Classification: Confidential

LLOYDS BANKING GROUP

SCOTTISH WIDOWS EUROPE

Solvency and Financial Condition Report

31 December 2019

Contents

Statement of Directors' Responsibilities

This Solvency and Financial Condition Report ("SFCR") presents information in the format prescribed by the applicable Solvency II European regulations and guidelines. It includes disclosures in relation to business performance, governance, risk profile, solvency and capital management. In doing so it sets out the financial position of Scottish Widows Europe and its two German and Italian insurance branches.

The Directors are responsible for preparing this SFCR in accordance with the Solvency II European regulations and guidelines. Each of the Directors, whose names are listed in the Board of Directors section of the SWE Annual Report and Financial Statements, confirm that, to the best of their knowledge:

- Throughout the reporting period (1 February 2019 to 31 December 2019), SWE continuously complied in all material respects with the requirements of the Solvency II regulations as applicable;

  and

- It is reasonable to believe that, at the date of the publication of this SFCR, SWE continues so to comply, and will continue so to comply in future.

On behalf of the Board,

Frédéric Chandelle
SWE Chief Risk Officer and Chief Actuary
06 April 2020

Note regarding comparative values: Where comparative values of Own Funds, Solvency II Technical Provisions, Solvency Capital Requirement and Minimum Capital Requirement are given, the "Start of Period" is taken to be as at the date of the transfer of business from Scottish Widows Limited (29 March 2019) and as reported in the initial Quantitative Reporting Templates at 31 March 2019. This is also referred to as the "Part VII Transfer" in some sections of this report.

Summary

A. Business and performance

Scottish Widows Europe S.A. ("the Company" or "SWE") is a life insurance company incorporated in the Grand Duchy of Luxembourg, with its registered office also in Luxembourg.

SWE is governed by Luxembourg law, incorporated on 19 October 2018 under the form of a public limited liability company (*société anonyme*). On 1 February 2019, SWE received approval to act as a life insurance company. In practice, it may be considered that SWE began its activities on 29 March 2019, the date from which the Company manages the run-off portfolio transferred from Scottish Widows Limited ('SWL'), its sole shareholder. SWE operates through two regulatory branches in the European Union, one in Germany and one in Italy.

SWL is a subsidiary of Scottish Widows Group Limited ('SWG'), itself part of Lloyds Banking Group plc ('LBG'). LBG, SWE's ultimate parent company, is a company registered in the UK and is quoted on the London Stock Exchange and the New York Stock Exchange. LBG is one of the largest companies in the FTSE 100 index of leading UK companies. For the purposes of this report, the ultimate parent company and all its subsidiaries are referred to as "Lloyds Banking Group", the "LBG Group" or "LBG".

SWE was set up to allow continued servicing of SWL's European policies following the United Kingdom's exit from the European Union. SWE's only business is the run-off of the insurance portfolio transferred from SWL. Currently SWE is not seeking new business. SWE has a mix of with-profits and unit-linked endowments, pensions and deferred annuities that have been sold in Germany, Austria, Italy and Luxembourg.

Despite economic uncertainty and volatility, and a low interest rate environment, SWE maintained a strong solvency ratio at 31 December 2019.

B. System of governance

The governance and organisational structure of the Company is set out in the Company's Articles of Association, Governance Framework and Terms of Reference. These define the responsibilities and authority of the members of the Board and Committees. SWE follows the principles, policies, procedures and processes of LBG and adapts them, if necessary, to the specific needs of Luxembourg and European legislation.

The Company's compliance with fit and proper requirements is assured through a combination of policies and related procedures at both LBG Group and Company level. In particular, the Company follows:

- the Insurance Fit & Proper Policy,
- the Company's Colleague Policy and special procedures related to appointments of Board and Management Committee Members,
- CEO, Key Function Holders and Branch Managers (nominations or changes) performance reviews and training.

A set of tools and templates facilitates the implementation of these policies, which collectively ensures that those who effectively run the undertaking or have other key functions

- are of good repute and integrity,
- possess the requisite skills, knowledge and expertise for their roles and
- have undergone or are undergoing all training required to enable such persons to perform their role effectively.

SWE's Risk Management Framework ('RMF') is aligned to LBG's, whilst adopting specific terminology and incorporating elements to address and support compliance with Luxembourg and Insurance-specific requirements. SWE operates a prudent approach to risk with rigorous management controls to ensure business continuity and minimise losses.

The RMF provides a robust and consistent approach to risk management across the organisation with mechanisms for developing and embedding risk policies and risk management strategies, which are aligned to the risks faced by the business. This in turn drives the risk profile of the business in line with risk appetite and through good risk-reward decision making.

The reader is invited to refer to section B of this report for more detailed information on SWE's governance system.

C. Risk profile

Current risk exposures are assessed and aggregated in accordance with the requirements of the Standard Formula for the calculation of the regulatory Solvency Capital Requirement ('SCR') defined by the Solvency II directive and its implementing measures, plus an internal provision covering the risks associated with the final cost of settlement of contracts previously sold mainly in Germany, Austria and Italy (*also referred to as "German Litigation" or "Mulberry Provision" in some sections of this report*).

A key component of SWE's Risk Appetite is the requirement to hold a Capital Buffer in excess of the SCR. Currently, SWE's Capital Buffer is aligned to the percentage of SCR calculated by SWG to withstand a 1-in-10 year event for its entire insurance business.

More information on the risk profile can be found in Section C of this report.

Underwriting risk

The principal risk that SWE faces under insurance contracts is that the actual claims and benefit payments exceed the amounts expected at the time of determining the insurance liabilities. The nature of SWE's business involves the accepting of insurance risks which primarily relate to expenses, persistency, mortality, and longevity.

Refer to section C.1 for more detailed information regarding these risks and the way they are managed within SWE.

Market risk

Interest rate and inflation are the two most important financial risks SWE is exposed to. The continued political uncertainty and associated volatile markets results in a more volatile solvency position for SWE. However, it should be noted that a hedging programme was established in late March / early April 2020 that substantially removes interest rate and inflation volatility from SWE's balance sheet.

All market risks are assessed and aggregated according to the Standard Formula for the calculation of the regulatory SCR. Note also that SWE has put in place a Board approved Investment Policy which sets out the key requirements of the Prudent Person Principle and the controls to ensure that the requirements are complied with.

Refer to section C.2 for more detailed information regarding these risks and the way they are managed within SWE.

Credit risk

SWE's counterparty risk relates to exposure to banks through cash holdings and SWL defaulting. SWE's Credit risk is assessed using the Standard Formula SCR.

Due to the reinsurance arrangement with SWL being heavily collateralised, the Standard Formula clearly overestimates SWE's effective exposure to credit risk.

Refer to section C.3 for more detailed information regarding these risks and the way they are managed within SWE.

Liquidity risk

Liquidity risk may result from:
- the inability to sell financial assets quickly at their fair values (which may make it difficult to re-attain a matched position after a stress event);
- an insurance liability falling due for payment earlier than expected;
- the inability to generate cash inflows as anticipated.

Liquidity risk is actively managed and monitored to ensure that SWE has sufficient liquidity to meet its obligations and remains within approved risk appetite.

Refer to section C.4 for more detailed information regarding these risks and the way they are managed within SWE.

Operational risk

Operational risk may be defined as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events which may result in financial loss, disruption or reputational damage". These include the availability, resilience and security of our core IT systems, people risk, regulatory and legal risk, governance risk and potential for failings in our customer processes.

Refer to section C.5 for more detailed information regarding these risks and the way they are managed within SWE.

D. Valuation for Solvency Purposes

Asset valuation under Solvency II

Assets are recorded at fair value in line with the valuation methodology described in the Solvency II Directive. The underlying concept is that assets are valued at an amount for which they could be exchanged, transferred or settled between knowledgeable and willing parties, in an arm's length transaction.

Valuation methods make maximum use of relevant market inputs and rely as little as possible on company specific inputs.

The assets of the Company are shown in the table below.

€	31 Dec 2019
Deferred tax assets	-
Collective Investments	2,255,899,139
Assets held for unit-linked contracts	273,232,527
Reinsurance recoverables	1,753,076,867
Insurance receivables	4,174,594
Trade receivables	78,710,694
Cash and cash equivalents	9,961,901
Total assets	**4,375,055,722**

Technical Provisions valuation under Solvency II

The Solvency II technical provisions represent the value of the Company's obligations if they were to be transferred to a third party at the valuation date. The value of the technical provisions is the sum of the Best Estimate of the Liability ('BEL' or 'BE') and Risk Margin ('RM'). The BEL is intended to correspond to the probability weighted average of the present value of future cash flows on a market consistent basis. The projection of future cash flows is performed using best estimate assumptions.

Discount rates are determined on a market consistent basis using the relevant risk-free term structure as specified by EIOPA.

The Risk Margin component exists to adjust the BEL value so that the total technical provisions reflect the price for risk that a potential purchaser would take into account when acquiring a book of insurance business.

The Risk Margin is calculated by projecting the run-off of the non-hedgeable SCR risks, applying the 6% cost of capital defined by EIOPA to the projected values and discounting using the risk-free rate.

The table below shows the technical provisions for SWE, split by business category and gross of reinsurance.

31 Dec 2019 €	Best Estimates of the Liabilities	Risk Margin	Total
Life			
a) Index-linked and unit-linked	341,938,518	24,016,867	365,955,385
b) Other	1,785,314,642	75,410,956	1,860,725,598
Total	**2,127,253,161**	**99,427,823**	**2,226,680,983**

Other liabilities valuation under Solvency II

The amounts recognised in SWE's balance sheet are shown in the table below.

€	31 Dec 2019
Provisions other than technical provisions	71,616,143
Deposits from Reinsurers	1,773,337,127
Deferred tax liabilities	18,166,736
Insurance and intermediaries payables	33,814,090
Trade payables	16,731,500

Total other liabilities	**1,913,665,596**

SWE had no subordinated liabilities during, or at the end of, the reporting period.
Other liabilities are recorded at fair value as required under Solvency II principles, the underlying concept being that items are valued at an amount for which they could be exchanged, transferred or settled, between knowledgeable willing parties in an arm's length transaction.

More information regarding the valuation rules for Solvency Purposes can be found in Section D of this report.

E. Capital Management

SWE's two most important objectives about Capital management are:
- To have sufficient Own Funds to safeguard the Company's ability to continue ensuring the orderly run-off of the transferred portfolio, providing benefits to policyholders as they fall due, so that it can continue to provide returns for the shareholder and benefits for other stakeholders.
- To comply with all regulatory capital requirements as set out under Solvency II.

A key component of SWE's Risk Appetite is the requirement to hold a Capital Buffer in excess of the SCR. Currently, SWE's Capital Buffer is aligned to the percentage of SCR calculated by SWG to withstand a 1-in-10 year event for its entire insurance business.

The regulatory SCR for SWE has been determined using the Standard Formula approach set out in the Solvency II Directive and its implementing measures.

SWE is also required to calculate a Minimum Capital Requirement ('MCR'). The MCR represents the minimum level below which the amount of financial resources should not fall. It is calculated in accordance with a formula prescribed in the Solvency II regulations and is subject to a floor and a cap equal to 25% and 45% of the SCR respectively.

The Own Funds, SCR and MCR for SWE as at 31 December 2019 are shown in the table below. This demonstrates SWE had a ratio of Own Funds to SCR / MCR significantly in excess of 100%.

€	31 Dec 2019
Eligible Own Funds to cover SCR	234,709,143
SCR	121,555,361
Ratio of Eligible Own Funds to SCR	1.93
Eligible Own Funds to cover MCR	234,709,143
MCR	30,388,840
Ratio of Eligible Own Funds to MCR	7.72

More information regarding Own Funds, SCR and MCR components can be found in Section E of this report.

***

A. Business and performance

A.1 Business

A.1.1 SWE Identifiers

Name of the undertaking: Scottish Widows Europe S.A

Scottish Widows Europe S.A ("the Company" or "SWE") is a life insurance company incorporated in the Grand Duchy of Luxembourg, with its registered office at:

Europe Building,
1, Avenue du Bois,
L-1251 Luxembourg.

SWE is a life insurance entity governed by Luxembourg law, incorporated on 19 October 2018 under the form of a public limited liability company (*société anonyme*). It has been registered with the Luxembourg trade register under number B228618 since 24 October 2018. The Company's legal entity identifier (LEI) is 213800KWRFPFZHUEMW58.

On 1 February 2019, SWE received approval from the Luxembourg Minister of Finance
- to act as a life insurance company, and
- to conduct class I and III life insurance business.

In practice, it may be considered that SWE began its activities on 29 March 2019, the date from which the Company manages the run-off portfolio transferred from SWL, its sole shareholder (see below).

SWE operates through two regulatory branches in the European Union, one in Germany and one in Italy:

Scottish Widows Europe S.A., Zweigniederlassung Deutschland
Im Breitspiel 2/4, 3rd Floor
D-69126 Heidelberg

Scottish Widows Europe S.A., Rappresentenza Generale Per l'Italia
Via Valtorta 47
I-20127 Milano

A.1.2 Supervisory Authorities

A.1.2.1 SWE's Supervisory Authority

Commissariat aux Assurances
7 Boulevard Joseph II, 1840 Luxembourg
Tel.: (+352) 22 69 11 - 1
caa@caa.lu, https://www.caa.lu/

A.1.2.2 Group's Supervisory Authority

LBG, as well as SWL (see below), are regulated in the United Kingdom by:
- the Prudential Regulatory Authority (PRA), and
- the Financial Conduct Authority (FCA).

Prudential Regulatory Authority (Bank of England)
Threadneedle St, London, EC2R 8AH
Tel.: +44 20 3461 4444, +44 20 3461 4878
enquiries@bankofengland.co.uk,
https://www.bankofengland.co.uk/contact

and:

Financial Conduct Authority (FCA)
FCA Head Office
12 Endeavour Square
London E20 1JN, United Kingdom
Telephone: +44 207 066 1000 (for consumers)
Telephone: +44 207 066 1000 (for firms)
www.fca.org.uk

A.1.3 External Auditors

A.1.3.1 SWE's External Auditor

SWE's external auditor appointed by its shareholder is:

PricewaterhouseCoopers
PwC Luxembourg
2 Rue Gerhard Mercator,
L-2182 Grand Duchy of Luxembourg
Tel.: +352 49 48 48 1
Fax: +352 49 48 48 29 00
info@lu.pwc.com, https://www.pwc.lu/

A.1.3.2 Group's External Auditor

SWG and its regulated insurance subsidiaries, including SWL, are audited by PricewaterhouseCoopers LLP. The contact details for the auditors are:

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
2 Glass Wharf
Bristol BS2 0FR

A.1.4 SWE's Shareholders

A.1.4.1 Scottish Widows Limited (SWL)

As at 31 December 2019, SWE is a subsidiary of SWL, its immediate parent company and only shareholder. Its product range includes life assurance and pensions. SWL is a limited company incorporated and existing under the laws of England and Wales, registered with Companies House Registrar of Companies for England and Wales under number 03196171. It has its registered office at 25 Gresham Street, London, EC2V 7HN, United Kingdom.

A.1.4.2 Scottish Widows Group ('SWG')

SWL is a subsidiary of SWG, itself part of Lloyds Banking Group plc ('LBG'). SWE, SWL and SWG form part of the LBG Insurance & Wealth Division.

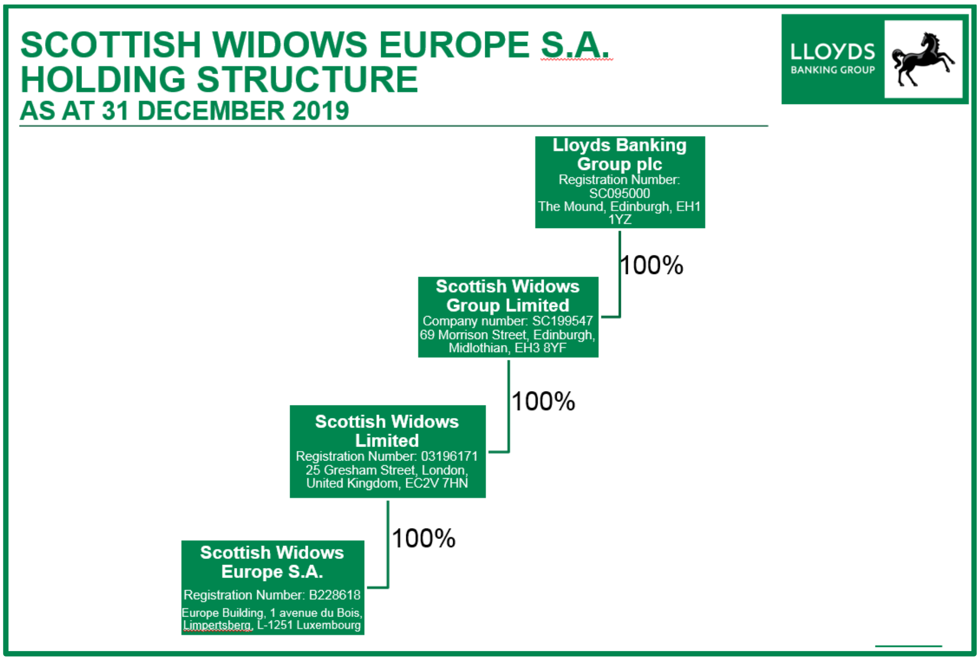
A.1.4.3 Lloyds Banking Group ('LBG')

LBG plc, SWE's ultimate parent company, is a company registered in the UK and is quoted on both The London Stock Exchange, and The New York Stock Exchange and is one of the largest companies in the FTSE 100 index of leading UK companies.

For the purposes of this report, the ultimate parent company and all its subsidiaries are referred to as "Lloyds Banking Group", the "LBG Group" or "LBG".

A.1.5 SWE's position within LBG

The Company's shareholding structure is currently as follows:



A.1.6 Material lines of business and geographical operation areas

SWE was set up to allow continued servicing of SWL's European policies following the United Kingdom's exit from the European Union as in the event of a no-deal, it would become illegal for SWL to continue to service these policies in the UK.

SWE's only business is the run-off of the insurance portfolio transferred from SWL. Currently SWE is not seeking new business however it could be used in the future (subject to obtaining appropriate permissions) as a receiving entity for further European business, following future acquisitions for example.

A.1.6.1 Material lines of business

SWE has a mix of with-profits and unit-linked endowments, pensions and deferred annuities that have been sold in Germany, Austria, Italy and Luxembourg. In addition, several of these policies have options, or obligations, to convert their plans to with-profits annuities on maturity.

Currently, there are limited numbers of with-profits annuities, but this will grow in the future, attributing to a large extent the long duration of SWE's technical provisions. Key features of the main product types are discussed below.

Unit-Linked Policies

The value of a Unit-Linked policy is determined by reference to the number and price of notional units allocated to the policy from a range of internal insurance funds.

Notional units are purchased, in the funds selected by the customer, following receipt of premiums. Benefits and claims are funded by the sale of the notional units at the price of those units at the point of sale. Funds are available that invest in a range of asset classes. The investment performance of the assets in the fund, net of fund management charges is reflected in the price of the units which can change on a daily basis.

Within the range of unit-linked funds are four "Guaranteed Access" unit-linked funds. Unlike other unit-linked funds these funds have minimum unit price guarantees, based on the highest unit price ever achieved by the fund (dependent on the fund, this ranges from 70% to 90% of maximum price achieved) and an asset allocation strategy that varies the asset mix depending on fund performance.

All policies have a basic death benefit of at least 101% of the value of units on death, and a number of policies also have additional life cover and other protection benefits.

Some life insurance policies have an option to specify a series of regular unit encashments, starting immediately or at a future date. Policyholders may also request partial unit encashments on an ad-hoc basis.

Unitised With-Profits

While notionally invested in "units", the characteristics of Unitised With-Profit ('UWP') policies are very different from unit-linked business. The mechanisms for distributing the performance of the fund rely on the application of bonuses which can increase the price of units and/or add additional value to certain claims.

The price of units increases with a declared bonus rate and as long as the policy is maintained until maturity or death, the policyholder is generally guaranteed to receive at least the unit price (which cannot decrease).

If lapsed early, the company can reduce the surrender value if the value of the underlying assets falls below the value represented by the unit price.

In addition to the value of units, an additional bonus may be declared on exit so that the claim value closer matches the overall performance of the fund.

UWP policies invest in the Clerical Medical With-Profits fund of SWL via a reassurance agreement between SWE and SWL.

A.1.6.2 Major geographical areas of operation

SWE's run-off insurance portfolio relates to contracts that were sold mainly in Germany, but also in Austria, and for a smaller part in Italy and Luxembourg. As at 31 December 2019, the number of in-force contracts were split Germany (82%), Austria (15%), Italy and Luxembourg (3%).

A.1.7 Significant 2019 or post 2019 business or other events with material impacts

Covid-19 impacts: The emergence of the Coronavirus has deep impacts in all areas of our daily lives, both private and professional. All SWE Stakeholders are affected directly as well as indirectly. The impacts of this unprecedented crisis on the company are discussed in more details in the separate paper "Covid-19 Update" added at the end of this original report.

A.2 Underwriting performance

The following table provides a summarised profit and loss account for the financial reporting period from 24 October 2018 to 31 December 2019, split by material lines of business ('LoB'). The detailed figures are available in SWE's 2019 financial statements.

In terms of "Lines of Business" regarding the risks inherent to SWE's main products we will differentiate between unit-linked products and unitised with-profit products. This defines the level of detail shown in the table below and, unless otherwise mentioned, used in most sections of this report.

€'000	With- Profit Products	Unit-Linked Products	Total
1. Earned premiums, net of reinsurance	7,058	16,605	23,662
2. Investment Income	4,979	2,660	7,639
3. Unrealized gains on investments	125,174	8,728	133,902
4. Other Technical income, net of reinsurance	30,861	-	30,861
5. Claims incurred, net of reinsurance	209,219	299,971	509,190
6. Change in other technical provisions, net of reinsurance	(205,954)	(337,365)	(543,319)
7. Bonuses and rebates, net of reinsurance	-	-	-
8. Net operating expenses	(24,239)	(4,235)	(28,473)
9. Investment charges	(128,056)	(520)	(128,576)
10. Unrealized losses on investments	(1,376)	(644)	(2,020)
11. Other technical charges, net of reinsurance	-	-	-
12. Allocated investment return transferred to the non-technical account (-)	57	6	62
13. Sub-total: Balance on the technical account - life assurance business	**17,723**	**(14,794)**	**2,929**

SWE manages a portfolio in run-off. As such

- no new policies entered the portfolio during 2019,
- Subscription of new risks is not part of Company strategy,
- The only premiums collected and commission paid during 2019 are related to existing contracts, and
- No other acquisition costs are spent by the company.

Total turnover in 2019 was €90.3m while commissions paid amounted to €11.4m.

A.3 Investment performance

A.3.1 Income and Expenses by asset class

At the date of the transfer of activity from SWL, the Company delegated the active management of the investment portfolio to SWL. The aim of the delegation was to continue the asset management strategy in place prior to the transfer without any disruption of processes.

Total investment management charges for this first period of exercise amounted to €129m, of which €104m was interest charges on reinsurer deposits (Funds Withheld).

A.3.2 Gains and losses recognised directly in equity

No investment gains or losses were recognised directly in equity.

A.3.3 Investments in securitisations

SWE does not hold any investments in securitisations.

A.4 Performance of other activities

The company does not enter in to any other business than the management of its insurance portfolio.

A.5 Any other information

A.5.1 Part VII transfer

On 29 March 2019, European policies were transferred from SWL to SWE. The Scheme of transfer identified the policies, policy servicing agreements and reinsurance agreements that were transferred. It specified the assets & liabilities of SWL's European business that were transferred from SWL to SWE and defined the operation of the funds within SWE.

Its aim was to make sure that policyholders' policies and the funds in which they invest would continue to operate in SWE in materially the same way as they did in SWL, whilst complying with the Luxembourg regulations and providing similar levels of protection to these policyholders.

In order to support this a number of arrangements were also put in place alongside the Scheme, including a reinsurance agreement for With-Profits investments, an Indemnity guarantee in relation to German Litigation and Servicing agreements.

A.5.2 Capital Injections

Throughout 2019, the following capital injections, in the form of share premiums were received from SWL:

- In March, €75m was received to support the establishment of SWE.
- In September €30m was received following the significant adverse market volatility.
- €70m was received in December 2019 in response to updated maintenance expense assumptions for the 31 December 2019 valuation.

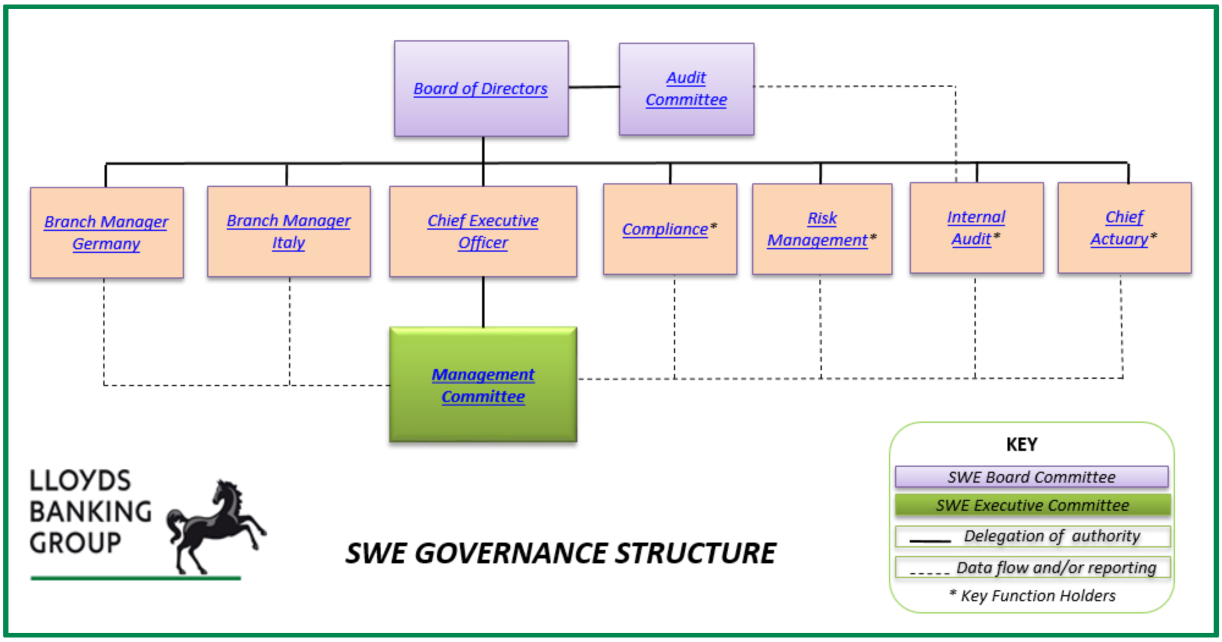
B. System of governance

B.1 General Information on the system of governance

B.1.1 Governance overview

The governance and organisational structure of the Company is set out in the Company's Articles of Association, Governance Framework and Terms of Reference. These define the responsibilities and authority of the members of the Board and Committees.

The governance structure is outlined in the diagram below:



B.1.1.1 Board of Directors

Role

The Board is collectively responsible for the management of the Company in a way to achieve the Company's purpose and in the Company's best interests. The Board is responsible for the sound and prudent management of the Company.

The Board sets the Company's strategy and oversees delivery against it and ensures that the Company manages its risk effectively, monitors reports appropriately, and has the necessary financial and human resources in place for the Company to meet its objectives.

The members of the Board bear ultimate responsibility and liability for meeting applicable legal obligations. They have the right and obligation to take all measures to fulfil their legal duties.

Composition

The Board comprises of four members, one of whom is an Executive Director and three of whom are Non-executive Directors. Two of the Non-executive Directors are independent, one of whom is the chair of Audit Committee.

The Chairman of the Board is a Non-executive Director appointed by the Board and has no individual delegations. The Chairman is responsible for leadership of the Board, ensuring its effectiveness on all aspects of its role. The Chairman has a critical role in creating the conditions for overall Board and individual director effectiveness, both inside and outside the boardroom.

The members of the Board are individuals with the abilities, professional background and personal character (including honesty and financial soundness) necessary and required to ensure an independent decision-making process in a critical exchange of ideas with the executive management.

Delegation and retained responsibilities of the Board

In order to support its work, the Board has delegated certain responsibilities and authorities to a number of committees and individuals. These include the Company's:
- Audit Committee
- CEO
- Management Committee
- Branch Managers
- Key Function Holders.

The Board retains ultimate responsibility, oversight and control of the delegated responsibilities and authorities.

B.1.1.2 Audit Committee

In order to support its work, the Board has established an Audit Committee which carries out its tasks in support of the Board. As a Board committee, the Audit Committee is accountable to the Board but does not, nor is able to, relieve the Board of any of its responsibilities.

Role

The role of the Audit Committee is to assist the Board in fulfilling its oversight responsibility including:
- the integrity of the Company's financial statements (including the Luxembourg statutory returns),
- the Company's internal controls regarding the financial reporting of the Company,
- the external auditor's qualification and independence as well as the performance and selection of the external auditor.

Composition

The Audit Committee is composed of three Non-executive Directors. The Chairman of the Audit Committee is responsible for chairing and overseeing the performance of the Audit Committee. The Chairman of the Audit Committee is an Independent Non-executive Director and is acting as Audit Director.

B.1.1.3 Chief Executive Officer ('CEO')

The CEO has executive responsibility for the overall day-to-day management of the Company's business and has authority to sign individually. The CEO represents the Company at the CAA, is resident in Luxembourg and has been approved by the Luxembourg Minister of Finance.

The CEO discharges his responsibility for the day-to-day management of the business through delegating elements of his authority to other Company's executives and with the assistance of the

Company's Management Committee. The CEO is the chair of the Management Committee (see below).

The CEO is also acting as a key function holder for distribution and as the anti-money laundering officer ("AMLO") and money laundering reporting officer ('MLRO') for the Company.

B.1.1.4 SWE Management Committee ('MC')

Role

The MC is responsible for managing the Company's business and supervising operational activities of the Company and its branches. It provides a cross-functional and cross-location communication platform and ensures that any matters relating to the Company are effectively communicated to the head office in Luxembourg and the branches.

The MC provides a holistic forum for the discussion of key risk and operational issues impacting the Company, putting customers at the heart of all decisions.

Composition

The MC is chaired by the CEO and is composed of six executive members: the CEO, the Head of Legal & Company Secretary, the Head of Operations & Compliance Officer, the CFO, the Lead Technical Product Manager and the Chief Risk Officer ('CRO') & Chief Actuary.

B.1.1.5 Solvency II and other key functions

The Board:
- is responsible for adopting appropriate measures to implement guidelines or policies relating to the key functions;
- nominates individuals as designated representatives of the respective key functions towards the Company;
- monitors the key functions to ensure they are adequately staffed with professionals possessing the requisite professional qualifications, knowledge and experience, and
- has full authority to investigate any matters within their respective duties.

Key function holders operate under the oversight of, and report directly to, the Board and Board Committees of the Company. Key function holders will report directly to the Board and Management Committee any issues that could have an impact on the Company.

Key Function Holders are authorised to:
- obtain independent professional advice,
- request external advisors to undertake specific tasks or to obtain any information from any director, officer or employee acting on behalf of the Company, and
- secure their attendance to the relevant meetings when necessary.

In line with Solvency II requirements, the Company has implemented the four Solvency II key functions (i.e. Compliance, Actuarial, Risk Management and Internal Audit).

There is a clear separation between the risk-taking and risk controlling (assurance) roles. The key functions have operational independence in performing their reporting functions with the exception of Internal Audit, which shall have complete independence in performing its reporting function.

The role of each of the four Solvency II key functions is described in the following sub-sections of this report:
- Compliance: Please refer to sub-section "B.4.2"
- Actuarial: Please refer to sub-section "B.6.1"

- Risk Management : Please refer to sub-section "B.3.2”
- Internal Audit: Please refer to sub-section "B.5.1”

B.1.1.6 Branch Managers

For each branch, the Board has appointed one person as branch manager and legal representative of the Company in the jurisdiction of the branch (the “Branch Manager”), who is in charge of the day-to-day management of the branch and conducting business in the name of the Company in the jurisdiction of the branch.

Branch Managers are regular attendees to the Management Committee and Board meetings.

B.1.1.7 Chief Financial Officer (‘CFO’)

The CFO holds responsibility for the management of the financial resources and reporting to the Board in relation to the financial affairs. The CFO is responsible for delivering local statutory and regulatory reporting for the Company, as well as providing insightful reporting and analysis to the Board, the CEO and internal LBG stakeholders (Group finance and commercial teams based in the UK).

The CFO is a direct report of the CEO and had also a dotted line to the Insurance Chief Financial Officer. He is a member of the Management Committee and a regular attendee of the Board and the Audit Committee.

B.1.2 Changes in the system of governance over the reporting period

As this is the first report published since the incorporation of the Company in October 2018, there are no material changes to report.

The System of Governance has been set up in the course of 2019, with the following actions taken:

- Appointment of CEO, Key Function Holders and Branch Managers (for the newly established branches in Germany and Italy) in March 2019;
- Adoption by the Board of all the necessary LBG Group policies and procedures in March 2019 and approval of specific policies and relevant addendums to Group policies in September and November 2019;
- Establishment of a Management Committee in May 2019 to assist the CEO for managing the Company’s businesses and supervising operational activities of the Company and its branches as set out in applicable terms of reference;
- Change in the composition of the Board from a single Director at incorporation to a Board composed of four members including two Independent Non-executive Directors since July 2019;
- Establishment of an Audit Committee in November 2019 to assist the Board in fulfilling its oversight responsibility as they relate to the integrity of the Company’s financial statements, the Company’s internal controls regarding the financial reporting, the external auditor’s qualification, independence, performance and selection as set out in applicable terms of reference.

B.1.3 Remuneration

A core principle of the remuneration approach is that any remuneration decisions should be performance-driven and should
- reward employees for appropriate conduct and behaviour
- comply with all Group’s Risk Appetite Framework Requirements.

The Company's remuneration policy is driven by that of the wider LBG Group, where the policy is set by the LBG Remuneration Committee.

SWE employees are subject to the Insurance Group Remuneration Policy.
The remuneration policy is founded on four reward principles designed to encourage alignment with business strategy, corporate values and the Group's risk appetite.

The four reward principles are:
- Customer alignment
- Simple, affordable and motivating
- Shareholder Alignment
- Competitive, performance-driven and fair.

B.1.4 Material transactions with shareholders, SWE's Board or Management Committee members

Details of material transactions with shareholders (excluding Part VII Transfer), with persons who exercise a significant influence on the undertaking, and with members of the administrative, management or supervisory body are given below.

The ultimate shareholder of SWE is the UK based Lloyds Banking Group plc, through the structure described in Section A.1 of this report.

B.1.4.1 Transactions between SWE and its immediate parent, SWL.

Balance sheet positions and transactions

In relation to financing activities with SWL

€	Called-up Share Capital	Share Premium Account
Balance at beginning of reporting period	30,000	-
Capital injection - March 2019	5,970,000	75,000,000
Capital injection - September 2019	-	30,000,000
Capital injection - December 2019	-	70,000,000
Balance at 31 December 2019	**6,000,000**	**175,000,000**

In relation to the transfer of life insurance business to SWE and reinsurance back to SWL

The balances and transactions in respect of reinsurance back to SWL, as detailed in Section D.3.1 were as follows:

Balances at 31 December 2019	Counterparty	Amount (€)
Reinsurers share of technical provisions	SWL	1,753,483,642
Funds Withheld Liability	SWL	(1,773,337,127)

During the reporting period:
- SWE recognised
  - reinsurance premiums payable to SWL of €66,596,606 and
  - reinsurance claims recoverable from SWL of €197,121,546
- SWL

- credited SWE Annual Management Charges (AMC's) of €17,824,831 and
- recharged SWE Investment Management expenses of €2,066,623.

In relation to Policyholder Claims/Rectifications

During the reporting period, SWE recharged SWL €2,623,087 in respect of indemnified pre-transfer policy rectifications.

In relation to Dividends

No dividends were paid during the financial reporting period from 24 October 2018 to 31 December 2019.

B.1.4.2 Transactions occurring between SWE and other LBG entities

Scottish Widows Services Limited ('SWSL'), a fellow subsidiary of LBG, is the Insurance Group's service company and as such recharges employee, pension and overhead costs to the other Insurance Group entities.

During the reporting period SWSL charged SWE expenses of €4,039,001.

B.2 Fit and proper requirements

B.2.1 Requirements applicable to Board Members and Key Function Holders (KFH)

The Company's compliance with fit and proper requirements is assured through a combination of policies and related procedures at both LBG Group and Company level. In particular, the Company follows:

- the Insurance Fit & Proper Policy,
- the Company's Colleague Policy and special procedures related to appointments of Board and Management Committee Members,
- CEO, Key Function Holders and Branch Managers (nominations or changes) performance reviews and training.

A set of tools and templates facilitate the implementation of these policies, which collectively ensure that those who effectively run the undertaking or have other key functions

- are of good repute and integrity,
- possess the requisite skills, knowledge and expertise for their roles and
- have undergone or are undergoing all training required to enable such persons to perform their role effectively.

B.2.2 "Fit and Proper" Continuous Assessment Process

Compliance of the Board, Management Committee, Key Function Holders and Branch Managers with Fit & Proper requirements is reviewed at various stages, as shown in the table below:

Stage	Activities
Initial assessment	The Company has adopted specific policies and standards describing the appointment process and the skill/experience required. The Company screens nominees upfront (e.g. CV, passport, criminal records, non-bankruptcy check) and uses the LBG Group approval process and fitness and propriety assessment including pre-recruitment vetting by Group HR.
Induction	Newly appointed members receive an induction package covering a range of Group/Company topics.
Training	Training sessions are offered during the year and often integrated in the agenda of regular Board meetings, which are scheduled on a quarterly basis. All relevant colleagues must undertake relevant annual mandatory training, including where applicable Codes of Responsibility, Financial Crime, Market Abuse and Conflicts of Interests, to ensure familiarity with their obligations.
Collective Assessment	A formal performance review of the Board and the Management Committee is conducted annually during a private session. Board/Management Committee members individually prepare the review with a self-assessment questionnaire and checklist, which specifically refers to Fit& Proper requirements. Gaps and action items (e.g. training needs, suggested changes to board committees) are documented for follow-up. The composition of the Board and the Management Committee is reviewed regularly. Board and Management Members must collectively possess and maintain appropriate qualification, experience and knowledge (in order to meet relevant legal and business requirements) about at least - Insurance and financial markets - Business strategy and business model - System of governance - Finance and actuarial analysis - Regulatory framework and requirements
Ongoing and ad-hoc assessment	All individuals subject to Fit & Proper requirements have to complete an annual attestation, which focuses on the validation of the propriety to cover the assigned position. Re-assessments are performed if (a) additional responsibilities are assigned to a concerned individual, (b) if concerned individuals become aware that they no longer meets the Company's fit and proper criteria, or (c) if the performance or the behaviour of a concerned individual raises serious doubts about this person meeting the fit and proper criteria.

B.3 Risk management system including the ORSA

B.3.1 Risk Management System (Framework) description

B.3.1.1 Overview

The operation of System of Governance ('SoG') components within SWE can be described, delivered and assessed holistically in the context of the adoption, application and monitoring of the wider Lloyds Banking Group Insurance Risk Management Framework outlined in the diagram below.

SWE System of Governance diagram

In March 2019, the Board agreed to adopt the principles and framework of the Lloyds Banking Group Insurance Risk Management Framework (designed for entities based and regulated in the United Kingdom), subject to at least an annual review to ensure it remains appropriate for the SWE business and its environment control (Luxembourg regulatory regime based, as regards the prudential aspect, inter alia on European Solvency II requirements).

SWE's Risk Management Framework ('RMF') is aligned to LBG's, whilst adopting specific terminology and incorporating elements to address and support compliance with Luxembourg and Insurance-specific requirements. SWE operates a prudent approach to risk with rigorous management controls to support sustainable business growth and minimise losses.

The RMF provides a robust and consistent approach to risk management across the organisation with mechanisms for developing and embedding risk policies and risk management strategies, which are aligned to the risks faced by the business. This in turn drives the risk profile of the business in line with risk appetite and through good risk-reward decision making.

The RMF is structured around six components, as set out in the diagram above, which align with, and meet, the industry-accepted internal control framework issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO).

These components apply across all risk types and are outlined in more detail below.

B.3.1.2 Analysis of the system of governance of the Risk Management Framework

Component 1 – Role of the Board and senior management

At the highest level, key responsibilities of the Board and senior management (as much for SWE as for its shareholders) include:
- Setting risk appetite and risk policies;
- Cascade of delegated authority;
- Effective oversight over risk management in accordance with the agreed risk appetite.

Component 2 – Risk Culture and the Customer

Supporting the formal frameworks of the RMF is the underlying culture, or shared behaviours and values, which sets out in clear terms what constitutes good behaviour and good practice. In order to effectively manage risk across the organisation, the functions encompassed within the Three Lines of Defence have a clear understanding of risk appetite, business strategy and an understanding of (and commitment to) the role they play in delivering it. A number of levers are used to reinforce the risk culture, including tone from the top, clear accountabilities, effective communication and challenge and an appropriately aligned performance incentive and structure.

Component 3 – Risk Appetite

Overview

Risk appetite is set by the Board of Directors with reference to the SWG Insurance Board ('Insurance Board') approved risk preferences. The Insurance business defines risk appetite as 'the amount and type of risk that our organisation either prefers, accepts or wishes to avoid'.

SWE risk appetite is aligned to LBG's Risk Principles that drive the Group Risk Appetite statements:
- Insurance Underwriting Risk,
- Market Risk,
- Capital Risk,
- Credit Risk,
- Liquidity Risk,
- Operational Risk,
- People Risk,
- Conduct Risk,
- Regulatory and Legal Risk,
- Model Risk and
- Governance Risk.

Risk appetite statements set limits for exposures to the key risks faced by the business. SWE risk appetite is reviewed at least annually by the Insurance Board and evolves in tandem with the Insurance business strategy.

A key component of SWE's Risk Appetite is the requirement to hold a Capital Buffer in excess of the SCR. Currently, SWE's Capital Buffer is aligned to the percentage of SCR calculated by SWG to withstand a 1-in-10 year event for its entire insurance business.

Note that for the purposes of quantifying risk and to reflect its risk profile, SWE uses the so-called "Standard Formula" defined by the Solvency II directive (2009-138) and its implementing measures, including the Delegated Regulation 2015/35 of the EU.

Reporting

Risk appetite is reported quarterly in full to the SWE Board and to the Insurance & Wealth Risk Oversight Committee ('ROC').

Reporting focuses on ensuring and demonstrating to the SWE Board that the business is run in line with approved risk appetite. Any breaches of risk appetite must be escalated to the SWE Board and require clear plans and timescales for resolution.

Embedding

SWE management formulates its business strategy, objectives and plans within its risk appetite. Risk appetite forms part of Insurance Executives' Balanced Scorecard Objectives. Insurance Executive and Board paper templates have an explicit risk appetite section to ensure proposals consider risk appetite impacts and are within agreed tolerances. One of the SWE CEO's main target is to make sure that all risk appetite metrics remain within agreed control limits.

Component 4 – Risk and Control Self-Assessment

An enterprise-wide risk management framework for the identification, measurement, management, monitoring and reporting of risk is in place. The framework is in line with LBG's risk management principles and covers the full spectrum of risks that the Insurance Group (and insurance entities within it, including SWE) is exposed to. Under this framework, risks are categorised according to an approved LBG risk language which has been adopted across the Group. This covers the principal risks faced by the Group, including those mentioned in "Component 2" above.

The process for risk identification, measurement and control is integrated into the overall framework for risk governance. Risk identification processes are forward looking to ensure emerging risks are identified. Risks are captured in comprehensive risk logs/registers, and measured using robust and consistent quantification methodologies. The measurement of risks includes the application of stress testing and scenario analysis, and considers whether relevant controls are in place before risks occur. The SWG Internal Model (for the evaluation of the provision relating to the "Mulberry Risk") and the Own Risk and Solvency Assessment (ORSA) are key elements of this process.

Identified risks are logged and reported at least monthly or as frequently as necessary to the appropriate committee. The extent of the risk is compared to the overall risk appetite as well as specific limits or triggers. When thresholds are breached, actions and timeframes required to resolve the breach and bring risk within given tolerances are put in place and tracked to completion. There is a clear process for escalation of risks and risk events. Business areas monitor and review the effectiveness of their internal controls and put in place a programme of enhancements where appropriate.

Component 5 – Risk Governance frameworks

SWE Policy Framework is aligned to the LBG Policy Framework, supplementing LBG requirements with SWE and Luxembourg specific policy requirements. Risk policies define mandatory requirements for risk management and control and they are aligned to the agreed risk appetite.

Regular reporting of risk exposures (including SWE) and the control environment take place through the monthly “Insurance Consolidated Risk Report” presented to the LBG Insurance and Wealth Risk Committee.

The report enables monitoring of performance against risk appetite, summarises key changes to the Enterprise Risk Management ('ERM') profile, with the 2nd Line of Defence Risk Opinion and commentary facilitating the Risk Committee discussion on key risks and issues (including emerging risks) and agreement of remedial actions.

The Risk Committee is asked to discuss the Risk Opinion provided by the Insurance Chief Risk Officer ('CRO') and agree any subsequent actions and to approve the ERM ratings and key risks for onward reporting to ROC and LBG.

Material events are reported and escalated to the Risk Committee, Group Executive and Risk Division. The events are recorded on the Operation Risk System and actions to address the root cause are monitored.

Insurance also operates the Insurance Policy framework, which is aligned to the LBG Policy Framework, supplementing LBG requirements with Insurance-specific policy requirements.

Risk policies (including those specific to SWE) define mandatory requirements for risk management and control and are aligned to the agreed risk appetite.

In line with Solvency II requirements, the Insurance Group also monitors the risk exposures and capital position through the Own Risk and Solvency Assessment (ORSA).

The same monitoring process exists for SWE, where its Board of Directors and Management Committee are regularly informed of the evolution of the solvency ratio, both on a regulatory basis (Eligible Own Funds / SCR Pillar 1) and on an internal basis which is more conservative ((Eligible Own Funds / [SCR Pillar 1 + Mulberry Provision]).

Component 6 – Three Lines of Defence model

The RMF of the Group applies also to SWE. It is implemented through a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities and ensures that effective independent oversight and assurance activities covering key decisions take place.

The business lines (first line) have primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within their areas of accountability and implementing the requirements of the RMF and its components.

The Risk Function (second line) is represented by the Insurance CRO, whose role includes providing oversight and independent constructive challenge to the effectiveness of risk decisions taken by business management, reviewing and challenging the risk profile of the Insurance Group and ensuring that mitigating actions are appropriate. The same missions, for SWE activities, are assigned to the SWE CRO, who benefits from the support of the Insurance & Wealth "Risk Oversight" team.

Group Audit (third line) provides independent, objective assurance and consulting activity designed to add value and improve the organisation's operations. It helps the Insurance Group accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Group Audit provides independent assurance to the IAC (and for SWE to its specific Audit committee) and the Insurance Board that risks within the Insurance Group are recognised, monitored and managed within acceptable parameters. Group Audit is fully independent of the Risk Division and the business, and seeks to ensure objective challenge to the effectiveness of the risk governance framework.

B.3.2 Risk Management Function

B.3.2.1 Description

The objective of the Risk Function is to provide both proactive oversight and constructive challenge to the business i.e. management of SWE run-off portfolio, for which the SWE CRO assumes oversight responsibilities. It also has a key role in promoting the implementation of a strategic approach to risk management through the development, implementation and maintenance of the Risk Management Framework.

Particular focus is on:
- Developing and embedding effective risk management processes;
- Risk monitoring and reporting;
- Maintenance of a constructive dialogue with the first line through provision of advice, development of common methodologies, understanding, education and training.

B.3.2.2 The Chief Risk Officer: roles and responsibilities

The CRO has oversight responsibilities for the SWE business across all risk types, with the support of specialist UK teams. The CRO is a member of the Management Committee and a regular attendee of the Board and the Audit Committee. The CRO is a direct report of the CEO and also has a dotted line to the Insurance Group Chief Risk Officer.

Key accountabilities of the CRO are:
- Develop, implement and maintain an effective Risk Management Framework,
- Advise and recommend on Risk Appetite to the Board, including impacts on SWE’s overall risk strategy,
- Monitor SWE risk profile and provide a regular comprehensive view of it, taking account of both current and emerging risks, as well as pending regulatory changes,
- Advise on future management actions to ensure continuous compliance with SWE’s overall Risk Appetite Framework,
- Conduct SWE ORSA process and co-ordinate its implementation,
- Develop the risk management and internal control systems (identify, measure, monitor, manage and report risks and their interdependencies),
- Maintain a constructive dialogue with the first line through provision of advice, development of common methodologies, understanding, education and training.

The CRO is an actuary recognised as “Fit and Proper” by the Commissariat Aux Assurances.

B.3.3 Own Risk and Solvency Assessment (‘ORSA’)

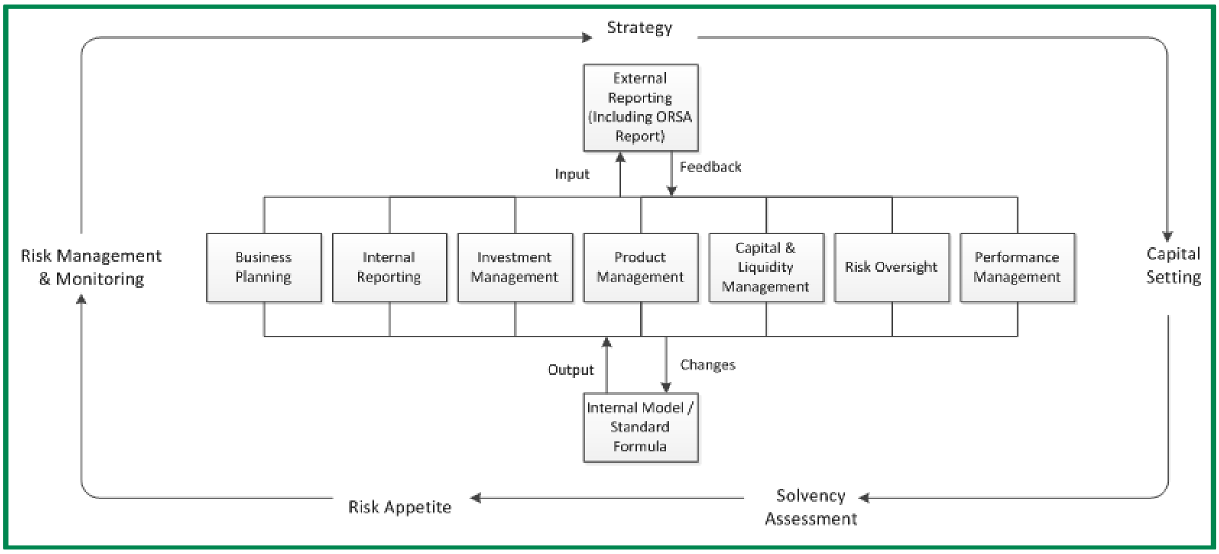
B.3.3.1 Overview

The business objective of the ORSA is to ensure that all risks are appropriately identified, assessed, measured, monitored and managed within prescribed limits and to ensure that the organisation has sufficient capital and liquidity to meet liabilities as they become due, including under stressed conditions.

The ORSA is integrated into day-to-day management and decision-making through a defined ORSA process, which considers whether in scope activities are undertaken to the required quality and by the appropriate parties on a timely basis. At the hub of this is the solvency assessment and the understanding of how the assessment is expected to change in both base and adverse scenarios moving forward.

Critical to a successful ongoing ORSA process is that the insights gained from one assessment inform the next process, creating a virtuous circle of improvement.

In practice, the sub-processes of the ORSA are performed by a variety of functional areas in the normal performance of their responsibilities. An overview of the ORSA process and the associated sub-processes is summarised below:



The primary objective of ORSA reporting is to enable the SWE Directors and Management Committee Members to make an assessment of the overall solvency position, risk profile and risk strategy of the business, including the status of any key actions identified. This information can then be used to refine the risk and capital management strategy.

The ORSA report consolidates key data and outputs from the underlying ORSA processes and seeks to highlight areas of specific current or future concern, with recommendations for action required made where appropriate. The report highlights any key changes made to processes, issues identified and key decisions made impacting the risk and capital profile.

The SWE Board of Directors is actively involved in the ORSA process. The results and conclusions of the ORSA are reported at least annually and are presented to a range of audiences, including at Group Level, the Insurance Group Board, for review before going to SWE Board of Directors for approval.

The first SWE ORSA report was submitted to the CAA in November 2019. Future reports will be produced on the basis of year-end figures, in accordance with prudential and financial reporting (QRT's and Annual Accounts), also taking into account the 4 Year Operating Plan.

The SWE CRO & Chief Actuary is responsible for overall production of SWE ORSA Report.

B.3.3.2 Frequency

The ORSA process is carried out at least annually but additional (ad-hoc) editions may be carried-out either on request of the Board of Directors or the Commissariat Aux Assurances, or in case of an event that could significantly / materially change the risk profile of the undertaking or its solvency ratio.

B.3.3.3 Determination of overall solvency needs (OSN)

SWE's OSN in function of its Risk Profile

Scottish Widows Europe needs to maintain sufficient financial resources to meet liabilities to policyholders as they fall due, support the ongoing operations of the business, including meeting regulatory capital requirements, and ultimately to generate excess capital to fund distributions or invest in new initiatives.

The Capital & Liquidity Management sub-process of the ORSA is fundamental to this and covers the following areas:

- Capital / Solvency Management including:
  - Monitoring compliance with key solvency ratios / risk appetite limits
  - Setting of capital buffers (in excess of regulatory requirements)
  - Capital planning including management of excess capital / capital shortfalls (including raising or repayment of internal/external debt, capital initiatives, reinsurance) and ensuring that capital and liquidity is available in the appropriate place
  - Monitoring and managing risks to capital
- Dividend planning / payments within the Insurance Group and to LBG
- Co-ordination with Rating Agencies
- Stress and scenario testing, including Reverse Stress Testing and the identification of potential actions in response to stressed conditions
- Asset Liability Matching
- Liquidity management
- Review and Approval of Capital Buffers
- Monitoring of Risk Appetite
- Review of all Board papers which have capital implications

SWE manages its business on an 'internal view' of capital that is the same as a 'regulatory (or external) view', except that:

- capital is held in respect of German litigation risk (Also referred to as "Mulberry" risk) and
- buffer capital is held above regulatory requirements (SCR Pillar 1) and German litigation provision, at a level consistent with its risk appetite.

SWE's Overall Solvency Needs and Capital Management interactions

Overall solvency needs amount to a percentage of the internal (or Pillar 2) SCR, which is the sum of:

- regulatory (Pillar 1), SCR, calculated according to the standard formula of the European regulation and
- the provision held to cover the German litigation risk.

The percentage of the internal SCR is aligned to the percentage of SCR calculated by SWG to withstand a 1-in-10 year event for its entire insurance business.

B.4 Internal control system

B.4.1 Internal control system

SWE's Risk Management Framework ('RMF') aligns to the LBG Risk Management Framework, adopting its mechanisms, Principles and Policies and supplementing it with insurance-specific mechanisms to address relevant regulations and requirements.

At the highest level, the RMF acts as the organisation's internal control system, and its documentation fulfils the requirement for an internal control policy. At the heart of this is the identification of material risks and the subsequent monitoring and measurement of those risks. Thereafter, a series of reviews and attestations are undertaken to demonstrate that risks are being appropriately managed.

The following sections give additional information on this control framework.

B.4.1.1 Risk Inventory and Identification processes

All business areas are required to document the material risks which the business faces and ensure that controls are designed and operated effectively to mitigate these risks. Risk identification and assessment focuses on the material and severe risks that could impact customers or the reputation of the Business, or that may have financial and/or resourcing impacts.

Key controls cover the following areas:
- Financial, Prudential and Regulatory reporting: covering the production of Solvency II, Lux-GAAP and IFRS results.
- ORSA process and governance controls.
- LBG Risk Policies: including controls to ensure compliance with policies.

B.4.1.2 Risk Measurement, Monitoring and Reporting processes

Key business risks are reviewed on an ongoing basis with assessments made of the scale of risk before and after controls are applied, to ensure that residual exposures remain within acceptable limits and to identify where improvements to controls are required. The assessments are also updated to reflect any issues identified. The Standard Model approach is used for the quantification of risks and to ensure risks are managed within risk appetite limits set by the SWE Board and approved by the Insurance Board.

B.4.1.3 Risk assurance

Within Lloyds Banking Group there is a defined Risk Framework which is applied to all Divisions and Legal entities within the Lloyds Banking Group ('LBG'). The purpose of the framework is to ensure that all key risks and controls are assessed on an ongoing basis in order to identify and resolve any issues identified.

The control framework for SWE is supported through:
- Existing processes within the UK, which were developed to support the European business.
- Policy administration which is supported by HLSM in Germany.
- The establishment of operations within Luxemburg and additional support required for business in Germany, Austria and Italy.

The development of the infrastructure and control framework within SWE will continue into 2020.

Key controls are confirmed by a combination of self-assessment by the responsible business area with independent review undertaken by control functions to confirm the operation of controls. The assessment also takes into account any known issues, including:
- Those identified by the regulator, LBG's external auditors, LBG Group Audit, Insurance Risk Assurance and Business Unit Risk Functions in conjunction with business management.
- Significant and Material Events identified.
- Any known policy gaps or waivers in place.

Independent audits are conducted by Group Audit based on an annual plan of activities.

The status of issues and controls is monitored by the SWE Board and within the LBG Insurance and Wealth Division.

B.4.2 Compliance Function

B.4.2.1 Overview

Compliance activity is split between prudential compliance and conduct compliance within the Insurance Group, to which SWE belongs as a subsidiary of SWL. The Compliance Function requirements under Solvency II relate to prudential compliance, which is owned by the Insurance Finance Director.

Solvency II developments and the impact of these are assessed through activity undertaken by Risk, Actuarial and Technical teams throughout the LBG Insurance business, such as through monitoring of publication of consultation papers, discussion with industry peers and with regulators. The impacts on SWE are considered as part of this process. Impacts are communicated to and assessed by relevant teams within the business. For significant developments, the associated impacts are communicated through senior management and where appropriate to Board and Board Committee level.

On an annual basis, the LBG Insurance Group undertakes a self-assessment against the requirements of Solvency II (including any changes to regulation that have been implemented). This process includes a formal assessment of Solvency II compliance risk.

B.4.2.2 The Compliance Officer: roles and responsibilities

The Compliance Officer is the overall owner of the management of the Compliance Function. They:

- provide primary assurance oversight,
- assists management in the design of remedial actions and
- oversees their implementation.

The Compliance Officer report directly to the CEO with an indirect link to the Insurance Chief Risk Officer. The Compliance Officer is also the Head of Operations for the Company, a member of the Management Committee and a regular attendee to the Board and Audit Committee.

B.5 Internal Audit Function

B.5.1 Overview

LBG has a Group Internal Audit ('GIA') function which provides independent assurance as the third Line of Defence. The primary role of GIA is to help the Board and Executive Management protect the assets, reputation and sustainability of LBG.

GIA does this by:

- Assessing whether all significant risks to LBG are identified and reported appropriately to the Board and Executive Management;
- Assessing the design and operation of key controls to determine whether they are effective at mitigating significant risks e.g. to ensure customers are treated fairly, to protect the capital and/or financial position of LBG; and
- Challenging Executive Management to improve the effectiveness of governance, risk management and internal controls by providing assurance over the effectiveness of the first and second lines of defence functions.

GIA is independent of LBG's operational management and has no direct operational responsibility of authority over the activities it reviews. GIA adopts the definition of internal audit as defined by the Chartered Institute of Internal Auditors ('CIIA'), which is that: internal auditing is "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes"[1].

GIA does not provide consultancy services to the Group or assurance services for the benefit of parties outside of LBG except as required by regulation, law or where deemed appropriate by the CIA, and notified to the Audit Committee.

LBG, in recognition of the nature, scale and complexity of its financial services business activities, is also mindful of the requirements of the regulatory requirements and expectations, including those outlined in Section 3 of the PRA Rulebook in relation to the independence of the mandate, responsibilities and reporting arrangements of an internal audit function.

GIA receives its authority from the Group Board and the Group Audit Committee. The LBG Chief Internal Auditor ('Group CIA') position is a senior role within LBG with appropriate standing and authority to be able to challenge the Executive. The Group CIA has a primary reporting line into the Chair of the Group Audit Committee and a secondary reporting line into the LBG Group Chief Executive. He is an attendee of the LBG Group Executive Committee and the LBG Group Risk Committee.

All GIA colleagues report directly or indirectly to the Group CIA, including the Audit Director, Insurance & Wealth. The Audit Director, Insurance & Wealth also serves as Chief Internal Auditor for Scottish Widows, reporting to the Chair of the Insurance Audit Committee. He has a secondary reporting line to the Group Director, Insurance and Chief Executive Officer, Scottish Widows.

GIA colleagues are responsible for being independent, objective, and constructive in the conduct of their work and avoiding conflicts of interest and personal, business or other issues that may impair impartiality.

They are also required to follow the CIIA's Code of Ethics which, on the subject of objectivity, states: "Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgements."

GIA has Audit Director and Heads of Audit positions of appropriate seniority in comparison with the senior management across the business whose activities they are responsible for auditing.

The Audit Director, Insurance & Wealth attends the Scottish Widows Europe Board and Scottish Widows Europe Audit Committee.

GIA has unrestricted right of access to all of LBG's records and management information, including material events, necessary to discharge its responsibilities. This includes access to the Group and Insurance & Wealth Executive Committees and their respective sub-committees, including the Scottish Widows Europe Audit Committee and Board, as well as the right to attend any other key management or decision-making forum to help gain an understanding of the business and provide perspectives on risk and control.

[1] CIIA's International Professional Practices Framework - https://www.iia.org.uk/resources/ippf/

Furthermore, the Group and Scottish Widows Europe Audit Committees monitor and assess the independence of the Group's internal audit function and receive an independent external assessment of GIA at least once every five years, which includes a review of the independence of the Group's internal audit function's regular assessment of its own effectiveness.

The external assessments are undertaken by a qualified independent assessor or assessment team from outside LBG.

B.5.2 Conflict of interest

In discharging any part of its mandate, GIA avoids conflicts of interest and any other activity that could possibly threaten the independence, objectivity, integrity, confidentiality or the reputation of GIA. Professional standards require GIA to take reasonable steps to identify circumstances that could pose a conflict of interest, and apply appropriate safeguards to eliminate threats or reduce them to an acceptable level.

With respect to conflicts of interest, it is each individual's responsibility to identify / consider if a situation creates either an actual or potential conflict of interest. Colleagues should disclose any threats to independence or objectivity that arise immediately to their line manager (Head of Audit, Audit Director or CIA as applicable) who must then decide and note any remedial action that is necessary to address this threat.

In addition, the GIA Risk team in Strategy Risk & Support (SRS) maintain a conflicts of interest questionnaire that all colleagues must complete when they join GIA, experience a significant change in circumstances and annually. The SRS Risk team monitors responses and provide extracts to Audit Directors, so that they can conclude and confirm that they are comfortable with any remedial actions. For any Audit Director threats, the Group CIA will conclude and confirm they are comfortable with any remedial actions.

In many cases, we can safeguard any threat or perceived threat to independence by, for example, segregation of duties, increased oversight or restrictions in undertaking audits in certain areas.

B.5.3 The Audit Director: roles and responsibilities

The SWE Audit Director ('AD') is responsible for the management of the internal audit function with support from the Audit Director Insurance & Wealth and LBG Group Chief Internal Auditor. The AD is an Independent Non-executive Director, who chairs and attends the Audit Committee, providing a clear escalation route to the Board's Chairman.

B.6 Actuarial Function

B.6.1 Overview

Insurance companies are required to maintain an Actuarial Function in line with Solvency II requirements. The Chief Actuary for SWE, who also acts as Chief Risk Officer, has responsibility for the Solvency II Actuarial Function.

The Chief Actuary holds a degree in actuarial sciences and has been recognised "Fit and Proper" by the Commissariat Aux Assurances (CAA). He is a member of the "Institut Luxembourgeois des Actuaires" and of the "Institut des Actuaires en Belgique".

The primary function of the Actuarial Function is to review and provide an opinion on the reliability and adequacy of technical provisions, the overall underwriting policy and the adequacy of reinsurance arrangements.

The SWE Actuarial Function, within SWE and with the support of its shareholder:

- Recommends to the SWE Board the methodology and assumptions to be used in the calculation of SWE technical provisions,
- Undertakes independent model validation for core models used in the calculation of technical provisions to help ensure that these models used are adequate and robust,
- Reports annually to the Board with its opinion on the adequacy of the technical provisions, taking into account
  - its review of the results and its view on the appropriateness of the methodology and assumptions used,
  - the reliability of the models used,
  - the sufficiency and quality of data used,
  - the sensitivity of the results to changes in assumptions and
  - a comparison of actual and expected experience (back testing)
- reports, on an annual basis, to the Board with its opinion on the adequacy of the underwriting policy and product pricing and
- reports on the adequacy of the reinsurance arrangements.

In addition, within the Actuarial Function, teams reporting to Insurance & Wealth Chief Actuary are responsible for activities which support SWE in the identification, quantification and monitoring of the risks that SWE is, or could be, exposed to and of its solvency positions.

For example actuarial teams within the Actuarial Function:

- Develop and recommend to the Board the methodology and assumptions to be used in quantifying risk exposures and calculating the Solvency Capital Requirement ('SCR'),
- Undertake independent model validation for core models used in the calculation of risk exposures and the SCR,
- Undertake ongoing monitoring and reporting of solvency and risk positions relative to risk appetite, providing insight on drivers of change and forward looking outlook,
- Prepare the annual ORSA report,
- Carry out ongoing management of SWE capital and liquidity, including asset and liability matching.

B.6.2 The Chief Actuary: roles and responsibilities

The Chief Actuary is the overall owner of the management of the Actuarial Function. Responsibilities include key functional activities of continuous solvency monitoring and performance of asset liability management within agreed policy and appetite. They are also responsible for providing the Board with advice on actuarial matters, primarily relating to risk and capital management.

The Chief Actuary reports to the CEO with a dotted line to the Insurance Finance Director.

The Chief Actuary is a member of the Management Committee and a regular attendee to the Board and Audit Committee.

B.7 Outsourcing

The SWE business model makes extensive use of external suppliers including a range of outsourced arrangements. Where a decision is made to outsource, consideration will be given to where services and expertise can best be provided. This will include consideration of internal provision from elsewhere in LBG as well as the use of external providers.

This has resulted in two operational outsourcing models:
- shared services within the wider banking group (LBG shared services); and
- external supplier outsourcing arrangements.

LBG shared services

The LBG shared services provide infrastructure support to SWE seeing a number of centralised teams providing IT, finance, audit, Digital and people services. The provision of these defined services to SWE is managed through a structured account management approach for key services aligning to the Internal Service Provision Policy with all requirements set out in the Intra Group Agreements between SWE and other LBG entities.

External supplier outsourced arrangements

As a result of a strategic decision by SWL a number of years ago to divest its non-UK business, outsourced relationships were put in place in Germany, Italy and Luxembourg to service customers and these agreements have been transferred to SWE.

Some of the reasons that the SWE business uses external suppliers and outsources are:
- Provision of specialist expertise or services for example, systems and people
- Flexibility and capacity to complement the Group Model
- Cost efficiencies.

The LBG Group Policy framework adopted and approved by the SWE Board defines the Risk Appetite for both external and intra group arrangements.

B.7.1 Outsourcing Policy, Procedure and Process

B.7.1.1 Policy

The SWE Board has adopted Lloyds Banking Group's Policies that clearly outline a set of mandatory requirements for the business to comply with. Using services from external suppliers is defined as 'Sourcing' and all requirements are set out in a Group Sourcing & Supply Chain Management Policy. This has underlying procedures which ensure that we fulfil all obligations under Solvency II and other local regulation.

The policy defines appropriate monitoring and reporting requirements aligned to the services being provided by the supplier. It covers all LBG suppliers and details an end to end process providing a consistent framework aimed at mitigating risks inherent in dealing with external suppliers. The policy is reviewed and updated on an annual basis.

The key aspects of the policy are the following;
- Ensuring our suppliers understand and comply with our Conduct approach, especially where suppliers have direct contact with our customers.
- Mitigating the regulatory risks associated with the outsourcing of activities and or operations
- Entering into business relationships with third parties who share SWE and the Group's approach to Ethics and Social responsibility.
- SWE enters into commercially viable arrangements with appropriate external suppliers, supported by an underlying policy that defines the basis of the relationship and in particular roles and responsibilities.
- That we pay our suppliers in a timely manner and to terms agreed.

To assess the risk of a supplier and outsourced relationship, a supplier is assessed against four key policy areas and will be segmented into one of five categories. This then drives the required treatment strategy for the management of that supplier and ensures appropriate resource and oversight is in place.

SWE has put a separate Service Provision Policy and Procedure in place for intra group services (Refer to Section B.7.2 below).

B.7.1.2 Procedures

A number of procedures underpin the sourcing policy and each one defines a set of controls and activities the company and its colleagues are required to follow depending on the complexity of the supplier relationship. These are described hereafter.

Outsourcing procedure

This defines both accountabilities and responsibilities for engagement and approval for all outsourcing activity. It defines the role of the SWE Accountable Executive within the overall control framework explicitly defining requirements in the management, supervision and oversight of such arrangements and ensures compliance with the Solvency II requirements. It also defines the appropriate governance including the engagement of LBG Sourcing and appropriate cost board and regulatory approvals where applicable.

Right way to buy procedure

This underpins SWE's Cost Management process, through which all external expenditure is managed, controlled and approved. It supports the business to source goods and services in the right way, maximising value for our customers and shareholders.

Supplier management procedure

The key objective of this procedure is to achieve a single framework of governance and oversight in line with SWE's risk appetite. It ensures that SWE is compliant with their regulatory and/or statutory obligations where operational processes are dependent on supplier performance.

Completing these specific activities ensures that we do not enter into inappropriate supplier relationships and outsourced contracts and have in place adequate oversight to ensure risk is managed during the life of an agreement.

B.7.1.3 Process

The Central Group Sourcing team on-boards all new external suppliers in line with the policy and ensures suppliers' obligations that comply with the policy are written into individual contracts.

Both the contract and performance of suppliers are monitored through completing the specific activities outlined in the treatment strategies and the receipt of management information as outlined with the requirements of the contract. Further assurance activity may also be undertaken through visits to supplier premises to assess the robustness of the control environment and to ensure that our customers are receiving fair outcomes. Any weaknesses identified have appropriate actions agreed and are subject to monitoring and reporting through internal governance structures. This assurance activity is split between Group Sourcing and the SWE Business but all resulting activity and decisions are made by SWE in line with approved policy.

A centralised supplier qualification process is an integral part of the on boarding and the assurance process of new suppliers. It manages policy compliance in a standardised way and targets assurance activity on a risk based approach appropriate to each supplier.

These activities are monitored through a set of defined metrics which the relationship manager compiles and reports to SWE management and upwards into Group governance. Performance is reported monthly to the SWE Management Committee.

B.7.2 Material intra group outsourced arrangements

SWE has a number of intra group arrangements across service providers within LBG. These are services provided by LBG to SWE and includes IT servicing and finance.

Services are detailed within an Intra Group Agreement ('IGA'). Each agreement is appended to an overarching agreement between the Insurance Group and LBG. The Group functions providing these services are subject to agreements which are refreshed regularly.

A Service Provision Policy provides consistent and robust principles to manage and govern intra group services across LBG.

The key aspects are as follows:

- Key Services provided are defined and captured within specific schedules of an IGA as well as outlining management information ('MI') and key performance indicators ('KPIs').
- The schedules also contain the agreed processes for service remediation and dispute resolution.
- These are subject to defined governance sign-off processes and are approved by the provider and recipient of services.
- Governance and reporting arrangements are in place to allow the Insurance Group and in particular SWE to have effective oversight, review and challenge of service performance including key service risks and issues.
- Agreements are regularly reviewed to ensure alignment with the policy is maintained.
- All these schedules are Solvency II compliant.
- SWE complies with the Internal Service Provision policy.

Services provided by our internal partners are monitored and reported to SWE in monthly Service Provision meetings. Issues are escalated in the SWE monthly Management Committee meetings.

B.8 Any other information

There is no other information regarding SWE Governance issues to report.

B.9 System of Governance Adequacy Assessment

The SWE Board will carry out an annual evaluation of its system of governance against relevant best practice standards in order to assess whether the system of governance remains adequate to the nature, scale and complexity of the risks inherent in SWE's business. As the system of governance was only established during 2019, a review will be performed in 2020.

C. Risk profile

C.1 Underwriting risk

Underwriting (or Insurance) risk is defined as "*the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions or volatility in earnings and/or value*".

The principal risk that SWE faces under insurance contracts is that the actual claims and benefit payments exceed the amounts expected at the time of determining the insurance liabilities.

C.1.1 Risk measurement

Current and potential future risk exposures are assessed and aggregated on a range of stresses including risk measures based on 1-in-200 year stresses in the Standard Formula SCR assessment and other supporting measures where appropriate.

Risk type €	31 Dec 2019
Mortality	3,334,025
Longevity	1,447,725
Disability / morbidity	-
Expenses	90,921,719
Lapse	28,549,445
Life catastrophe	1,125,818
Total underwriting SCR	**109,530,071**

C.1.2 Risk exposure

The nature of SWE's business involves the accepting of insurance risks which primarily relate to expenses, persistency, mortality, and longevity.

SWE has written insurance contracts with the following benefits:

- Life assurance: Where the life of the policyholder is insured against death usually for pre-determined amounts;
- With-Profits Annuity: Where typically the policyholder is entitled to payments which cease upon death.

For contracts where death is the insured risk, the most significant factors that could increase the overall level of claims are epidemics or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected. The possibility of a pandemic, for example one arising from influenza, is regarded as a potentially significant mortality risk.

For contracts where survival is the insured risk, the most significant factor is continued improvement in medical science and social conditions that would increase longevity.

For with-profits contracts, the nature of these contracts results in a significant portion of the insurance risk being shared with the policyholder.

Insurance risk is also affected by policyholders' rights

- to pay reduced or no future premiums,
- to terminate the contract completely or
- to exercise a guaranteed annuity option.

As a result, the amount of insurance risk is also subject to policyholder behaviour. On the assumption that policyholders will make decisions that are in their best interests, overall insurance risk will generally be increased by policyholder behaviour.

For example, it is likely that policyholders whose health has deteriorated significantly will be less inclined to terminate contracts insuring death benefits than those policyholders who remain in good health.

SWE has taken account of the expected impact of policyholder behaviour in setting the assumptions used to measure insurance and investment contract liabilities:

- Rates of mortality are investigated annually, based on SWE's recent experience
- Future mortality assumptions are set using the latest population data available

Expense risk arises because SWE's business is in run-off and the per-policy expenses will, in relative terms, increase as the business runs off, due to limited ability to increase charges to meet higher expenses.

The liabilities associated with the business, especially after considering the annuities vesting in future, will have a long duration, resulting in significant exposure to expense inflation risk. At lower interest rates the discounted present value of future expense cashflows increases thus increasing the risk.

Persistency risk exists on profitable unitised business due to the amounts of fund-based charges. High levels of lapses would lead to a reduction in the funds under management and hence a direct reduction in future charge based income.

There is no material underwriting risk exposure from off-balance sheet positions.

There is no transfer of risk to special purpose vehicles.

C.1.3 Risk appetite

Underwriting risk appetite is set at Insurance Group level, rather than specific SWE statements.

C.1.4 Risk mitigation

C.1.4.1 Mitigation

Insurance risk is mitigated through pooling and through diversification across large numbers of individuals, geographical areas, and different types of risk exposure.

A number of processes are used to control insurance risk including:

- Claims management;
- Product design and management;
- Reinsurance; and
- Cost controls and efficiencies.

In addition, risk appetite limits (by risk type) are assessed through the business planning process and used as a control mechanism to ensure risks are taken within risk appetite.

C.1.4.2 Monitoring

There is ongoing monitoring of relevant experience against expectations (for example claims experience, persistency experience, expenses and non-disclosure of risks at the point of sale).

Additionally, the progression of insurance risk capital against limits is monitored, as is the sensitivity of profit before tax to the most significant insurance risks.
The effectiveness of controls put in place to manage insurance risk is evaluated and significant divergences from experience or movements in risk exposures are investigated and remedial action taken.

C.1.5 Risk concentration

SWE is not exposed to the risk of concentration of underwriting risk.

C.2 Market risk

Market risk is defined as "*the risk that unfavourable market movements (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value*".

The credit risk component of the market risk SCR relates to credit spread widening on fixed interest securities (including loans) as a result of an increase in the market expectations of future defaults and downgrade risk.

Credit risk arising from reinsurance exposures and certain receivables generates a separate SCR, which is covered in Section C.3.

C.2.1 Risk measurement

Current and potential future risk exposures are assessed and aggregated on a range of stresses including risk measures based on 1-in-200 year stresses in the Standard Formula SCR assessment and other supporting measures where appropriate.

Risk type €	31 Dec 2019
Interest rates	11,415,862
Equity	22,785,769
Property	-
Credit spread	10,560,710
Concentration	-
Currency	1,273,789
Total market SCR	**39,151,026**

C.2.2 Risk exposure

The majority of SWE's business is Unitised With-Profits business, the investment element of which is reinsured with SWL into their Clerical Medical With-Profits Fund. Market risk on UWP business arises due to guarantees, as when asset values fall, resultant asset shares may fall below the guaranteed value.

With-Profits Annuities are also reinsured with SWL into their Clerical Medical With-Profits Fund. At vesting, guaranteed annuity rates apply, so there is a market risk that asset values are not sufficient to meet the level of guarantee.

On unit-linked business, the majority of the market risk is borne by the policyholders.

Market risk arises indirectly in relation to charges taken as a percentage of funds under management. Falling asset values reduce overall policy values and hence result in lower charges received. The future value charges, expenses and other elements of the non-linked technical provisions of the business also vary with market risk.

C.2.3 Risk appetite

Risk Appetite statements in respect of sensitivity to Interest rate and Inflation are to be developed.

C.2.4 Risk mitigation

C.2.4.1 Mitigation

SWE continues to consider and implement hedging strategies in order to protect the solvency position of the company.

C.2.4.2 Monitoring

SWE complies with the Group's Investment strategy, including monitoring of risk exposures across all types of business.

C.2.5 Risk concentration

Market concentration risk is generally managed via investment strategy and process. No additional capital (as assessed by the Standard Formula) was held at 31 December 2019 in respect of concentration risk.

C.3 Credit risk

Credit risk is defined as *"the risk that counterparties with whom we have contracted default and fail to meet their financial obligations, resulting in losses to SWE".*

The risk exists with reinsurers and policyholder debtors (but such exposures are minor).

Note that capital is held for the risk of credit spread widening on fixed interest securities (including loans) within the market risk capital requirement (see Section C.2 above).

C.3.1 Risk measurement

Credit risk is assessed using the Standard Formula SCR, taking into account
- the 'probability of default' by the counterparty on its contractual obligations;
- current exposures to the counterparty; and
- the likely loss ratio on the defaulted obligations (the 'loss given default').

The capital held at 31 December 2019 in the Counterparty Default module of the SCR calculated according to the Standard Formula (SF) is €15,914,883.

C.3.2 Risk exposure

SWE's counterparty risk relates to exposure to
- banks through cash holdings and
- Scottish Widows Limited (SWL) defaulting under the Reinsurance and Indemnity Agreement.

SWE needs to hold capital for single counterparty exposure under the Standard Formula related to the cash holdings. The Charge Arrangement that is in place to protect against SWL's possible insolvency or downgrade reduces the economic exposure of such an event to SWE; however, credit cannot be taken for this charge within the SF calculation of SWE’s capital requirements.

C.3.3 Risk appetite

An annual review is undertaken of SWE's reinsurance arrangements.

C.3.4 Risk mitigation

C.3.4.1 Mitigation

The SWL reinsurance arrangement is heavily collateralised (Withheld Fund).

C.3.4.2 Monitoring

Exposures are compared to approved limits and triggers on a regular basis. This is monitored and reported by Risk and where appropriate, escalation procedures are in place.

C.3.5 Risk concentration

SWE's asset allocation is designed in such a way that it does not expose the company to the risk of the concentration of "counterparty default risk" and will continue to do so in the future.

C.4 Liquidity risk

Liquidity risk is defined as "*the risk that SWE has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost*".

C.4.1 Risk measurement

Liquidity risk in SWE is managed in line with SWE Liquidity Risk Policy and the monthly position is reported through the production of Insurance Group's liquidity scorecard.

As a result of the policies and processes in place and active management, the Board believes that liquidity risk is adequately mitigated, therefore no additional capital is held.

C.4.2 Risk exposure

Liquidity risk may result from

- the inability to sell financial assets quickly at their fair values (which may make it difficult to re-attain a matched position after a stress event);
- an insurance liability falling due for payment earlier than expected;
- the inability to generate cash inflows as anticipated.

In order to measure liquidity risk exposure, liquidity is assessed in a stress scenario. Liquidity risk appetite considers two time periods:

- Three month stressed outflows are required to be covered by primary liquid assets;
- One year stressed outflows are required to be covered by primary and secondary liquid assets, after taking account of management actions.

Primary liquid assets are gilts or cash, and secondary liquid assets are tradable non-primary assets (e.g. corporate bonds).

Liquidity risk is actively managed and monitored to ensure that SWE has sufficient liquidity to meet its obligations and remains within approved risk appetite.

There is no risk exposure from off-balance sheet positions, or from the transfer of risk to special purpose vehicles.

C.4.3 Risk appetite

The liquidity risk appetite is reviewed and set annually by the Board.

C.4.4 Risk mitigation

C.4.4.1 Mitigation

Liquidity is actively monitored to ensure that, even under stress conditions, there is sufficient liquidity to meet obligations and remain within approved risk appetite. Liquidity risk in respect of each of the major product areas is primarily mitigated as follows.

Unitised With-Profits contracts

For with-profits business, a portfolio of assets is held in line with investment mandates, which is consistent with policyholders' reasonable expectations. Liquidity is maintained within the portfolio via the holding of cash balances and a substantial number of highly liquid assets, principally gilts, bonds and listed equities.

Management also have the ability to sell less liquid assets at a reduced price if necessary. However, less liquid assets such as property are managed on a prospective basis to avoid having to potentially sell in future at a reduced price.

Losses are managed and mitigated by anticipating policyholder claim payments to plan sales of underlying assets within funds.

Vested Annuity contracts

Assets held are specifically chosen to correspond to the expected timing of annuity payments.

Unit-linked Contracts

For unit-linked products, portfolios are invested in accordance with unit fund mandates. Deferral clauses are included in policyholder contracts to give time, when necessary, to realise linked assets without being a forced seller (e.g. within property-linked funds). As at 31 December 2019, there were no funds subject to deferral.

C.4.4.2 Monitoring

As described above, liquidity is actively monitored to ensure that, even under stress conditions, there is sufficient liquidity to meet SWE's obligations and remain within approved risk appetite.

Routine reporting is in place to senior management and through the Group's committee structure. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

Liquidity risk is controlled via approved liquidity policies which are subject to independent internal oversight and maintenance of liquidity facilities with LBG.

C.4.5 Risk concentration

Liquidity concentration risk arises where SWE could be unable to meet its obligations as they fall due or could do so only at an excessive cost, due to over-concentration of investments in particular financial assets or classes of financial asset.

As most of the invested assets are diversified across a range of marketable equity and debt securities in line with the investment options offered to policyholders, it is unlikely that a material concentration of liquidity could arise.

C.4.6 Expected Profit Included in Future Premiums (‘EPIFP’)

EPIFP is defined as “*the expected present value of future cash flows which result from the inclusion in technical provisions of premiums relating to existing insurance and reinsurance contracts that are expected to be received in the future, but that may not be received for any reason, other than because the insured event has occurred, regardless of the legal or contractual rights of the policyholder to discontinue the policy*”. (Definition 46 in Article 1 of Delegated Regulation 2015/35 and Article 260 of the same Regulation)

As at 31 December 2019, the value of the EPIFP is € 27,577,115.

C.5 Operational risk

Operational risk may be defined as “*the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events which may result in financial loss, disruption or reputational damage*”.

These include the availability, resilience and security of our core IT systems, people risk, regulatory and legal risk, governance risk and potential for failings in our customer processes.

The largest contributions to operational risk for SWE are
- regulatory,
- German litigation,
- financial reporting,
- conduct,
- business and
- information security risks.

C.5.1 Risk measurement

For regulatory reporting, operational risk is evaluated using the Standard Formula SCR. The capital requirement at 31 December 2019 is € 8,916,321.

C.5.2 Risk exposure

The material operational risks to which SWE is exposed are as follows. There is no operational risk exposure from off-balance sheet positions or from the transfer of risk to special purpose vehicles as SWE does not make use of either derivatives or special purpose vehicles.

C.5.2.1 Regulatory and legal risk

Regulatory and legal risk is defined as “*the risk that SWE is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings in the courts (or equivalent) and the risk that SWE is unable to enforce its rights as anticipated*”.

Regulators aim to protect the rights of customers, ensuring firms satisfactorily manage their affairs for the benefit of customers and that they retain sufficient capital and liquidity. SWE has embedded a risk framework to closely monitor and manage its legal and regulatory risks, and maintains regular interaction with all its supervisory authorities.

C.5.2.2 Litigation risk

German litigation risk is defined as "*the cost for SWE of potential claims from customers relating to the mis-selling between late 1990s and early 2000s of policies sold by independent intermediaries, mainly in Germany, but also in Austria and Italy*".

Following decisions by the German Federal Court of Justice ('FCJ'), LBG has established provisions to cover the resulting liability. The validity of these claims depends upon the circumstances of each case and as a result the ultimate financial effect will only be known once all relevant claims have been resolved.

In addition to the Standard Formula SCR used for regulatory reporting, SWE also holds – on a voluntary basis – an additional "capital add-on" of €30m in respect of this litigation risk. In SWE's financial accounts, this add-on is included in the non-technical provisions of the balance sheet.

This add-on is based on a number of prudent scenarios including possible deteriorations in future new claim volumes and/or amounts caused, for example, by possible future adverse legal jurisprudence.

As this does not form part of the formal Standard Formula, it is only used for internal management purposes, in order to comply with LBG Risk Management Framework (RMF) and its overall Risk Appetite Statements.

C.5.2.3 Financial reporting risk

Financial reporting risk is defined as "*the risk that SWE suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial and regulatory reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose accurate and timely information"*.

Financial reporting of the Company is based on Luxembourg GAAP (lux-GAAP) framework – as defined by the Law of 8 December 1994 as amended – with the application of the fair value option. In accordance with Lux-GAAP principles all financial balances are evaluated with prudence.

The accounting policies and valuation rules, apart from those defined by Luxembourg law or by the Commissariat aux Assurances, are determined and applied by the Board of Directors.

In addition all year-end closing assumptions are validates by the Board of Directors.

Application of closing framework is controlled through an escalation process with final sign-off due by the Chief Executive Officer of the Company.

C.5.2.4 Conduct risk

Conduct risk is defined as "*the risk of customer detriment or regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment or business conduct*".

SWE is focused on delivering fair customer outcomes, and has embedded a risk framework to effectively monitor and manage its conduct risks.

C.5.2.5 Business risk

Business risk is defined as "*the risk to planned profit arising from sub-optimal business strategy or sub-optimal implementation of the strategic plan*".

Ultimately, these risks may have an impact on SWE's ability to meet its strategic objectives due to:

- Formulation of a strategy which cannot be achieved or failure to react to changing conditions;
- Selection of an inappropriate strategy or deviation from the chosen strategy;
- Failure to manage and control the business within risk appetite;
- Failure to participate or withdraw from markets, segments etc. as appropriate;
- Competitive pressure;
- Political and macroeconomic factors;
- Ineffective prioritisation of change projects.

On a financial point of view, the Company build a 4-year operating plan ('4YOP') at least once a year. The 4YOP of the Company is then consolidated in the 4YOP of its Parent Company. The 4YOP is then used to monitor the evolution of the business.

In addition a yearly review of the overall strategy of the Company is performed by the Management Committee and reviewed by Board of Directors.

C.5.2.6 Information security risk and IT systems and Cyber risk

Information security risk relates to "*the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the security of SWE's information and data*".

IT systems and cyber risk relates to "*the risk of reductions in earnings and/or value through financial or reputational loss resulting from the failure to develop, deliver, maintain, or protect the company's IT solutions against cyber-attack*".

The SWE Management Committee has embedded a risk framework and monitors the effective operation of these two risks across SWE, ensuring continuous compliance with GDPR requirements.

C.5.2.7 Sourcing and service provision risk

Sourcing risk covers "*the risk of reductions in earnings and/or value through financial or reputational loss from risks associated with activity related to the agreement and management of services provided by third parties, including outsourcing*".

Service provision risk covers "the risks associated with provision of services to a third party and with the management of internal intra group service arrangements".

Overall service quality has been defined in the Outsourced Service Agreement with third parties translating into a Service Level Agreement (SLA). SLAs are monitored on a monthly basis for main suppliers; monitoring is reviewed at Management Committee level.

C.5.2.8 Financial crime and fraud risk

Financial crime and fraud risk is defined as "*the risk of reduction in earnings and/or value, through financial or reputational loss, including censure, fines or the cost of litigation due to activity related to money laundering, sanctions, terrorist financing and bribery or acts intended to defraud, misappropriate property or circumvent the law*".

C.5.2.9 Governance risk

Governance risk is defined as "*the risk that SWE's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively*".

C.5.2.10 People risk

People risk is defined as "*the risk that SWE fails to lead, manage and enable colleagues to deliver to customers, shareholders and regulators leading to an inability to deliver its strategy*".

SWE's Management Committee is supported in all its duties by dedicated resources at LBG Group level ensuring that local processes are documented and understood. For key function holders, a yearly succession exercise is performed.

C.5.3 Risk appetite

SWE's operational risk appetite is designed to safeguard the interests of customers, internal and external stakeholders, and shareholders. This is expressed through high level statements (examples below), each of which are defined with limits and triggers approved by the Board, and are regularly monitored by risk committees.

C.5.3.1 Financial loss

SWE does not expect to experience cumulative fraud or operational losses above a defined level of budgeted SWE income, or individual losses above a defined amount.

C.5.3.2 Management time and resources

SWE does not expect internal events that divert excessive senior management time from running the business or have extensive impact on colleague time and/or morale.

C.5.3.3 Cyber

SWE minimises the impact from cyber-attacks and information breaches that result in a significant loss of customer confidence or undermine the financial stability of the Insurance Group.

C.5.3.4 Risk culture

All colleagues are responsible for risk within their individual roles. SWE sets a strong tone from the top and embraces a risk culture across the business which is aligned to its strategy, vision, values and codes of responsibility. SWE encourages an open dialogue and rapid escalation of potential threats and events.

C.5.4 Risk mitigation and monitoring

Operational risks are measured and monitored to ensure that they stay within risk appetite and that actions can be taken in a timely manner to prevent material losses occurring. The method and frequency of monitoring is appropriate to the materiality and type of risk, and the relevant controls. All operational risks that are considered to be inherently material or severe have controls in place to mitigate the risk.

We assess the overall design and operational effectiveness of each key control in relation to the risk it is mitigating. Key indicators are in place and reviewed monthly for the most material risks to monitor for early warnings that controls are not operating as intended and/or that risk exposures are increasing.

The operational risk profile is reported regularly, highlighting material changes in the profile and tracking progress in closing high priority actions. An indemnity arrangement is in place with

Scottish Widows Limited relating to the German litigation risk, which places an upper bound on the exposure of SWE.

C.5.5 Risk concentration

Operational risks arise from diverse sources and as such do not give rise to material risk concentrations. However the combined exposure of these various risks is evaluated and the most material operational risks are reported appropriately.

C.6 Other material risks

C.6.1 Capital risk

Capital risk is defined as "*the risk that SWE*

- *has a sub-optimal amount or quality of capital or an inefficient capital structure;*
- *has insufficient capital to meet its regulatory capital requirements;*
- *has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite;*
- *loses reputational status by having capital that is regarded as inappropriate, either in quantity or type".*

SWE's objectives when managing capital are:

- to have sufficient capital to safeguard its ability to orderly run-off its portfolio of insurance contracts (Transferred Business from SWL) so that it can continue to provide returns for its shareholder and benefits for other stakeholders;
- to comply with capital requirements set out by the European and Local Regulations.

The capital management strategy is such that the SWE will hold additional buffer capital in line with the stated risk appetite for the business.

It is intended that all surplus capital above that required to absorb such a stress event will be distributed to SWL.

C.6.2 Political risk

The continued political uncertainty and associated volatile markets results in a more volatile solvency position for SWE.

C.6.3 Group risk

Certain risks could arise because SWE, like its sole shareholder SWL and the other underlying solo entities, operate as part of a Group. These include:

- Contagion risk (spill-over effect of risks from other parts of the group);
- Risks arising from intra-group transactions and group level risk concentration, (notably in relation to participations, intra-group or internal reinsurance, intra-group loans and intra-group outsourcing);
- Interdependencies within the group and their impact on the group risk profile;
- Risk arising from the complexity of the group structure.

These risks can be considered non-critical for SWE, even immaterial, thanks to the intra-group reinsurance agreement and its associated collateral (assets left as guarantee) protecting the SWE from the consequences of a possible insolvency of its SWL shareholder.

As part of broader risk identification process, a monthly "Insurance Consolidated Risk Report" (ICRR) is regularly produced. This captures any significant risk events of this nature and the associated management actions. The intra-Group exposure register also acts as an additional method of identifying, controlling and recording these risks.

C.6.4 Climate risk and sustainability strategy

Climate risk is a key emerging risk for LBG. The Group's approach to identifying and managing it is founded on

- embedding it into its Risk Management Framework,
- integrating through policies, authorities and risk control mechanisms.

SWE complies with this Risk Management Framework and is not directly exposed to this type of risk, which could nevertheless affect the company indirectly, either through a sharp decline in the market value of its investments or through difficulties that could arise from SWL.

However, this risk is not considered significant for SWE because:

- the investment component of the technical provisions relating to SWE's Unitised With-Profits business is reinsured with SWL, whose solvency ratio is significantly higher than regulatory requirements and
- the reinsurance arrangement is heavily collateralised.

Regarding LBG's sustainability strategy and adherence of the Group to the evolving regulatory requirements on climate risk, further details of the LBG approach of transitioning to a low carbon economy can be found in the Lloyds Banking Group Annual Report and Accounts, which can be downloaded via www.lloydsbankinggroup.com.

C.7 Any other material information

There is no other material information regarding SWE's risk profile to mention.

C.8 Prudent Person Principle

SWE has put in place a Board-approved Investment Policy which sets out the key requirements of the Prudent Person Principle and the controls to ensure that the requirements are complied with.

The policy is part of the formal policy governance framework requiring regular reporting and an annual review of compliance with the Principle.

To further embed the policy requirements, the Prudent Person Principle is a standing agenda item at committees making investment decisions in relation to shareholder and policyholders' assets.

The committees review any decisions to ensure alignment with the key requirements.

The investment strategy for assets is specified in the Market Risk Policy. It is dependent on the nature of the funds in question and is summarised in Section C.2. "Market Risks".

For non-linked funds' investments, limits on the exposure to a single entity are specified and monitored. Bond exposures are managed through credit rating bands and maximum exposures to individual assets, sectors, and non-UK countries are set.

Assets are restricted to securities in a specified list of countries, and limits applicable to property portfolios are set to prevent concentration of exposure to single tenants and single buildings.

C.9 Stress testing: sensitivity and scenario analysis

As part of the ORSA process, SWE has to perform various stress and scenario tests.

The first ORSA (December 2019) included some market sensitivities showing the sensitivity of SWE's excess capital to the key market risks it faces, which are

- changes in interest rates and
- inflation rates.

For subsequent ORSA reports (the next being due in summer 2020) SWE plans to perform a set of scenario analyses conducted over the four-year business planning period, encompassing a wider range of risks than in the market sensitivity work (including insurance risks specific to SWE), to provide further insight into the risks faced by SWE.

This should include quantification of the impact of the potential changes being considered as part of EIOPA's proposals regarding the so-called "2020 review" of the Solvency II European directive.

D. Valuation for solvency purposes

Summary balance sheet – overview

€	31 Dec 2019
Total assets	4,375,055,722
Total technical provisions	(2,226,680,983)
Total other liabilities	(1,913,665,596)
Total subordinated debt	-
Excess of assets over liabilities	**234,709,143**

This section of the report explains the valuation principles underpinning the Solvency II balance sheet, represented in its simplified form above.

Further detail is set out in:
Section D1: assets
Section D2: technical provisions, representing Best Estimate Liabilities ('BEL') and risk margin
Section D3: other liabilities including subordinated debt.

D.1 Assets

D.1.1 Asset valuation under Solvency II

The assets of the Company are shown in the table below.

The commentary which follows sets out the nature of each asset class and its valuation principles, analysed at a level reflecting the materiality, nature, function and inherent risk of each type of asset.

€		31 Dec 2019
Deferred tax assets	a	-
Collective investments	b	2,255,899,139
Assets held for unit-linked contracts	c	273,232,527
Reinsurance recoverables	d	1,753,076,867
Insurance receivables	e	4,174,594
Trade receivables	f	78,710,694
Cash and cash equivalents	g	9,961,901
Total assets		**4,375,055,722**

Assets are recorded at fair value in line with the valuation methodology described in the Solvency II Directive, and the valuation principles are set out below.

The underlying concept is that assets are valued at an amount for which they could be exchanged, transferred or settled between knowledgeable and willing parties, in an arm's length transaction.

In particular, assets are valued using quoted market prices, and where quoted market prices do not exist, a mark-to-model approach is used, which is calibrated to available market information.

No value is given to intangible assets.

In general, these asset values are consistent with Luxembourg accounting principles, which underpin the valuation in the Company financial statements.

Any material differences between valuation for solvency purposes and the valuation basis used in the financial statements are detailed in Section D.1.2.

The Board of SWE may make use of assumptions, judgement or estimation in determining the reported value of assets.

Any such assumptions, judgement or estimation are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Where the valuation of specific assets has been determined by way of assumptions, judgement or estimation, commentary is given below on how the value has been derived.

D.1.2 Solvency II valuation principles followed by SWE

Valuation methods make maximum use of relevant market inputs and rely as little as possible on company specific inputs.

The hierarchy applied is:

Method (i): Unadjusted quoted prices for identical investments actively traded in recognised financial markets. Fair value is determined by reference to quoted market bid prices at the final pricing point on the reporting date. Prices are provided by vendors such as Reuters or Bloomberg, or by direct reference to the stock exchange.

Method (ii): Quoted prices for similar investments actively traded in recognised financial markets with adjustment to reflect any differences, such adjustments are required to reflect factors specific to the asset, such as the:

- condition or location
- extent to which inputs relate to items that are comparable to the asset
- volume or level of activity in the markets within which the inputs are observed.

Method (iii):
Quoted prices for identical or similar assets in markets that are not active;
Inputs other than quoted prices that are observable for the asset, including interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads;
Market-corroborated inputs, which are based on or supported by observable market data. These markets inputs will be adjusted to reflect factors specific to the asset, such as the:

- condition or location
- extent to which inputs relate to items that are comparable to the asset
- volume or level of activity in the markets within which the inputs are observed.

Where there is little, if any, market activity for the asset or market information for the inputs to any valuation models at the measurement date, unobservable inputs are required. These inputs reflect the assumptions the Group considers that market participants would use in pricing the asset, including assumptions about risk inherent in the specific valuation method used to measure fair value and the risk inherent in the inputs of that valuation method.

An active market is one in which similar arm’s length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis.

Where estimates are used, these are based on a combination of independent third party evidence and internally developed models, calibrated to market observable data where possible.

Management review the fair value of the SWE's financial assets and the sensitivities to these inputs on a regular basis through expert judgement reviews, valuation steering groups and a fair value pricing committee.

D.1.2.1 Deferred Tax Assets

1) Recognised deferred tax assets

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts within the Solvency II balance sheet at the reporting date.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and legislation enacted at the reporting date.

The treatment of deferred tax assets/liabilities is detailed in section D3.

2) Unrecognised deferred tax assets

There are no unrecognised deferred tax assets in SWE.

D.1.2.2 Collective Investments

These pooled fund vehicles, such as unit trusts, OEICs (open ended investment companies) and SICAVs (société d'investissement à capital variable) can then invest in underlying assets of varying classes.

Investments in collective investment vehicles are primarily held to match policyholder liabilities and the majority of the risk from a change in the value of SWE's investment is matched by a change in policyholder liabilities.

The Group sponsors a range of collective investment vehicles and limited partnerships where it acts as the decision maker over the investment activities and markets the funds under one of LBG's brands.

The Group earns fees from managing the investments of these funds.

The significant majority of holdings are in active market quoted unit trusts, OEICs and SICAVs. The fair value of the SWE holdings is determined using the last published price applicable at the reporting date.

€	31 Dec 2019
Collective investments Method (i)	2,255,899,139
Method (ii)	-
Method (iii)	-
Total collective investments	2,255,899,139

There are no non-quoted investments included within the collective investments category.

D.1.2.3 Assets held for unit-linked contracts

These assets comprise the same investment asset classes described throughout this section, applying the same valuation principles. The linked funds hold €273,232,527 of holdings in collective investment undertakings.

These assets are segregated to enable direct matching to unit-linked policyholder liabilities.

D.1.2.4 Reinsurance recoverables

Represents the share of technical provisions for reinsured business determined in a manner consistent with the underlying contractual agreement and the underlying gross business data per treaty, explained in Section D.2.

D.1.2.5 Insurance receivables

These balances represent monies owed in the course of SWE's insurance business and are determined to be short term in nature and therefore recorded in the balance sheet at the contractual value which represents a value consistent with Solvency II principles. They refer to outstanding premiums and commissions receivable at the balance sheet date.

D.1.2.6 Trade receivables

Trade receivables are other amounts which are receivable by SWE. They are recorded in the balance sheet at their contractual value at the reporting date, which represents a value consistent with Solvency II principles. The main component of trade receivables relates to an indemnity from SWL to SWE in respect of German litigation as detailed in Section D.3.

D.1.2.7 Cash and cash equivalents

Cash and cash equivalents include cash at bank, short-term highly liquid investments with original maturities of three months or less and bank overdrafts where a legal right of set off exists. Cash is carried within the Solvency II balance sheet at a value not less than the amount payable on demand, which represents a value consistent with Solvency II principles.

D.1.3 Variation from values assigned in the financial statements

There are no material differences in the valuation techniques which have been adopted for Solvency II and those used to prepare the financial statements under Luxembourg accounting principles.

D.1.4 Changes to basis of recognition or valuation of assets during the reporting period

There have been no other changes to the basis of recognition or valuation of assets during the reporting period.

D.2 Technical provisions

D.2.1 Value of technical provisions

The table below shows the technical provisions for SWE, split by business category and gross of reinsurance.

€	BEL	Risk Margin	Total
Life			
a) Index-linked and unit-linked	341,938,518	24,016,867	365,955,385
b) Other	1,785,314,642	75,410,956	1,860,725,598
Total	**2,127,253,161**	**99,427,823**	**2,226,680,983**

Note that in the QRTs for SWE we classify all contracts, and hence technical provisions, as having an option or guarantee as we deem that all products have a degree of an option or guarantee (for example, annuities are guaranteed to be paid until death, policyholders have the option to cancel non-annuities etc).

D.2.2 Methodology and assumptions

The Solvency II technical provisions represent the value of the insurance company's obligations if they were to be transferred to a third party at the valuation date. The value of the technical provisions is the sum of the BEL and Risk Margin.

D.2.2.1 Best Estimate Liability methodology

The BEL is intended to correspond to the probability weighted average of the present value of future cashflows on a market consistent basis. The cashflows include the expected future values of

- Payments to policyholders (e.g. claims, maturity payments, annuity payments)
- Expenses incurred administering the business
- Investment expenses incurred
- Premiums to be collected from policyholders
- Charges received from policies (e.g. management charges on unit-linked business)
- Taxation

The projection of future cash flows is performed using best estimate assumptions, which are covered in more detail in Section D.2.2. Discount rates are determined on a market consistent basis using the relevant risk-free term structure as specified by EIOPA.

The approach taken to determine the BEL varies by type of product as discussed below.

a) Unit-linked business

Unit-linked business is valued as the **face value of the units held plus an allowance for non-unit cash flows** (*future expenses, policy charges, claims etc.*). The value of non-unit cash flows is calculated by projecting future cash flows using realistic assumptions, taking into account the contract boundary, and discounting using the risk-free curve.

There is no minimum value to the technical provisions and so the resulting BEL could be negative.

b) Unitised With-Profits business

The BEL for Unitised With-Profits (UWP) business (within the 'Other' line in the table above) comprises:

- The With-Profits Benefit Reserve;
- Future policy related liabilities;
- Liabilities in respect of vested with-profits annuities.

The With-Profits Benefit Reserve represents accumulated asset shares plus any (past) miscellaneous surplus to be included.

Future policy related liabilities represent the expected (present value of) future cost of providing benefits in excess of the With-Profits Benefit Reserve, including the cost for the provision of options and guarantees, net of the planned deductions from policies for the costs of guarantees, options and smoothing. This item also includes cash flows relating to annual management charges and company expenses.

A reinsurance arrangement with SWL exists for the with-profits business such that the Clerical Medical With-Profits fund (CMWP) of SWL receives premiums from SWE, and calculates and holds asset shares with an additional reserve to cover the cost of provision of guarantees, net of the planned deductions from policies for the costs of guarantees and smoothing. If guarantees bite, then the CMWP fund of SWL pays the difference rather than SWE.

There is a small volume of vested with-profits annuities. The liabilities for these are determined by projecting expected benefit, and expense and annual management charge cashflows and discounting back to the valuation date using the EIOPA Euro risk free curve.

Contract boundaries: The Solvency II regulations state that future premiums to be considered within the BEL and Risk Margin are those that fall within the “contract boundary”.

The contract boundary varies by product depending on the nature of the benefits; and may be the valuation date, the next policy anniversary or the maturity date.

All SWE business is defined as being on a short contract boundary, which means that the regular premium contracts are treated as receiving no premiums after the valuation date and have no discernible life cover/guarantees.

This includes the unit-linked component of hybrid contracts (i.e. contracts invested in unit-linked and unitised with-profit funds) with no discernible life cover/guarantees.

Grouping: The BEL is determined separately for each policy with the exception of with-profits business where policies are grouped due to the large number of scenarios required to be evaluated.

Recoverables from reinsurance contracts and special purpose vehicles: The reinsurance arrangement with SWL is described above. Two non-material external reinsurance arrangements are in place, whereby life, critical illness and waiver of premium benefits are reinsured. There are no special purpose vehicles within SWE.

D.2.2.2 Risk Margin methodology

The Risk Margin component exists to adjust the BEL value so that the total technical provisions reflect the price for risk that a potential purchaser would take into account when acquiring a book of insurance business.

This is derived by determining the cost of capital associated with the capital requirements that the third party would be required to hold during the run-off of the business (assuming that the acquirer took steps to minimise its capital requirements).

The Risk Margin is calculated by projecting the run-off of the non-hedgeable SCR risks, applying the 6% cost of capital defined by EIOPA to the projected values and discounting using the risk-free rate.

D.2.2.3 Key assumptions in deriving the technical provisions for Life business

As covered in the Best Estimate Liability methodology section above, future cash flows are projected with an allowance for best estimate demographic and expense assumptions.

The key best estimate assumptions are described below. **Appendix 2** contains a summary of the key best estimate assumptions.

Discount rate

Solvency II liabilities are valued on a market consistent basis using the Euro risk-free yield curve prescribed by EIOPA.

Lapses

Lapse assumptions are significant for unit-linked products where income from future charges is dependent on the continuation of premium payments and/or the policy remaining in force.

Experience is reviewed annually to set the assumptions. Assumptions are set by country and contract type (single/regular premium). Where the information is available, assumptions are based on the average of recent experience, typically over the last four years. Where data is not available, or if past data is not deemed to be representative of the future due to changes in the business and/or regulatory environment, expert judgement is applied in order to set appropriate rates.

All such judgements are set by suitably qualified subject matter experts.

Longevity

Future longevity is a key assumption for the vested with-profits annuity business, as policyholders living longer than expected will result in more annuity payments being paid than anticipated, resulting in higher technical provisions.

Longevity assumptions are also required for the other products to determine the timing of maturity benefits and the cessation of charge income/expense outgo.

Expenses

Future cash flows include allowance for expected levels of maintenance and claim expenses.

The levels of expenses are based on the year prior to the valuation date.

Adjustments are applied for any business plans where the impacts are starting to materialise.

Non-recurring expenses, such as project related costs, are excluded from the expenses allocated to the per policy assumptions.

Renewal expenses are assumed to increase in line with price inflation. The expense inflation assumption is derived as a weighted average of UK and Euro inflation. The UK component contains an additional allowance for salary growth in excess of the reference index.

Matching adjustment

SWE does not use the matching adjustment.

Volatility adjustment

SWE does not use the volatility adjustment.

Transitional risk-free interest rate-term structure

SWE does not use the transitional risk-free interest rate-term structure.

D.2.3 Simplifications

There are areas in the valuation of the BEL and Risk Margin where simplifications are adopted after considering materiality and proportionality.

D.2.3.1 Best Estimate Liabilities

Probability weighted average

The BEL is intended to represent the probability weighted average of the future cash flows. Our methodology makes the simplifying assumption that a projection using best estimate deterministic non-economic assumptions will yield a probability weighted average.

This simplification is made for practical reasons and is not considered to be significant.

With-Profits business

Simplifications relating to management actions and investment strategy are made in the calculation of the UWP reinsurance asset.

Dynamic policyholder behaviour

For the unit-linked business, policyholder behaviour is allowed for in the calculation of the Best Estimate Liabilities by using deterministic best estimate assumptions only.

Whilst these assumptions will have regard to the expected future policyholder behaviour given past experience and current conditions, dynamic future policyholder behaviour is not directly allowed for, which is in line with industry practice.

Incorporating dynamic policyholder behaviour would require stochastic modelling which is not deemed proportionate, particularly because there is insufficient empirical evidence from which realistic dynamic policyholder actions could reasonably be determined.

It is therefore considered to be more appropriate that the uncertainty associated with dynamic policyholder behaviour is captured implicitly through the derivation of best estimate assumptions, as they are set based on historic experience, along with there being some further implicit allowance in the Risk Margin (which includes a cost of capital charge on adverse policyholder behaviour).

D.2.3.2 Risk Margin

The theoretical approach to calculating the Risk Margin would require all future 1-in-200 capital requirements to be calculated.

Undertaking such a calculation would be so computationally intensive that it is essentially impossible to implement from a practical perspective.

The industry has therefore developed approaches to simplify the calculation. The Risk Margin is calculated by projecting the non-hedgeable SCR, assuming that diversified risk exposures for each non-hedgeable risk type and each class of business run off in proportion to a suitable driver.

In addition, the calculation of the Risk Margin assumes that the reference entity taking on the business of SWE would be able to invest its assets in such a way as to remove all market risk. This is a simplifying assumption.

D.2.3.3 Homogenous risk groups

A particular concept within the Solvency II Directive is that of separating the business into “homogeneous risk groups” for the purposes of calculating the Technical Provisions and assessing the capital requirements. In practical terms, this means splitting the business into small enough groups so that assumptions can be set at a level at which they will sufficiently represent the business.

D.2.4 Uncertainty

There will always be a degree of uncertainty in setting assumptions for the calculation of technical provisions.

In some cases there is little uncertainty as assumptions may be largely prescribed under the regulations, particularly for market risks. In other cases, there will be more significant uncertainty and there will need to be a balance between using information from past experience, current conditions and future expectations.
It may be necessary to make expert judgements if it is deemed inappropriate to rely on the available data alone and there may be a range of plausible outcomes.

It is recognised that there is subjectivity in deciding upon the relevance of the data for

- representing the current risk exposure,
- the time period of historical data to use in the analysis,
- in the grouping of data and
- whether past experience is an appropriate guide to the future expectations.

There is also subjectivity in the view of how potential future changes in social, regulatory, economic and business conditions might impact on experience and whether any adjustments might be required.

The majority of assumptions are set deterministically.

However in the with-profit fund cashflows economic assumptions are modelled stochastically to appropriately capture the cost of embedded options and guarantees with financial risk factors (e.g. equity, interest rates etc.) whereas non-financial risk factors (e.g. longevity, persistency etc.) are modelled deterministically using best estimate assumptions.

For example, in setting best estimate lapse assumptions, judgements are made in selecting the period over which to average historical experience.

This judgement reflects a balance between the need to incorporate sufficient experience for the data to be credible whilst also placing greater emphasis on more recent (and hence relevant) experience.

In addition product types with similar features and which might be expected to have similar experience going forward are also grouped.

D.2.5 Material differences between LUX GAAP and Solvency II

As at 31 December 2019, for SWE, the movement from the LUX GAAP reserves reported in the financial statements to the Solvency II technical provisions is provided below, split by line of business.

€	With-profit	Index and unit-linked	Total
LUX GAAP technical provisions (net of reinsurance)	206,361,083	336,957,986	543,319,069
a) Less VIF	(174,530,083)	1,617,769	(172,912,313)
b) Plus IAS 39 reserves		2,154,020	2,154,020
c) Less IAS 39 VIF		(1,319,867)	(1,319,867)
d) Allow for contract boundaries		2,935,385	2,935,385
e) Risk Margin	75,410,956	24,016,867	99,427,823
SII technical provisions (net)	107,241,956	366,362,160	473,604,116
Reinsurance recoverables (see Section D.2.2.1)	1,753,483,642	(406,775)	1,753,076,867
SII technical provisions (gross)	1,860,725,598	365,955,385	2,226,680,983

Additional notes regarding the table:

a) Since the value in-force ('VIF') is implicitly part of the Solvency II BEL, it needs to be deducted from the LUX GAAP liability. This relates to the VIF on insurance accounted business.
b) The LUX GAAP methodology does not require non-unit reserves to be held for non-insurance accounted business as they do not contain a significant insurance guarantee. Solvency II requires the technical provisions to include non-unit reserves within the BEL, and so they are included in this adjustment.
c) Linked to item a., the VIF on non-insurance accounted business is deducted as the VIF is an implicit part of the Solvency II BEL.
d) The Solvency II definition of contract boundaries differs from LUX GAAP. Solvency II does not allow for future premiums which do not fall within the contract boundary whereas LUX GAAP allows for all expected future premiums.
e) Addition of the Risk Margin is required for the Solvency II technical provisions.

D.3 Other liabilities

D.3.1 Other liabilities valuation under Solvency II

The amounts recognised in SWE's balance sheet are shown in the table below. The commentary which follows sets out the nature of each class of liability and its valuation principles, analysed at a level reflecting the materiality, nature, function and inherent risk of each type of liability.

€		31 Dec 2019
Provisions other than technical provisions	a	71,616,143
Deposits from Reinsurers	b	1,773,337,127
Deferred tax liabilities	c	18,166,736
Insurance and intermediaries payables	d	33,814,090
Trade payables	e	16,731,500
Total other liabilities		**1,913,665,596**

SWE had no subordinated liabilities during, or at the end of the reporting period. Other liabilities are recorded at fair value as required under Solvency II principles, the underlying concept being that items are valued at an amount for which they could be exchanged, transferred or settled, between knowledgeable willing parties in an arm's length transaction.

In general, these liability values are consistent with Luxembourg accounting principles, which underpin the valuation in the individual company financial statements.

Any material differences between valuation for solvency purposes and the valuation basis used in the financial statements are detailed in Section D.3.2.

The Board of SWE may make use of assumptions, judgement or estimation in determining the reported value of other liabilities. Any such assumptions, judgement or estimation are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Where the valuation of specific liabilities has been determined by way of assumptions, judgement or estimation, commentary is given below on how the value has been derived.

D.3.1.1 Provisions other than technical provisions: German litigation

€	31 Dec 2019
German insurance business litigation	71,616,143
Total provisions	**71,616,143**

This provision relates to claims in Germany from customers with policies transferred to the Company by SWL, which it had issued under its former name of Clerical Medical Investment Group Limited.

An intercompany balance representing the amount recoverable under the indemnity agreement entered into with SWL is included within 'receivables (trade not insurance)'.

The validity of the claims facing SWE depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

D.3.1.2 Deposits from reinsurers

Immediately following the portfolio transfer, SWE entered into a reinsurance agreement with its parent company SWL, whereby all of the risks relating to contracts with a profit sharing feature were reinsured back to SWL.

This arrangement enables customers to keep their investments in the SWL Clerical Medical With-Profits Fund. Although the investment components of the policies (and the associated risks) are reinsured, policy charges are retained by SWE to meet ongoing expenses and the cost of additional risk benefits.

To mitigate the counterparty risk arising from this reinsurance arrangement, a security arrangement has also been put in place to ensure the transferring policyholders are ranked alongside other SWL policyholders and their status preserved.

To comply with the tied asset requirements in the Grand Duchy of Luxembourg, SWE withheld the initial reinsurance premium payable to SWL. Consequently, SWE recognised a liability under 'deposits from reinsurers': the Funds Withheld ("FWH"). The amount of this liability is re-measured and rebalanced quarterly and set to equal to the higher of

- the Solvency II Best Estimate Liabilities backing the reinsured business (excluding the with-profits estate) and
- the Luxembourg GAAP reserves.

The assets covering SWE's FWH are legally held by SWE and are represented on the Asset side of its balance sheet ("Reinsurer's shares of technical provisions").

D.3.1.3 Deferred tax liabilities

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts within the Solvency II balance sheet at the reporting date.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and legislation enacted at the reporting date. SWE recognises current and deferred tax assets and liabilities in line with IAS 12 "Income Taxes".

In recognising these positions, management takes into account the likely impact of any tax issues that are subject to ongoing discussion with the Luxembourg Inland Revenue (ACD) and other tax authorities.

With regard to SWE's deferred tax assets, a significant feature is the management judgement applied in determining the timing, sensitivities and probability of them crystallising. This judgement is based on tax forecasts reflecting new business assumptions, sensitivities and proposed management actions.

Deferred tax assets and liabilities are undiscounted although those relating to the BEL and risk margin are based on the discounted gross asset/liability. Deferred tax assets and liabilities are offset when there is a legally enforceable right and when the deferred taxes relate to the same fiscal authority. As a result, a net deferred tax liability is presented in the QRTs.

The following deferred tax (assets) and liabilities are recognised as a net deferred tax liability within Own Funds:

€	31 Dec 2019
Timing differences resulting from basis changes for technical provisions	
Difference between SII BEL and tax basis (Lux GAAP) policyholder liabilities	43,030,667
Risk margin	(24,863,931)
Net deferred tax liability	**18,166,736**

None of the deferred tax assets and liabilities above have an expiry date.

D.3.1.4 Insurance and intermediaries payables

These balances represent monies owed in the course of SWE's direct business and are determined to be short term in nature and therefore recorded in the balance sheet at the contractual value. They refer predominantly to outstanding claims and commission at the balance sheet date.

D.3.1.5 Trade payables

Amounts which are payable to suppliers of SWE and which are expected to be settled in the short term, in less than one year. They are therefore recorded in the balance sheet at their contractual value at the reporting date, which represents a value consistent with Solvency II principles.

D.3.2 Variation from values assigned in the financial statements

The material differences in the valuation of other liabilities between the Solvency II balance sheet and the financial statements concern Deferred tax liabilities : these will differ between the financial statements and Solvency II valuation basis, reflecting the difference in the underlying tax timing differences affected by the differences between Solvency II technical provisions and Lux GAAP liabilities described in Section D.2.

D.4 Alternative methods for valuation

Any alternative valuation methods applied in determining the fair value of assets are set out for each asset category in Section D.1.

SWE adopts the principle of maximising the use of relevant observable inputs and limits (wherever necessary) the use of unobservable inputs in the calculation of the assets and liabilities.

As there is no active market for the SWE technical provisions, the 'income' approach to valuation is adopted i.e. using a discounted cashflow approach.

Discount rates are derived from the EIOPA risk free curve. The assumptions underlying this valuation approach are documented in Section D.2 of this report.

Valuation uncertainty is assessed via sensitivity testing. Sensitivity tested values are compared with reported balance sheet values and to historical results, and validated to confirm reasonableness.

All methodologies and assumptions are approved by the SWE Board.

The valuation methodology and assumptions are periodically reviewed for appropriateness in view of company experience.

D.5 Any other material information

There is no other material information to report.

E. Capital Management

E.1 Own funds

E.1.1 Objectives, policies and processes employed for managing own funds

SWE's objectives when managing Own Funds are:

- To have sufficient Own Funds to safeguard the Company's ability to continue ensuring the orderly run-off of the transferred portfolio, providing benefits to policyholders as they fall due, so that it can continue to provide returns for the shareholder and benefits for other stakeholders.
- To comply with all regulatory capital requirements as set out under Solvency II.
- To provide an adequate return to the shareholder by pricing insurance and investment contracts according to the level of risk and capital associated with the business written.
- In respect of with-profits business, to meet the requirements of the Part VII Scheme of Transfer effected on 29 March 2019.
- To maintain an appropriate quality of Own Funds.

The capital management strategy is such that SWE will hold additional buffer capital in line with the stated risk appetite for the business.

Any surplus Own Funds above the capital buffer is available for distribution to the parent to the extent it is not required for other purposes over the 4-year business planning period.

In addition, target levels of capital are determined for each tier such that there is not expected to be a de-recognition of capital in the event of a stress, calibrated to a level consistent with SWE's internal risk appetite.

All of these minimum capital limits were exceeded at 31 December 2019.

The capital management strategy is aligned to the requirements of the Lloyds Banking Group Capital Policy. Policy and procedures are operated within SWE to comply with the Group Capital Policy and these include:

- Setting SWE Risk Appetite.
- Managing Own Funds within the SWE Risk Appetite.
- Monitoring Own Funds against the Risk Appetite metrics.
- Maintaining a capital buffer in conjunction with minimum limits relating to capital quality.
- Future capital projections are produced annually as part of the 4 Year Operating Plan ('4YOP') and summarised within the ORSA. A 'forward looking' capital assessment is compared to risk appetite under a range of stress scenarios, with management plans established as appropriate where a breach of risk appetite is projected to occur.
- Capital stress testing is undertaken on a regular basis. In particular, stress testing is completed annually as part of the 4YOP and ORSA report.
- Capital requirements are measured using a Standard model approved by the CAA.
- There have been no material changes to the policies, processes and objectives for management of Own Funds over the reporting period. Further details of the role of the SWE Board and Risk Appetite can be found in Section B of this report.

E.1.2 Components of own funds: nature, amount and quality by Tier

Key solvency metrics

For the purposes of Solvency II, insurers must maintain sufficient Own Funds, of appropriate quality, to cover the regulatory Solvency Capital Requirement ('SCR'). Where a firm does not have sufficient Own Funds, it must submit a recovery plan to the CAA to restore coverage of the SCR within six months or, in the case where the Own Funds cannot cover the Minimum Capital Requirement ('MCR'), a plan to restore coverage of the MCR within three months.

Not all of the items comprising Own Funds have the same ability to absorb losses. It is therefore necessary to classify the Own Funds into different tiers.

There are two main criteria used to determine the classification of Own Funds into the tiering levels. These criteria are:
- how available is the item under both going-concern and winding up scenarios;
- how does it rank in terms of subordination relative to policyholder liabilities.

Depending on how an item matches these criteria, it is then classed as Tier 1, Tier 2 or Tier 3, with Tier 1 having the greatest loss absorbing capacity (and hence is the highest quality capital such as paid-in ordinary share capital).

The components of Own Funds, their nature and quality are shown in the table below. SWE Own Funds are all Tier 1. There are
- no Ancillary Own Funds,
- no Own Funds items subject to Solvency II transitional arrangements
- no Own Funds items subject to any restriction affecting their availability or transferability.

	31 Dec 2019	31 Mar 2019
Own Funds component €	**Tier 1 Unrestricted**	**Tier 1 Unrestricted**
Share capital	181,000,000	81,000,000
Reconciliation reserve	53,709,143	87,876,591
Available Own Funds to cover SCR	**234,709,143**	**168,876,591**
Eligible Own Funds to cover SCR	**234,709,143**	**168,876,591**

E.1.2.1 Equity

Subscribed Capital

The share capital at 31 December 2019 comprises 6m shares of €1 each, issued and fully paid and a share premium of €175m.

The share capital is undated, subordinate to all other liabilities and is immediately available to absorb losses.

Distributions can be cancelled where there is non-compliance with the SCR or where payment of the distribution would result in non-compliance with the SCR. Share capital is classified as Tier 1.

Share Premium

During the period since 31 March 2019, SWL has injected further capital in the form of share premium as follows: September 2019 (€30m) and December 2019 (€70m).

E.1.2.2 Reconciliation reserve

The reconciliation reserve represents the Solvency II retained earnings attributable to the ordinary shareholders of the company, after allowing for the payment of foreseeable dividends.

The company has full flexibility on the payment of any dividends from the reconciliation reserve and it is subordinate to all other liabilities.

It is therefore immediately available for loss absorption, and is classified as Tier 1, in line with the ordinary share capital.

The reconciliation reserve has fallen during the period, reflecting the adverse impact of market volatility and model enhancements, off-set by, Part VII true-up and improved surplus in the business in-force at transfer date.

E.1.2.3 Tier Limits

No Tiering limits apply to SWE as at 31 December 2019.

E.1.3 Eligible Amount of Own Funds to cover the SCR classified by Tier
E.1.4 Eligible Amount of Own Funds to cover the MCR classified by Tier

The Own Funds, SCR and MCR for SWE as at 31 December 2019 are shown in the Table below.

€	31 Dec 2019
Eligible Own Funds to cover SCR	234,709,143
SCR	121,555,361
Ratio of Eligible Own Funds to SCR	1.93
Eligible Own Funds to cover MCR	234,709,143
MCR	30,388,840
Ratio of Eligible Own Funds to MCR	7.72

As at 31 December 2019, SWE retained sufficient capital to cover both the MCR and the SCR throughout the reporting period.

The excess of assets over liabilities in the reported balance sheet position of SWE as described in Section D of this report, forms the basis of the funds available to meet the SCR.

E.1.5 Material differences between Equity (as shown in the Financial Statements) and the Excess of Assets over Liabilities (as calculated for Solvency Purposes)

The table below presents a comparison of equity and reserves shown in SWE financial statements and the excess of assets over liabilities calculated for solvency purposes as at 31 December 2019.

€	31 Dec 2019
Equity per LUX GAAP financial statements	**183,141,569**
Valuation differences Please refer also to descriptions given in Section D.2	
Technical provisions (Greater in LUX GAAP than in Solvency II)	69,714,954
Deferred tax Liabilities (Only in Solvency II Framework)	(18,166,736)
Other	19,356
Solvency II excess of assets over liabilities from the balance sheet	**234,709,143**

E.1.6 Additional information regarding Deferred Taxes

E.1.6.1 Description of the calculated amount of DTA without assessing their probable utilisation

SWE does not recognise any Deferred Tax Asset.

E.1.6.2 Description of the extent to which those DTA have been recognised

SWE does not recognise any Deferred Tax Asset.

E.1.6.3 For recognised DTA: description of the assets likely to be utilised by reference to probable future taxable profit and by reference to the reversion of DTL

SWE does not recognise any Deferred Tax Asset.

E.1.6.4 Additional Information regarding Net Deferred Taxes (recognised DTA – DTL)

SWE does not recognise any Deferred Tax Asset.

E.2 SCR and MCR

E.2.1 Solvency Capital Requirement ('SCR')

E.2.1.1 Period-End Amounts (Total and split by Risk Module of the Standard Formula)

The SCR for SWE has been determined using the Standard Formula approach set out in the Directive. The resulting capital requirements at 31 December 2019 are as follows:

Solvency Capital Requirement €	31 Dec 2019
Market risk	**39,151,026**
Counterparty default risk	**15,914,883**
Life underwriting risk	**109,530,071**
Diversification within basic SCR	(33,790,203)
Basic SCR	**130,805,777**
Operational risk	8,916,321
Loss absorbing capacity of deferred taxes	(18,166,736)
Total SCR	**121,555,361**

E.2.1.2 Material changes over the reporting period and associated reasons

Changes observed during the reporting period are shown and explained in Section E.6.1 of this report.

E.2.1.3 Use of simplifications within the Standard Formula

There are no risk modules or sub-modules of the Standard Formula calculation for which the Company applies simplified calculations.

E.2.1.4 Use of Undertaking-Specific Parameters

The Company does not use any undertaking-specific parameters within the Standard Formula calculation.

E.2.2 Minimum Capital Requirement ('MCR')

The MCR represents the minimum level below which the amount of financial resources should not fall. It is calculated in accordance with a formula prescribed in the Solvency II regulations and is subject to a floor and a cap equal to 25% and 45% of the SCR respectively. It is based on factors applied to the technical provisions and capital at risk as at the reporting date.

E.2.2.1 Period-End Amounts calculated and Inputs used

The components of the calculation of the MCR as at 31 December 2019 are presented below:

Solvency Capital Requirements €	31 Dec 2019
Linear MCR	3,653,599
SCR	121,555,361
MCR Cap	54,699,912
MCR Floor	30,388,840
MCR	**30,388,840**

For SWE the minimum 25% floor of the SCR bites compared to the linear component.

E.2.2.2 Material changes over the reporting period and associated reasons

The MCR at both 31 March 2019 and 31 December 2019 is based on the floor of the SCR and as such, the change in MCR over this period is driven by the same factors as the change in SCR.

E.2.3 Loss Absorbing Capacity of Deferred Taxes

The amount by which the Solvency Capital Requirement has been adjusted in respect of the loss-absorbing capacity of deferred taxes (LACDT) at 31 December 2019 is €18,166,736.

SWE does not use carry-back or rely on future profits within its calculation of LACDT. LACDT is only recognised up to the level of the deferred tax liability.

E.3 Use of the duration-based equity risk sub-module

SWE does not use the duration-based equity risk sub-module in the calculation of the SCR (option set out in Article 304 of Directive 2009/138/EC).

E.4 Differences standard formula / internal model

SWE calculates its SCR in conformity with the Standard Formula and does not use any partial or full internal model.

E.5 Non-compliance with the MCR / SCR

SWE retained sufficient capital to cover both the MCR and the SCR throughout the reporting period.

E.6 Any other information

E.6.1 Capital Roll-Forward

The Group to which SWE belongs is a member of the CFO Forum (‘CFOF’). In 2018, the CFOF agreed a structure and content for a common “roll-forward” disclosure. The aim of the table below is to provide users of the disclosures with sufficient information to understand the movements in the Solvency II capital position.

Capital Roll-Forward Table (As proposed by CFOF Solvency II Disclosures Working Group)

€m		Eligible Own Funds	SCR
Initial Calculation as at 31 March 2019		**168.9**	**90.7**
Mergers, acquisitions & disposals (1)		25.4	-
Regulatory & other model changes (2)		(17.7)	10.7
Operating impacts:	New business contribution (3)	0.7	0.1
	Expected in-force contribution	11.0	(3.5)
	Assumption changes & experience variances	(6.9)	(1.3)
	Debt costs		
Market variances		(46.8)	9.4
Material miscellaneous items (4)		0.1	15.5
Other non-operating changes		-	-
Capital management (5)		100	-
Closing balance as at 31 December 2019		**234.7**	**121.6**

Notes
(1): In respect of the transfer of business between SWL and SWE.
(2): Model enhancements and change in operational risk methodology.
(3): Impact of incremental new business
(4): Including tax relief availability.
(5): Share premium injection.

E.6.2 Others

All important information regarding the capital management of SWE has been addressed in the sections above.

*****

Appendix 1: List of Abbreviations

4YOP : Four-Year Operating Plan

(SWE)AC: SWE Audit Committee

AML: Anti Money Laundering

BaFin: Bundesanstalt für Finanzdienstleistungsaufsicht, the financial regulatory authority for Germany

BAU: Business As Usual

BE(L): Best Estimate (of Liabilities)

BoD : Board of Directors

CAA: Commissariat Aux Assurances

CM(IG): Clerical Medical (Insurance Group)

CTF: Counter Terrorism Financing

EIOPA : European Insurance and Occupational Pensions Authority

EUC: End User Computing

GAAP: Generally Accepted Accounting Principles

HLSM: Heidelberg Leben Service Management

IT: Information Technology

IVASS: Istituto per la vigilanza sulle assicurazioni, Institute for the Supervision of Insurance in Italy

IWALCO: Insurance & Wealth Asset –Liability Committee

IWRC: Insurance & Wealth Risk Committee

LAC DT / TP : Loss Absorbing Capacity of Deferred Taxes / Technical Provisions

LBG: Lloyds Banking Group

LoD: Line of Defence

LRM: Legal Regulatory and /or Mandatory

MLRO: Money Laundering Reporting Officer

OF: Own Funds

ORSA: Own Risk & Solvency Assessment

PAM: Pack Assurance Management

QRT: Quantitative Reporting Template (=> Pillar 3 Solvency II, Pillar 1 Figures)

RAS: Risk Appetite Statement

RM: Risk Margin

RM(F): Risk Management (Framework)

RSR: Regulatory Solvency Report

SCR: Solvency capital Requirement (In this report, otherwise mentioned: Pillar 1 Standard Formula)

SF: Standard Formula (=> SCR Calculation)

SFCR: Solvency & Financial Conditions Report

SoG: System of Governance

SWE (MC): Scottish Widows Europe (Management Committee)

SWG, SWL: Scottish Widows Group, Scottish Widows Limited

TP: Technical Provisions

UL: Unit Linked

UWP: Unitised With Profit

Appendix 2: Technical provisions – Assumptions

Key assumptions in deriving the technical provisions

Section D.2.2 covers the approach taken to determine key best estimate assumptions used for calculating the technical provisions. Sample assumptions have been provided below.

Lapses

These assumptions reflect the future rates at which policies are expected to lapse.

These are significant assumptions for unit-linked products where income from future charges is dependent on the continuation of premium payments and/or the policy remaining in force.

For UWP products there are specific lapse rate assumptions to reflect product features, such as the minimum investment term for single premium business.

	Unit-linked		UWP
Policy Year	Regular Premium	Single Premium	Single Premium
1	2.25%	3.63%	3.63%
5	2.38%	3.63%	3.63%
10	1.50%	2.38%	2.38%
15	1.63%	3.25%	2.88%
20	1.38%	2.75%	6.25%

Longevity

Future longevity is a key assumption for annuity business, which is within the 'Other' line of business, as policyholders living longer than expected will result in more annuity payments being paid than anticipated, resulting in higher technical provisions.

Products	Assumptions
Vested with-profits annuity business	Base: 100% DAV2004R (2nd order) Improvements:CMI16, M/F(7.75), 1.90% LTR, T80-110
Other products	30.6% AM80 Ultimate for males 36.9% AF80 Ultimate for females

Appendix 3: Quantitative Reporting Templates *(All amounts in euro)*

S.02.01.02
Balance sheet

		Solvency II value
	Assets	C0010
R0010	Goodwill	
R0020	Deferred acquisition costs	
R0030	Intangible assets	
R0040	Deferred tax assets	
R0050	Pension benefit surplus	
R0060	Property, plant & equipment held for own use	0.00
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	2,255,899,138.62
R0080	*Property (other than for own use)*	0.00
R0090	*Holdings in related undertakings, including participations*	0.00
R0100	*Equities*	0.00
R0110	*Equities - listed*	
R0120	*Equities - unlisted*	
R0130	*Bonds*	0.00
R0140	*Government Bonds*	0.00
R0150	*Corporate Bonds*	0.00
R0160	*Structured notes*	0.00
R0170	*Collateralised securities*	0.00
R0180	*Collective Investments Undertakings*	2,255,899,138.62
R0190	*Derivatives*	
R0200	*Deposits other than cash equivalents*	0.00
R0210	*Other investments*	0.00
R0220	Assets held for index-linked and unit-linked contracts	273,232,526.83
R0230	Loans and mortgages	0.00
R0240	*Loans on policies*	0.00
R0250	*Loans and mortgages to individuals*	
R0260	*Other loans and mortgages*	
R0270	Reinsurance recoverables from:	1,753,076,866.71
R0280	*Non-life and health similar to non-life*	0.00
R0290	*Non-life excluding health*	
R0300	*Health similar to non-life*	
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	1,753,483,641.97
R0320	*Health similar to life*	0.00
R0330	*Life excluding health and index-linked and unit-linked*	1,753,483,641.97
R0340	*Life index-linked and unit-linked*	-406,775.27
R0350	Deposits to cedants	0.00
R0360	Insurance and intermediaries receivables	4,174,594.62
R0370	Reinsurance receivables	
R0380	Receivables (trade, not insurance)	78,710,693.98
R0390	Own shares (held directly)	
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0.00
R0410	Cash and cash equivalents	9,961,901.33
R0420	Any other assets, not elsewhere shown	
R0500	**Total assets**	4,375,055,722.08

		Solvency II value
	Liabilities	C0010
R0510	Technical provisions - non-life	0.00
R0520	*Technical provisions - non-life (excluding health)*	0.00
R0530	*TP calculated as a whole*	
R0540	*Best Estimate*	
R0550	*Risk margin*	
R0560	*Technical provisions - health (similar to non-life)*	0.00
R0570	*TP calculated as a whole*	
R0580	*Best Estimate*	
R0590	*Risk margin*	
R0600	Technical provisions - life (excluding index-linked and unit-linked)	1,860,725,598.49
R0610	*Technical provisions - health (similar to life)*	0.00
R0620	*TP calculated as a whole*	0.00
R0630	*Best Estimate*	0.00
R0640	*Risk margin*	0.00
R0650	*Technical provisions - life (excluding health and index-linked and unit-linked)*	1,860,725,598.49
R0660	*TP calculated as a whole*	0.00
R0670	*Best Estimate*	1,785,314,642.24
R0680	*Risk margin*	75,410,956.25
R0690	Technical provisions - index-linked and unit-linked	365,955,384.86
R0700	*TP calculated as a whole*	0.00
R0710	*Best Estimate*	341,938,518.28
R0720	*Risk margin*	24,016,866.58
R0730	Other technical provisions	
R0740	Contingent liabilities	0.00
R0750	Provisions other than technical provisions	71,616,142.69
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	1,773,337,126.60
R0780	Deferred tax liabilities	18,166,735.92
R0790	Derivatives	
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	
R0820	Insurance & intermediaries payables	33,814,090.13
R0830	Reinsurance payables	
R0840	Payables (trade, not insurance)	16,731,500.31
R0850	Subordinated liabilities	0.00
R0860	*Subordinated liabilities not in BOF*	
R0870	*Subordinated liabilities in BOF*	0.00
R0880	Any other liabilities, not elsewhere shown	
R0900	**Total liabilities**	4,140,346,578.99
R1000	**Excess of assets over liabilities**	234,709,143.09

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

	Life	Line of Business for: life insurance obligations		
		Insurance with profit participation	Index-linked and unit-linked insurance	Total
		C0220	C0230	C0300
	Premiums written			
R1410	*Gross*	73,654,472.63	16,604,576.60	90,259,049.23
R1420	*Reinsurers' share*	66,596,605.98		66,596,605.98
R1500	*Net*	7,057,866.65	16,604,576.60	23,662,443.25
	Premiums earned			
R1510	*Gross*	73,654,472.63	16,604,576.60	90,259,049.23
R1520	*Reinsurers' share*	66,596,605.98		66,596,605.98
R1600	*Net*	7,057,866.65	16,604,576.60	23,662,443.25
	Claims incurred			
R1610	*Gross*	-1,826,618,866.00	-299,971,043.00	-2,126,589,909.00
R1620	*Reinsurers' share*	-1,617,400,022.00		-1,617,400,022.00
R1700	*Net*	-209,218,844.00	-299,971,043.00	-509,189,887.00
	Changes in other technical provisions			
R1710	*Gross*	1,959,437,950.00	336,957,986.30	2,296,395,936.30
R1720	*Reinsurers' share*	1,753,483,642.00	-406,775.27	1,753,076,866.73
R1800	*Net*	205,954,308.00	337,364,761.57	543,319,069.57
R1900	**Expenses incurred**	130,066,571.17	21,627,778.09	151,694,349.26
R2500	**Other expenses**			743,581.00
R2600	**Total expenses**			152,437,930.26

S.05.02.01

Premiums, claims and expenses by country

		C0150	C0160	C0170	C0180	C0190	C0200	C0210
	Life	**Home Country**	**Top 5 countries (by amount of gross premiums written) - life obligations**					**Total Top 5 and home country**
R1400			**DE**	**AT**				
		C0220	C0230	C0240	C0250	C0260	C0270	C0280
	Premiums written							
R1410	*Gross*		70,729,337.35	15,623,334.77				86,352,672.12
R1420	*Reinsurers' share*	66,596,605.98						66,596,605.98
R1500	*Net*	-66,596,605.98	70,729,337.35	15,623,334.77				19,756,066.14
	Premiums earned							
R1510	*Gross*		70,729,337.35	15,623,334.77				86,352,672.12
R1520	*Reinsurers' share*	66,596,605.98						66,596,605.98
R1600	*Net*	-66,596,605.98	70,729,337.35	15,623,334.77				19,756,066.14
	Claims incurred							
R1610	*Gross*		-1,751,295,353.00	-343,675,412.50				-2,094,970,765.50
R1620	*Reinsurers' share*	-1,617,400,022.00						-1,617,400,022.00
R1700	*Net*	1,617,400,022.00	-1,751,295,353.00	-343,675,412.50				-477,570,743.50
	Changes in other technical provisions							
R1710	*Gross*		1,888,717,455.00	367,445,399.40				2,256,162,854.40
R1720	*Reinsurers' share*	1,753,076,867.00						1,753,076,867.00
R1800	*Net*	-1,753,076,867.00	1,888,717,455.00	367,445,399.40				503,085,987.40
R1900	**Expenses incurred**		120,041,039.50	26,515,052.38				146,556,091.88
R2500	**Other expenses**							743,581.00
R2600	**Total expenses**							147,299,672.88

S.12.01.02
Life and Health SLT Technical Provisions

		Insurance with profit participation	Index-linked and unit-linked insurance			Total (Life other than health insurance, incl Unit-linked)
				Contracts without options and guarantees	Contracts with options or guarantees	
		C0020	C0030	C0040	C0050	C0150
R0010	**Technical provisions calculated as a whole**		0.00			0.00
R0020	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty					0.00
	Technical provisions calculated as a sum of BE and RM					
	Best estimate					
R0030	**Gross Best Estimate**	1,785,314,642.24			341,938,518.28	2,127,253,160.52
R0080	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	1,753,483,641.97			-406,775.27	1,753,076,866.71
R0090	Best estimate minus recoverables from reinsurance/SPV and Finite Re	31,831,000.26		0.00	342,345,293.55	374,176,293.81
R0100	**Risk margin**	75,410,956.25	24,016,866.58			99,427,822.83
	Amount of the transitional on Technical Provisions					
R0110	Technical Provisions calculated as a whole					0.00
R0120	Best estimate					0.00
R0130	Risk margin					0.00
R0200	**Technical provisions - total**	1,860,725,598.49	365,955,384.86			2,226,680,983.35
R0210	**Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total**	107,241,956.51	366,362,160.13			473,604,116.64
R0220	**Best estimate of products with a surrender option**	1,723,111,007.15	27,985,250.46			1,751,096,257.61
	Gross BE for cash flow					
	Cash out-flows					
R0230	*Future guaranteed and discretionary benefits*		14,814,821.35			2,211,190,811.90
R0240	*Future guaranteed benefits*	695,871,203.80				695,871,203.80
R0250	*Future discretionary benefits*	1,500,504,786.75				1,500,504,786.75
R0260	*Future expenses and other cash out-flows*	178,325,204.70	54,274,019.26			232,599,223.96
	Cash in-flows					
R0270	*Future premiums*	592,601,351.68	382,849.14			592,984,200.81
R0280	*Other cash in-flows*					0.00
R0290	**Percentage of gross Best Estimate calculated using approximations**	3.48%	59.27%			
R0300	**Surrender value**	1,899,664,988.86	274,172,680.00			2,173,837,668.86
R0310	Best estimate subject to transitional of the interest rate					0.00
R0320	Technical provisions without transitional on interest rate	1,860,725,598.49	365,955,384.86			2,226,680,983.35
R0330	Best estimate subject to volatility adjustment					0.00
R0340	Technical provisions without volatility adjustment and without others transitional measures	1,860,725,598.49	365,955,384.86			2,226,680,983.35
R0350	Best estimate subject to matching adjustment					0.00
R0360	Technical provisions without matching adjustment and without all the others	1,860,725,598.49	365,955,384.86			2,226,680,983.35

S.23.01.01
Own Funds

	Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	6,000,000.00	6,000,000.00		0.00	
R0030	Share premium account related to ordinary share capital	175,000,000.00	175,000,000.00		0.00	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0.00	0.00		0.00	
R0050	Subordinated mutual member accounts	0.00		0.00	0.00	0.00
R0070	Surplus funds	0.00	0.00			
R0090	Preference shares	0.00		0.00	0.00	0.00
R0110	Share premium account related to preference shares	0.00		0.00	0.00	0.00
R0130	Reconciliation reserve	53,709,143.09	53,709,143.09			
R0140	Subordinated liabilities	0.00		0.00	0.00	0.00
R0160	An amount equal to the value of net deferred tax assets	0.00				0.00
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	0.00	0.00	0.00	0.00	0.00
	Own funds from the financial statements that should not be represented					
R0220	Own funds from the financial statements that should not be represented	0.00				
	Deductions					
R0230	Deductions for participations in financial and credit institutions	0.00				
R0290	**Total basic own funds after deductions**	234,709,143.09	234,709,143.09	0.00	0.00	0.00
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	0.00				
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0.00				
R0320	Unpaid and uncalled preference shares callable on demand	0.00				
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0.00				
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0.00				
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0.00				
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0.00				
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0.00				
R0390	Other ancillary own funds	0.00				
R0400	**Total ancillary own funds**	0.00			0.00	0.00
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	234,709,143.09	234,709,143.09	0.00	0.00	0.00
R0510	Total available own funds to meet the MCR	234,709,143.09	234,709,143.09	0.00	0.00	
R0540	Total eligible own funds to meet the SCR	234,709,143.09	234,709,143.09	0.00	0.00	0.00
R0550	Total eligible own funds to meet the MCR	234,709,143.09	234,709,143.09	0.00	0.00	
R0580	**SCR**	121,555,361.26				
R0600	**MCR**	30,388,840.32				
R0620	**Ratio of Eligible own funds to SCR**	193.09%				
R0640	**Ratio of Eligible own funds to MCR**	772.35%				

	Reconciliation reserve	C0060
R0700	Excess of assets over liabilities	234,709,143.09
R0710	Own shares (held directly and indirectly)	0.00
R0720	Foreseeable dividends, distributions and charges	
R0730	Other basic own fund items	181,000,000.00
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0.00
R0760	**Reconciliation reserve**	53,709,143.09
	Expected profits	
R0770	Expected profits included in future premiums (EPIFP) - Life business	27,577,114.59
R0780	Expected profits included in future premiums (EPIFP) - Non- life business	
R0790	**Total Expected profits included in future premiums (EPIFP)**	27,577,114.59

S.25.01.21

Solvency Capital Requirement - for undertakings on Standard Formula

		Gross solvency capital requirement	USP	Simplifications
		C0110	C0090	C0120
R0010	Market risk	39,151,025.67		
R0020	Counterparty default risk	15,914,882.56		
R0030	Life underwriting risk	109,530,071.41		
R0040	Health underwriting risk	0.00		
R0050	Non-life underwriting risk	0.00		
R0060	Diversification	-33,790,202.78		
R0070	Intangible asset risk	0.00		
R0100	**Basic Solvency Capital Requirement**	130,805,776.85		

	Calculation of Solvency Capital Requirement	C0100
R0130	Operational risk	8,916,320.89
R0140	Loss-absorbing capacity of technical provisions	0.00
R0150	Loss-absorbing capacity of deferred taxes	-18,166,736.48
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0.00
R0200	**Solvency Capital Requirement excluding capital add-on**	121,555,361.26
R0210	Capital add-ons already set	0.00
R0220	**Solvency capital requirement**	121,555,361.26
	Other information on SCR	
R0400	Capital requirement for duration-based equity risk sub-module	0.00
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	0.00
R0420	Total amount of Notional Solvency Capital Requirements for ring fenced funds	0.00
R0430	Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios	0.00
R0440	Diversification effects due to RFF nSCR aggregation for article 304	0.00

	Approach to tax rate	C0109
R0590	Approach based on average tax rate	Yes

	Calculation of loss absorbing capacity of deferred taxes	LAC DT
		C0130
R0640	LAC DT	-18,166,736.48
R0650	LAC DT justified by reversion of deferred tax liabilities	-18,166,736.48
R0660	LAC DT justified by reference to probable future taxable economic profit	0.00
R0670	LAC DT justified by carry back, current year	0.00
R0680	LAC DT justified by carry back, future years	0.00
R0690	Maximum LAC DT	-33,889,957.67

S.28.01.01
Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

	Linear formula component for non-life insurance and reinsurance obligations	C0010
R0010	MCR_{NL} Result	0.00

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

	Linear formula component for life insurance and reinsurance obligations	C0040
R0200	MCR_{L} Result	3,653,598.97

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0050	C0060
R0210	Obligations with profit participation - guaranteed benefits	31,831,000.26	
R0220	Obligations with profit participation - future discretionary benefits	0.00	
R0230	Index-linked and unit-linked insurance obligations	342,345,293.55	
R0240	Other life (re)insurance and health (re)insurance obligations		
R0250	Total capital at risk for all life (re)insurance obligations		113,478,431.23

	Overall MCR calculation	C0070
R0300	Linear MCR	3,653,598.97
R0310	SCR	121,555,361.26
R0320	MCR cap	54,699,912.57
R0330	MCR floor	30,388,840.32
R0340	Combined MCR	30,388,840.32
R0350	Absolute floor of the MCR	3,700,000.00
R0400	**Minimum Capital Requirement**	30,388,840.32

Contacts and Editorial Responsibility

Scottish Widows Europe S.A.
Europe Building,
1, Avenue du Bois,
Limpertsberg, L-1251 Luxembourg
www.scottishwidowseurope.com

“Covid-19 Update”

Addendum to Solvency and Financial Condition Report

May 2020

Contents

Statement of Directors' Responsibilities

This additional section to the 2019 Solvency and Financial Condition Report ("SFCR") presents information in the format prescribed by the applicable Solvency II European regulations and guidelines.

It includes disclosures in relation to
- business performance,
- governance,
- risk profile,
- solvency and
- capital management.

In doing so it sets out the financial position of Scottish Widows Europe and its two German and Italian insurance branches.

The Directors are responsible for preparing this addendum to the original SFCR in accordance with the Solvency II European regulations and guidelines.

Each of the Directors, whose names are listed in the Board of Directors section of the SWE Annual Report and Financial Statements, confirm that, to the best of their knowledge:

- Throughout the reporting period (1 February 2019 to 31 December 2019), SWE continuously complied in all material respects with the requirements of the Solvency II regulations as applicable and
- It is reasonable to believe that, at the date of the publication of this SFCR, SWE continues so to comply, and will continue so to comply in future.

On behalf of the Board,
Frédéric Chandelle
SWE Chief Risk Officer and Chief Actuary
21 May 2020

Summary

On 17th March, EIOPA published its “Statement on actions to mitigate the impact of Coronavirus/COVID-19 on the EU insurance sector”, covering issues related to business continuity, solvency and capital position of (re)insurance undertakings.

On 20th March EIOPA published “Recommendations on supervisory flexibility regarding the deadline of supervisory reporting and public disclosure”. These recommendations enable insurers to concentrate their efforts on monitoring and assessing the impacts of the Coronavirus crisis and are addressed to national competent authorities (CAA, Commissariat aux Assurances for Luxembourg) to help provide a consistent approach to supervision across Europe. The CAA announced in March and April its intention to follow EIOPA Guidelines.

On 23rd March the PRA (UK Supervisor of Scottish Widows Group (‘SWG’), SWE sole shareholder) also published its approach with regard to supervisory reporting and public disclosure in light of the Covid-19 pandemic. In respect of the 2019 SFCR, the PRA confirmed that the Covid-19 situation should be considered a “major development” as per Article 54(1) of the European Solvency II Directive and that information relating to the effect of Covid-19 should be published at the same time as the SFCR. SWE also decided to follow this approach, in line with EIOPA Recommendations.

The PRA published an update to this statement on 16 April 2020 stating that the PRA would not object to firms taking a view that Technical Provisions at year-end 2019 would not be updated for the subsequent impact of Covid-19.

This approach would mean that Covid-19 would not be listed as a material difference in Technical Provisions between Solvency II and the financial statements as at year-end 2019.

Scottish Widows Europe (‘SWE’), like SWG, is presenting the information on the effect of Covid-19 as an addendum to the 2019 SFCR (‘the main report’).

The nature of Covid-19 is that it is on-going and significantly uncertain and, consistent with the PRA update of 16 April, it is therefore considered a non-adjusting post balance sheet event. Figures disclosed in SWE main report have therefore not been adjusted for Covid-19.

This addendum sets out primarily qualitative information to explain the potential impact of Covid-19 on each of the sections contained within the original main report and should be read in conjunction with that report.

While further details are contained in the sections that follow, it should be noted that SWE continues to have substantial capital in excess of regulatory capital requirements at 30 April 2020 and that no supplementary specific management actions have been required to be taken to date to protect or improve SWE solvency ratios.

A. Business and performance

The Covid-19 pandemic and the related impact on the world economy will clearly have a significant impact on the business of all major financial institutions, including large Insurance groups such as SWG. The size and nature of these impacts will ultimately depend on the duration and scale of the pandemic and of the severity of its economic and financial consequences.

However SWE is a life only, run-off and largely reinsured company, heavily collateralised (Withheld Fund, see section 3.4.1 of the main report). The impacts of the Covid-19 pandemic should therefore be limited.

The nature and volume of its activities are most likely to remain unaffected and the crisis is also unlikely to materially influence the timing of its future benefits and expenses.

On the financial side, policyholders' contract values have suffered from the market volatility despite the different containment measures decided by central Governments, regional and local Authorities. This will impact SWE's profitability as

- the observed drop in unit values will reduce the level of future management fees and/or
- guarantees underpinning certain contracts will become more valuable to the policyholder.

The current high levels of the solvency ratios of SWE observed through March and April demonstrate its resilience even in these volatile times, especially with the recent implementation of the hedging strategy to manage its financial buffers (see Section C "Risk Profile" of the report).

B. Systems of governance

Standard governance arrangements in place prior to the onset of the Covid-19 pandemic continue to operate as before. Consistent with SWE ORSA framework and in response to the current situation :

- solvency indicators are monitored more closely and frequently (up to every other day) to ensure that all risks are appropriately identified, assessed, measured, monitored and managed within prescribed limits and to ensure that the organisation has sufficient capital and liquidity to meet liabilities as they become due, including under stressed conditions and,

- Management Committee members ensure that all Board members are regularly informed between Board sessions (immediately in the event of any development that could affect the solvency of the company).

On the operational side, teams have been re-organised through a mix of office presence with required social distancing and remote working in all locations to ensure availability. Some delays could be encountered but these should be limited both in numbers and in time.

SWE has a number of outsourced services, including to critical business processes. A series of actions have been taken by SWE Management Committee Members and their teams to ensure service continuity.

C. Risk profile

Overall there will be some impact on both the profitability and solvency of the Company given the decline and increased volatility of financial markets. It is however too early to assess precisely all long-term impacts of this crisis as no one can yet measure neither its magnitude and severity nor its duration over time.

Key points to note are:

- Covid-19 together with the resulting market volatility should not result in any significant change in SWE's risk profile.

- In the absence of experience data, it is too early to tell whether Covid-19 will have any longer-term impact on underwriting risk profiles, specifically mortality, longevity and persistency.

- From a solvency perspective, company's ratios are now less sensitive to fluctuations in interest rates than to fluctuations in inflation rates, as a result of a recently implemented hedging strategy (see Section C "Risk Profile" of the main report).

    - First, a further drop in market interest rates has been witnessed immediately at the beginning of the Coronavirus Crisis in Europe, before being followed by a partial recovery. Overall this is now (April-May 2020) without significant impact on the solvency position of the company.

    - Second, inflation rates are also decreasing since the beginning of the crisis and these should remain at low levels in the aftermath of the economic slowdown (or even recession) to come. The fact that inflation rates remain at low levels is a positive element for SWE's solvency ratios.

- Covid-19 has not highlighted any specific concentration risk to which SWE is or could be exposed.

This crisis has put both current and emerging risks under the spotlight. SWE continues to manage all risks on an ongoing basis and as a consequence has put in place or reinforced different control measures to assess and mitigate their possible impacts, such as:

- Quality measurement of policyholder administration, which is pursued to ensure no business disruption and to maintain adequate level of service quality,
- Solvency, which is estimated every two days to assess the need of additional actions in addition to the recently implemented hedging program aimed at protecting SWE's current level of own funds.
- Liquidity, which is not a source of concern as liquidity ratios (available liquid assets divided by liquidity needs) are and remain very high.

D. Valuation for solvency purposes

In respect of the valuation for solvency purposes key points to note are:

- Assets continue to be recorded at fair value in line with the valuation methodology described in the Solvency II Directive and its implementing measures, more particularly the delegated regulation 2015/35.
- It is still too early to assess the longer term impact on assumptions underlying the calculation of SWE Technical Provisions and the share of reinsurers in SWE Technical provisions. The impact on the long term 'post pandemic' assumptions is uncertain and dependent on how long both the Covid-19 pandemic and any longer term implications (for example on the economy) will persist.
  - The key economic assumptions for the calculation of Technical Provisions are interest rates, whose future evolution is of course unknown even if one may reasonably expect that they should remain at very low levels at least in the short and middle terms.
  - The prospective long-term demographic assumptions should not be materially impacted if the pandemic is contained and ultimately resolved (for example via social distancing, widespread testing and/or medical advances).
  - It is not expected that the crisis could materially affect the level of expenses, and at this stage it is still too early to assess precisely the longer term evolution of per policy costs given the interaction with policy persistency.

E. Capital management

Covid-19 should have no material impact on the eligibility of Own Funds of Scottish Widows Europe, with coverage of the SCR and MCR being comfortably maintained throughout Q1 2020. The table below sets out the values within which solvency ratios have typically been during Q1 2020.

SWE keeps maintaining a ratio of Own Funds to SCR / MCR significantly in excess of 100%.

SWE Solvency Ratios **Eligible Own Funds / SCR**	**31 December 2019**	**Q1 2020 (*)**
Eligible Own Funds (€)	234,709,143	214,808,569
SCR (€)	121,555,361	116,317,825
EOF / SCR	1.93	1.85
MCR (€)	30,388,840	29,079,456
EOF / MCR	7.72	7.39

Contacts and Editorial Responsibility

Scottish Widows Europe S.A.
Europe Building,
1, Avenue du Bois,
Limpertsberg, L-1251 Luxembourg
www.scottishwidowseurope.com