

# Solvency and Financial Condition Report 2019

---



## Contents

<b>Introduction .....</b>	<b>4</b>
1 Summary .....	5
2 Statement of directors responsibility .....	10
3 Independent auditors report .....	11
<b>A. Business and performance .....</b>	<b>14</b>
A.1 Business .....	14
A.2 Underwriting performance .....	18
A.3 Investment performance .....	21
A.4 Performance of other activities .....	23
A.5 Any other information .....	23
<b>B. System of governance .....</b>	<b>24</b>
B.1 General information on the system of governance .....	24
B.2 Fit and proper requirements .....	30
B.3 Risk management system including the Own Risk and Solvency Assessment (ORSA) .....	31
B.4 Internal control system .....	33
B.5 Internal Audit function .....	34
B.6 Actuarial function .....	35
B.7 Outsourcing .....	35
B.8 Any other information .....	37
<b>C. Risk profile .....</b>	<b>38</b>
C.1 Underwriting risk .....	39
C.2 Market risk .....	42
C.3 Credit risk .....	44
C.4 Liquidity risk .....	45
C.5 Operational risk .....	46
C.6 Other material risks .....	47
C.7 Any other information .....	49
<b>D. Valuation for solvency purposes .....</b>	<b>51</b>
D.1 Assets .....	53
D.2 Technical provisions .....	58
D.3 Other liabilities .....	64
D.4 Alternative methods for valuation .....	66
D.5 Any other information .....	67

<b>E. Capital management .....</b>	<b>68</b>
E.1 Own funds .....	69
E.2 Solvency Capital Requirement and Minimum Capital Requirement.....	72
E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement .....	75
E.4 Differences between the standard formula and any internal model used .....	75
E.5 Non-compliance with the Minimum Capital Requirement and non- compliance with the Solvency Capital Requirement .....	75
E.6 Any other information .....	76
<b>Appendices.....</b>	<b>77</b>
Appendix 1 Company Structure Charts .....	77
Appendix 2 Quantitative Reporting Templates .....	79

## Introduction

### 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 4,445m**

Gross Customer Claims (2019)

**OVER 99%**

Death Claims paid out (in 2019)

#### 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 & Remuneration 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 appropriately capitalised

As of 31 December 2019, ZAL's SCR ratio was above the requirement of 100%.

**126%**

Solvency II SCR ratio (as of 31 December 2019)

**GBP 1,534 m**

Own funds under Solvency II (as of 31 December 2019)

## 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 2019, the Group had a solvency ratio of 221% 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-/positive 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](http://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 2019 ZAL had total assets under management (AuM) in excess of £29.6bn (2018: £46.6bn) and 3.1m (2018: 3.4m) policyholders and scheme members. The completion of the Part VII transfer of the Zurich Corporate Savings business (ZCS) (£20.8bn of assets) in the year is the principal driver in the drop in AuM (described in more detail below). ZAL's UK GAAP loss for the year before taxation was £101m (2018: £188m profit), which in addition to underlying trading profit, includes a loss of £17m from an increase in Technical Provisions resulting from demographic basis updates, £29m loss from a strengthening of the reinsurer default reserve and losses and losses of £85m as a result of rising equity markets due to the derivative strategy used to mitigate equity risk.

ZAL's total annual premium equivalent was £125m (2018: £208m). In 2019 gross claims were £27bn (2018: £10.5bn). This differs from the number in the overview above due to platform movements, which are explained below and the Part VII transfer of the Zurich Corporate Savings business and the surrender (£20.6bn) associated with it. ZAL paid over 90% (2018: over 90%) of critical illness claims, over 99% (2018: over 99%) of death claims and 98% (2018: over 95%) of income protection claims in 2019. 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.

Technical provisions have decreased primarily due to the completion of the Part VII transfer of the ZCS business in the year (£20.8bn of liabilities). With this removed we see an increase in provisions as markets have risen in the year.

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 transfer of business was completed via a Business Transfer Scheme under Part VII of the Financial Services and Markets Act 2000 on 1<sup>st</sup> July 2019 and resulted in £20.8bn of Assets and £20.8bn of Liabilities being transferred from the Company. The large surrender from this Part VII transfer (£20.6bn) has not been

reflected in the Gross Customer Claims number above due to this being the surrender as part of the Part VII transfer.

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 2018, and has continued in the first half of 2019. The headline Gross Customer Claims number in the above overview (£4,445m) does not include these ZCS platform movements due to this being a strategic move, rather than actual customer claims. This has now completed with the completion of the ZCS Part VII transfer.

Following the launch of the new Life Protection Proposition (LPP) in 2018, the UK business has benefited from material growth in new business volumes. Overall protection APE has grown by 25% year on year which has been achieved through the strength of the new products and propositions on LPP, particularly the critical illness and income protection products and increased sales of corporate protection products through the Zurich Corporate Retail Platform. This has led to the UK business winning new distribution arrangements and increasing sales through existing supporters.

Consumer confidence fell by 0.1 points in February 2020 but was still 3.0 points higher than a year ago. The employment rate reached another record high of 76.5% in the fourth quarter of 2019. This is 0.4 percentage points above the level recorded in the previous quarter.

The UK economy continued to flatline in the three months to January 2020, recording GDP growth of 0.0% compared to the previous three-month period.

Whilst the FTSE ended the year 12% up on 2018, all gains have been more than erased in the period since the balance sheet date, with the FTSE currently at a level around 30% lower than it started the year.

Since August 2018, interest rates have been set at 0.75%. On 11 March 2020, The Bank of England cut interest rates to 0.25% and on 19 March, it cut them again to 0.1%, their lowest ever level. In addition to the significant fall in interest rates, the 10-year gilt yield is around 0.5% lower than at 31 December and credit spreads have widened by around 50% over the same period.

## **Post 2019 Events**

The directors recognise the possible consequences arising from COVID-19 and have considered the operational impact on the business as well as the possible economic impacts due to fluctuations in the market. A derivative strategy is used to mitigate equity risk within the unit-linked business and protect the solvency position of the Company against equity market movements. The Company has well established business continuity plans and regular solvency monitoring processes and as such the directors believe that the Company is well positioned to cope with any changes in circumstances as they may arise. The Company also has regular solvency monitoring processes and protocols in place including an agreement in place to receive financial support from the Group should this be required and as such the directors believe that the Company is well positioned to assess and adjust to any changes in circumstances as they may arise.

The UK left the EU on 31 January 2020 with a transition period until the 31 December 2020. While this removes near-term uncertainty, the Prime Ministers' insistence that the transition period not be extended beyond the end of 2020 reintroduces a different uncertainty. As a result Sterling currency movements post this announcement more than erased post-election gains. Following the outbreak of COVID-19, it is possible that the transition period will need to be extended. There has however been no official announcement from the UK Government on this topic to date.

The economy is expected to have contracted marginally in the first quarter of 2020, by 0.5% quarter on quarter. In Q2 2020 UK GDP is likely to see a fall of 15%. If restrictions on business and the wider population are loosened by Q3 2020 then there is likely to be a bounce back in the third and fourth quarter of the year. Over 2020 as a whole GDP is expected to be 4% lower than in 2019. 2019 GDP growth stood at 1.4%. Interest rates and inflation are likely to remain low in the coming months but are expected to rise in 2021 as the economy recovers.

Whilst there is uncertainty in the business environment, the Company has a strong risk management and governance framework in place and benefits from the financial security provided from being a member of the Zurich Group. The risks arising from the COVID-19 pandemic continue to be closely monitored and the Company is well positioned to identify and implement a range of mitigants in response to future developments.

The COVID-19 outbreak has caused some short term challenges and uncertainties and the impacts from the COVID-19 pandemic continue to be closely monitored. The Company is well positioned to identify and implement a range of actions in response to future developments.

Due to the significant falls in the markets post the balance sheet date and in particular the fall in gilt rates, the Company's solvency capital fell to below its internal target level. Whilst it continued to meet its regulatory solvency requirement, the Company received a capital injection of £70m on 10 March to restore the capital level to above its internal targets.

The above information regarding the impact of the Brexit negotiations and Coronavirus outbreak on the business environment relevant to the Company is accurate at the time of writing but as a result of the on-going discussions and developments, may not reflect the situation at the time of reading.

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.

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 & Remuneration 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 a specific Life function 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 has not changed from 2018.

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**

Total Assets have been valued at £31.2bn (UK GAAP: £32.1bn), with valuation differences in Deferred Acquisition Costs and Reinsurance Recoverables making up the majority of this difference.

Technical Provision liabilities have been valued at £28.9bn (UK GAAP: £30.9bn), 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 £667m (UK GAAP: £555m), 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 £1.7bn (UK GAAP: £658m).

IFRS 16 Accounting for Leases (the IASB's replacement for IAS 17) introduces a single lessee accounting model and requires a lessee to recognise assets (Right of Use Asset) and liabilities (Lease Liability) for all leases with a term of more than twelve months, unless the underlying asset is of low value. IFRS 16 came in to effect for accounting periods beginning on or after 1<sup>st</sup> January 2019, with Solvency II using the same model. Although the Balance Sheet values are relatively large, as the impact is on both Assets and Liabilities the change to the Net assets of the Company is not material. On implementation the Company has opted to apply the modified retrospective approach consistent with the IFRS reporting approach applied by the Zurich Group.

Reserves are set considering the claims that would be expected throughout the lifetime of the policies, and hence take a long view on the overall mortality that the Company would experience. This is based on industry tables and historic experience. While COVID-19 may result in a rise in deaths in 2020, it is expected to predominantly impact the elderly and those with pre-existing health conditions. The medium-



term mortality could be light, given the insured population will include those who were resilient to COVID-19. Overall, given the long-term nature of the projection the directors remain comfortable with the current best estimate mortality view.

No material changes to the valuation methods of the assets and liabilities have occurred during the reporting period, other than those mentioned above. The directors recognise the possible consequences arising from COVID-19 and note this is a non-adjusting post year end event. As such, the assumptions and judgments applied in calculating the assets and liabilities at 31 December 2019 do not take into account the potential specific impacts of the Covid-19 related events.

## **E. Capital Management**

ZAL ensures it has excess capital 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 2019.

As at 31 December 2019, the total eligible Own Funds to meet the SCR was £1,534m, all of which was classified as tier one. The Company's SCR, calculated using a Standard Formula approach, at 31 December was £1,218m. The surplus of eligible Own Funds above the SCR gives a cover ratio of 126%. This is a reduction from the 2018 cover ratio of 137%, with the key changes over the period causing the reduction being:

- Changes in Own Funds: There have been reductions in own funds primarily due to the payment of a dividend of £122m in the year. This decision was taken to reduce the overall ratio towards a level in line with our target range.
- Changes in SCR: The SCR increased by £17m over the year. Increases from the writing of new business and reductions in yields have been partially offset by a reduction in the counterparty default risk following the part VII transfer as fund reinsurance was transferred off ZAL's balance sheet.

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.

As at 31 December 2019, the MCR was £305m, in comparison to £300m at 31 December 2018. Both of these were equal to 25% of SCR.

The directors recognise the possible consequences arising from COVID-19 and note this as a non-adjusting post year end event. As such, the assumptions and judgments applied in calculating the capital requirement at 31 December 2019 do not take into account the potential specific impacts of the Covid-19 related events.

Due to the significant falls in the markets post the balance sheet date and in particular the fall in gilt rates, the Company's solvency capital fell to below its internal target level. Whilst it continued to meet its regulatory solvency requirement, the Company received a capital injection of £70m on 10 March to restore the capital level to above its internal targets.

## **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 2019 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

Tulsi Naidu

Chief Executive Officer

April 2020

### 3 Independent auditors report

**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 2019:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2019, (**'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;
- 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 2019 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based as supplemented by supervisory approvals and 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**

We have nothing to report in respect of the following matters in relation to which the 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.

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.

### **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 approvals and determinations 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](http://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 2020*

## 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

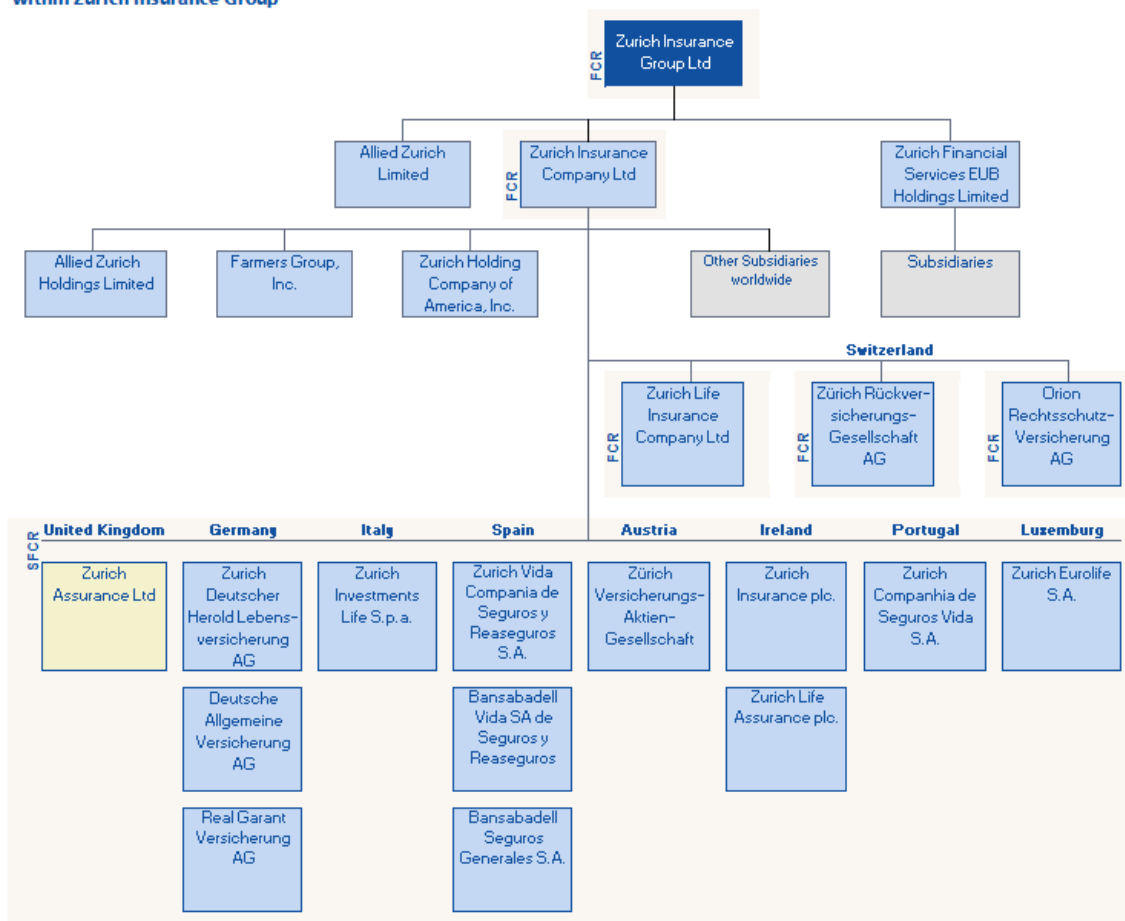
Name, Location and legal form of the undertaking	ZAL is a limited company domiciled and incorporated in the UK. The registered office is The Grange, Bishops Cleeve, Cheltenham, Gloucestershire, GL52 8XX. The principal activity of the Company is the provision of long term insurance business carried out 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	<p>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 12 Endeavour Square, London E20 1JN.</p> <p>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.</p>
Name and contact details of the external auditor of the undertaking	<p>PricewaterhouseCoopers LLP</p> <p>2 Glass Wharf, Bristol, BS2 0FR.</p>
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	<p>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.</p> <p>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'.</p> <p>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.</p>

	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	<p>ZIG Ltd has a 100% shareholding and voting power in ZIC.</p> <p>ZIC has a 100% shareholding and voting power in AZH.</p> <p>AZH has a 100% shareholding and voting power in UKISA.</p> <p>UKISA has a 100% shareholding and voting power in ESH.</p> <p>ESH has a 100% shareholding and voting power in ZAL.</p>
Where the undertaking belongs to a group, details of the undertaking's position within the legal structure of the group	<p>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.</p> <p>The Company operates in the UK business unit as part of the Group, and was part of the UK business unit during 2019.</p> <p>ZIG Ltd and ZIC are both incorporated in Switzerland. AZH is incorporated in Jersey. UKISA and ESH are both incorporated in England.</p>
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 – Life reinsurance	This represents the inwards reinsurance of unit linked business from Scottish Widows.
Undertaking's material lines of business – Non material Line of Business (LoB)	These represents the accepted reinsurance treaties on health business. This line of business is 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

Current disclosure

Note: The purpose of the chart above is to provide a simplified overview of the Group's major subsidiaries (as reported at December 31, 2019), 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 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**

The UK business completed the Part VII transfer of its workplace and savings business, Zurich Corporate Savings (ZCS), to the Lloyds Banking Group in July 2019. Part of the ZCS business was operated by the Company. This has resulted in £20.8bn of Assets and £20.8bn of Liabilities being transferred from the Company. As part of the Part VII transfer a reinsurance treaty was put in place to allow Lloyds Banking Group to keep certain unit linked assets invested with Zurich.

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 ageing 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.

One dividend has been paid in the period totalling £122m. This has been paid in line with ZALs capital policy.

Whilst the FTSE ended the year 12% up on 2018, all gains have been more than erased in the period since the balance sheet date, with the FTSE currently at a level around 30% lower than it started the year.

Since August 2018, interest rates have been set at 0.75%. On 11 March 2020, The Bank of England cut interest rates to 0.25% and on 19 March, it cut them again to 0.1%, their lowest ever level. In addition to the significant fall in interest rates, the 10-year gilt yield is around 0.5% lower than at 31 December and credit spreads have widened by around 50% over the same period.

Consumer confidence fell by 0.1 points in February 2020 but was still 3.0 points higher than a year ago. The employment rate reached another record high of 76.5% in the fourth quarter of 2019. This is 0.4 percentage points above the level recorded in the previous quarter.

The UK economy continued to flatline in the three months to January 2020, recording GDP growth of 0.0% compared to the previous three-month period.

**Post Year End Events**

The UK left the EU on 31 January 2020 with a transition period until the 31 December 2020. While this removes near-term uncertainty, the Prime Ministers' insistence that the transition period not be extended beyond the end of 2020 reintroduces a different uncertainty. As a result Sterling currency movements post this announcement more than erased post-election gains. Following the outbreak of COVID-19, it is possible that the transition period will need to be extended. There has however been no official announcement from the UK Government on this topic to date.

The directors recognise the possible consequences arising from COVID-19 and have considered the operational impact on the business as well as the possible economic impacts due to fluctuations in the market. A derivative strategy is used to mitigate equity risk within the unit-linked business and protect the solvency position of the Company against equity market movements. The Company has well established business continuity plans and regular solvency monitoring processes and as such the directors believe that the Company is well positioned to cope with any changes in circumstances as they may arise. The Company also has regular solvency monitoring processes and protocols in place including an agreement in place to receive financial support from the Group should this be required and as such the directors believe

that the Company is well positioned to assess and adjust to any changes in circumstances as they may arise.

The economy is expected to have contracted marginally in the first quarter of 2020, by 0.5% quarter on quarter. In Q2 2020 UK GDP is likely to see a fall of 15%. If restrictions on business and the wider population are loosened by Q3 2020 then there is likely to be a bounce back in the third and fourth quarter of the year. Over 2020 as a whole GDP is expected to be 4% lower than in 2019. 2019 GDP growth stood at 1.4%. Interest rates and inflation are likely to remain low in the coming months but are expected to rise in 2021 as the economy recovers.

Whilst there is uncertainty in the business environment, the Company has a strong risk management and governance framework in place and benefits from the financial security provided from being a member of the Zurich Group. The risks arising from the COVID-19 pandemic continue to be closely monitored and the Company is well positioned to identify and implement a range of mitigants in response to future developments.

The COVID-19 outbreak has caused some short term challenges and uncertainties and the impacts from the COVID-19 pandemic continue to be closely monitored. The Company is well positioned to identify and implement a range of actions in response to future developments.

Due to the significant falls in the markets post the balance sheet date and in particular the fall in gilt rates, the Company's solvency capital fell to below its internal target level. Whilst it continued to meet its regulatory solvency requirement, the Company received a capital injection of £70m on 10 March to restore the capital level to above its internal targets.

## 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 loss for the year before taxation was £101m (2018: Profit £188m). As well as underlying trading profit, this includes a loss of £85m 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'. From a solvency perspective the derivative loss is offset by expected higher future profits from policies, whereas in the profit before tax under UKGAAP there is no recognition of the expected higher future profits. This also includes an £17m loss from an increase in Technical Provisions resulting from demographic basis updates and a £29m loss from a strengthening of the reinsurer default reserve.

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 2019 (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 participa- tion	Index- linked and unit-linked insurance	Other life insurance	Life reinsurance	Non material LoBs	TOTAL
Gross Premiums	2019	243,118	7,306	3,104,630	674,110	251,664	2,212	4,283,040
	2018	212,078	9,599	5,371,128	646,132	-	2,551	6,241,488
Reinsurers' share of premiums	2019	(107,864)	(329)	(9,007)	(503,060)	-	-	(620,260)
	2018	(98,295)	(342)	(8,914)	(462,167)	-	-	(569,718)
Gross Claims	2019	(130,768)	(154,892)	(26,196,221)	(507,288)	(13,637)	(1,598)	(27,004,404)
	2018	(119,699)	(203,792)	(9,724,752)	(452,683)	-	(2,201)	(10,503,127)
Reinsurers' share of claims	2019	66,743	390	11,555	464,530	-	-	543,218
	2018	58,445	103	4,098	413,506	-	-	476,152
Gross changes in technical provisions (TP)	2019	(82,192)	41,534	17,333,031	(542,157)	(247,103)	252	16,503,365
	2018	(6,817)	192,485	6,580,144	127,593	-	441	6,893,846
Reinsurers' share of changes in TP	2019	44,359	-	1,841	321,009	-	-	367,209
	2018	22,266	-	(3,627)	(113,718)	-	-	(95,079)
Expenses	2019	(38,297)	(6,719)	(187,642)	(165,147)	-	(1,325)	(399,130)
	2018	(74,713)	(10,497)	(210,116)	(151,627)	-	(630)	(447,583)

The numbers above do not include the deposit accounting adjustment made for Investment Contracts, which are included in the UK GAAP numbers. The reconciliation further down this section shows the value of these adjustments.

UK Life business's strategic decision to move corporate pension business onto the Zurich UK platform has continued to contribute to the 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 £1,37bn of premium and claims in 2019 (2018: £1,95bn). The movement of schemes on to the platform has now finished since the completion of the Part VII transfer.

With the completion of the Part VII transfer of the Zurich Corporates Savings business a surrender of £20.6bn was made and this has been reflected in the Gross Claims number. With this removed we see a reduction in year on year claims, which reflects the claims no longer being made as part of the Zurich Corporate Savings business. This is also reflected in our lower year on year premiums, although the continuing strength of the new LPP business has steadied this.

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 3.1 million (2018: 3.4 million) policyholders or scheme members at 31 December 2019.

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 2019 ZAL's retail protection business paid out over 90%

(2018: 90%) of critical illness claims, over 99% (2018: over 99%) of death claims and over 98% (2018: 95%) 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 2019 comprised total regular premiums of £1,32bn (2018: £1,54bn) and total single premiums of £2,96bn (2018: £4,71bn).

Technical provisions decreased in the year by £16.6bn. The material changes are:

- Index-linked and unit linked decreased by £17.3bn with the main movements being the Part VII transfer of the Zurich Corporate Savings business and the removal of the associated provisions. Markets have increased in the period with the FTSE 12% up on prior year and this has partially offset the movement from the sale.
- Insurance with-profit participation decreased by £41.5m with market movements, in particular rises in bond vales, partially offsetting the run-off of the business.
- Health and other life insurance increased by £545m, with increases seen from reduction in yields, demographic basis updates and new business volumes.
- Life reinsurance increased by £247m, following an inwards reinsurance treaty agreement put in place over the year

Reinsurance recoverables increased in the year by £367m, with Other life insurance driving this movement due to reductions in yields and demographic basis updates.

Expenses in the year included acquisition costs, investment expenses and overhead expenses. The continued push from the business to reduce costs, as well as the removal of the ZCS business has seen this reduce by 11% in the period.

Total annual premium equivalent ("APE") for the year was **£125m** (2018: £208m). APE comprises of new regular premiums plus 10% of new single premiums. The 2018 figure included an intermediated longevity swap that generated £106m of APE. When excluding longevity swaps, the APE for the year was **£124m** (2018: £102m). The increase in APE reflects an increase in sales on the Life Protection Platform and from Zurich Corporate Risk.

ZAL's primary market is the United Kingdom, with significantly over 90% of all business completed in this market.

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:

<b>SII to UK GAAP reconciliation</b>		
<b>In £'000</b>	<b>2019</b>	<b>2018 restated</b>
Gross Premiums (as per S.05, table above) *	4,283,040	6,241,488
Reinsurers' share of premiums (as per S.05, table above)	(620,260)	(574,718)
Gross Claims (as per S.05, table above) *	(27,004,404)	(10,503,127)
Reinsurers' share of claims (as per S.05, table above)	543,218	476,152
Gross Changes in Technical Provisions (as per S.05, table above) *	16,503,365	6,893,846

Reinsurers' share of Changes in TP (as per S.05, table above)	367,209	(92,079)
Expenses (as per S.05, table above)	(399,130)	(447,583)
Investment Performance (see Section A.3 below)	6,457,601	(2,019,393)
Other Technical Income, net of reinsurance *	17,478	18,621
Tax charge attributable to Long-Term Business	(250,658)	181,834
Transfers from / (to) Fund for Future Appropriations (FFA)	(3,639)	5,300
Non-Technical Income / Expenses (see Section A.4 below)	5,254	8,606
Other Activities	(163)	(387)
<b>Total UK GAAP (Loss) / Profit before Taxation</b>	<b>(101,089)</b>	<b>188,560</b>
Tax on (Loss) / Profit (see Section A.4 below)	19,016	(34,185)
<b>Total UK GAAP (Loss) / Profit after Taxation</b>	<b>(82,073)</b>	<b>154,375</b>

\* 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	(3,229,068)	(5,228,893)
DA adjustment for Gross Claims	24,978,124	8,396,217
DA adjustment for Gross Changes in Technical Provisions	(21,845,261)	(3,286,078)
DA adjustment for Other Technical Income, net of reinsurance	96,205	118,754
<b>Total deposit accounting adjustments (UK GAAP)</b>	<b>-</b>	<b>-</b>

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. These have been restated due to prior year adjustments going through.

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:

<b>Investment Performance</b>						
<b>In £'000</b>	<b>Net Investment Income</b>		<b>Net capital gains (losses)</b>		<b>Investment result</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
Cash and cash equivalents	1,749	1,119	214	(18)	1,963	1,101
Equity securities	7,139	7,787	32,960	(39,639)	40,099	(31,852)
Debt securities	73,209	75,206	189,920	(76,499)	263,129	(1,293)
Real estate held for investment	(73)	(73)	2,238	5,794	2,165	5,721
Mortgage loans	86	7	25	190	111	197
Other loans	1,362	1,586	-	-	1,362	1,586
Collective Investments Undertakings	1,685	1,594	711	9,787	2,396	11,381
Derivatives	-	-	(90,812)	47,100	(90,812)	47,100
Assets held for index-linked and unit-linked contracts	736,799	773,444	5,520,691	(2,861,105)	6,257,490	(2,087,661)
Other investments	3,702	(866)	(24,004)	35,193	(20,302)	34,327
<b>Investment performance, gross</b>	<b>825,658</b>	<b>859,804</b>	<b>5,631,943</b>	<b>(2,879,197)</b>	<b>6,457,601</b>	<b>(2,019,393)</b>
Investment expenses					(59,344)	(80,391)
<b>Investment performance, net</b>					<b>6,398,257</b>	<b>(2,099,784)</b>

Gains on equity securities during 2019 reflect a rise in equity markets over the period. The increase on the FTSE 100 index was 12% in 2019 (12% fall in 2018).

Gains on debt securities in 2019 reflect increases in both government and corporate bond indices over the year, with yields falling.

Gains on Real estate in 2019 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.

Losses on derivatives of £91m (2018: gains of £47m) included a loss of £85m (2018: 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 A.2 'Underwriting performance' and C.2 'Market risk'. The remaining loss on derivatives of £6m (2018: gain of £3m) 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 £21m at 31 December 2019 (2018: £24m). 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 2019 of £24.3m (income of £29.9m minus expenses of £5.6m), which consisted of the following:

<b>Other income and expenses</b>				
<b>In £'000</b>	<b>Income</b>		<b>Expenses</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
Investment result in non-technical account *	-	4,000	(4,021)	(129)
Other income and expenses in non-technical account *	68	5,735	(1,593)	(1,000)
Other activities*	10,800	-	-	-
Tax on (Loss) / Profit	19,016	-	-	(34,185)
<b>Total of other income/ expenses</b>	<b>29,884</b>	<b>9,735</b>	<b>(5,614)</b>	<b>(35,314)</b>

\* The sum of the non-technical income and expenses in the first three 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'.

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

'Tax on (Loss) / Profit' 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 has entered into certain lease contracts in relation to land and buildings where ZAL is lessor and has also entered into contracts with tenants where ZAL is the lessee. These consist of six head lease, four sublease and twenty ground rent lease 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**

ZAL is required to maintain a comprehensive and up-to-date governance map and fulfils this requirement by producing a Management Responsibilities Map in accordance with the Senior Manager and Certification Regime (SMCR). 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 has not changed during the year.

#### **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 & Remuneration 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. Although J.R. Sykes was CEO at end of 2019, he has subsequently resigned and been replaced by T.R. Naidu as CEO, T.R. Naidu will be responsible for the signing off of this report. The table below shows the composition of the ZAL Board during 2019:

<b>Zurich Assurance Ltd Board of Directors</b>		
<b>Individual</b>	<b>Role</b>	<b>Comments</b>
C.S. Fairclough	Independent Non-executive Director	Chair of Risk Committee
T.R. Naidu*	Executive Director	CEO
H.A. Pickford	Executive Director	CFO - Appointed to the Board in March 2020
G.P.J. Shaughnessy	Non-executive Director	
I.C.R. Stuart	Independent Non-executive Director	Chair of Board, Investment Committee and Nomination & Remuneration Committee
P. Bishop	Independent Non-executive Director	Chair of Audit Committee
J. Platt	Independent Non-executive Director	Appointed October 2019
J.R.Sykes*	Executive Director	CEO, Resigned February 2020
J.T.G. Butler	Independent Non-executive Director	Resigned June 2019

\* T.R. Naidu is currently CEO taking over from J.R. Sykes who resigned in February 2020

## **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 Internal Audit function (see section B.5 for more details) and 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 & Remuneration Committee**

The Nomination & Remuneration 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 Company has adopted its own Remuneration Policy Addendum, which is considered and approved on an annual basis.

The Committee shall further:

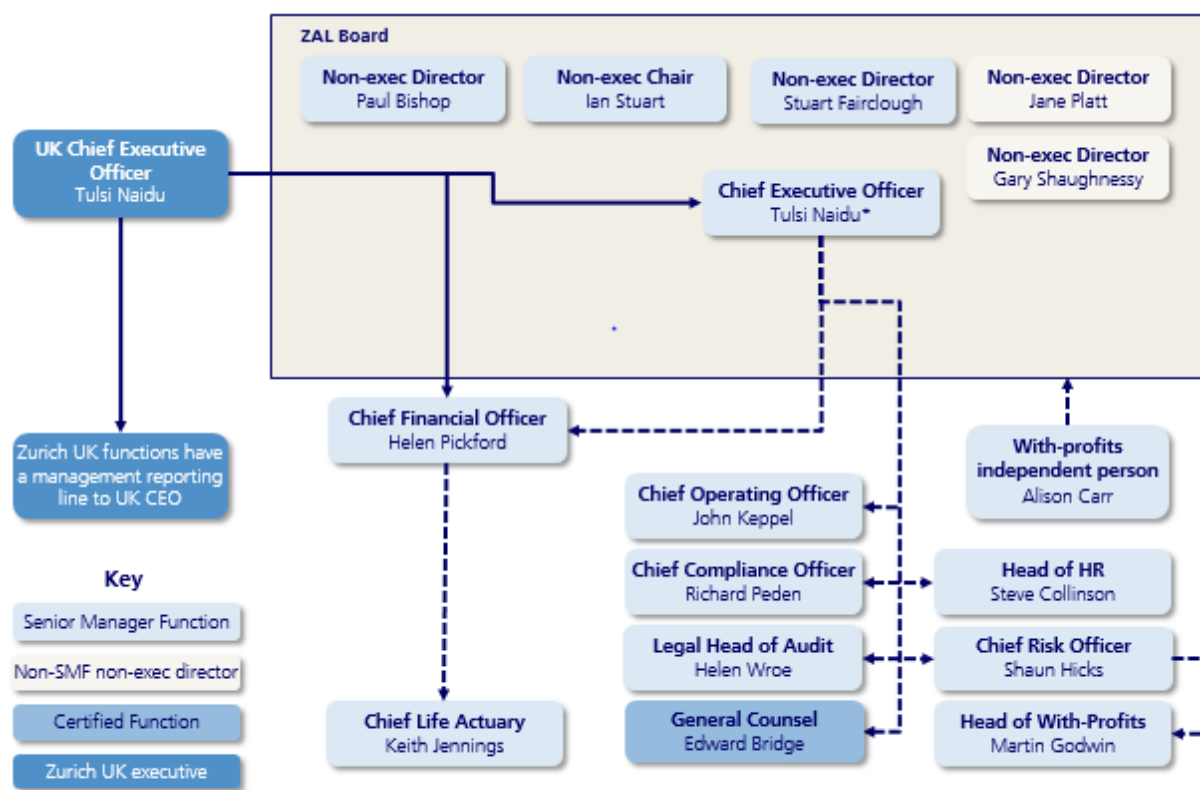
- Provide oversight and guidance in relation to the structure and composition of the Company's Board and assisting in identifying issues requiring Management's attention in relation to these matters;
- Monitoring the balance of skills, independence, knowledge, experience and diversity on the Board;
- 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;
- Consider proposed remuneration packages for new senior manager appointments with responsibility for the Company;
- Monitor on at least an annual basis the remuneration of senior managers with responsibility for the Company;
- Escalating matters that require the further attention of the Board.

### **Executive Committee**

Although not a direct committee of ZAL, the Executive Management structure reflects the organisation 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 its Board and a Senior Manager Function that includes the heads of Operations, Finance, HR, Internal Audit, Compliance and Risk. The majority of these heads, also sit on the overarching UK Executive Committee.

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 ZAL Board and its Senior Manager Function as at 31 December 2019:



\*CEO following the resignation of Jim Sykes in February 2020

## 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

## 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 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 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 Nomination & Remuneration Committee. The Nomination & Remuneration 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 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 working on behalf 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.

## **B.2 Fit and proper requirements**

ZAL applies fit and proper requirements to its, Senior Management Functions, Certified Functions 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 Management Functions, Certified Functions 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 EMEA CRO. He also has confidential access to the Chairperson of the Board Risk Committee to maintain organisational independence.

### Climate Risk Responsibility

The Prudential Regulation Authority's (PRA) supervisory statement 3/19 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change', published in April 2019, formalises the regulator's views on how climate change risks should be approached. The paper shares the types of risk that firms should be considering in relation to climate change and shares a number of requirements, spanning governance, risk management, scenario analysis and disclosure. The expectations include a requirement to appoint a senior management function responsible for the identification and management of the financial risks from climate change under the Senior Managers and Certification Regime; Zurich's UK CRO was approved for this role in November 2019.

Zurich's drivers for tackling climate change span considerably more broadly than regulatory requirements. Regardless of the drivers, regulator engagement is a strong catalyst for change, providing firms with valuable insights into how they can make a difference through their actions, aligning and challenging approaches and giving rise to the opportunity to contribute to the formation of best practice. The PRA intends to publish more detailed expectations relating to the financial risks from climate change in due course and work is ongoing to ensure Zurich UK meets these responsibilities.

### 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.

Management are 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 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

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

- Steer and approve the Model Risk Management Framework and its associated policies, in order that it complies with the requirements of the regulatory environment and meets the needs of the UK Life business.
- Review model development and approve models in scope of the MGC, endorsing these to the boards as appropriate.
- Recommend major model changes, as appropriate, to the boards in accordance with the materiality metrics in the Model Risk Management Framework.
- Review ongoing appropriateness of models in scope.
- Challenge/approval of matters escalated from first line committees as described in the Model Risk Management Framework.

## 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 recommends to the ZAL Board the approval of the internal audit plan annually, and reviews reports from the Legal Entity Head of Audit on significant risk, control and governance issues every quarter as a minimum. The Legal Entity Head of Audit meets regularly with the Chairperson of the Audit Committee and 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 Legal Entity Head of Audit is responsible for ensuring issues identified as a result of audit activities which could have an impact on ZAL's operations are brought to the attention of the Audit Committee and management and monitors and reports the status of agreed actions arising from such issues until provided with evidence from management supporting the completion of the actions.

The Legal Entity Head of Audit 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, where it considers it appropriate, the work of other assurance functions and the external auditors.

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 2019 ZAL continued its temporary arrangement for Lloyds Banking Group to provide some front and back office administration services for Zurich's DC Platform business. Post July 2019 a small number of these schemes have remained with Zurich, and a new relationship for services relating to these schemes has been entered into with Capita (an extension of Zurich's existing contract with Capita Life & Pensions Regulated Services). At the moment Lloyds Banking Group are assisting with the knowledge transfer of

related activities under a Transitional Services Agreement. It is anticipated that Capita will take on full responsibility in the first half of 2020.

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.

<b>Outsourcers</b>		
<b>Operational function</b>	<b>Outsourcer</b>	<b>Location</b>
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 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.

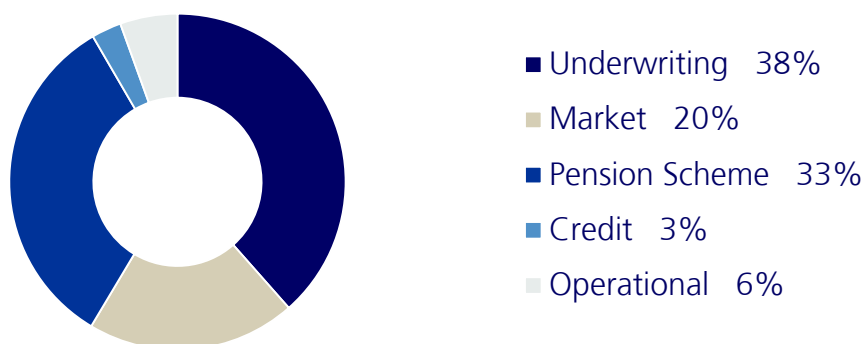
ZAL's business model results in it being subject to a range of risks associated with the activity of issuing insurance and investment contracts and the use of financial instruments.

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, for example through the liquidity risk framework, with oversight from the Asset and Liability Management Investment Committee (ALMIC).

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:

### ZAL Solvency II Capital by Risk (Undiversified) %, as of 31 December 2019



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 2019. 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. Risk appetite is the primary term ZAL uses to define the boundaries for all material risk types within which businesses pursue profits. ZAL's risk appetite framework reflects ZAL's willingness and capacity to take risks, considering all material aspects of the company strategy in terms of:

- Capital and liquidity
- Earnings
- Non-financial risks

Throughout 2019 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 has a wide range of products 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 morbidity and mortality reinsurance also reduce the lapse risk on retail protection business. 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.

<b>Impact of life insurance risk scenarios on basic own funds</b>		
<b>Life insurance risk scenario results</b>	<b>Impact on BOF (in £'000)</b>	<b>Impact on SCR coverage (in %)</b>
Lapse	(122,924)	-6.6%
Expenses	(74,584)	-7.0%
Longevity	(25,054)	-2.5%
Morbidity	(27,957)	-2.5%
Mortality	173	0.0%

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 reduction in lapses of 25% on all policies where this gives an increase in the BEL
- 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

Lapse and expenses are the most material risks for ZAL. Changes in ZAL's business model with the sale of its corporate savings business and the growing retail business has resulted in ZAL's biting lapse stress changing to lapses down from mass lapse. This change was expected. ZAL actively managed and monitors its lapse risk and whilst the current level of risk is within its risk appetite it has a number of risk mitigation actions it could implement if required.

As expenses are actively monitored, ZAL would have time to implement management strategies to mitigate the impact. ZAL has a proven track record of managing its expenses and the current level of expense risk is within its Risk Appetite.

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 maintain net interest rate risk within approved limits.

### 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.

<b>Impact of market risk scenarios on basic own funds</b>		
<b>Sensitivity Scenarios</b>	<b>Impact on BOF (in £'000)</b>	<b>Impact on SCR coverage (in %)</b>
Interest rate up	30,724	8.1%
Interest rate down	(35,243)	-8.3%
Credit spreads widen	(42,760)	-3.4%
Credit spreads narrow	44,420	3.6%
Equity up	6,031	-0.9%
Equity down	(3,887)	0.8%
Currency	(45,153)	-3.3%

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
- Longevity Swap Contracts

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. The transfer of ZAL's corporate pensions business to Scottish Widows during 2019 significantly reduced ZAL's exposure to fund reinsurance.

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.

The share of ZAL's total SCR attributable to counterparty default risk has more than halved since end 2018, the driver of which is the transfer of the corporate pension business following its sale in 2017.

#### 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 Committee.

#### 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 committee, chaired by the CLA.

ZAL has significant reinsurance arrangements with ZIC - an entity internal to the Zurich Group. ZIC has a strong balance sheet and is subject to Swiss Solvency Test (SST). Its capital position is such that it is deemed to be able to withstand a 1 in 2,000 year scenario as measured by its internal capital model, consistent with its strong credit rating.

ZAL's has set its counterparty credit risk appetite on this internal reinsurance as ensuring that its solvency ratio following the loss on default of an internal counterparty, plus the increase in capital requirements and risk margin required to recapture the risk does not breaching its MCR.

### 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 risk reinsurers, and this exposure is mitigated using collateral arrangements where appropriate. 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, including under stress scenarios. 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 2019 ZAL's expected profit included in future premiums (EPIFP) was £482m. 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, as well as under a range of stressed scenarios.

### **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 and operational resilience processes. ZAL has put 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 another group 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 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. The ORSA includes an annual scenario focusing on Group risk to enable the Board to understand this risk and to identify mitigating actions to manage it appropriately.

## C.7 Any other information

### Global Pandemic – Covid-19

The emergence of the Covid-19 coronavirus in 2020 and its development into a global pandemic represents a significant change in the external risk environment and presents material risks to insurers, as well as the wider UK and global economy.

The Zurich Group is coordinating its coronavirus response on a global scale, allowing the pooling of expertise and resources and allowing business units to leverage the strength of Zurich. There is also significant activity being coordinated within the UK business unit of which ZAL forms part, with business continuity and crisis management plans in place to maintain operational and financial resilience required to deliver to our customers.

The situation continues to develop rapidly and there remains a significant degree of uncertainty over both the duration and severity of the pandemic. ZAL is taking active measures to mitigate a range of risks arising from the pandemic including life and health risks, market risks and operational risks as part of its pandemic response. The risks arising from the Covid-19 pandemic continue to be closely monitored and ZAL is well positioned to identify and implement a range of mitigants in response to future developments.

The directors recognise the possible consequences arising from COVID-19 and have considered the operational impact on the business as well as the possible economic impacts due to fluctuations in the market. A derivative strategy is used to mitigate equity risk within the unit-linked business and protect the

solvency position of the Company against equity market movements. The Company has well established business continuity plans and regular solvency monitoring processes and as such the directors believe that the Company is well positioned to cope with any changes in circumstances as they may arise. The Company also has regular solvency monitoring processes and protocols in place including an agreement in place to receive financial support from the Group should this be required and as such the directors believe that the Company is well positioned to assess and adjust to any changes in circumstances as they may arise.

Whilst there is uncertainty in the business environment, the Company has a strong risk management and governance framework in place and benefits from the financial security provided from being a member of the Zurich Group. The risks arising from the COVID-19 pandemic continue to be closely monitored and the Company is well positioned to identify and implement a range of mitigants in response to future developments.

The COVID-19 outbreak has caused some short term challenges and uncertainties and the impacts from the COVID-19 pandemic continue to be closely monitored. The Company is well positioned to identify and implement a range of actions in response to future developments.

Due to the significant falls in the markets post the balance sheet date and in particular the fall in gilt rates, the Company's solvency capital fell to below its internal target level. Whilst it continued to meet its regulatory solvency requirement, the Company received a capital injection of £70m on 10 March to restore the capital level to above its internal targets.

## 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 directors recognise the possible consequences arising from COVID-19 and note this is a non-adjusting post year end event. As such, the assumptions and judgments applied in calculating the assets and liabilities at 31 December 2019 do not take into account the potential specific impacts of the Covid-19 related events.

The table below presents a summarised balance sheet as at 31 December 2019 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 2019 in £'000	Financial Statements (UK GAAP)	Reclassification within Assets / Liabilities	Reclassification between Assets and Liabilities	Restated UK GAAP	Valuation differences	Solvency II
<b>D.1 Valuation of asset types for financial reporting and solvency purposes</b>						
<b>Total Assets split by material classes of assets</b>						
Deferred acquisition costs	230,495	-	-	230,495	(230,495)	-
Property, plant & equipment held for own use	29,877	-	-	29,877	-	29,877
Investments (other than assets held for index- linked and unit-linked contracts)	3,313,522	22,591	-	3,336,113	4,975	3,341,088
Assets held for index- linked and unit-linked contracts	26,059,342	(81,211)	-	25,978,131	316	25,978,447
Loans and mortgages	55,566	425	-	55,991	-	55,991
Reinsurance recoverables	1,966,363	66,570	-	2,032,933	(669,514)	1,363,419
Insurance and intermediaries receivables	116,220	-	1,590	117,810	29	117,839
Reinsurance receivables	72,538	-	-	72,538	-	72,538
Receivables (trade, not insurance)	51,486	(8,375)	14,905	58,016	4,896	62,912
Cash and cash equivalents	177,879	-	-	177,879	-	177,879
Any other assets, not elsewhere shown	22,096	-	29,083	51,179	(16,989)	34,190
<b>Total assets</b>	<b>32,095,384</b>	<b>0</b>	<b>45,578</b>	<b>32,140,962</b>	<b>(906,782)</b>	<b>31,234,180</b>

<b>D.2 Valuation of technical provisions for financial reporting and solvency purposes</b>						
<b>Material lines of business of technical provisions</b>						
Insurance with-profits participation	1,437,334	503	-	1,437,837	(229,362)	1,208,475
Other life (excluding health and index-linked and unit-linked)	2,898,063	1,629	-	2,899,692	(830,379)	2,069,313
Index-linked and unit-linked	25,487,764	-	-	25,487,764	(451,320)	25,036,444
Health insurance (direct business)	608,228	-	-	608,228	(269,978)	338,250
Health reinsurance (reinsurance accepted)	1,862	-	-	1,862	(585)	1,277
Other life insurance (reinsurance accepted)	247,103	-	-	247,103	-	247,103
Claims outstanding	202,222	(202,222)	-	-	-	-
<b>Total technical provisions</b>	<b>30,882,576</b>	<b>(200,090)</b>	<b>-</b>	<b>30,682,486</b>	<b>(1,781,624)</b>	<b>28,900,862</b>
<b>D.3 Valuation of other liabilities for financial reporting and solvency purposes</b>						
<b>Material classes of other liabilities</b>						
Provisions other than technical provisions	11,760	-	-	11,760	-	11,760
Deferred tax liabilities	167,083	-	-	167,083	(18,868)	148,215
Derivatives	9,014	-	-	9,014	-	9,014
Financial liabilities other than debts owed to credit institutions	44,946	-	-	44,946	6,771	51,717
Insurance & intermediaries payables	112,622	200,090	1,590	314,302	1	314,303
Reinsurance payables	23,347	-	-	23,347	-	23,347
Payables (trade, not insurance)	51,229	-	14,905	66,134	(11)	66,123
Any other liabilities, not elsewhere shown	134,998	-	29,083	164,081	(121,542)	42,539
<b>Total other liabilities</b>	<b>554,999</b>	<b>200,090</b>	<b>45,578</b>	<b>800,667</b>	<b>(133,649)</b>	<b>667,018</b>
<b>Total liabilities</b>	<b>31,437,575</b>	<b>(0)</b>	<b>45,578</b>	<b>31,483,153</b>	<b>(1,915,273)</b>	<b>29,567,880</b>
<b>Excess of assets over liabilities</b>	<b>657,809</b>	<b>(0)</b>	<b>-</b>	<b>657,809</b>	<b>1,008,491</b>	<b>1,666,300</b>

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'.

For Solvency II purposes Claims Outstanding is disclosed in 'Insurance & intermediaries payables'. Under UK GAAP this is recorded under the 'Technical Provisions' section.

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 using the adjusted equity method, therefore a subsidiary's own funds value is market consistent. 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.

### **Property, plant and equipment held for own use**

Property, plant and equipment are included at fair value. Fair value includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use.

#### *IFRS 16 Leases*

During 2019, the International Accounting Standards Board has issued IFRS 16, which requires lessees to recognise assets and liabilities for most leases.

The Company has reviewed its lease arrangements and where applicable reported under the new standard. The Company has elected the modified retrospective approach to the implementation of the standard.

The Company has recognised Right of Use Assets and Lease Liabilities for its remaining lease and Finance Lease Receivable for future income on the sub-leases deemed to be finance leases. The Right of Use Assets are depreciated on a straight line basis over the remaining life of the lease agreement and the Lease Liability is amortised using an effective interest rate method. These valuations are in line with those completed under UK GAAP.

### **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. Items such as some forms of Bonds, which come under this section can be viewed as an alternative form of valuation.

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 UK National Supplement 2018 (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 2019.

#### *Infrastructure loans*

Infrastructure loans 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.

#### *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.

#### *IFRS 16 Leases*

The new changes from IFRS 16 have resulted in receivables coming under Loans and Mortgages, which is in line with UK GAAP.

### **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.

### **Property**

These are valued under the new IFRS 16 principles in line with what has been described in the Property, Plant and Equipment held for own use section above.

### **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. Differences between measures are described below the table above.

#### **Reinsurance receivables**

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.



**Receivables (trade, not insurance)**

Assets are recorded at fair value, which is their nominal amount adjusted for the probability of default of the counterparty. Differences between measures are described below the table above.

**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 using the adjusted equity method, therefore a subsidiary's own funds value is market consistent. Although there is no significant difference in the valuations, the debtors and creditors between the participations and ZAL are presented differently.

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

Other than the change to Right of Use Assets through IFRS 16, there have been no other 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 infrastructure 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.

<b>Sensitivity analysis</b>				
<b>In £'000</b>	<b>Less favourable values (absolute change)</b>	<b>Decrease in reported fair value</b>	<b>More favourable values (absolute change)</b>	<b>Increase in reported fair value</b>
<b>Key Assumptions</b>				
Discount rates	+100bps	(3,882)	-100bps	5,410
Credit spread	+100bps	(6,964)	-100bps	8,530

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.

<b>Technical provisions by line of business</b>				
<b>As at 31 December 2019</b>				
<b>In £'000</b>	<b>Best Estimate</b>	<b>Risk Margin</b>	<b>Technical provisions as a whole</b>	<b>Technical provisions (total)</b>
Insurance with-profits participation	1,155,820	52,655	-	1,208,475
Other life (excluding health and index-linked and unit-linked)	1,813,361	255,952	-	2,069,313
Index-linked and unit-linked	(340,372)	71,475	25,305,341	25,036,444
Health insurance (direct business)	31,317	66,498	240,435	338,250
Health reinsurance (reinsurance accepted)	1,277	-	-	1,277
Other life insurance (reinsurance accepted)	-	-	247,103	247,103
<b>Total</b>	<b>2,661,403</b>	<b>446,580</b>	<b>25,792,879</b>	<b>28,900,862</b>

Material changes in technical provisions over the year

In 2019, ZAL's technical provisions reduced by £16.7bn. The material changes are:

- Technical provisions as a whole: these reduced by £17.0bn with the main movements being the sale of the corporate savings business. Markets have increased in the period with the FTSE 12% up on prior year and this has partially offset the movement from the sale.
- BEL and Risk Margin: these increased by £345m over the year. Within the BEL the main movements were an increase in the other life and health BEL, due to new business written, demographic basis updates and from reduction in yields (largely whole of life and term business). This was partly offset by reductions from the with-profits BEL due to the run-off of with-profits business.
- Other Life reinsurance (reinsurance accepted) increased by £247m, following an inwards reinsurance treaty agreement put in place over the year

## 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, 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 considered 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. 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.

Reserves are set considering the claims that would be expected throughout the lifetime of the policies, and hence take a long view on the overall mortality that the Company would experience. This is based on industry tables and historic experience. While COVID-19 may result in a rise in deaths in 2020, it is expected to predominantly impact the elderly and those with pre-existing health conditions. The medium-term mortality could be light, given the insured population will include those who were resilient to COVID-19. Overall, given the long-term nature of the projection the directors remain comfortable with the current best estimate mortality view.

## **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 2019	Interest Rates		Expenses	Mortality Rates		Lapse Rates	
<b>Key assumptions</b>	0.5%	-0.5%	5% + 0.5% expense	+7.5% on assurance only	-10% on annuity only	25%	-25%
<b>Technical provisions</b>	-1.21%	1.30%	0.30%	0.42%	0.99%	-1.10%	1.10%

The sensitivity percentages have increased compared to end 2018 due to the transfer of the ZCS business in 2019. This made up a significant proportion of the end 2018 technical provisions but contributed very little to the sensitivity movement. 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 -0.01% for +7.5% on assurances and 0.17% 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. The tables above in section D2 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 £172m. 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**

#### **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.

##### *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.

##### *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 in force, 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***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.

*Lease Liabilities*

These are valued under the new IFRS 16 principles in line with what has been described in the Property, Plant and Equipment held for own use section included in D.1 Assets.

**Insurance & intermediaries payables**

Measured at fair value.

**Reinsurance payables**

Measured at fair value.

**Payables**

Measured at fair value.

**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 using the adjusted equity method, therefore a subsidiary's own funds value is market consistent. 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 any single 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.

Other than the change to Lease Liabilities through IFRS 16, there have been no other 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 2019 was 118%.

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](http://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;
- 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. The directors recognise the possible consequences arising from COVID-19 and note this as a non-adjusting post year end event. As such, the assumptions and judgments applied in calculating the capital requirement at 31 December 2019 do not take into account the potential specific impacts of the Covid-19 related events.

All own funds items are classed as tier one and are available:

- to meet the Solvency Capital Requirement (SCR).
- 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:

<b>Composition of own funds</b>			
<b>In £'000</b>	<b>31 December 2019</b>	<b>31 December 2018</b>	<b>Change</b>
Assets	31,234,180	48,133,835	(16,899,655)
Technical provisions	(28,900,862)	(45,577,029)	16,676,167
Other liabilities	(667,018)	(789,311)	122,293
<b>Excess of assets over liabilities</b>	<b>1,666,300</b>	<b>1,767,495</b>	<b>(101,195)</b>
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	(132,153)	(125,006)	(7,147)
<b>Total Basic Own Funds after deductions</b>	<b>1,534,147</b>	<b>1,642,489</b>	<b>(108,342)</b>
<b>Total available and eligible Own Funds to meet the SCR</b>	<b>1,534,147</b>	<b>1,642,489</b>	<b>(108,342)</b>
SCR	(1,218,415)	(1,201,513)	(16,902)
<b>Excess available funds for SCR over SCR</b>	<b>315,732</b>	<b>440,976</b>	<b>(125,244)</b>
<b>Ratio of Eligible Own Funds to SCR</b>	<b>126%</b>	<b>137%</b>	<b>-11%</b>
<b>Total available and eligible Own Funds to meet the MCR</b>	<b>1,534,147</b>	<b>1,641,865</b>	<b>(107,718)</b>
MCR	(304,604)	(300,378)	(4,226)
<b>Excess available funds for MCR over MCR</b>	<b>1,229,543</b>	<b>1,341,487</b>	<b>(111,944)</b>
<b>Ratio of Eligible Own Funds to MCR</b>	<b>504%</b>	<b>547%</b>	<b>-43%</b>

During 2019 ZAL paid a dividend totaling £122m 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 increased over 2019 primarily due to the increase in the asset values on the 90:10 fund over the period. The 100:0 fund has stayed relatively stable over the period.

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

<b>Segmentation of own funds by tier of capital</b>								
In £'000	<b>31 December 2019</b>				<b>31 December 2018</b>			
<b>Own Funds</b>	<b>Tier 1</b>	<b>Tier 2</b>	<b>Tier 3</b>	<b>Total</b>	<b>Tier 1</b>	<b>Tier 2</b>	<b>Tier 3</b>	<b>Total</b>
<b>Covering the SCR</b>	1,534,147	-	-	1,534,147	1,641,865	-	624	1,642,489
<b>Covering the MCR</b>	1,534,147	-	-	1,534,147	1,641,865	-	-	1,641,865
<b>Ratio of Eligible Own Funds to SCR</b>				<b>126%</b>				<b>137%</b>
<b>SCR Surplus</b>				<b>315,732</b>				<b>440,976</b>

## 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.

<b>Valuation of equity for Solvency II and financial reporting purposes</b>		
In £'000	<b>31 December 2019</b>	<b>31 December 2018 restated</b>
Solvency II Assets	31,234,180	48,133,835
Solvency II Liabilities	29,567,880	46,366,340
<b>Solvency II Excess of Assets over Liabilities</b>	<b>1,666,300</b>	<b>1,767,495</b>
<b>Financial Statements Equity including Fund for future appropriations</b>	<b>657,809</b>	<b>857,000</b>
<b>Difference</b>	<b>1,008,491</b>	<b>910,495</b>

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.

2018 Financial Statements have been restated from 2018 from 879,714 to 857,000 due to prior year adjustments, this has also been reflected in the table below.

The difference above is explained by:

<b>Explanation of differences in Excess of Assets over Liabilities and Financial Statements Equity</b>		
<b>In £'000</b>	<b>31 December 2019</b>	<b>31 December 2018 Restated</b>
Difference in gross technical provisions	1,781,624	1,579,473
Difference in reinsurers' share of technical provisions	(602,944)	12,760,964
Assets held for index-linked and unit-linked contracts	(81,211)	(13,340,575)
Deferred acquisition costs	(230,495)	(230,043)
Deferred origination fees	58,926	76,404
Fund for future appropriations	45,498	41,859
Difference in deferred tax asset and liability	18,868	15,099
Contingent liabilities	-	(5,300)
Other	18,225	12,614
<b>Difference explained</b>	<b>1,008,491</b>	<b>910,495</b>

Own funds consists of the following items:

<b>Composition and description of own funds</b>		
<b>As at 31 December 2019</b>	<b>In £'000</b>	
<b>Basic Own Fund Items</b>	<b>Amount</b>	<b>Description</b>
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	279,970	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	1,018,045	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.
<b>Total Tier 1 Capital</b>	<b>1,534,147</b>	
An amount equal to the value of net deferred tax assets	-	An amount equal to the value of net deferred tax assets as noted in Article 76 of the Commission Delegated Regulation (EU) 2015/35.
<b>Total Basic Own Funds</b>	<b>1,534,147</b>	

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. In accordance with the Standard Formula Calculation, 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 2019.

SCR and MCR calculated using the Standard Formula			
In £'000	31 December 2019	31 December 2018	Change
SCR	1,218,415	1,201,513	16,902
MCR	304,604	300,378	4,226

### 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 2019	31 December 2018	Change
Market Risk	303,281	289,376	13,905
Counterparty Default Risk	41,413	103,335	(61,922)
Life Risk	479,045	417,562	61,483
Health Risk	100,869	86,933	13,936
<b>Total Undiversified Risk</b>	<b>924,608</b>	<b>897,206</b>	<b>27,402</b>
Diversification Effect	(243,624)	(258,071)	14,447
<b>BSCR</b>	<b>680,984</b>	<b>639,135</b>	<b>41,849</b>



Adjustments for Loss Absorbing Capacity of Deferred Taxes	(8,689)	(4,599)	(4,090)
Adjustments for Loss Absorbing Capacity of Technical Provisions	(47,837)	(38,751)	(9,086)
Operational Risk	83,367	90,878	(7,511)
Adjustment due to ring fenced funds	11,590	15,850	(4,260)
Capital Add-on (Pension Scheme Risk)	499,000	499,000	-
<b>SCR</b>	<b>1,218,415</b>	<b>1,201,513</b>	<b>16,902</b>

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 increased over the year primarily due to change in equity stress to apply, market movements over the year, offset in part by the run off of the unit linked business.

The IFRS 16 change which is summarised in section D means we have a lease asset and a broadly offsetting lease liability, which are treated as property risk and interest rate risk respectively within the SCR calculation. This has a trivial impact on the SCR at YE19.

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 primarily due to the transfer of the corporate savings business, and the corresponding reduction in fund reinsurance.

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 underwriting risk and health underwriting risk have increased over the year, primarily due to new business written and movements in yields 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 2019 was £499m, which is unchanged from 31 December 2018. 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.

<b>Inputs used to calculate the MCR</b>			
<b>In £'000</b>	<b>31 December 2019</b>	<b>31 December 2018</b>	<b>Change</b>
Linear MCR	236,885	265,071	(28,186)
SCR	1,218,415	1,201,513	16,902
MCR Cap (45% of SCR)	548,287	540,681	7,606
MCR Floor (25% of SCR)	304,604	300,378	4,226
MCR	304,604	300,378	4,226

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 at the end of 2019, which was the case 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 2019, in accordance with Article 112 of the Delegated Regulation.

#### Use of undertaking specific parameters

No undertaking specific parameters have been used.

#### Post Year End Events

The economy is expected to have contracted marginally in the first quarter of 2020, by 0.5% quarter on quarter. In Q2 2020 UK GDP is likely to see a fall of 15%. If restrictions on business and the wider population are loosened by Q3 2020 then there is likely to be a bounce back in the third and fourth quarter of the year. Over 2020 as a whole GDP is expected to be 4% lower than in 2019. 2019 GDP growth stood at 1.4%. Interest rates and inflation are likely to remain low in the coming months but are expected to rise in 2021 as the economy recovers.

Whilst the FTSE ended the year 12% up on 2018, all gains have been more than erased in the period since the balance sheet date, with the FTSE currently at a level around 30% lower than it started the year.

Since August 2018, interest rates have been set at 0.75%. On 11 March 2020, The Bank of England cut interest rates to 0.25% and on 19 March, it cut them again to 0.1%, their lowest ever level. In addition to the significant fall in interest rates, the 10-year gilt yield is around 0.5% lower than at 31 December and credit spreads have widened by around 50% over the same period.

Whilst there is uncertainty in the business environment, the Company has a strong risk management and governance framework in place and benefits from the financial security provided from being a member of the Zurich Group. The risks arising from the COVID-19 pandemic continue to be closely monitored and the Company is well positioned to identify and implement a range of mitigants in response to future developments.

The COVID-19 outbreak has caused some short term challenges and uncertainties and the impacts from the COVID-19 pandemic continue to be closely monitored. The Company is well positioned to identify and implement a range of actions in response to future developments.

Due to the significant falls in the markets post the balance sheet date and in particular the fall in gilt rates, the Company's solvency capital fell to below its internal target level. Whilst it continued to meet its regulatory solvency requirement, the Company received a capital injection of £70m on 10 March to restore the capital level to above its internal targets.

Throughout 2019, 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 2019.

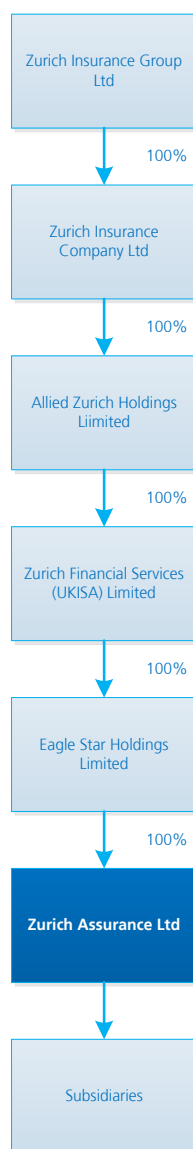
## **E.6 Any other information**

There is no other information to report here.

## Appendices

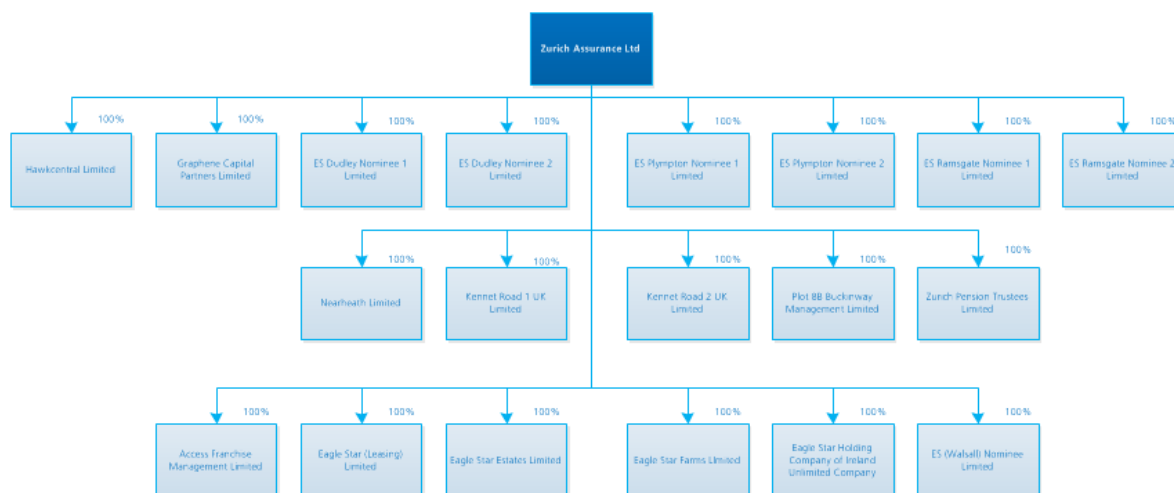
### Appendix 1 Company Structure Charts

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



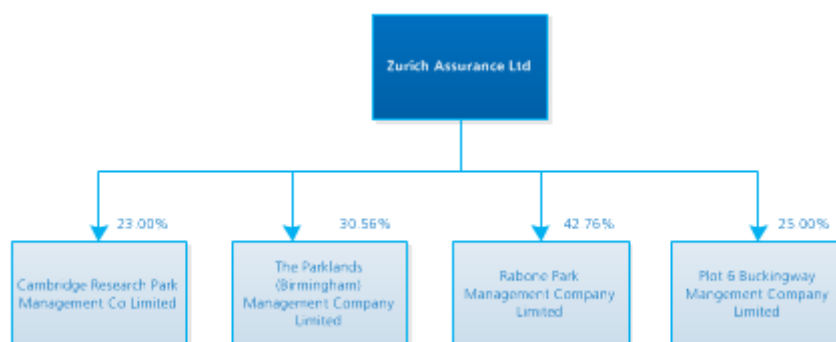
ZIG and ZIC are both incorporated in Switzerland. AZH is incorporated in Jersey. UKISA and ESH are both incorporated in England. The shareholding indicated above is identical to the voting power.

### Subsidiary undertakings



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

		Solvency II value
in GBP thousands, as of 31 December 2019		C0010
<b>Assets</b>		
Intangible assets	R0030	-
Deferred tax assets	R0040	-
Pension benefit surplus	R0050	-
Property, plant & equipment held for own use	R0060	29,877
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	3,341,088
Property (other than for own use)	R0080	5,612
Holdings in related undertakings, including participations	R0090	29,205
Equities	R0100	160,891
Equities – listed	R0110	160,881
Equities – unlisted	R0120	10
Bonds	R0130	3,043,643
Government Bonds	R0140	1,588,830
Corporate Bonds	R0150	1,411,989
Structured notes	R0160	9,287
Collateralised securities	R0170	33,536
Collective Investments Undertakings	R0180	55,000
Derivatives	R0190	12,812
Deposits other than cash equivalents	R0200	33,925
Other investments	R0210	-
Assets held for index-linked and unit-linked contracts	R0220	25,978,447
Loans and mortgages	R0230	55,991
Loans on policies	R0240	52,141
Loans and mortgages to individuals	R0250	3,851
Other loans and mortgages	R0260	-
Reinsurance recoverables from:	R0270	1,363,419
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	1,278,432
Health similar to life	R0320	156,453
Life excluding health and index-linked and unit-linked	R0330	1,121,979
Life index-linked and unit-linked	R0340	84,987
Deposits to cedants	R0350	-
Insurance and intermediaries receivables	R0360	117,838
Reinsurance receivables	R0370	72,538
Receivables (trade, not insurance)	R0380	62,912
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	177,879
Any other assets, not elsewhere shown	R0420	34,191
<b>Total assets</b>	<b>R0500</b>	<b>31,234,180</b>

## S.02.01.02 - Balance Sheet, Liabilities

		<b>Solvency II value</b>
<b>in GBP thousands, as of 31 December 2019</b>		<b>C0010</b>
<b>Liabilities</b>		
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	3,617,315
Technical provisions – health (similar to life)	R0610	339,527
TP calculated as a whole	R0620	240,434
Best Estimate	R0630	32,594
Risk margin	R0640	66,498
Technical provisions – life (excluding health and index-linked and unit-linked)	R0650	3,277,788
TP calculated as a whole	R0660	-
Best Estimate	R0670	2,969,182
Risk margin	R0680	308,606
Technical provisions – index-linked and unit-linked	R0690	25,283,547
TP calculated as a whole	R0700	25,552,444
Best Estimate	R0710	(340,372)
Risk margin	R0720	71,475
Contingent liabilities	R0740	-
Provisions other than technical provisions	R0750	11,760
Pension benefit obligations	R0760	-
Deposits from reinsurers	R0770	-
Deferred tax liabilities	R0780	148,215
Derivatives	R0790	9,014
Debts owed to credit institutions	R0800	-
Financial liabilities other than debts owed to credit institutions	R0810	51,717
Insurance & intermediaries payables	R0820	314,304
Reinsurance payables	R0830	23,347
Payables (trade, not insurance)	R0840	66,123
Subordinated liabilities	R0850	-
Subordinated liabilities not in BOF	R0860	-
Subordinated liabilities in BOF	R0870	-
Any other liabilities, not elsewhere shown	R0880	42,539
<b>Total liabilities</b>	<b>R0900</b>	<b>29,567,880</b>
<b>Excess of assets over liabilities</b>	<b>R1000</b>	<b>1,666,300</b>



## S.05.01.02 - Premiums, claims and expenses by line of business, Life

## Line of Business for: life insurance obligations

in GBP thousands, as of 31  
December 2019

		Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance
		C0210	C0220	C0230	C0240
<b>Premiums written</b>					
Gross	<b>R1410</b>	243,118	7,306	3,104,630	674,110
Reinsurers' share	<b>R1420</b>	107,864	329	9,007	503,060
Net	<b>R1500</b>	135,254	6,977	3,095,623	171,049
<b>Premiums earned</b>					
Gross	<b>R1510</b>	243,118	7,306	3,104,630	674,110
Reinsurers' share	<b>R1520</b>	107,864	329	9,007	503,060
Net	<b>R1600</b>	135,254	6,977	3,095,623	171,049
<b>Claims incurred</b>					
Gross	<b>R1610</b>	130,768	154,892	26,196,221	507,288
Reinsurers' share	<b>R1620</b>	66,743	390	11,555	464,530
Net	<b>R1700</b>	64,024	154,503	26,184,667	42,758
<b>Changes in other technical provisions</b>					
Gross	<b>R1710</b>	(82,192)	41,534	17,333,031	(542,157)
Reinsurers' share	<b>R1720</b>	(44,359)	-	(1,841)	(321,009)
Net	<b>R1800</b>	(37,833)	41,534	17,334,872	(221,148)
<b>Expenses incurred</b>	<b>R1900</b>	38,297	6,719	187,642	165,147
<b>Other expenses</b>	<b>R2500</b>				
<b>Total expenses</b>	<b>R2600</b>	-	-	-	-

## S.05.01.02 - Premiums, claims and expenses by line of business, Life

in GBP thousands, as of 31 December 2019		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
<b>Premiums written</b>						
Gross	<b>R1410</b>	-	-	2,212	251,664	4,283,041
Reinsurers' share	<b>R1420</b>	-	-	-	-	620,261
Net	<b>R1500</b>	-	-	2,212	251,664	3,662,780
<b>Premiums earned</b>						
Gross	<b>R1510</b>	-	-	2,212	251,664	4,283,041
Reinsurers' share	<b>R1520</b>	-	-	-	-	620,261
Net	<b>R1600</b>	-	-	2,212	251,664	3,662,780
<b>Claims incurred</b>						
Gross	<b>R1610</b>	-	-	1,598	13,637	27,004,404
Reinsurers' share	<b>R1620</b>	-	-	-	-	543,218
Net	<b>R1700</b>	-	-	1,598	13,637	26,461,186
<b>Changes in other technical provisions</b>						
Gross	<b>R1710</b>	-	-	252	(247,103)	16,503,364
Reinsurers' share	<b>R1720</b>	-	-	-	-	(367,210)
Net	<b>R1800</b>	-	-	252	(247,103)	16,870,574
<b>Expenses incurred</b>	<b>R1900</b>	-	-	-	-	397,804
<b>Other expenses</b>	<b>R2500</b>			-		1,326
<b>Total expenses</b>	<b>R2600</b>	-	-	-	-	<b>399,130</b>

## S.12.01.02 - Life and Health SLT Technical Provisions

in GBP thousands, as of 31 December 2019		Insurance with profit participation	Index-linked and unit-linked insurance		
				Contracts without options and guarantees	Contracts with options or guarantees
		C0020	C0030	C0040	C0050
<b>Technical provisions calculated as a whole</b>	<b>R0010</b>	-	25,305,341	-	-
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	<b>R0020</b>	-	82,141	-	-
<b>Technical provisions calculated as a sum of BE and RM</b>					
<b>Best Estimate</b>					
<b>Gross Best Estimate</b>	<b>R0030</b>	1,155,820	-	-	(340,372)
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	<b>R0080</b>	(690)	-	-	2,846
Best estimate minus recoverables from reinsurance/SPV and Finite Re – total	<b>R0090</b>	1,156,511	-	-	(343,218)
<b>Risk Margin</b>	<b>R0100</b>	52,655	71,475	-	-
<b>Amount of the transitional on Technical Provisions</b>					
Technical Provisions calculated as a whole	<b>R0110</b>	-	-	-	-
Best estimate	<b>R0120</b>	-	-	-	-
Risk margin	<b>R0130</b>	-	-	-	-
<b>Technical provisions – total</b>	<b>R0200</b>	<b>1,208,475</b>	<b>25,036,444</b>	<b>-</b>	<b>-</b>

## S.12.01.02 - Life and Health SLT Technical Provisions

in GBP thousands, as of 31 December 2019

**Technical provisions calculated as a whole**

Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole

**Technical provisions calculated as a sum of BE and RM**  
**Best Estimate**

**Gross Best Estimate**

Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default

Best estimate minus recoverables from reinsurance/SPV and Finite Re – total

**Risk Margin**  
**Amount of the transitional on Technical Provisions**

Technical Provisions calculated as a whole

Best estimate

Risk margin

		Other life insurance		
			Contracts without options and guarantees	Contracts with options or guarantees
		C0060	C0070	C0080
<b>R0010</b>		-	-	-
<b>R0020</b>		-	-	-
<b>R0030</b>		-	-	1,813,362
<b>R0080</b>		-	-	1,122,669
<b>R0090</b>		-	-	690,692
<b>R0100</b>		255,952	-	-
<b>R0110</b>		-	-	-
<b>R0120</b>		-	-	-
<b>R0130</b>		-	-	-
<b>Technical provisions – total</b>	<b>R0200</b>	<b>2,069,313</b>	<b>-</b>	<b>-</b>

## S.12.01.02 - Life and Health SLT Technical Provisions

in GBP thousands, as of 31 December 2019		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
<b>Technical provisions calculated as a whole</b> Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole <b>Technical provisions calculated as a sum of BE and RM</b> <b>Best Estimate</b> <b>Gross Best Estimate</b> Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default Best estimate minus recoverables from reinsurance/SPV and Finite Re – total <b>Risk Margin</b> <b>Amount of the transitional on Technical Provisions</b>  Technical Provisions calculated as a whole  Best estimate Risk margin	R0010	-	247,103	25,552,444
	R0020	-	-	82,141
	R0030	-	-	2,628,810
	R0080	-	-	1,124,825
	R0090	-	-	1,503,985
	R0100	-	-	380,082
	R0110	-	-	-
	R0120	-	-	-
	R0130	-	-	-
	<b>Technical provisions – total</b>	<b>R0200</b>	-	<b>247,103</b>

## S.12.01.02 - Life and Health SLT Technical Provisions

in GBP thousands, as of 31  
December 2019

**Technical provisions  
calculated as a whole**

Total Recoverables from  
reinsurance/SPV and Finite  
Re after the adjustment for  
expected losses due to  
counterparty default  
associated to TP as a  
whole

**Technical provisions  
calculated as a sum of  
BE and RM**

**Best Estimate**

**Gross Best Estimate**

Total Recoverables from  
reinsurance/SPV and Finite  
Re after the adjustment for  
expected losses due to  
counterparty default

Best estimate minus  
recoverables from  
reinsurance/SPV and Finite  
Re – total

**Risk Margin  
Amount of the  
transitional on Technical  
Provisions**

Technical Provisions  
calculated as a whole

Best estimate

Risk margin

**Technical provisions –  
total**

		Health insurance (direct business)		
			Contracts without options and guarantees	Contracts with options or guarantees
		C0160	C0170	C0180
<b>R0010</b>		240,434	-	-
<b>R0020</b>		-	-	-
<b>R0030</b>			-	31,317
<b>R0080</b>			-	156,453
<b>R0090</b>			-	(125,136)
<b>R0100</b>	66,498		-	-
				-
<b>R0110</b>	-		-	-
<b>R0120</b>			-	-
<b>R0130</b>	-		-	-
<b>R0200</b>	<b>338,250</b>		-	-

## S.12.01.02 - Life and Health SLT Technical Provisions

in GBP thousands, as of 31  
December 2019

**Technical provisions  
calculated as a whole**

Total Recoverables from  
reinsurance/SPV and  
Finite Re after the  
adjustment for expected  
losses due to  
counterparty default  
associated to TP as a  
whole

**Technical provisions  
calculated as a sum of  
BE and RM**

**Best Estimate**

**Gross Best Estimate**

Total Recoverables from  
reinsurance/SPV and  
Finite Re after the  
adjustment for expected  
losses due to  
counterparty default

Best estimate minus  
recoverables from  
reinsurance/SPV and  
Finite Re – total

**Risk Margin**

**Amount of the  
transitional on  
Technical Provisions**

Technical Provisions  
calculated as a whole

Best estimate

Risk margin

**Technical provisions –  
total**

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

R0010	-	-	240,434
R0020	-	-	-
R0030	-	1,277	32,594
R0080	-	-	156,453
R0090	-	1,277	(123,859)
R0100	-	-	66,498
R0110	-	-	-
R0120	-	-	-
R0130	-	-	-
<b>R0200</b>	<b>-</b>	<b>1,277</b>	<b>339,527</b>

## S.23.01.01 - Own funds

in GBP thousands, as of 31 December 2019

**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)	<b>R0010</b>
Share premium account related to ordinary share capital	<b>R0030</b>
Initial funds, members' contributions or the equivalent basic own – fund item for mutual and mutual-type undertakings	<b>R0040</b>
Subordinated mutual member accounts	<b>R0050</b>
Surplus funds	<b>R0070</b>
Preference shares	<b>R0090</b>
Share premium account related to preference shares	<b>R0110</b>
Reconciliation reserve	<b>R0130</b>
Subordinated liabilities	<b>R0140</b>
An amount equal to the value of net deferred tax assets	<b>R0160</b>
Other own fund items approved by the supervisory authority as basic own funds not specified above	<b>R0180</b>

**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

**Deductions**

Deductions for participations in financial and credit institutions

**Total basic own funds after deductions****Ancillary own funds**

Unpaid and uncalled ordinary share capital callable on demand	<b>R0300</b>
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual – type undertakings, callable on demand	<b>R0310</b>
Unpaid and uncalled preference shares callable on demand	<b>R0320</b>
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	<b>R0330</b>
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	<b>R0340</b>
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	<b>R0350</b>

Total	Tier 1 – unrestricted	Tier 1 – restricted	Tier 2	Tier 3
C0010	C0020	C0030	C0040	C0050
236,132	236,132		-	
-	-		-	
-	-		-	
-		-	-	-
279,970	279,970			
-		-	-	-
-		-	-	-
1,018,045	1,018,045			
-		-	-	-
-				-
-	-	-	-	-
-				
-				
-	-	-	-	-
<b>1,534,147</b>	<b>1,534,147</b>	<b>-</b>	<b>-</b>	<b>-</b>
-			-	
-			-	
-			-	-
-			-	-
-			-	
-			-	-



Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC

<b>R0360</b>	-			-	
--------------	---	--	--	---	--

Supplementary members calls – other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC

<b>R0370</b>	-			-	-
--------------	---	--	--	---	---

Other ancillary own funds

<b>R0390</b>	-			-	-
--------------	---	--	--	---	---

**Total ancillary own funds**

<b>R0400</b>	-	-	-	-	-
--------------	---	---	---	---	---

**Available and eligible own funds**

Total available own funds to meet the SCR

<b>R0500</b>	1,534,147	1,534,147	-	-	-
--------------	-----------	-----------	---	---	---

Total available own funds to meet the MCR

<b>R0510</b>	1,534,147	1,534,147	-	-	
--------------	-----------	-----------	---	---	--

Total eligible own funds to meet the SCR

<b>R0540</b>	1,534,147	1,534,147	-	-	-
--------------	-----------	-----------	---	---	---

Total eligible own funds to meet the MCR

<b>R0550</b>	1,534,147	1,534,147	-	-	
--------------	-----------	-----------	---	---	--

**SCR**

<b>R0580</b>	1,218,415				
--------------	-----------	--	--	--	--

**MCR**

<b>R0600</b>	304,604				
--------------	---------	--	--	--	--

**Ratio of Eligible own funds to SCR**

<b>R0620</b>	126%				
--------------	------	--	--	--	--

**Ratio of Eligible own funds to MCR**

<b>R0640</b>	504%				
--------------	------	--	--	--	--

**Reconciliation reserve**

Excess of assets over liabilities

<b>R0700</b>	1,666,300	
--------------	-----------	--

Own shares (held directly and indirectly)

<b>R0710</b>	-	
--------------	---	--

Foreseeable dividends, distributions and charges

<b>R0720</b>	-	
--------------	---	--

Other basic own fund items

<b>R0730</b>	516,102	
--------------	---------	--

Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

<b>R0740</b>	132,153	
--------------	---------	--

**Reconciliation reserve**

<b>R0760</b>	1,018,045	
--------------	-----------	--

**Expected profits**

Expected profits included in future premiums (EPIFP) – Life business

<b>R0770</b>	482,179	
--------------	---------	--

Expected profits included in future premiums (EPIFP) – Non- life business

<b>R0780</b>	-	
--------------	---	--

**Total Expected profits included in future premiums (EPIFP)**

<b>R0790</b>	482,179	
--------------	---------	--

## S.25.01.21 - Solvency Capital Requirement - for undertakings on Standard Formula

in GBP thousands, as of 31 December 2019		Gross solvency capital requirement	USP	Simplifications
		C0110	C0090	C0120
Market risk	R0010	307,774		No
Counterparty default risk	R0020	42,160		
Life underwriting risk	R0030	487,622	No	No
Health underwriting risk	R0040	102,689	No	No
Non-life underwriting risk	R0050	-	No	No
Diversification	R0060	(247,670)		
Intangible asset risk	R0070	-		
<b>Basic Solvency Capital Requirement</b>	<b>R0100</b>	<b>692,575</b>		

## C0100

## Calculation of Solvency Capital Requirement

Operational risk	R0130	83,367
Loss-absorbing capacity of technical provisions	R0140	(47,837)
Loss-absorbing capacity of deferred taxes	R0150	(8,689)
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	R0160	
<b>Solvency capital requirement excluding capital add-on</b>	<b>R0200</b>	<b>719,415</b>
Capital add-on already set	R0210	499,000
<b>Solvency capital requirement</b>	<b>R0220</b>	<b>1,218,415</b>
<b>Other information on SCR</b>		
Capital requirement for duration-based equity risk sub-module	R0400	
Total amount of Notional Solvency Capital Requirement for remaining part	R0410	624,257
Total amount of Notional Solvency Capital Requirements for ring fenced funds	R0420	95,158
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 2019

		<b>C0040</b>	
	<b>R0200</b>	236,885	
		<b>Net (of reinsurance/SPV) best estimate and TP calculated as a whole</b>	<b>Net (of reinsurance/SPV) total capital at risk</b>
		<b>C0050</b>	<b>C0060</b>
Obligations with profit participation – guaranteed benefits	<b>R0210</b>	996,649	
Obligations with profit participation – future discretionary benefits	<b>R0220</b>	159,862	
Index-linked and unit-linked insurance obligations	<b>R0230</b>	25,127,085	
Other life (re)insurance and health (re)insurance obligations	<b>R0240</b>	807,267	
Total capital at risk for all life (re)insurance obligations	<b>R0250</b>		22,113,058
		<b>C0070</b>	
Linear MCR	<b>R0300</b>	236,885	
SCR	<b>R0310</b>	1,218,415	
MCR cap	<b>R0320</b>	548,287	
MCR floor	<b>R0330</b>	304,604	
Combined MCR	<b>R0340</b>	304,604	
Absolute floor of the MCR	<b>R0350</b>	3,187	
		<b>C0070</b>	
<b>Minimum Capital Requirement</b>	<b>R0400</b>	304,604	