using UK GAAP.

Recognition of Assets

All regular purchases and sales of financial investments are recognised on the trade date i.e. the date the Company commits to purchase or sell the investments. Such purchases or sales of financial investments are those under a contract whose terms require the delivery of assets within the time frame established by regulation or market convention.

Asset valuation methodologies for Solvency II

The asset valuation methodologies used to calculate this balance sheet are set out below.

Deferred acquisition costs ("DAC")

Under Solvency II the economic value of the DAC asset is nil.

Under UK GAAP the costs of acquiring new business, other than for with-profits business, where the benefit of such costs will be obtained in subsequent accounting periods, are deferred to the extent that they are recoverable out of margins in future matching revenues. Deferred acquisition costs are included in the balance sheet as an asset and amortised over a period, which is consistent with the assessment of the expected pattern of receipt of future revenue margins for each product type. Impairment reviews are carried out annually or more frequently if circumstances exist that indicate the likelihood of impairment.

The carrying values are adjusted to recoverable amounts and any resulting impairment losses recognised.

Deferred tax assets

Provision is made for deferred tax assets, using the liability method, on all material timing differences including revaluation gains and losses on investments recognised in the profit and loss account. Deferred tax is calculated at the rates at which it is expected that the tax will arise. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

The deferred tax asset held is in respect of certain investment losses which can be utilised against certain future investment gains and has no maturity date.

The difference reflects the underlying valuation of the assets and liabilities under UK GAAP compared to SII.

Property, plant and equipment held for own use

Property, plant and equipment are included at fair value, depreciated on a straight line basis over the estimated useful life. Fair value includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for it intended use.

Investments (other than assets held for index-linked and unit-linked contracts)

Assets valued using mark to market methods

The fair value of instruments traded in active markets is based on quoted bid prices provided by third party data providers as at the valuation date. In certain cases prices are provided using other valuation techniques, but where all significant valuation inputs are based on observable market data (e.g. broker quotes) these assets are considered as mark to market. Liquidity and market activity levels are used to determine fair value where the pricing of these assets are not based on fully observable inputs.

Assets valued using mark to model methods

For assets that do not meet the mark to market criteria, in accordance with International Financial Reporting Standard (IFRS) 13, a mark to model valuation approach is used to determine fair value. The allocation criteria of all assets is reviewed at least once a year. The valuation approaches described are deemed to be the most appropriate for each type of asset.

The mark to model valuation approach relates to pricing techniques where at least one of the significant inputs is not based on observable market data and applies to the valuation of the assets of ZAL below.

Derivatives

ZAL has holdings of over-the-counter (OTC) options. OTC options use a valuation model based on a number of parameters, including market value of the underlying interest rate curve, volatility surfaces and dividend yields.

Holdings in related undertakings, including participations

All assets and liabilities of subsidiaries are valued in line with Solvency II valuation rules using the adjusted equity method. Therefore a subsidiary's own funds value is market consistent. Participations represent the value of ZAL's subsidiary companies.

Property (other than for own use)

The Fair value model is used for the valuation of investment property. The investment method of valuation determines the fair and best value of a freehold or leasehold interest in commercial property reflecting the risk, return and expectation of growth through the application of yields and assessment of current rental value, assessed by the analysis of comparable investment or rental transactions.

Properties are valued on a monthly basis by Jones Lang LaSalle Limited and CBRE Limited, with the exception of the agricultural portfolio that is valued on an annual basis by Bidwells LLP and Savills (UK) Limited. The valuations are undertaken in accordance with the RICS Valuation – Global Standards 2017 (incorporating the International Valuation Standards) and the RICS Valuation – Professional Standards UK January 2014 (revised April 2015) (the "Red Book"), by external valuers who have the relevant qualifications and experience.

The date of the last valuation for all land and buildings was 31 December 2018.

Private loans secures on real estate

Private loans secured on real estate are included at fair value. Fair value is arrived at by discounting the known cash flows by an appropriate discount rate, which gives consideration to prevailing market rate plus an idiosyncratic spread relating to the risk of the investment.

Assets held for index-linked and unit-linked contracts

Assets valued using mark to market methods

The significant majority of ZAL's assets are unit-linked assets, which are valued using mark to market methods as described under the Investments (other than assets held for index-linked and unit-linked contracts) section above.

Asset and Liabilities Held for Sale

The Company's workplace and corporate savings (ZCS) constitutes a disposal group, as defined in IFRS 5 Non-Current Assets held for Sale. All assets and liabilities of ZCS were classified as held for sale from the date of the sale announcement. Upon classification as Held for Sale all assets and liabilities of the disposal group were measured at the lower of their carrying amount and the fair value less costs to sell upon classification as held for sale.

The majority of the assets held in this category sit in the Assets held for index-linked and unit-linked contracts line.

Derivatives

ZAL permits holdings of derivatives including OTC foreign exchange (FX) forwards within unit-linked funds, where appropriate and relevant to the investment objective, for the purposes of efficient portfolio management. In these cases, the value of the FX forward is an exposure within the specific unit-linked fund and is valued using discounted interest rate curves and FX spot rates.

Loans and Mortgages

Loans and Mortgages have been valued in accordance with International Accounting Standard (IAS) 39. They are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These investments are initially recognised at cost, being the fair value of the consideration paid for the acquisition of the investments, and are subsequently valued at fair value. All transaction costs directly attributable to the acquisition are also included in the cost of the investments.

Reinsurance recoverables

With the exception of the Fund Reinsurance arrangements in place within ZAL (which are determined on the basis of the market price of the underlying funds), the future cash flows associated with ZAL's other reinsurance obligations cannot be replicated reliably using financial instruments for which a reliable market value is observable.

The value of the Reinsurance recoverable associated with these future cash flows is therefore calculated using the same 'Mark to Model' techniques used to calculate the Best Estimate Liabilities (BEL), see section D.2 'Calculation of the Best Estimate Liabilities' for further details.

The valuation of the reinsurance recoverable asset differs between Solvency II and UK GAAP due to the difference in valuation of the underlying liabilities, see section D.2 'Technical provisions - reconciliation to financial statements' for more information on this.

Other valuation methods

Insurance and intermediaries receivables

Assets are recorded at fair value, which is their nominal amount adjusted for the probability of default of the counterparty.

Reinsurance receivables

Assets are recorded at fair value, which is their nominal amount adjusted for the probability of default of the counterparty.

Receivables (trade, not insurance)

Assets are recorded at fair value, which is their nominal amount adjusted for the probability of default of the counterparty.

Asset and Liabilities Held for Sale

As per the description under Assets held for index-linked and unit-linked contracts.

Cash and cash equivalents

Assets are recorded at fair value, which is their nominal amount adjusted for the probability of default of the counterparty.

There are no valuation or presentational differences between Solvency II and UK GAAP.

Any other assets, not elsewhere shown

Assets are recorded at fair value, which is their nominal amount adjusted for the probability of default of the counterparty.

Under UK GAAP participations are valued at their fair value, after adjusting for balances due to or due from ZAL. Under Solvency II participations are valued at their fair value, which is the amount that they could be sold for, before taking in to account balances due to and from ZAL. Although there is no significant difference in the valuations, the debtors and creditors between the participations and ZAL are presented differently.

ZAL is not party to any finance lease arrangements.

ZAL has no material operating lease arrangements as described in section A.4.

There have been no material changes made to the recognition and valuation basis during the period.

There are no future management actions that would impact on the above.

No assets are deemed to be long term in nature, therefore no adjustments have been made in respect of uncertain future events.

Sensitivities

Fair values for assets valued using mark to model methods are sensitive to changes in key assumptions, within the following categories:

Holdings in related undertakings including participations

There is no material sensitivity around the fair value of each of ZAL's interests in subsidiary undertakings.

Shares and other variable yield securities and units in unit trusts

There is no material sensitivity around the fair value of Shares and other yield securities and units in unit trusts.

Debt securities and other fixed income securities

This asset category includes asset-backed securities and real estate loan.

The key assumptions driving the valuation of these investments include discount rates and credit spreads. The effect on reported fair values of using alternative values for each of these assumptions, while the other key assumptions remain unchanged, is disclosed in the table below.

Sensitivity analysis

In £'000	Less favourable values (absolute change)	Decrease in reported fair value	More favourable values (absolute change)	Increase in reported fair value
Key Assumptions				
Discount rates	+100bps	(1,714)	-100bps	1,714
Credit spread	+100bps	(5,289)	-100bps	5,289

The sensitivity analysis is intended to reflect the uncertainty inherent in the valuation of these investments under current market conditions. Furthermore, the analysis does not indicate a probability of such changes occurring and it does not necessarily represent ZAL's view of expected future changes in the fair value of these investments. Any management actions that may be taken to mitigate the inherent risks are not reflected in this analysis.

The table above gives the impact on fair value of the assets excluding the Assets held for index-linked and unit-linked contracts. Any change in the fair value of the Assets held for index-linked and unit-linked contracts will be offset by the movement within the technical provisions, so no material direct impact on the basic own funds.

D.2 Technical provisions

Technical provisions overview

The technical provisions are prepared in accordance with the Solvency II requirements. The value of the technical provisions is the sum of the Best Estimate Liabilities (BEL), the risk margin and the technical provisions as a whole.

ZAL's approach to the valuation of BEL, risk margin and technical provisions as a whole is described in more detail below.

Technical provisions by line of business

As at 31 December 2018 In £'000	Best Estimate	Risk Margin	Technical provisions as a whole	Technical provisions (total)
Insurance with-profits participation	1,224,527	52,203	-	1,276,730
Other life (excluding health and index-linked and unit-linked)	1,418,385	93,213	-	1,511,598
Index-linked and unit-linked	(268,773)	175,864	42,581,341	42,488,432
Health insurance (direct business)	8,945	56,795	233,040	298,780
Health reinsurance (reinsurance accepted)	1,489	-	-	1,489
Total	**2,384,573**	**378,075**	**42,814,381**	**45,577,029**

Material changes in technical provisions over the year

In 2018, ZAL's technical provisions reduced by £6.7bn. The material changes are:

- Technical provisions as a whole: these reduced by £6.7bn with the main movements being premiums of £5.4bn, claims of £9.8bn and investment income and gains/(losses) of £(2.1)bn.

- BEL and Risk Margin: these reduced by £5m over the year. Within the BEL the main movements were an increase in the unit linked BEL due to the run off of the business and market falls, with offsetting reductions from the with-profits BEL due to the run-off of with-profits business.

Calculation of the Best Estimate Liabilities

Insurance with-profits participation (with-profits business)

The BEL is calculated as the present value of the expected future cash flows in respect of the policies (for example premiums, investment returns, claims and cost of administrations) projected using a stochastic valuation. A wide range of economic outcomes are considered in the valuation of any options and guarantees. The BEL also includes provision for vested and future bonuses at rates consistent with ZAL's Principles and Practices of Financial Management.

Index-linked and unit-linked insurance, other life insurance, and health (direct and reinsurance accepted) insurance

The BEL is calculated as the present value of the expected future cash flows on the policies, projected using a single set of best estimate assumptions, less any unit liabilities which are reported under technical provisions as a whole.

Where products have material options and guarantees, the BEL includes an extra allowance for the potential changes in the financial market to increase or decrease the value of the options and guarantees before their expiry.

Main assumptions

Discount rate

The risk-free interest rate used for discounting and projecting cash flows in the technical provision calculations is the 'GBP risk-free term structure' as published by EIOPA.

Mortality and morbidity

To set the best estimate mortality and morbidity assumptions, ZAL management annually investigates its mortality and critical illness experience over the previous four calendar years. Allowance is made for expected future mortality improvements on annuity business and conventional protection business, and for any other factors ZAL considers relevant to future experience. The assumptions are changed to reflect the more recent investigation unless the difference in experience is deemed to be statistically insignificant, in which case the assumptions are left unchanged.

The assumptions are set with reference to relevant industry and reinsurance information - in particular mortality assumptions are set with reference to the standard tables provided by the Continuous Mortality

Investigation (CMI) and a CMI projections model. These tables are based on industry-wide experience and wider population experience. ZAL management sets the percentage assumption based on its own studies.

If lower mortality rates were assumed to apply, the technical provisions would increase in respect of annuity products and decrease in respect of protection products. If lower morbidity rates were assumed to apply, the technical provisions would decrease. The effects on the value of the technical provisions from changes in the assumptions are shown in the 'Indication of the level of uncertainty in the technical provisions' section.

Expenses

ZAL's best estimate expense assumption includes allowance for all expenses associated with servicing its ongoing insurance obligations. This includes:

- Internal servicing and claims costs - both those directly attributable to the policies plus an allocation of overhead costs
- Outsourced administration costs
- Investment management expenses

Per policy expense assumptions are set based on an annual expense analysis.

If lower expenses were assumed to apply, the technical provisions would decrease. The effects on the value of the technical provisions from changes in the assumptions are shown in the 'Indication of the level of uncertainty in the technical provisions' section

Withdrawal rate and lapse rate

ZAL's best estimate withdrawal or lapse rate assumptions are reviewed annually. They are based on the average rates experienced over the previous two calendar years for all products apart from the whole of life assurances where four calendar years is used. In setting the rates the experience data is grouped by similar product types to ensure it is sufficiently credible. The assumptions are changed to reflect the more recent investigation unless the difference in experience is deemed to be statistically insignificant, in which case the assumptions are left unchanged.

If lower withdrawal or lapse rates were assumed to apply, the technical provisions would increase for some policies and decrease for others. Overall, higher withdrawal/lapse rates would reduce technical provisions as shown in the 'Indication of the level of uncertainty in the technical provisions' section.

Risk margin

The risk margin is an addition to the BEL to ensure that the value of the technical provisions is equivalent to the amount that companies would be expected to require in order to take over and meet the insurance obligations. It represents the theoretical compensation for the risk of future experience being worse than that assumed in the BEL and for the cost of holding regulatory capital against this. See section E.2 'Solvency Capital Requirement and Minimum Capital Requirement' for more details on the capital requirements. The risk margin is calculated using the cost of capital approach.

The cost of capital rate is specified by the regulation, and is currently 6%. The risk margin is calculated as the present value of the cost of holding the SCR.

Separate calculations are carried out for each of the two ring-fenced with-profits funds and the remaining fund. The relevant risk types for risk margin are:

- Underwriting risk;
- Counterparty default risk; and
- Operational risk.

Simplifications used in the calculation of the risk margin

ZAL makes use of a simplified method when calculating the SCR for each of the future years that is used to determine the risk margin.

ZAL employs the proxy approach, where each of the relevant risk types within the SCR are projected using their expected run-off pattern. These risks are then aggregated to determine the overall projected SCR for each of the future years.

Technical provisions as a whole

In general, insurers are required to value the best estimate and the risk margin separately when calculating technical provisions. However, where future cashflows associated with insurance obligations can be replicated reliably using financial instruments with observable market values, the value of technical provisions associated with those future cashflows can be determined using the market value of those financial instruments without the need of calculating BEL and risk margin separately.

For ZAL, this represents the unit liabilities of its unit-linked business.

Indication of the level of uncertainty in the technical provisions

The uncertainty in the technical provisions primarily relates to how actual experience will differ from the best estimate. However, the assumption setting process is robust and well controlled to ensure any limitations are understood and documented.

Sensitivity impact on own funds were given in sections C.1 and C.2. The following table shows the percentage change in just the technical provisions for these sensitivities to highlight the impact of changes in the key assumptions.

Sensitivity analysis of the technical provisions for life business	As at 31 December 2018	Interest Rates		Expenses	Mortality Rates		Lapse Rates	
	Key assumptions	0.5%	-0.5%	5%	+7.5% on assurance only	-10% on annuity only	25%	-25%
	Technical provisions	-0.99%	0.96%	0.19%	0.26%	0.55%	-0.62%	0.62%

Whilst the interest rate curve used in the calculation of technical provisions is not an assumption, ZAL is exposed to the mismatch risks between assets and liabilities. The movement in technical provisions is partly offset by the movement in assets.

Reinsurance is used to mitigate some of the mortality risk and after allowing for reinsurance recoverable the mortality sensitivity changes to 0.04% for +7.5% on assurances and 0.13% for -10% on annuities, where the change is the percentage change in technical provisions less reinsurance recoverables.

Technical provisions – reconciliation to financial statements

The table at the start of chapter D sets out the differences between the valuation of technical provisions under Solvency II and UK GAAP.

The UK GAAP reserves are shown in the financial statements as technical provisions for long term business provision and technical provisions for linked liabilities. Tables 1 and 3 show these reserves presented differently by the Solvency II lines of business.

Insurance with-profits participation

The UK GAAP reserves for with-profits business is calculated as the Solvency II BEL plus an adjustment for the policyholders' share of any excess assets over BEL. The risk margin is not explicitly included, but forms part of the excess assets over BEL, most of which is included in UK GAAP reserves through the policyholders' share of this.

Index-linked and unit-linked Insurance, other life Insurance, and health (direct and reinsurance accepted) insurance

The main differences between the UK GAAP reserves and the Solvency II technical provisions for the index-linked and unit-linked insurance, other life insurance and health insurance lines of business are set out below:

- Under UK GAAP the contracts are classified as either insurance or investment contracts. All investment contracts are unit-linked and the reserve held is the unit reserve. Under Solvency II the corresponding technical provisions allows for expected future cash flows in addition to the unit reserve;
- For insurance contracts the UK GAAP assumptions include a margin for prudence while Solvency II assumptions use best estimate in the BEL with a separate risk margin;
- The UK GAAP reserve calculation uses a flat discount rate, derived from the assets ZAL holds, whilst the Solvency II BEL uses a yield curve specified by EIOPA; and
- Under UK GAAP a minimum reserve of zero is held for each contract. However, for Solvency II technical provisions can be negative for each contract.

Overall the reserves held for UK GAAP are higher than the Solvency II technical provisions reflecting the additional prudence in the UK GAAP reserve calculation. This difference is slightly reduced when considering the deferred acquisition cost asset and deferred fees liability held on the UK GAAP balance sheet, which is an overall net asset of £154m. No corresponding asset is held under Solvency II.

Matching adjustment

ZAL does not apply a matching adjustment to the technical provisions.

Volatility adjustment

ZAL does not apply a volatility adjustment to the technical provisions.

Transitional risk-free interest rate term structure

ZAL does not apply a transitional risk-free interest rate.

Transitional deduction

ZAL does not apply a transitional deduction to the technical provisions.

Recoverables from reinsurance contracts and special purpose vehicles

The reinsurance recoverables in respect of the majority of the reinsurance arrangements in place within ZAL are calculated on an individual policy basis using the same valuation approach and best estimate assumptions that are used to calculate the gross BEL.

ZAL does not make use of special purpose vehicles (SPVs). Consequently, there will be no recoverables from SPVs.

Other material information

Assumptions about future management actions

The cash flow projections used in the calculation of the BEL reflect the actions that management would reasonably expect to carry out over the duration of the projections, and the time taken to implement those future management actions.

The following assumptions about future management actions have been made within the calculation of the BEL:

Asset mix

For with-profits business, the cash flow projection starts with the actual mix of assets and, at the end of each year, adjusts the holdings in accordance with the current long term investment strategy for the relevant part of the fund.

Bonus rates, future enhancements and market value reductions

Annual and regular bonus rates are assumed to remain unchanged from the valuation date, with final bonus rates adjusted to target a payout of 100% of asset share for each policy grouping, subject to:

- a minimum bonus rate of zero;
- smoothing of maturity payouts in certain market conditions, as set out in ZAL's published Principles and Practices of Financial Management (PPFM) for the with-profits funds; and
- a market value reduction cannot be applied on certain dates chosen in advance by policyholders, for example the maturity date for endowments, or on death.

D.3 Other liabilities

This section sets out the principles of valuation that ZAL has used to calculate other liabilities for Solvency II reporting.

The table at the top of the chapter D shows a summary of the Other liabilities using the Solvency II balance sheet presentation. It also sets out the differences between the valuation of Other liabilities under Solvency II and UK GAAP.

Other liability valuation methodologies for Solvency II

Contingent Liabilities

On 12 October 2017 the UK business announced the sale of its workplace and corporate savings business, ZCS to the Lloyds Banking Group. Under the terms of the agreement any profits generated on this business from the completion date of the Platform business (3 April 2018) to the effective date of the Part VII (expected to be mid 2019) are required to be set aside for the buyer. All amounts are contingent on the completion of the Part VII.

Under Solvency II reporting, material contingent liabilities are required to be recognised in the Balance Sheet, whereas under UK GAAP they are not required to be recognised in the Balance Sheet.

Provisions other than technical provisions

Provisions other than technical provisions

Valuation of provisions is in accordance with IAS 37. IAS 37 is used as a reasonable approximation for fair value as these provisions are materially short term in nature. Key assumptions are noted below.

Contingent liabilities

Valuation is based on the probability-weighted average of future cash flows required to settle the contingent liability over its lifetime, discounted at the relevant risk-free interest rate.

Remediation and complaints

Estimated redress costs are included in technical provisions. The key assumption is the expected volume of future complaints. Whilst this provision has been based on recent actual experience, uncertainty regarding the ultimate cost remains. This provision relates to the cost of investigating and resolving currently identified operational issues which have resulted in customer detriment. The provision covers the costs of correcting the issue, identifying the customers impacted and the administration of the customer redress. It is expected that the provision will be fully utilised within the next year.

Onerous property obligations

The provision takes into account assumptions as to the period the property will remain vacant or, where applicable, the period for which the property expense exceeds rent receivable. The position is regularly reviewed and any changes in circumstances are reflected in the calculation of the provision. It is expected that the provision will be utilised over the period of the leases of one to eleven years.

Deferred tax liabilities

Provision is made for deferred tax liabilities, using the liability method, on all material timing differences including revaluation gains and losses on investments recognised in the profit and loss account. Deferred tax is calculated at the rates at which it is expected that the tax will arise.

The deferred tax liability is primarily in respect of the long term business of the Company, and mainly relates to unrealised gains on investments, deferred expenses and deferred origination fees. Tax losses carried forward are expected to be recovered out of future profits arising in respect of policies inforce, future investment income and gains.

The differences in the underlying valuation of the assets and liabilities under UK GAAP compared to Solvency II result in deferred tax differences between the two reporting measures.

Derivatives

Measured at fair value.

Financial liabilities other than debts owed to credit institutions

All assets and liabilities of subsidiaries are valued in line with Solvency II valuation rules using the adjusted equity method. Therefore a subsidiary's own funds value is market consistent. Participations represent the value of ZAL's subsidiary companies.

Insurance & intermediaries payables

Measured at fair value.

Reinsurance payables

Measured at fair value.

Payables

Measured at fair value.

Asset and Liabilities Held for Sale

As described in the D.1 Assets.

Any other liabilities, not elsewhere shown

Measured at fair value.

Under UK GAAP Deferred Origination Fees (DOF) are included in the balance sheet as a liability. Under Solvency II the economic value of the DOF liability is nil. Under the same basis the Fund for Future Appropriations (FFA) is also valued at nil under Solvency II.

Under UK GAAP participations are valued at their fair value, after adjusting for balances due to or due from ZAL. Under Solvency II participations are valued at their fair value, which is the amount that they could be sold for, before taking in to account balances due to and from ZAL. Although there is no significant difference in the valuations, the debtors and creditors between the participations and ZAL are presented differently.

There are no material liabilities arising as a result of lease arrangements.

There are no future management actions that would impact on the above.

No liabilities are deemed to be significantly long term in nature or have significant assumptions or judgments where uncertain future events would need to be reflected in the valuation.

There have been no material changes made to the recognition and valuation basis during the period.

Guarantees and contingent liabilities

ZAL has indemnified Zurich Advice Network Limited (ZAN) from any liability, arising from any claim or complaint relating to any products previously marketed, advised upon or sold (whether directly or indirectly) by ZAN or its predecessor or any of their advisers at any time from 5 June 1997.

The fair value is considered negligible as ZAL assumes any liability in respect of its own products and therefore the probability of economic transfer being required as a result of this indemnity is considered to be remote.

ZAL has indemnified Zurich Independent Wealth Management Limited (ZIWM) against any liability arising from any claim or complaint relating to any products previously marketed, advised upon or sold by ZIWM or any adviser connected to ZIWM.

ZAL has provided a deed of indemnity to a group company, Zurich Legacy Solutions Services (UK) Limited (formerly Eagle Star Insurance Company Limited), in relation to the assignment to ZAL of the lease for premises at The Grange, Bishops Cleeve, Cheltenham. The term of the lease is for twenty years from and including 19 December 2001. The maximum liability arising under this deed of indemnity per annum is estimated at £3m.

For the above indemnities, the directors do not consider it necessary to provide for any amounts in respect of these indemnities.

D.4 Alternative methods for valuation

Alternative methods of valuation have been reported in sections D.1 'Assets' under the mark to model and other valuation methods sections, D.2 'Technical provisions' and D.3 'Other liabilities' under the other liability valuation methodologies for Solvency II section. There are no other alternative methods to report other than those already reported in these sections.

D.5 Any other information

There is no other material information to report.

E. Capital management

Objectives of capital management in the context of the Zurich Group

ZAL is part of ZIG and in addition to the capital and liquidity held within ZAL, ZIG holds a substantial amount of capital and liquidity centrally at Group level. This centrally held capital can be deployed into subsidiaries if needed, and therefore provides resilience to absorb potential losses caused by very large risk events. The solvency and financial condition of ZAL therefore must be understood in the context of the resilience and stability of the Group. The Group pools risk, capital and liquidity centrally as much as possible, considering local legal requirements. The Group endeavours to maintain sufficient capital buffer above the Solvency Capital Requirement (SCR) at local level.

The Group manages its capital to maximize long-term shareholder value while maintaining financial strength within its 'AA' target range, and meeting regulatory, solvency and rating agency requirements. In particular, the Group endeavours to manage its shareholders' equity under IFRS to balance maximization of shareholder value and constraints imposed by its economic framework, rating agencies and regulators.

Internally, the Group uses its Zurich Economic Capital Model (Z-ECM), which also forms the basis of the Swiss Solvency Test (SST) model. Z-ECM targets a total capital level that is calibrated to an 'AA' financial strength. The Group defines the Z-ECM capital required as being the capital required to protect the Group's policyholders in order to meet all of their claims with a confidence level of 99.95 percent over a one-year time horizon.

The Z-ECM ratio as of 1 July 2018 was 135%.

The Group discloses more information on its risk and capital management in its risk review, an integral part of ZIG's annual report available on www.zurich.com.

ZAL's capital management framework

ZAL endeavours to manage its capital so that it meets regulatory Solvency Capital Requirements at all times. In addition, ZAL's capital management policy is consistent with the Zurich Group's capital management policy as set out above. The key elements of ZAL's capital management framework are set out below.

- The ZAL Board is responsible for ensuring that regulatory solvency is managed in line with regulatory and business requirements. The CFO is responsible for managing regulatory solvency within a range in order to avoid unnecessarily frequent capital movements to and from its shareholder. This range reflects legal, regulatory and business considerations. ZAL's solvency ratio is currently above the upper boundary and it is anticipated that ZAL will take actions over time to manage the ratio to within the target range, such as remitting excess capital to the shareholder;
- The lower solvency boundary of this range reflects a safety buffer above the SCR. In the case of a deficiency against the lower solvency boundary, the CFO proposes corrective actions to the ZAL Board and Group Treasury and Capital Management. Corrective actions include requesting capital support from the shareholder if deemed appropriate;
- The upper boundary includes an adequate buffer in order to absorb solvency volatility under normal economic conditions. In case of excess capital above the upper solvency boundary, the CFO proposes

to the ZAL Board and Group Treasury and Capital Management to remit the excess to the shareholder as soon as permissible from a legal, regulatory and business perspective;
- Regulatory solvency is monitored on a regular basis and reported to the regulator as requested.

E.1 Own funds

Structure of the own funds

The own funds are derived from the excess of assets over liabilities shown on the balance sheet at the top of chapter D (see sections D.1 'Assets', D.2 'Technical provisions' and D.3 'Other liabilities' for valuations of those items). There is a deduction for restricted own funds items in respect of ring-fenced funds as required by Article 70 1 (e) (i) of The Delegated Level 2 Regulations.

All own funds items are in tier one with the exception of the deferred tax asset which is classed as tier three as required by Article 76 (a) (iii) of The Delegated Level 2 Regulations. All own funds are available:

i) to meet the Solvency Capital Requirement (SCR).
ii) to meet the Minimum Capital Requirement (MCR) with the exception of the tier three own funds.

The composition of own funds is set out in the table below:

Composition of own funds

In £'000	31 December 2018	31 December 2017	Change
Assets	48,133,835	55,165,379	(7,031,544)
Technical provisions	(45,577,029)	(52,238,874)	6,661,845
Other liabilities	(789,311)	(910,376)	121,065
Excess of assets over liabilities	**1,767,495**	**2,016,129**	**(248,634)**
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	(125,006)	(131,548)	6,542
Total Basic Own Funds after deductions	**1,642,489**	**1,884,581**	**(242,092)**
Total available and eligible Own Funds to meet the SCR	**1,642,489**	**1,884,581**	**(242,092)**
SCR	(1,201,513)	(1,177,059)	(24,454)
Excess available funds for SCR over SCR	**440,976**	**707,522**	**(266,546)**
Ratio of Eligible Own Funds to SCR	**137%**	**160%**	**-23%**
Total available and eligible Own Funds to meet the MCR	**1,641,865**	**1,883,956**	**(242,091)**
MCR	(300,378)	(296,216)	(4,162)
Excess available funds for MCR over MCR	**1,341,487**	**1,587,740**	**(246,253)**

Ratio of Eligible Own Funds to MCR	**547%**	**636%**	**-89%**

During 2018 ZAL paid dividends totalling £250m up to its parent company, which largely explains the movement in own funds over the year.

The 'adjustment for restricted own funds items in respect of ring-fenced funds' above removes from own funds the contribution from each with-profits fund that is due to policyholders after allowing for the notional SCR of the fund. The adjustment has decreased over 2018 primarily due to a reduction in assets on the 90:10 fund over the period. Markets over the period for both bonds and equities have been down over the period and so causing the drop in asset values. The 100:0 fund has stayed relatively stable over the period.

The own funds split by tier are set out in the table below:

Segmentation of own funds by tier of capital

In £'000	31 December 2018				31 December 2017			
Own Funds	**Tier 1**	**Tier 2**	**Tier 3**	**Total**	**Tier 1**	**Tier 2**	**Tier 3**	**Total**
Covering the SCR	1,641,865	-	624	1,642,489	1,883,956	-	624	1,884,580
Covering the MCR	1,641,865	-	-	1,641,865	1,883,956	-	-	1,883,956
Ratio of Eligible Own Funds to SCR				**137%**				**160%**
SCR Surplus				**440,976**				**707,521**

Reconciliation to financial statements

The difference between the 'Solvency II Excess of Assets over Liabilities' and the 'Financial Statements Equity including Fund for Future Appropriations' is explained in the table below.

Valuation of equity for Solvency II and financial reporting purposes

In £'000	31 December 2018	31 Dec 2017
Solvency II Assets	48,133,835	55,165,379
Solvency II Liabilities	46,366,340	53,149,250
Solvency II Excess of Assets over Liabilities	**1,767,495**	**2,016,129**
Financial Statements Equity including Fund for future appropriations	**879,714**	**998,823**
Difference	**887,781**	**1,017,306**

The fund for future appropriations represents the amounts in the participating ring-fenced funds for which the allocation to participating policyholders and the shareholder has not been determined at the balance sheet date.

The difference above is explained by:

Explanation of differences in Excess of Assets over Liabilities and Financial Statements Equity

In £'000	31 December 2018	31 December 2017
Difference in gross technical provisions	1,579,473	1,811,794
Difference in reinsurers' share of technical provisions	12,760,964	15,373,237
Assets held for index-linked and unit-linked contracts	(13,368,575)	(16,040,299)
Deferred acquisition costs	(230,043)	(246,994)
Deferred origination fees	76,404	95,025
Fund for future appropriations	41,859	47,159
Difference in deferred tax asset and liability	20,099	13,715
Contingent liabilities	(5,300)	-
Other	12,900	(36,331)
Difference explained	**887,781**	**1,017,306**

Own funds consists of the following items:

Composition and description of own funds

As at 31 December 2018 Basic Own Fund Items	In £'000 Amount	Description
Ordinary share capital (net of own shares)	236,132	Relates to allotted, issued and fully paid ordinary share capital and capital contributions. The share capital and the capital contributions are not subordinated and have no restricted duration.
Surplus funds	252,663	Surplus funds that are not considered as insurance and reinsurance liabilities in accordance with Article 91(2) of Directive 2009/138/EC as noted in Article 69 a (iv) of the Commission Delegated Regulation (EU) 2015/35.
Reconciliation reserve	1,153,071	Reconciliation reserve as noted in Article 70 of the Commission Delegated Regulation (EU) 2015/35. The Reconciliation reserve consists of the excess of assets over liabilities as reported in the Balance Sheet less the Ring-fenced Fund Restriction less Basic Own Funds items. The restriction is that which is applied to the with-profits funds, removing all excess applicable to policyholders. The Basic Own Funds is made up of Surplus, Deferred Tax assets (as reported in the Balance Sheet) and the Ordinary Share Capital held by ZAL.
Total Tier 1 Capital	**1,641,866**	
An amount equal to the value of net deferred tax assets	624	An amount equal to the value of net deferred tax assets as noted in Article 76 of the Commission Delegated Regulation (EU) 2015/35.
Total Tier 3 Capital	**624**	
Total Basic Own Funds	**1,642,490**	

There were no significant changes to the material classes in own funds during the year.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

SCR and MCR

The SCR and MCR both represent capital requirements that must be held in addition to the technical provisions. ZAL's SCR is calculated using the standard formula approach. Both these values are subject to final supervisory assessment.

The SCR is the capital required to ensure that ZAL will be able to meet its obligations over the next 12 months with a probability of at least 99.5%. In addition to the SCR capital a MCR is calculated which represents the threshold below which the regulator would intervene. The MCR is intended to correspond to an 85% probability of adequacy over a one year period and is bounded between 25% and 45% of the SCR.

The following table shows the total SCR and MCR at 31 December 2018.

SCR and MCR calculated using the Standard Formula

In £'000	31 December 2018	31 December 2017	Change
SCR	1,201,513	1,177,059	24,454
MCR	300,378	296,216	4,162

SCR split by risk module or category

The SCR is held to cover the relevant risks described in section C and can be broken down by the different types of risk as shown in the following table. The capital requirement is initially calculated for each risk in isolation with an allowance then made for any diversification benefits between the different risks. This subtotal of diversified Market, Counterparty Default, Life and Health risks is known as the Basic SCR (BSCR). Operational risk is not assumed to diversify with other risk types. Further adjustments are made for the loss absorbing capacity of deferred tax and technical provisions, and for any capital add-on to determine the SCR.

SCR charges by risk module or risk category

In £'000	31 December 2018	31 December 2017	Change
Market Risk	289,376	347,352	(57,976)
Counterparty Default Risk	103,335	139,789	(36,454)
Life Risk	417,562	413,223	4,339
Health Risk	86,933	72,227	14,706
Total Undiversified Risk	**897,206**	**972,591**	**(75,385)**

Diversification Effect	(258,071)	(284,400)	26,329
BSCR	**639,135**	**688,191**	**(49,056)**
Adjustments for Loss Absorbing Capacity of Deferred Taxes	(4,599)	(17,488)	12,889
Adjustments for Loss Absorbing Capacity of Technical Provisions	(38,751)	(59,469)	20,718
Operational Risk	90,878	87,462	3,416
Adjustment due to ring fenced funds	15,850	18,363	(2,513)
Capital Add-on (Pension Scheme Risk)	499,000	460,000	39,000
SCR	**1,201,513**	**1,177,059**	**24,454**

Market risk covers interest rate, equity, property, spread, concentration and currency risks which are described further in section C.2 'Market risk'. Market risk has reduced over the year primarily due to market movements over the year and the run off of the unit linked.

Counterparty default risk covers the risk associated with a loss or potential loss from counterparties failing to fulfil their financial obligations. This is described further in Section C.3 'Credit risk'. The reduction over the year is due to a combination of market movements and business run off.

Life underwriting risk covers mortality, longevity, disability/morbidity, expense, lapse and life catastrophe risks. Health underwriting risk covers mortality, longevity, disability/morbidity, expense and lapse risks for health business and health catastrophe risks. These are described further in section C.1 'Underwriting risk'. Life risk has remained broadly static over the year. Within the life risk, we have seen an increase in mass lapse risk, due to a change in methodology following clarity from EIOPA on the calculation approach. This change meant we needed to increase the calculation to allow for some overhead expenses that were previously assumed to run off in line with the number of policies. Within the calculation, we also introduced some appropriate, Board approved management actions that would apply in such an event, that were factored into the calculation. This overall increase in lapse risk was in part offset by a reduction in mass lapse risk, caused by market movements and run off. The increase in health risk is driven by new business written over the year.

A capital add-on is held in respect of the pension scheme risk which is not covered by the standard formula calculation. ZAL is currently developing a partial internal model to model this risk, which will replace the capital add-on in due course, subject to regulatory approval. The size of the capital add-on at 31 December 2018 was £499m, an increase of £39m from the previous value. This is described further in section C.6 'Other material risks'.

The SCR is calculated separately for each of the ring-fenced funds (RFFs) and the remaining fund. The presentation of the SCR split by risk module in the table above is shown at a total ZAL level with the difference between the fund level and company level calculation shown on the line "adjustment due to Ring Fenced Funds".

After diversification there are adjustments for the loss-absorbing capacity of Technical Provisions and deferred taxes.

The loss-absorbing capacity of Technical Provisions is due to the ability of ZAL to reduce benefit pay-outs on with-profits policies in line with falling asset shares in market stresses.

The loss-absorbing capacity of deferred taxes is due to ZAL's ability to re-evaluate its deferred taxes and thereby potentially absorbing a portion of any pre-tax losses.

Inputs used to calculate the MCR

The following table shows the inputs used to calculate the MCR.

Inputs used to calculate the MCR

In £'000	31 December 2018	31 December 2017	Change
Linear MCR	265,071	296,216	-31,145
SCR	1,201,513	1,177,059	24,454
MCR Cap (45% of SCR)	540,681	529,677	11,004
MCR Floor (25% of SCR)	300,378	294,265	6,113
MCR	300,378	296,216	4,162

The MCR is calculated as the linear MCR subject to a floor of 25% of the SCR and a cap of 45% of the SCR. The linear MCR is a linear function of a set of the following variables: ZAL's technical provisions (net of reinsurance), written premiums, capital-at-risk and administrative expenses. Values for which can be found on QRT S.28 in the appendix.

The MCR is based on the MCR floor, as at the end of 2018. This has increased slightly over the year as a result of the increase in technical provisions (net of reinsurance).

Any other information

Use of simplified calculations in the SCR

The following simplifications have been used in the SCR calculation in the counterparty default risk module:

- The risk-mitigating impact of reinsurance has been calculated for each reinsurance arrangement using the simplification as set out in Article 107 of the Delegated Regulation. This means the total risk mitigating impact from all reinsurance is allocated to individual reinsurers in proportion to the reinsurance recoverable for that reinsurer.
- Where collateral is provided under a reinsurance treaty, the risk adjusted value of this has been taken as 85% of the asset value held at end 2018, in accordance with Article 112 of the Delegated Regulation.

Use of undertaking specific parameters

No undertaking specific parameters have been used.

Throughout 2018, ZAL was compliant with the applicable Solvency Capital Requirements.

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

ZAL has not opted to use the duration-based equity risk sub-module of the Solvency II regulations.

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

ZAL applies the Standard formula model and does not use an internal model to calculate the SCR.

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

ZAL has been compliant with both the Minimum Capital Requirement and Solvency Capital Requirement during 2018.

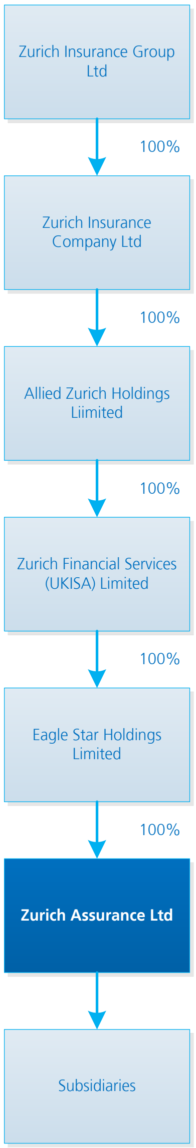
E.6 Any other information

There is no other information to report here.

Appendices

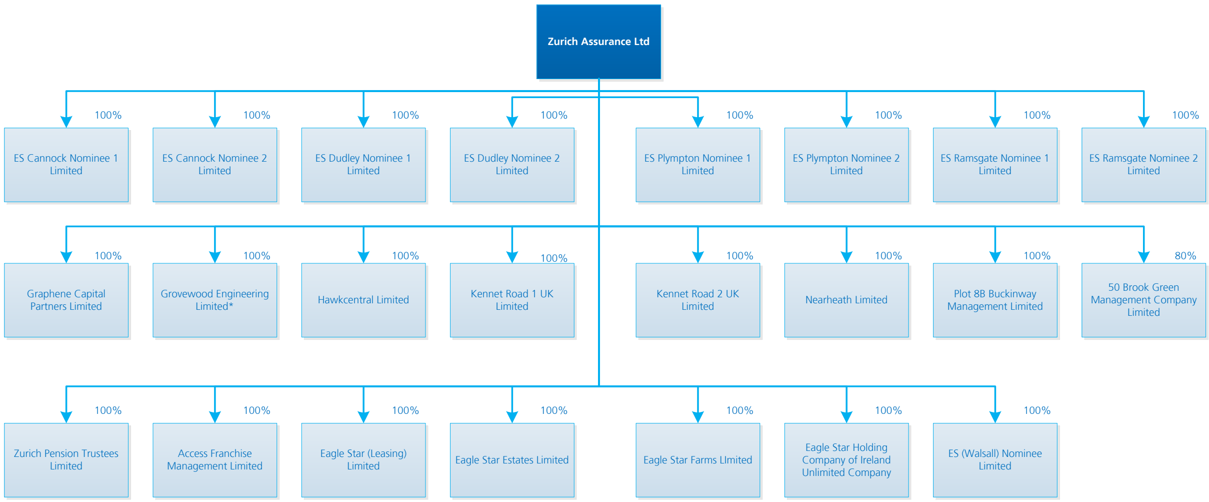
Appendix 1 Company Structure Charts

Simplified structure of the Zurich Insurance Group showing ZAL's position in the Group



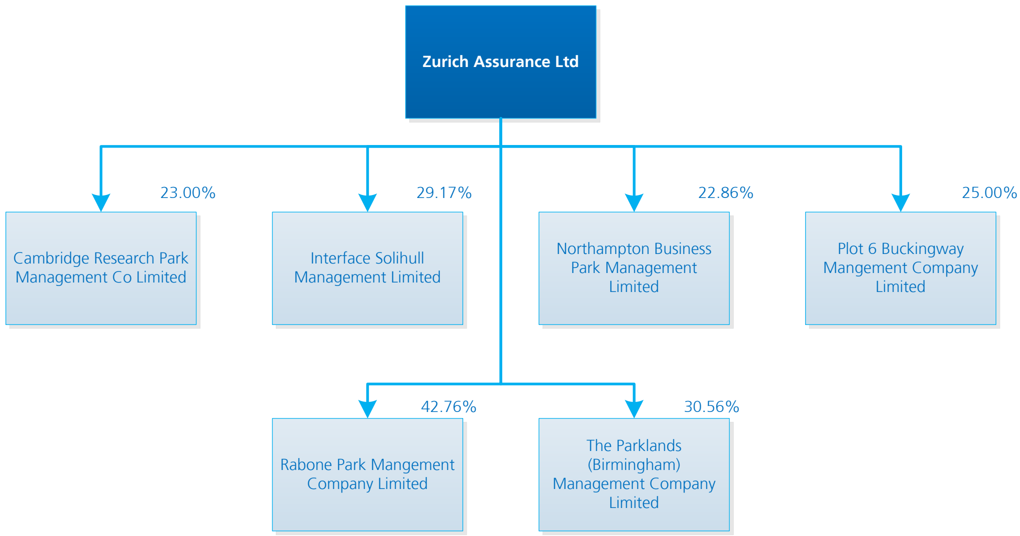
ZIG and ZIC are both incorporated in Switzerland. AZH is incorporated in Jersey. UKISA and ESH are both incorporated in England. The shareholding indicated above is identical to the voting power.

Subsidiary undertakings



*Grovewood Engineering Limited was dissolved on 23 January 2019.
The Companies listed above are incorporated in England and Wales with the exception of Eagle Star Holding Company of Ireland Unlimited Company which is incorporated in the Republic of Ireland.
The voting power ZAL has in its subsidiary companies is equal to the percentage of the nominal value held by ZAL as indicated in the chart above.

Significant holdings in undertakings other than subsidiary undertakings



The companies listed above are incorporated in England and Wales. The voting power is equal to the percentage of the nominal value held by ZAL.

Appendix 2 Quantitative Reporting Templates

S.02.01.02

Balance Sheet, Assets

in GBP thousands, as of 31 December 2018		Solvency II value C0010
Assets		
Intangible assets	R0030	-
Deferred tax assets	R0040	624
Pension benefit surplus	R0050	-
Property, plant & equipment held for own use	R0060	2,984
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	3,336,651
Property (other than for own use)	R0080	7,591
Holdings in related undertakings, including participations	R0090	26,268
Equities	R0100	146,481
Equities – listed	R0110	145,919
Equities – unlisted	R0120	562
Bonds	R0130	3,024,783
Government Bonds	R0140	1,543,323
Corporate Bonds	R0150	1,437,914
Structured notes	R0160	10,301
Collateralised securities	R0170	33,245
Collective Investments Undertakings	R0180	48,762
Derivatives	R0190	16,863
Deposits other than cash equivalents	R0200	65,903
Other investments	R0210	-
Assets held for index-linked and unit-linked contracts	R0220	29,562,122
Loans and mortgages	R0230	55,238
Loans on policies	R0240	55,123
Loans and mortgages to individuals	R0250	115
Other loans and mortgages	R0260	-
Reinsurance recoverables from:	R0270	14,439,041
Non-life and health similar to non-life	R0280	-
Non-life excluding health	R0290	-
Health similar to non-life	R0300	-
Life and health similar to life, excluding health and index-linked and unit-linked	R0310	1,067,074
Health similar to life	R0320	140,894
Life excluding health and index-linked and unit-linked	R0330	926,180
Life index-linked and unit-linked	R0340	13,371,967
Deposits to cedants	R0350	-
Insurance and intermediaries receivables	R0360	101,939
Reinsurance receivables	R0370	228,327
Receivables (trade, not insurance)	R0380	100,235
Own shares (held directly)	R0390	-
Amounts due in respect of own fund items or initial fund called up but not yet paid in	R0400	-
Cash and cash equivalents	R0410	291,676
Any other assets, not elsewhere shown	R0420	14,997
Total assets	**R0500**	**48,133,835**

S.02.01.02

Balance Sheet, Liabilities

in GBP thousands, as of 31 December 2018		Solvency II value
		C0010
Liabilities		
Technical provisions – non-life	R0510	-
Technical provisions – non-life (excluding health)	R0520	-
TP calculated as a whole	R0530	-
Best Estimate	R0540	-
Risk margin	R0550	-
Technical provisions – health (similar to non-life)	R0560	-
TP calculated as a whole	R0570	-
Best Estimate	R0580	-
Risk margin	R0590	-
Technical provisions – life (excluding index-linked and unit-linked)	R0600	3,088,597
Technical provisions – health (similar to life)	R0610	300,269
TP calculated as a whole	R0620	233,040
Best Estimate	R0630	10,433
Risk margin	R0640	56,795
Technical provisions – life (excluding health and index-linked and unit-linked)	R0650	2,788,328
TP calculated as a whole	R0660	-
Best Estimate	R0670	2,642,912
Risk margin	R0680	145,416
Technical provisions – index-linked and unit-linked	R0690	42,488,432
TP calculated as a whole	R0700	42,581,341
Best Estimate	R0710	(268,773)
Risk margin	R0720	175,864
Contingent liabilities	R0740	5,300
Provisions other than technical provisions	R0750	29,959
Pension benefit obligations	R0760	-
Deposits from reinsurers	R0770	-
Deferred tax liabilities	R0780	28,341
Derivatives	R0790	18,914
Debts owed to credit institutions	R0800	-
Financial liabilities other than debts owed to credit institutions	R0810	23,117
Insurance & intermediaries payables	R0820	300,179
Reinsurance payables	R0830	246,574
Payables (trade, not insurance)	R0840	59,806
Subordinated liabilities	R0850	-
Subordinated liabilities not in BOF	R0860	-
Subordinated liabilities in BOF	R0870	-
Any other liabilities, not elsewhere shown	R0880	77,121
Total liabilities	R0900	46,366,340
Excess of assets over liabilities	R1000	1,767,495

S.05.01.01

Premiums, claims and expenses by line of business, Life

in GBP thousands, as of 31 December 2018		Line of Business for: life insurance obligations			
		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance
		C0210	C0220	C0230	C0240
Premiums written					
Gross	R1410	212,078	9,599	5,371,128	646,132
Reinsurers' share	R1420	98,295	342	8,914	462,167
Net	R1500	113,782	9,257	5,362,214	183,965
Premiums earned					
Gross	R1510	212,078	9,599	5,371,128	646,132
Reinsurers' share	R1520	98,295	342	8,914	462,167
Net	R1600	113,782	9,257	5,362,214	183,965
Claims incurred					
Gross	R1610	119,699	203,792	9,724,752	452,683
Reinsurers' share	R1620	58,445	103	4,098	413,506
Net	R1700	61,254	203,689	9,720,654	39,176
Changes in other technical provisions					
Gross	R1710	-6,817	192,485	6,580,144	127,593
Reinsurers' share	R1720	- 22,266	-	3,627	113,718
Net	R1800	15,449	192,485	6,576,517	13,875
Expenses incurred	R1900	74,713	10,497	210,116	151,627
Other expenses	R2500				
Total expenses	**R2600**	**74,713**	**10,497**	**210,116**	**151,627**

S.05.01.01 Premiums, claims and expenses by line of business, Life	in GBP thousands, as of 31 December 2018		Line of Business for: life insurance obligations		Life reinsurance obligations		Total
			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	
			C0250	C0260	C0270	C0280	C0300
Premiums written							
Gross	**R1410**		-	-	2,551	-	6,241,488
Reinsurers' share	**R1420**		-	-	-	-	569,718
Net	**R1500**		-	-	2,551	-	5,671,770
Premiums earned							
Gross	**R1510**		-	-	2,551	-	6,241,488
Reinsurers' share	**R1520**		-	-	-	-	569,718
Net	**R1600**		-	-	2,551	-	5,671,770
Claims incurred							
Gross	**R1610**		-	-	2,201	-	10,503,127
Reinsurers' share	**R1620**		-	-	-	-	476,152
Net	**R1700**		-	-	2,201	-	10,026,975
Changes in other technical provisions							
Gross	**R1710**		-	-	441	-	6,893,846
Reinsurers' share	**R1720**		-	-	-	-	95,079
Net	**R1800**		-	-	441	-	6,798,767
Expenses incurred	**R1900**		-	-	-	-	446,953
Other expenses	**R2500**				-		630
Total expenses	**R2600**		**-**	**-**	**-**	**-**	**447,583**

S.05.02.01							
Premiums, claims and expenses by country, Life in GBP thousands, as of 31 December 2018			**Home Country**	**Top 5 countries (by amount of gross premiums written) – life obligations**			**Total Top 5 and home country**
			C0150	**C0160**	**C0170**	**C0180**	**C0210**
	R1400			HK	MT	IM	
			C0220	**C0230**	**C0240**	**C0250**	**C0280**
Premiums written							
Gross	**R1410**		6,214,635	26,385	466	2	6,241,488
Reinsurers' share	**R1420**		567,880	1,838	-	-	569,718
Net	**R1500**		5,646,755	24,547	466	2	5,671,770
Premiums earned							
Gross	**R1510**		6,214,635	26,385	466	2	6,241,488
Reinsurers' share	**R1520**		567,880	1,838	-	-	569,718
Net	**R1600**		5,646,755	24,547	466	2	5,661,770
Claims incurred							
Gross	**R1610**		10,447,590	46,972	7,633	932	10,503,127
Reinsurers' share	**R1620**		474,645	794	-	713	476,152
Net	**R1700**		9,972,946	46,177	7,633	218	10,026,975
Changes in other technical provisions							
Gross	**R1710**		6,884,433	5,251	3,163	999	6,893,846
Reinsurers' share	**R1720**		94,138	-	-	941	95,079
Net	**R1800**		6,790,295	5,251	3,163	58	6,798,767
Expenses incurred	**R1900**		440,170	6,390	271	122	446,953
Other expenses	**R2500**						630
Total expenses	**R2600**			**-**	**-**	**-**	**447,583**

S.12.01.02						
Life and Health SLT Technical Provisions	**in GBP thousands, as of 31 December 2018**		**Insurance with profit participation**	**Index-linked and unit-linked insurance**		
					Contracts without options and guarantees	**Contracts with options or guarantees**
			C0020	**C0030**	**C0040**	**C0050**
Technical provisions calculated as a whole	**R0010**		-	42,581,341	-	-
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	**R0020**		-	13,370,447	-	-
Technical provisions calculated as a sum of BE and RM						
Best Estimate						
Gross Best Estimate	**R0030**		1,224,526	-	-	(268,773)
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	**R0080**		-509	-	-	1,520
Best estimate minus recoverables from reinsurance/SPV and Finite Re – total	**R0090**		1,225,036	-	-	(270,292)
Risk Margin	**R0100**		52,203	175,864	-	-
Amount of the transitional on Technical Provisions						
Technical Provisions calculated as a whole	**R0110**		-	-	-	-
Best estimate	**R0120**		-		-	-
Risk margin	**R0130**		-	-	-	-

Technical provisions – total	**R0200**	**1,276,730**	**42,488,432**	**-**	**-**

S.12.01.02

Life and Health SLT Technical Provisions

in GBP thousands, as of 31 December 2018

			Other life insurance		
				Contracts without options and guarantees	Contracts with options or guarantees
			C0060	C0070	C0080
Technical provisions calculated as a whole	**R0010**		-	-	-
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	**R0020**		-	-	-
Technical provisions calculated as a sum of BE and RM					
Best Estimate					
Gross Best Estimate	**R0030**		-	-	1,418,385
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	**R0080**		-	-	926,689
Best estimate minus recoverables from reinsurance/SPV and Finite Re – total	**R0090**		-	-	481,696
Risk Margin	**R0100**		93,213	-	-
Amount of the transitional on Technical Provisions					
Technical Provisions calculated as a whole	**R0110**		-	-	-
Best estimate	**R0120**		-	-	-
Risk margin	**R0130**		-	-	-
Technical provisions – total	**R0200**		**1,511,598**	**-**	**-**

S.12.01.02

Life and Health SLT Technical Provisions

in GBP thousands, as of 31 December 2018			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, incl. Unit-Linked)
			C0090	C0100	C0150
Technical provisions calculated as a whole	R0010		-	-	42,581,341
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0020		-	-	13,370,447
Technical provisions calculated as a sum of BE and RM					
Best Estimate					
Gross Best Estimate	R0030		-	-	2,374,139
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080		-	-	927,700
Best estimate minus recoverables from reinsurance/SPV and Finite Re – total	R0090		-	-	1,436,439
Risk Margin	R0100		-	-	321,280
Amount of the transitional on Technical Provisions					
Technical Provisions calculated as a whole	R0110		-	-	-
Best estimate	R0120		-	-	-
Risk margin	R0130		-	-	-
Technical provisions – total	**R0200**		**-**	**-**	**45,276,760**

S.12.01.02					
Life and Health SLT Technical Provisions	in GBP thousands, as of 31 December 2018		Health insurance (direct business)		
				Contracts without options and guarantees	Contracts with options or guarantees
			C0160	C0170	C0180
	Technical provisions calculated as a whole	R0010	233,040	-	-
	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0020	-	-	-
	Technical provisions calculated as a sum of BE and RM				
	Best Estimate				
	Gross Best Estimate	R0030		-	8,945
	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080		-	140,894
	Best estimate minus recoverables from reinsurance/SPV and Finite Re – total	R0090		-	-131,950
	Risk Margin	R0100	56,795	-	-
	Amount of the transitional on Technical Provisions				-
	Technical Provisions calculated as a whole	R0110	-	-	-
	Best estimate	R0120		-	-
	Risk margin	R0130	-	-	-
	Technical provisions – total	**R0200**	**298,780**	**-**	**-**

S.12.01.02

Life and Health SLT Technical Provisions

in GBP thousands, as of 31 December 2018		Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
		C0190	C0200	C0210
Technical provisions calculated as a whole	R0010	-	-	233,040
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0020	-	-	-
Technical provisions calculated as a sum of BE and RM				
Best Estimate				
Gross Best Estimate	R0030	-	1,489	10,433
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080	-	-	140,894
Best estimate minus recoverables from reinsurance/SPV and Finite Re – total	R0090	-	1,489	-130,461
Risk Margin	R0100	-	-	56,795
Amount of the transitional on Technical Provisions				
Technical Provisions calculated as a whole	R0110	-	-	-
Best estimate	R0120	-	-	-
Risk margin	R0130	-	-	-
Technical provisions – total	**R0200**	**-**	**1,489**	**300,269**

S.23.01.01

Own funds

in GBP thousands, as of 31 December 2018		Total	Tier 1 – unrestricted	Tier 1 – restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation (EU) 2015/35						
Ordinary share capital (gross of own shares)	**R0010**	236,132	236,132		-	
Share premium account related to ordinary share capital	**R0030**	-	-		-	
Initial funds, members' contributions or the equivalent basic own – fund item for mutual and mutual-type undertakings	**R0040**	-	-		-	
Subordinated mutual member accounts	**R0050**	-		-	-	-
Surplus funds	**R0070**	252,663	252,663			
Preference shares	**R0090**	-		-	-	-
Share premium account related to preference shares	**R0110**	-		-	-	-
Reconciliation reserve	**R0130**	1,153,071	1,153,071			
Subordinated liabilities	**R0140**	-		-	-	-
An amount equal to the value of net deferred tax assets	**R0160**	624				624
Other own fund items approved by the supervisory authority as basic own funds not specified above	**R0180**	-	-	-	-	-
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds						
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	**R0220**	-				
Deductions						
Deductions for participations in financial and credit institutions	**R0230**	-	-	-	-	-
Total basic own funds after deductions	**R0290**	**1,642,489**	**1,641,865**	**-**	**-**	**624**
Ancillary own funds						
Unpaid and uncalled ordinary share capital callable on demand	**R0300**	-			-	
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual – type undertakings, callable on demand	**R0310**	-			-	

Unpaid and uncalled preference shares callable on demand	R0320	-			-	-
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	R0330	-			-	-
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	R0340	-			-	
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	R0350	-			-	-
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0360	-			-	
Supplementary members calls – other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0370	-			-	-
Other ancillary own funds	R0390	-			-	-
Total ancillary own funds	**R0400**	**-**	**-**	**-**	**-**	**-**
Available and eligible own funds						
Total available own funds to meet the SCR	R0500	1,642,489	1,641,865	-	-	624
Total available own funds to meet the MCR	R0510	1,641,865	1,641,865	-	-	-
Total eligible own funds to meet the SCR	R0540	1,642,489	1,641,865	-	-	624
Total eligible own funds to meet the MCR	R0550	1,641,865	1,641,865	-	-	-
SCR	R0580	1,201,513				
MCR	R0600	300,378				
Ratio of Eligible own funds to SCR	R0620	137%				
Ratio of Eligible own funds to MCR	R0640	547%				

		C0060	
Reconciliation reserve			
Excess of assets over liabilities	R0700	1,767,495	
Own shares (held directly and indirectly)	R0710	-	
Foreseeable dividends, distributions and charges	R0720	-	
Other basic own fund items	R0730	489,418	
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	R0740	125,006	
Reconciliation reserve	R0760	1,153,071	
Expected profits			
Expected profits included in future premiums (EPIFP) – Life business	R0770	435,244	
Expected profits included in future premiums (EPIFP) – Non- life business	R0780	-	
Total Expected profits included in future premiums (EPIFP)	**R0790**	**435,244**	

S.25.01.21

Solvency Capital Requirement - for undertakings on Standard Formula

in GBP thousands, as of 31 December 2018		Gross solvency capital requirement	USP	Simplifications
		C0110	C0090	C0120
Market risk	R0010	295,796		No
Counterparty default risk	R0020	106,017		
Life underwriting risk	R0030	428,393	No	No
Health underwriting risk	R0040	89,189	No	No
Non-life underwriting risk	R0050	-	No	No
Diversification	R0060	(264,411)		
Intangible asset risk	R0070	-		
Basic Solvency Capital Requirement	R0100	654,985		
			-	-

		C0100
Calculation of Solvency Capital Requirement		
Operational risk	R0130	90,878
Loss-absorbing capacity of technical provisions	R0140	(38,751)
Loss-absorbing capacity of deferred taxes	R0150	(4,599)
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	R0160	
Solvency capital requirement excluding capital add-on	R0200	702,513
Capital add-on already set	R0210	499,000
Solvency capital requirement	R0220	1,201,513
Other information on SCR		
Capital requirement for duration-based equity risk sub-module	R0400	
Total amount of Notional Solvency Capital Requirement for remaining part	R0410	627,059
Total amount of Notional Solvency Capital Requirements for ring fenced funds	R0420	75,454
Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	R0430	
Diversification effects due to RFF nSCR aggregation for article 304	R0440	

S.28.01.01

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

in GBP thousands, as of 31 December 2018		C0040
	R0200	265,071

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0050	C0060
Obligations with profit participation – guaranteed benefits	R0210	1,085,497	
Obligations with profit participation – future discretionary benefits	R0220	139,844	
Index-linked and unit-linked insurance obligations	R0230	28,940,601	
Other life (re)insurance and health (re)insurance obligations	R0240	594,275	
Total capital at risk for all life (re)insurance obligations	R0250		24,428,746

		C0070
Linear MCR	R0300	265,071
SCR	R0310	1,201,513
MCR cap	R0320	540,681
MCR floor	R0330	300,378
Combined MCR	R0340	300,378
Absolute floor of the MCR	R0350	3,288

-	-	C0070
Minimum Capital Requirement	**R0400**	300,378