London & Colonial Assurance PCC PLC

Solvency and Financial Condition Report ('SFCR')

for the financial year ended 31 December 2019

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Executive Summary

Business and Performance

London and Colonial Assurance PCC PLC (LCA) is an Insurance Company incorporated on 25 May 2001. Since September 2016 LCA has been part of STM Group Plc, a leading cross-border financial services group, listed in London on the LSE AIM market. The Company is authorised to write Class I, Class III and Class VI business.

LCA had written little new business between April 2015 and June 2019 when two new unit-linked annuity products were launched.

During 2019 the new premiums received were £4.9m compared to nothing in 2018. In addition, £79.6m of policyholder assets were received in relation to the novation of Gibraltar and UK policies from STM Life Assurance PCC PLC to LCA (Section 1.3 provides details on the novation).

Claim payments were £32.3m in 2019 compared to £36.3m in 2018, and expenses were £1.1m compared to £0.8m in 2018.

Return on investments for 2019 was £3.6m compared to £2.9m in 2018. Unrealised gains in 2019 were £23.6m compared to an unrealised loss in 2018 of £11.6m.

Further details on the business performance are provided in **Section A. Business and Performance**.

System of Governance

LCA's corporate governance framework ensures that the interests of shareholders, policyholders and other stakeholders are appropriately protected. The Company has adopted the 'Three Lines of Defence' model to ensure appropriate segregation of roles and responsibilities.

The Board of Directors is responsible for setting the business objectives and strategic direction, supervising the operations, ensuring compliance with legal requirements, and for implementing an effective risk management system. The Board has established three sub-committees to deal with certain functions in detail:

- Risk and Compliance Committee,
- Audit Committee and
- Product Governance Committee.

For further details see **Section B. System of Governance.**

Capital Management

The Solvency Capital Requirement (SCR) for LCA is calculated using the Solvency II Standard Formula.

The Risk Management Function works closely with the Actuarial Function to ensure that:

- the assessment of the capital needs is informed by the material risks in the risk register and
- as part of the Own Risk and Solvency Assessment the risks not covered in the standard formula SCR are identified and it is considered if additional capital would be required as a quantitative mitigation.

LCA has maintained own funds in excess of the Minimum Capital Requirement (MCR) and SCR throughout the reporting period.

The solvency position as at 31 December 2019 is as follows:

	Capital Requirement	Eligible Capital	Solvency Ratio
SCR	£6.6m	£12.5m	190.3%
MCR	£3,2m	£12.5m	393.3%

The solvency ratio of 190.3% is lower than the ratio as at 31 December 2018 (210.7%) mainly as a result of £2.4m of dividend payments made during 2019.

The valuation for solvency purposes of the assets, technical provisions and other liabilities is documented in **Section D**. **Valuation for Solvency Purposes.**

Solvency II requires that the Quantitative Reporting Templates (QRTs) are disclosed alongside the SFCR and the QRTs as at 31 December 2019 are published on the Company's website.

Risk Profile

Material risks based on their capital requirements

Insurance Risk

LCA's business does not carry any longevity risk as annuity payments are not guaranteed if the policyholder's fund runs out. LCA carries only negligible mortality risk on the portfolio bonds novated from STM Life during 2019.

The Life Underwriting Risk SCR increased in 2019 mainly as a result of the following changes:

- Expense Risk - there is a risk that expenses are higher than anticipated, which would impact the SCR. Since LCA became part of STM Group PLC, it has been possible to identify and execute cost savings. Further business efficiencies will present themselves with the closer alignment of STM Life and LCA entities as well as the planned IT system upgrade scheduled for 2020/21.

  The modelled "per-policy" expense was reduced in 2019 as a result of a detailed analysis of expenses. Expense risk applied to more policies in 2019 as a result of the increase in number of policies following completion of the novation of the policies between STM Life and LCA. A change was made to the calculation of expense risk in the actuarial model. The net result of these various different factors is a reduction in the undiversified Expense Risk component of the SCR.

- Lapse Risk - the major element of the Lapse Risk SCR is the result of the mass lapse shock.

  The undiversified Lapse Risk component of the SCR increased in 2019 mainly as a result of the additional novated policies.

Market Risk

As all the insurance business of LCA consists of unit-linked business much of the investment risk lies with the policyholders, although there is an element of Equity Risk borne by LCA. This Equity Risk arises from collecting fewer charges than anticipated on those unit-linked policies where charges are expressed as a percentage of policy value following an equity shock. A significant fall in market values of the unit-linked assets may lead to the charges collected being lower than anticipated.

Other components of Market Risk include interest risk, spread risk and concentration risk on the non-linked assets.

Overall, Market Risk was higher in 2019 compared to 2018 mainly due to an increase in Equity Type 1 Risk, which increased in 2019 mainly as a result of the additional novated policies from STM Life.

Operational Risk

As all current LCA business is unit linked, the main element affecting the calculation of Operational Risk is the expenses of running the business (Operational Risk is calculated as 25% of these expenses using the Standard Formula).

Operational risks also represent a significant proportion of the top risks in the risk register. As a relatively small company LCA relies on a number of key employees, as well as on outsourced service providers (predominantly affiliated companies). IT Systems adequacy and MI reporting are also key operational risks. The controls mitigating Operational risks are summarised in **Section C.5** below.

Material risks which are not in scope of the SCR

The material risks which are outside the scope of the SCR are documented in **Section C.6**. The key risks are:

Strategic Risk

LCA does not explicitly allocate capital for Strategic Risk, however the stress and reverse stress tests undertaken consider the impact of certain extreme events relating to strategic risks that could cause significant strain on the Company.

The most material strategic risk which has arisen in the first quarter of 2020 is that the Company's 2020 business plan may not be achieved as a result of the impact of the COVID-19 pandemic. Further details are provided in **Section C.6.1 Strategic Risk.**

Group Risk

Group Risk is a material risk for LCA because a number of key functions are outsourced to affiliated companies within STM Group. There is also a loan provided to STM Group. Further details on Group Risk are provided in **Section C.6.2 Group Risk.**

Stress and Scenario Testing

The results of stress testing and scenario analysis for the material risks in the SCR are documented in **Section C7**. The overall conclusion is that LCA is well placed to withstand the stresses.

A. Business and Performance

A.1 Business and Performance

A.1.1 The Company

London and Colonial Assurance PCC PLC (LCA) is an Insurance Company incorporated on 25 May 2001.

The Company is a wholly owned subsidiary of London & Colonial Holdings Limited (LCH), which in turn is 100% owned by STM Group PLC, a leading cross-border financial services group, listed in London on the LSE AIM market.

LCA is a Gibraltar Protected Cell Company subject to the legal provisions laid out in the Protected Cell Companies Act 2001. This means that LCA can create legally recognised 'cells' within the Company in order to segregate and protect each Policyholder's assets. Each cell has its own designation (the policy number) and it is the duty of the Directors to keep the assets and liabilities of each cell separate and therefore accounted for separately whilst observing legislative provisions.

The Company's registered office and operating address is:

Montagu Pavilion

8-10 Queensway

Gibraltar

GX11 1AA

The Company is authorised and regulated by the Gibraltar Financial Services Commission (GFSC). The contact details are:

PO Box 940

Suite 3, Ground Floor Atlantic Suites

Europort Avenue

Gibraltar

Tel:+350 20040283

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E-Mail: information@fsc.gi

The Company's external auditor is:

Deloitte Limited

Merchant House

22/24 John Mackintosh Square

Gibraltar

GX11 1AA

As at 31 December 2019 LCA had 1,297 policyholders.

A.1.2 Products

The Company is authorised to write Class I, Class III and Class VI business, and does not offer any financial, tax or investment advice. Our products are unit-linked annuities or bonds.

LCA is authorised to carry out services under EEA passporting arrangements in the following countries:

- Spain;
- France;
- Portugal; and
- United Kingdom.

A.1.3 Significant Business Events

In 2019, 277 UK and Gibraltar unit-linked policies with a total unit-linked asset value of £79.6m were novated from STM Life to LCA.

STM Life is owned by LCA's parent company, STM Group, and the decision to novate the policies was part of the Group's Brexit contingency planning.

The administration of the novated policies is performed by STM Life's team on an outsourced basis.

A small number of novated policies have some distressed assets. These assets could result in potential professional indemnity (PI) claims against LCA. STM Life has committed to indemnifying LCA from its non-cellular assets for any direct losses, interest, penalties, legal costs and other expenses incurred by LCA in relation to the distressed assets (as defined in the novation agreement).

As at the novation date, there were no PI notifications made to STM Group's insurer for the distressed assets in these policies, because STM Life did not consider this to be necessary.

There are some additional risks associated with the novated policies:

- Potentially dissatisfied clients due to the poor performance of certain investments within their portfolio. In theory this is not an issue for LCA and/or STM Life as investments are selected and purchases instructed by the customers' IFAs, but this disquiet could lead to an increased administration overhead.
- Insufficient liquid assets being available in the clients' accounts to meet LCA's charges.

A project has been initiated to evaluate the feasibility of merging STM Life and LCA. Assuming the feasibility analysis is supportive of merging the two Life companies, the intent would be to complete a Gibraltar Court approved portfolio transfer as soon as practical, ideally before the end of 2020.

A.2 Underwriting Performance

The table below shows the premiums received, claims and expenses:

	2019 £'000	2018 £'000
New Gross Premiums	4,931	0
Premiums (assets) relating to Novated Policies	79,606	0
Gross Claims (including annuity payments)	(32,363)	(36,327)
Expenses (Acquisition & Administration)	(1,088)	(759)

In June 2019, the Company launched two new unit-linked products and as a result the new gross written premiums totalled £4.9m compared to nothing in 2018.

In October 2019, most of STM Life's Gibraltar and UK unit-linked policies were novated to LCA with a total unit-linked asset value of £79.6m.

Claims in the form of annuity payments, transfers out and the transfer of deceased proceeds to the estates were 11% less than in 2018.

Expenses in 2019 were above those in 2018, £1.088m compared to £0.759m. The increase in expenses is mainly due to increased inter-company recharges. Further details are provided in **Section A.4.2**.

A.3 Investment Performance

The investment return for 2019 compared to 2018 was as follows:

	2019 £'000	2018 £'000
Investment return attributable to unit-linked policyholders	27,044	(8,808)
Investment returns on assets held to meet insurance liabilities	225	127
Investment Return	**27,269**	**(8,681)**

The investment income and investment performance in 2019 on assets held to meet the non-linked insurance liabilities of the Company are as follows:

In £'000	Income Received	Realised and Unrealised Gains	Total
Loans & Receivables	1	42	43
Cash & Other Investments	158	24	182
Total	**159**	**66**	**225**

A.4 Other Material Income and Expense

A.4.1 Overview of Revenue

The principal activity of the Company is that of the provision of life assurance business. The table below provides an analysis of the Company's revenue on a GAAP basis:

Revenue	**2019** £'000	**2018** £'000
Net fee income from authorised activities	1,977	1,936
Income from investments	183	113
Income from Group undertakings	42	14
Total Revenue	**2,204**	**2,063**

Further information relating to the Company's performance can be found in the Income Statement of LCA's 2019 Financial Statements.

A.4.2 Overview of Expenses

The table below provides an analysis of the Company's other operating and administrative expenses on a GAAP basis as presented within the 2019 Financial Statements (note 8: Net Operating Expenses).

	2019 £'000	**2018** £'000
Staff Costs	182	188
Premise Costs	31	-
Other General Expenses	16	21
IT & Communications	11	10
Inter-Company Recharges	553	276
Audit	37	34
Actuarial	73	86
Other Professional Fees	82	81
License Fees	55	44
Bank Charges	10	1
Depreciation	4	5
Non-Executive Directors Fees	34	12
Total Expenses	**1,088**	**758**

The increase in the 2019 expenses compared to 2018 is mainly due to higher inter-company recharges.

B. System of Governance

B.1 Governance Structure

LCA has established an effective corporate governance framework, which is appropriate and proportionate for its size, nature, complexity and risk profile.

The responsibilities of the Board and Committees are summarised in **Section B.1.2** below.

The responsibilities of the key functions are documented in the respective sections below.

The material changes in the System of Governance over the reporting period were as follows:

- The CEO retired and the new CEO and Operations Director were formally appointed to the Board with effect from the 28th August 2019.
- The iNED resigned in October 2019. The Board was strengthened with the appointment of two new iNEDs who joined in October 2019.
- The Risk, Audit and Compliance Committee was separated into two committees: Audit Committee and Risk and Compliance Committee.
- The ownership of the Risk Management Function was changed in January 2020 from the Chief Actuary to the newly appointed Head of Life Risk.

B.1.1 Three Lines of Defence

LCA has adopted the 'Three Lines of Defence' model to ensure appropriate segregation of roles and responsibilities across the Company:

The First Line of Defence is performed by the business functions. Their role is to:

- Identify and monitor material risks, implement effective control activities to reduce them.
- Perform risk and control self-assessment and record the results in the risk register on a quarterly basis.
- Propose actions to further reduce risks and improve the controls; implement the actions assigned to them.
- Ensure that recommendations for control improvements (from Board and committees, internal audit or Compliance function reports) in their respective area are implemented.
- Communicate to the Risk Management Function any emerging risks from their respective areas.
- Report any loss events and near miss incidents; co-operate with management on incident investigations.
- Ensure that the process and controls are documented in policies, procedures, flowcharts and manuals. Ensure that the procedures are followed.

The Second Line of defence is performed by the Risk Management and Compliance functions. They provide assurance to the Board that risks are appropriately identified and mitigated by the business functions, and that internal policies are adhered to. The Actuarial Function plays a role in the Second Line of defence as well by contributing to the Risk Management system (with respect to the risk modelling and the ORSA). Further details for the Second Line of Defence functions are provided in **Sections B.3, B.4.2** and **B.6**.

The Third Line of Defence is performed by the Internal Audit function. It provides independent assurance to the Board on the design and operation of the risk management and internal controls frameworks. Further details are provided in **Section B.5.**

The Second and Third Line of Defence functions are designed to be independent from the First Line of Defence.

B.1.2 Responsibilities of Board and Committees

The key responsibilities of the Board of Directors are:

- Approve the strategy, business plan, financial statements and Solvency II submissions.
- Oversee performance against the business plan.
- Ensure that there is an effective governance structure and internal controls system.
- Ensure that there is an effective risk management framework; define the risk strategy and risk appetite; approve the risk management and internal control policies.
- Ensure that Senior Management takes necessary steps to identify, measure, monitor and control risks to the Company.
- Review the capital requirements relative to the business strategy and risk profile, such that they are assured as to the adequacy of the company's solvency position.
- Ensure compliance with statutory and regulatory obligations.
- Monitor the preparedness of the Company to cope with major disruption by ensuring that business continuity and disaster recovery plans are up to date and regularly tested.
- Oversee the performance of the outsourced functions.

The Board meets at least four times per year.

The Board has delegated authority to a number of committees, which assist the Board in delivering its responsibilities.

The key responsibilities of the committees are summarised below.

Risk and Compliance Committee

The Risk and Compliance Committee assists the Board in its leadership and oversight of risk across the Company. This includes the understanding and, where appropriate, optimisation of current and future risk strategy, risk appetite, risk management framework, and the promotion of a risk awareness culture throughout the Company. The Committee also assists the Board in fulfilling its oversight responsibilities in respect of the integrity of the Company's systems of internal control.

The Committee consists of three Non-Executive Directors (two of them independent), the Operations Director and the Chief Actuary. One of the iNEDs chairs the Committee. The Compliance Function holder and the Head of Life Risk attend meetings of the Committee by invitation.

The responsibilities of the Risk and Compliance Committee are to:

- Ensure that independent, effective and sufficiently resourced Risk Management and Compliance functions are established and that these functions operate effectively as the second line of defence.
- Review and recommend to the Board for approval the risk management, compliance and governance policies.
- Make recommendations to the Board concerning the Company's overall risk appetite, tolerance and strategy.
- Monitor, and advise the Board on the current risk exposures of the Company and future risk strategy.

- Monitor the effectiveness of the Company's internal controls framework and risk management system.
- Review reports on material risks and key risk indicators. Ensure that appropriate actions are taken to manage the risk profile.
- Monitor the effectiveness of internal controls. Approve actions to improve the controls and reduce the risks. Ensure that controls mitigating significant risks are regularly audited.
- Identify and assess the potential impact of emerging risks.
- Monitor the risk events (losses and near misses).

Audit Committee

The Audit Committee consists of three Non-Executive Directors (two of them independent). One of the iNEDs chairs the Committee.

The Audit Committee's key responsibilities are to:

- Keep under review the accounting policies; assess the adequacy and effectiveness of the Company's controls over financial reporting.
- Review and challenge where necessary the Company's financial statements (including the actions and judgments of management in relation to them) before submission to the Board.
- Make recommendations to the Board in relation to the appointment of the external auditors and oversee the selection process.
- Discuss with the external Auditors issues such as compliance with accounting standards and any proposals which the external auditors have made in relation to the Company's internal auditing standards.
- Approve the appointment or dismissal of the Internal Audit Function Holder.
- Review the outcome of the internal audit reviews and any resulting recommendations and ensuring appropriate action plans are implemented as a result.
- Monitor and review the Internal Auditor's and external Auditors' independence, objectivity and effectiveness.
- Review the adequacy and security of the Company's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters.
- Review the Company's procedures for detecting fraud.
- Review the Company's systems and controls for the prevention of bribery and receive reports on non-compliance.

Product Governance Committee

The purpose of LCA's Product Governance Committee is to:

- Ensure that the objectives, interests and characteristics of customers are taken into account when designing new products or making changes to existing products.
- Ensure that all new and existing products meet LCA's strategic objectives, commercial and technical standards and that any associated risk is evaluated under LCA's risk appetite framework.

The responsibilities of the Product Governance Committee are:

- Approval of new product proposals from initial outline to launch approval.
- Approval of changes to existing products. Confirmation that the products continue to meet the target market's objectives.
- Approval of product documentation (including 'target customer' documents).
- Monitoring the product distribution and ensuring that it is in the target market / to the target customer.

B.1.3 Key Functions

As required by the Solvency II regulations LCA has established the following key functions:

Key Function	Responsibilities documented in section:
Risk Management Function	B.3.2
Compliance Function	B.4.2
Actuarial Function	B.6
Internal Audit Function	B.5

B.1.4 Remuneration Policy

The Company applies the following remuneration principles:

- Reward and remuneration will be clear and up to date with the market so that individuals are motivated and the Company is able to attract and retain key talent.
- Remuneration packages will be competitive and will recognise the relative remuneration in comparable markets.
- The remunerations are structured in a way that does not encourage excessive risk-taking activities.
- Remuneration consists of a fixed salary, pension and other benefits.
- Currently there are no budgeted bonus (variable compensation) arrangements in place in LCA. However, the Company outsources its Sales and Business Development activities to a Group function. Roles in that function do have variable compensation arrangements in place across the Group.

Annual Bonus Scheme for the MD of LCA

The bonus scheme is predicated on the STM Group meeting its targeted Profit Before Tax (PBT) with any bonus pot thereafter being generated from the surplus in excess of the PBT target. Bonuses are a function of the achievement of both Group financial targets and the achievement of personal objectives.

Pension Scheme

LCA provides an employer sponsored occupational pension scheme to all staff following completion of a successful probationary period. The scheme is a fully authorised (under the Directive for Institutions for Operational Retirement Provision) with the Gibraltar Financial Services Commission. Benefits are provided on a defined contribution basis.

Non-Executive Directors' Fees

Remuneration for Non-Executive Directors comprises a basic fee.

Fees are benchmarked against similar roles in comparable organisations and calculated on an annual rather than a daily basis. However, it is assumed that to fulfil the basic role of a Non-Executive Director, sufficient time and commitment is required each month for review work and attendance at regular Board meetings, the Company's AGM, Special General Meetings (where appropriate), other ad-hoc meetings with regulators and advisers as may be required and training courses.

Non-Executive Directors' remuneration is not performance related nor pensionable and Non-Executive Directors do not participate in any incentive plans.

Fees for Non-Executive Directors are proposed by the Group Executive Directors and subject to approval of the Remuneration Committee of STM Group's Board.

Remuneration Committee

STM Group Plc has a Remuneration Committee in place. The Group Head of HR and CEO also attend the meetings. The Remuneration Committee sets the parameters and framework for Senior Management remuneration across the Group - typically Group Executive members.

Remuneration at the subsidiary level is overseen by local management.

Remuneration Policy

Group HR will be putting in place a Remuneration Policy across all jurisdictions in 2020.

B.2 Fit and Proper

The Company ensures that Board members, senior management and key function holders (including third-party service providers) comply with the fitness and propriety requirements as defined in the Fit and Proper Policy and summarised below.

Fitness and Propriety Assessment

Assessment of Fitness is the evaluation of the qualifications, skills, knowledge are experience.

Assessment of Propriety is the evaluation of a person's honesty, integrity, reputation and financial soundness.

Additional enhanced screening requirements and ongoing Fit and Proper requirements are also applied for individuals who fall within the following categories, as required by Solvency II requirements:

- Executive Management;
- Board members; and
- Key Function Holders.

During the recruitment process the following information is taken into account for fit and proper assessment:

- Interviews, case studies, role plays, knowledge and skills tests and other recruitment assessments.
- Employment history and experience e.g. CV.
- Employment and character references.
- Identity verification, financial sanctions checks, and work permit checks.
- Financial services register and Companies House checks.

- Qualifications checks e.g., certificates, membership of professional bodies.
- Background financial checks e.g., credit checks.
- Background criminal checks e.g., disclosure and barring service.
- Background reputational and disciplinary/enforcement checks.
- Regulatory authorisation application form declarations.
- The candidate's openness and co-operation in providing such information when requested.

All staff members (regardless of role) are required under their contract of employment to observe and act in accordance with the Company's Code of Ethics and Conduct.

The Company has a 'Fit and Proper' policy including a Fit and Proper declaration applicable to all key function holders. It requires information in respect of the following matters:

- Financial difficulties, arrangements with creditors, bankruptcy.
- Criminal prosecutions, civil proceedings.
- Complaints.
- Disciplinary matters.
- Business interests.

Board members are expected to collectively possess appropriate qualifications, experience, and knowledge about the following areas:

- Insurance and financial markets.
- Business strategy and business model.
- System of governance.
- Financial and actuarial analysis.
- Regulatory framework and requirements.

B.3 Risk Management Systems Including the Own Solvency and Risk Assessment

B.3.1 Risk Management System

Risk management is a continuous process which allows for an appropriate understanding of the nature and significance of the risks that the Company is exposed to, and the Company's ability to identify, assess, control and mitigate them. The effective management of risks is essential to the successful delivery of LCA's business strategy and objectives.

Risk Management is integrated (embedded) within the day-to-day operations and decision making processes. This is achieved through:

- the consideration and use of risk and capital MI reports at Board and Committee level when setting business strategy, developing new products, implementing business change projects etc.
- the use of Risk Appetite Statement monitoring reports and Risk Register MI reports for decision making.
- Business functions identifying, assessing, monitoring and reporting risk exposures.

The risk management strategy is documented and, together with the supporting risk policies, is subject to regular review, update and approval.

LCA adopts a 'Three Lines of Defence' approach to managing risk, it is documented in **Section B.1**. There are defined roles and responsibilities for the ownership, oversight and management of risks.

Risk Appetite

The business strategy has been converted into key strategic risk appetite measures which are documented in the Risk Appetite Statement. Risk Tolerances are the metrics used for monitoring each risk appetite category. Actual exposure against tolerance limits is monitored by the Risk Management Function and any risk appetite breach is reported to the Risk and Compliance Committee and the Board.

The Risk Appetite Statement is reviewed and updated annually by the Risk and Compliance Committee and the Board.

Risk Identification, Assessment and Mitigation

The Risk Management Function supports Management and the business in identifying all material risks. Management is responsible for ensuring that there are effective internal controls mitigating each risk.

The material risks are documented in the risk register and are subject to quarterly self-assessment by risk owners who assess the probability of the risk materialising and its impact on the business. The control owners perform quarterly self-assessments of the design and operation of controls. The Risk Management Function provides challenge to the risk and control owners' assessment.

Risk Management Reporting

The Risk and Compliance Committee and the Board review Risk MI reports on a quarterly basis, including outputs from the risk register and the risk appetite assessment. The Risk Management Function ensures that any actions and recommendations from the committee and Board meetings are implemented.

B.3.2 Risk Management Function

The key responsibilities of the function include:

- Develop, implement and maintain the Risk Management Framework and associated risk policies.
- Monitor the consistency of application and embedding of the risk management framework across the Company.
- Assist the Board in developing the Risk Appetite Statement.
- Identify and assess the impact of emerging risks.
- Undertake second line monitoring to assess whether the first line of defence is operating effectively.
- Provide regular risk reporting to the Board.
- Coordinate the Own Risk and Solvency Assessment processes and prepare the ORSA report.
- Facilitate the stress, scenario and reverse stress testing.
- Investigate any reported near-misses or loss events.
- Provide advice and training to business functions and the Board on risk and control-related matters.

- Coordinate assurance activities with the Compliance and Internal Audit functions.

The Risk Management Function works closely with the Actuarial Function to ensure that:

- the assessment of the capital needs is informed by the assessment of the material risks; and
- the risks not covered in the standard formula are identified and it is considered whether additional capital is required as a quantitative mitigation.

To ensure independence, the Risk Management Function has a reporting line to the Risk and Compliance Committee.

B.3.3 ORSA

Own Risk Solvency Assessment (ORSA) is defined as the entirety of processes and procedures employed to identify, assess, monitor, manage and report the current and emerging risks that the Company faces or may face and to determine the own funds necessary to ensure that overall solvency needs are met at all times.

ORSA informs the Board about the material risks and capital requirements over the coming years thus helping the Board to make strategic decisions.

ORSA Processes

The key processes that form part of the ORSA include:

- Risk appetite/tolerance statements (and their ongoing monitoring);
- Business planning processes (and ongoing monitoring of the implementation of the plan);
- Risks and controls assessment (documented in the risk register);
- Emerging risk assessment;
- Assessment of the risks that are not covered by the Standard Formula SCR (e.g. Group risk, Strategic risk);
- Consideration as to whether additional capital is required as a quantitative mitigation;
- Assessment of the risk profile vs. the assumptions underlying the Standard Formula;
- Actuarial Function’s assessment of compliance with technical provision requirements over the business planning period and the potential risks arising from the uncertainties connected to the technical provision calculation;
- Stress and scenario testing (including reverse stress tests); and
- Three-year capital projections and solvency assessment.

For the ORSA the Company deviates from some elements of the Solvency II standard formula where it believes the standard formula are not appropriate to calculate the required solvency capital and to assess overall solvency needs on an “own risk” assessment basis.

A three-year base-case projection of the Solvency II Balance Sheet and solvency capital requirement position is produced. This is based on a number of key assumptions about the level of new business, economic and demographic risks, insurance risks including morbidity, lapses and future expenses.

These projections are then subjected to a range of stress tests in robust downward scenarios including stresses for lower than expected new product sales, worsening morbidity, lapses and expenses over and above assumptions. The results of stress and scenario testing provide an indication of how much capital might be needed to absorb losses should large shocks occur. A range of events that could threaten the Company's business model (reverse stress tests) are also considered.

The Risk and Compliance Committee are involved in selecting the scenarios, and the Board is responsible for discussing the results and approving any management actions. Further details are provided in **Section C.7.**

ORSA Report

LCA's ORSA process operates continuously throughout the year with a full ORSA report produced annually for the Board.

Monitoring of critical metrics from the ORSA is carried out on a quarterly basis through regular risk and capital MI reporting to the Risk and Compliance Committee.

The Risk and Compliance Committee can decide that an ORSA update is required outside of the annual cycle and recommend to the Board a timetable for the completion of the report. The circumstances that may trigger the need for an ORSA outside the regular timescales are documented in the ORSA Policy and Process document.

The ORSA report is subject to independent review by an external actuary, while the ORSA process is subject to independent review by the Internal Audit Function.

Use of ORSA Results

The ORSA results are used for decision making, for example:

- The ORSA results are an integral input to business planning and strategic decision making.
- When developing new products, changing or discontinuing existing products the Board would consider the impact on the capital and risk position of the Company.
- The results from the ORSA capital projection are used for capital planning to ensure the continued solvency is maintained.
- New risks associated with the business plan can be identified during the ORSA, in which case the risk appetite statement may have to be updated and new procedures and controls for managing the risks will have to be implemented.
- Highlighting risk appetite breaches would require the Board to agree risk-reduction actions, or to decide that the risk appetite tolerance is not appropriate any longer and requires update.

B.4 Internal Control Systems

B.4.1 Internal Control Framework

The internal control framework is designed to:

- Mitigate risks and reduce the likelihood of losses, reputational damage or other adverse outcomes for the Company.
- Ensure compliance with legal and regulatory requirements.
- Ensure the accuracy of financial, management and regulatory reports.

The control framework includes the following elements:

- Effective corporate governance framework.

- Segregation of duties - applying the ‘Three Lines of Defence’ model (see **Section B.1.1** for further details).
- Assignment of clear responsibility and authority across the business.
- Training of staff to ensure that they understand their responsibilities in relation to internal controls.
- Regular review and approval of policies, procedures and terms of reference.
- Prevention of financial crime (fraud and money laundering).
- Monitoring and review of management and financial reports.
- Records keeping.
- IT system and data security controls.
- Safeguarding of assets.

LCA’s Management is responsible for establishing, maintaining and promoting effective internal controls.

The controls mitigating material risks are documented in the risk register. Controls’ design and operation are assessed on a quarterly basis and any ineffective controls are reported to the Risk and Compliance Committee, which ensures that actions are taken to address the underlying issues.

Risk events (near-misses or loss events) are recorded and investigated. If they result from control failings Management takes actions to prevent their reoccurrence.

B.4.2 Compliance Function

The Compliance Function is a key function which is approved by the Regulator as a controlled function (Compliance Oversight). This key function is held by the Gibraltar Head of Risk and Compliance and the compliance activities are outsourced to STM Fidecs Central Services Limited.

The Compliance Function is established as an independent control function operating under a Terms of Reference and Target Operating Model. The Compliance Function is not engaged in areas of the business which could create a conflict of interest.

The function has access to all information necessary to carry out its responsibilities and is responsible for reporting to Management any breaches or non-compliance with policies, rules and regulations.

The role and responsibilities of the Compliance Function are documented in the Compliance Manual. The function’s key responsibilities are:

- Advice and guidance – to support the business in respect of regulatory requirements and to make sure that any new regulatory rules are communicated to the relevant business areas.
- Develop compliance policies and procedures.
- Compliance monitoring – to assess the appropriateness of compliance controls and make sure that a monitoring plan is produced and implemented.
- Training – making sure that employees receive regulatory training and information.
- Liaise with the regulator(s) in order to develop and maintain open and cooperative relationships.
- Regulatory reporting– to respond to regulatory requests for information and submit reporting and information as required.

The Compliance Function reports to the Risk and Compliance Committee and the Board on a quarterly basis.

B.5 Internal Audit

B.5.1 Internal Audit Policy

The Internal Auditor performs the Third Line of Defence and provides independent assurance on the effectiveness of the risk management, governance and internal control systems.

The Internal Audit Function is outsourced to STM Group. The internal auditor has unrestricted access to all areas of the business and has direct access to the Chair of the Audit Committee. The role and responsibilities of the function are documented in the Group Internal Audit Charter.

Audit findings are reported to Management and to the Audit Committee, and feed into the risk assessment process. The Internal Audit Function monitors the implementation of the audit recommendations.

B.5.2 Internal Audit Plan

The Internal Audit Function prepares a risk-based audit plan on an annual basis. The plan ensures that all material risks are subject to a review at least once every 5 years.

The plan is flexible so that changes can be made during the year as a result of changes in priorities, external conditions and materiality of risks.

B.6 Actuarial Function

The Chief Actuary is the Key Function Holder of the Actuarial Function and is a member of the Board of Directors. He is a qualified actuary who is a Fellow of the Institute and Faculty of Actuaries and is complying with the specific professional obligations this requires.

The key responsibilities of the Chief Actuary are to:

- Ensure the appropriateness of the methodology, assumptions, systems and controls for actuarial calculations and reports.
- Contribute to the effective risk management system through modelling of risks and actuarial forecasts that form part of the ORSA process.
- Prepare regulatory reports on technical provisions and solvency capital requirements.
- Provide actuarial advice to the Company's senior management and Board.
- Contribute to the stress and scenario testing and reverse stress testing.
- Prepare the Actuarial Function report for the Board on an annual basis.
- Provide actuarial opinion on data quality and underwriting effectiveness.

B.7 Outsourcing

LCA benefits from the available expertise within STM Group. The Company outsources some of its key functions to the following affiliated companies:

Affiliated Service Providers:	Function / Work performed	Jurisdiction

Affiliated Service Providers:	**Function / Work performed**	**Jurisdiction**
STM Fidecs Central Services	Compliance services *(Solvency II key function)*	Gibraltar
STM Group PLC	Internal Audit services *(Solvency II key function)*	UK
STM Group PLC	Sales, Business Development and Marketing	UK
STM Group PLC; STM Fidecs Central Services	IT services	UK; Gibraltar
STM Fidecs Central Services	Company Secretarial services	Gibraltar
STM Fidecs Central Services	Human Resource management	Gibraltar
STM Fidecs Central Services	Legal services	Gibraltar
STM Life	Administration of the novated policies	Gibraltar

The Company has established an Outsourcing Policy which defines:

- the criteria for selection of outsourced service providers;
- the responsibilities for monitoring the performance of outsourced functions; and
- the requirements for written outsourcing agreements.

The Company applies the Fit and Proper procedures in assessing persons employed by the service provider to perform an outsourced key function.

The Board maintains oversight of the performance of the key outsourced functions.

C. Risk Profile

Risk categories based on their capital impact are as follows:

	2019 £'000	**2018** £'000
Life Underwriting Risk	4,939	4,378
Market Risk	2,754	1,908
Counterparty Risk	266	215
Diversification	(1,645)	(1,238)
Basic SCR	**6,315**	**5,264**
Operational Risk	272	191
SCR	**6,587**	**5,455**

The material risks based on their capital contribution are Underwriting Risk and Market Risk. The key risk drivers and the reasons for the changes in the 2019 numbers compared to 2018 are explained in the sections below.

The most significant changes between 2018 and 2019 affecting the figures are as follows:

- The "per-policy" expense reduced partly as a result of continued strong cost control and also due to a revised split between new business and maintenance expenses following a detailed expense analysis undertaken for the 2019 ORSA.
- The addition of 277 novated policies increased the Lapse Risk.
- Overall Life Underwriting Risk increased mainly as a result of the increased Lapse Risk.
- Market Risk has increased by £0.8m from 2018 to 2019. The main driver of the increase is an increase in Equity Type 1 Risk as a result of the novated policies.

C.1 Insurance Risk

Underwriting Risk

Underwriting Risk arises when premiums and investment income are insufficient to pay the contractual benefits on a policy, or when the actual demographic experience and/or expenses of administering a group of policies is worse than assumed in the calculation of best estimate liabilities.

Reserving Risk

Reserve Risk arises from the inherent uncertainty surrounding the adequacy of the reserves set aside to cover insurance liabilities.

C.1.1 Risk Assessment

Risk Category	**2019** £'000	**2018** £'000
Expense Risk	1,721	2,604
Lapse Risk	3,825	2,428
Mortality Risk	209	0
Diversification within risk module	(816)	(673)
Life Risk SCR	**4,939**	**4,359**

The approach to valuation of technical provisions is documented in **Section D.2**.

The key risks are as follows:

Expense Risk

In 2019, the "per-policy" expense was reduced as a result of a detailed expense analysis. All expenses were analysed in relation to new business and maintenance activities with overheads split into similar proportions.

The addition of the novated policies from STM Life in 2019 to the "in force" portfolio adds some Expense Risk.

A change in the calculation of expense risk in the actuarial model has led to a reduction in Expense Risk. If this change had been made at the end of 2018 then Expense Risk as at the end of 2018 would have been approximately £1m lower and the Life Risk SCR would have been approximately £800K lower.

Overall, Expense Risk has reduced in 2019 in comparison to 2018 by £0.9m.

Lapse Risk

This is the risk that a policyholder lapses or surrenders their policy earlier than expected resulting in a loss of future profits to the Company. The main Lapse risk that the Company is exposed to is that of higher lapses than expected meaning that charges collected will be lower than expected and hence the difference between charges and costs will be smaller than expected. This leads to a lower than expected future profit.

The reduction in "per-policy" expenses has contributed to an increase in Lapse Risk. The effect of lower "per-policy" expenses is to make in-force business more profitable in future years. This in turn means that the mass lapse shock yields a larger capital requirement to cover Lapse Risk. For the unit-linked contracts novated from STM Life, there is a surrender penalty in place for early lapse to recoup acquisition costs and hence the Company is protected against the risk of not recouping these costs. The main Lapse Risk that the Company is exposed to for these policies is that of higher lapses than expected meaning that in the long run charges will be lower than expected and hence the difference between charges and costs will be smaller than expected.

Overall it is the mass lapse shock which provides the majority of the Lapse Risk SCR.

Mortality Risk

This risk is not relevant to the historic unit-linked contracts written by LCA. However, there is an element of Mortality Risk for the policies novated from STM Life in that most provide an additional sum assured on death of 1% of the value of the assets capped at £2,000.

Longevity Risk

This risk is not relevant to the type of unit-linked contracts written by LCA.

C.1.2 Risk Mitigation

The Company has processes in place to monitor each of the insurance risks:

- Pricing adequacy is regularly assessed.
- The Chief Actuary is responsible for the reserving policy and for informing the Board of the reserving requirements on a quarterly basis.
- Controls are in place to ensure that reserving processes are adequate and that reserving data is complete and appropriate.
- Lapse Risk in the early years is mitigated by having early surrender charges for the unit-linked policies.
- There is regular monitoring of lapse and expense assumptions.

The Company does not have any reinsurance in place.

C.1.3 Risk Sensitivity

The Company assesses Underwriting and Reserving Risks by considering a number of stand-alone stress tests and scenarios affecting material demographic and expense assumptions in its ORSA. The analyses consider the impact of an immediate shock to the starting balance sheet in addition to the impact on its forward-looking assessment of the future balance sheet position. The results are presented in **Section C.7**.

C.2 Market Risk

Market risk can cause the Company to suffer losses as a result of inappropriate investment strategy or unfavourable fluctuations in the financial markets.

C.2.1 Risk Assessment

Risk Category	**2019** £'000	**2018** £'000
Concentration Risk	794	477
Equity Type 1 Risk	2,488	1,727
Interest Rate Risk	241	78
Spread Risk	180	154
Diversification within risk module	(949)	(528)
Market Risk SCR	**2,754**	**1,908**

There was an increase in Market Risk capital requirements in 2019 compared to 2018 mainly as a result of the increase in Equity Type 1 Risk and Concentration Risk.

The elements of Market Risk are:

Equity Type 1 Risk

No shareholder funds are invested in equities by LCA.

Equity Risk arises from the fact that anticipated future charges may not be collected following a large fall in equity values for those policies where the charging basis is a percentage of policy value rather than a percentage of the initial premium.

There is some protection against this risk in that each policy is subject to a minimum charge expressed in GBP.

Equity Type 1 Risk increased by almost £800K from 2018 to 2019 mainly as a result of the novated policies which accounted for £77.5m of the unit-linked assets of LCA at 31 December 2019.

Interest Rate Risk

Interest Rate Risk arises when a fluctuation in interest rates adversely affects the Company's SCR coverage. Both an increase and a decrease in interest rates are tested and the basic SCR is based on the more onerous reduction in interest rate scenario. This is driven by the basic SCR in respect of the assets backing the Own Funds.

The Own Funds are invested in fixed interest assets and thus there is a small, beneficial exposure to interest rate movements.

Currency Risk

This is not a risk that LCA is exposed to as all unit-linked assets are in GBP.

Concentration Risk

Concentration Risk tests the resilience of own funds against the diversification of a portfolio of assets. The Concentration Risk for LCA arises from the term deposits used to back the Preference Shares and a loan provided to Group.

Spread Risk

There is a small amount of Spread Risk arising from the intergroup loan.

C.2.2 Risk Mitigation

Investment of shareholders' funds is undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.

The Company has processes in place to mitigate Market Risks relating to shareholders' funds:

- The Company ensures that the 'Prudent Person Principle' is applied when investing the shareholders' assets (following the counterparty credit limits and concentration limits). The Company makes sure that new investments do not reduce the average credit rating of the bond portfolios.
- The Company's risk appetite statement sets thresholds for Market Risk as a proportion of the undiversified basic SCR.
- If there is a significant reduction in asset values, the Company will consider reducing management expenses and increasing charges where possible. Within the LCA policies terms and conditions, there is a provision for fees to be changed subject to giving policyholders at least 30 days' notice. The Board will review whether making such increases in charges treats our customers fairly and if so, a cost of living increase will be applied to the charges. A cost of living increase can be applied to the novated STM Life policies as well, in accordance with their terms and conditions.

There are a number of controls in the policyholder monies and investment process, e.g.:

- All management of clients' funds is based on instructions from the policyholders and their investment advisors.

- There are regular asset reconciliations with custodians.
- There is a List of Permitted Investments.
- There are regular communications with policyholders, IFAs and pension trustees.

C.2.3 Risk Sensitivity

The Company has assessed the sensitivity of the SCR coverage to a number of scenarios involving an instantaneous shock to the risk-free yield curve such that risk-free rates were assumed to be zero. This was performed on both a stand-alone basis and combined with the demographic assumption shocks.

As Market Risk is such a small element of the SCR, the shocks tested do not have a significant effect on SCR coverage.

C.3 Credit Risk

The only material Credit Risk that the Company faces is Counterparty Default Risk.

This risk arises when counterparty is unable to fulfil its obligations to the Company, thereby leading to a loss of the Company's financial assets.

C.3.1 Risk Assessment

	2019 £'000	**2018** £'000
Counterparty Risk	266	215

The funds held in bank accounts are the main element of this risk.

C.3.2 Risk Mitigation

The key mitigating control for Credit Risk is:

- The risk appetite statement sets thresholds for counterparty exposure in terms of monetary limits per counterparty and credit quality standing of counterparties. These are monitored regularly by the Risk and Compliance Committee and the Board.

C.3.3 Risk Sensitivity

Credit (Counterparty) Risk is not a material risk for the Company's SCR.

C.4 Liquidity Risk

Liquidity Risk arises when the Company is unable to meet its payment obligations as and when they fall due.

C.4.1 Risk Assessment

Liquidity Risk

Liquidity is not a material risk for the Company since policyholder liabilities are unit-linked liabilities.

£3.8m of policyholder assets is held in property funds, which represents an insignificant proportion of the assets (1.14%) and does not require additional capital to be held.

C.4.2 Risk Mitigations

Liquidity Risk is managed within the risk management and internal control frameworks. The Company ensures that sufficient liquidity is maintained to meet both immediate and foreseeable cash flow requirements.

The following controls mitigate Liquidity Risk:

- investment strategy that ensures significant portion of liquid assets are kept in the portfolio;
- asset-liability matching ensures that there are sufficient funds when payments are due; and
- cashflow projections and monitoring,

C.4.3 Expected Profit Included in Future Premiums

This requirement does not apply to LCA.

C.5 Operational Risk

Operational Risks arise from inadequate or failed processes and systems, as a result of human error or due to external events. These risks can impact the financial results of the Company, its operations or reputation.

C.5.1 Risk Assessment

As all current LCA business is unit-linked, the main element affecting the calculation of Operational Risk is the expenses of running the business with Operational Risk calculated as 25% of these expenses using the standard formula.

C.5.2 Risk Mitigation

Operational Risk is managed through:

- Effective corporate governance, including segregation of duties, avoidance of conflicts of interest, clear lines of management responsibility, adequate management information (MI) reporting.
- A strong internal control culture.
- Staff training/awareness of the control responsibilities relating to their roles.
- Appropriate and secure IT systems.
- Ensuring compliance with regulatory requirements.
- Recruiting/retaining adequately skilled staff, adequate performance assessment system.
- Procedures to minimise internal/external fraud.
- Monitoring outsourced service providers.
- Ensuring accurate and timely financial and other external reporting.

Disaster recovery and business continuity plans are put in place and take into account different types of plausible scenarios to which the Company's operations may be subject to.

Operational Risk exposures are monitored through the risk register and the risk appetite. There are defined key risk indicators which act as early warnings for increased risk of potential losses.

C.5.3 Risk Sensitivity

This is not currently a significant risk for the Company.

C.6 Other Material Risks

Certain risks are not in the scope of the SCR, however they are considered material for the Company and are monitored through the Risk Appetite Statement and the Risk Register. They are also considered in the stress and reverse stress testing process. These risks are as follows:

C.6.1 Strategic Risk

The failure to define or implement appropriate business strategy could result in financial losses and reputational damage. To mitigate this risk LCA is monitoring the market and competitive conditions, legal and regulatory changes and customer demand to decide if strategic adjustments are necessary. The Board also monitors the implementation of the strategy, business plan and business change projects on an ongoing basis.

LCA does not explicitly allocate capital for Strategic Risk, however the stress and reverse stress testing consider the impact of certain extreme events relating to these risks.

The key Strategic Risks for the Company are as follows:

COVID-19 Pandemic

On 12 March 2020 the World Health Organisation announced that the COVID-19 outbreak is a pandemic.

While the direct and indirect impact of this pandemic on LCA is difficult to establish at this time, the Company's preliminary risk assessment and contingency plans are as follows:

- There could be some impact on operations if a high proportion of staff members are unable to come to the office. The mitigation is that all employees have the tools to work from home, and at the time of writing this report most staff members are already working from home.
- There is a potential risk that internet services may have outages as a result of many people working from home or using streaming services at the same time.
- We do not expect any disruption as a result of outsourced service providers' failure as they are all part of STM Group, which has its own business continuity plans.
- Our key external supplier is Gibraltar Asset Management (GAM) and they confirmed that they have effective business continuity plans for all of their staff to work from home.
- The impact on the Company's revenue is difficult to assess at this time, however it is expected that sales may be lower than budgeted for 2020.
- There is likely to be some financial impact for the Company, because the fees for most LCA's policies are based on the policyholder assets' value, and the financial markets fell significantly in Q1 2020. The Q1 Solvency II valuation result showed an increase in non-unit reserves (i.e. a lower negative value) as a result of the lower asset values and a fall in the SCR as a result of lower lapse risk, lower expense risk and significantly lower market risk. The main reason for the large reduction in market risk was a lower value for the equity shock prescribed by EIOPA. As a result of the lower SCR and lower EIOPA discount rates, the Risk Margin also reduced. The overall effect was to reduce Own Funds and the SCR leading to an increase in the solvency ratio from 190.3% to 213.9%.

- Since the end of Q1, asset values have been rising again, which means that Own Funds are likely to have increased as will the SCR. Discount rates are likely to have reduced further and are likely to remain low for the foreseeable future.
- LCA is very well capitalised and has already demonstrated its ability to withstand a market shock of significant proportion and is therefore well placed to withstand any further shocks that may arise.
- Impact on IFAs - like all other businesses the distributors of our products will be impacted by the pandemic. It is not clear how long the UK will be impacted by the pandemic and when the IFAs will be able to return to business as usual.
- Customer service impact – there may be some minor delays in responding to policyholders' queries due to the increased workload that the Operations team is experiencing.
- From an Insurance Risk point of view there is not expected to be any impact on our business as we hold minimal Mortality Risk.

The Board will continue monitoring the developments and will implement any further necessary measures.

Merger of STM Life and LCA

A project has been initiated to evaluate the feasibility of merging STM Life and LCA.

Assuming the feasibility analysis is supportive of merging the two Life companies, the intent would be to complete a Gibraltar Court approved portfolio merger as soon as practical, ideally before the end of 2020.

C.6.2 Group Risk

Outsourcing to Group

LCA benefits from operational support through the services provided by Group functions as discussed in **Section B.7**. The Outsourcing Risk is mitigated by monitoring the performance of the outsourced services in accordance with the Outsourcing Policy and in line with documented Service Level Agreements.

The risk of failure of a Group company providing services to LCA is estimated as low due to the financial stability of STM Group. If this risk does materialise, the Board could outsource these services to external providers or alternatively, they could be brought in-house.

Group-wide Professional Indemnity (PI) insurance policy

LCA benefits from a Group-wide PI insurance policy in exchange for contributing to the insurance premium. There is a risk that another company within the Group could receive a number of complaints that result in significant PI claims, which could increase the insurance premium and consequently LCA's costs. Also, the terms of the PI insurance could become less favourable in the following years as a result of the claims experience e.g. significantly higher excess and/or buffer payments, which could increase the costs relating to future claims by LCA.

Group Loan

LCA has provided a loan (£1.051m as at 31 December 2019) to the ultimate parent company. The loan is repayable on demand and interest is charged at 3.75% per annum.

C.6.3 Reputational Risk

Reputational Risk arises from the negative perception on the part of customers, Independent Financial Advisors, shareholders, investors or regulators which can adversely affect LCA's ability to maintain existing, or establish new, business relationships.

The Company's brand and reputation could suffer as a result of:

- Internal event (e.g. material failure of internal control, financial reporting errors) or
- External events beyond our control (e.g. negative publicity for another subsidiary in the Group).

The risk is mitigated by:

- appropriate governance framework and effective operation of the three lines of defence,
- effective risk management and internal controls framework,
- strong culture of compliance with laws and regulations, and
- the Board's and Committees' oversight of the business.

C.6.4 Conduct Risk

Conduct Rrisk has the potential to arise if the Company's behaviour results in poor customer outcomes. The risk is inherent in any operation that provides products or services to customers.

Delivering good customer outcomes is a key driver in building a valuable, sustainable business and is a key measure as part of the Company's risk appetite.

LCA's products are distributed through regulated intermediaries, which mitigates the exposure to direct sales and distribution. Conduct Risk is further mitigated by a number of controls:

- The design of Company's products is aligned with policyholders' needs.
- The Compliance Function is part of the product documentation and marketing materials sign off process.
- Products' key features are communicated to the policyholders.
- The Product Governance committee approves any new products or product changes.
- Distribution is through regulated intermediaries.
- There are effective onboarding controls.
- There are complaints procedures and controls in place; complaints are monitored by the Board.
- Training is provided to employees.

C.6.5 Risk Exposure arising from Off-balance Sheet Positions

There are no risk exposures arising from Off-balance Sheet positions.

C.7 Stress and Scenario Testing

Stress testing and Scenario testing include consideration of single stresses and multi-faceted scenarios across all material risk categories to assess LCA's ability to meet the capital requirements under stressed conditions.

The risks considered in the scenario testing in the 2019 ORSA were:

- New business at 75% of planned volumes.

- An immediate fall of 25% in market values of policyholder assets.
- A 25% increase in expense levels.
- Mass surrender.
- A number of combinations of the above.

The results of the testing show that the Solvency Ratio over SCR would be in excess of the minimum target of 140% set by the Board. The conclusion is that LCA is well placed to withstand the stresses documented above.

D. Valuation for Solvency Purposes

D.1 Assets

Summary of asset valuation

The table below sets out the valuation of the Company's assets on a GFRS102 and Solvency II basis as at 31 December 2019:

Assets (£'000)	2019		2018	
	GFRS 102	Solvency II	GFRS 102	Solvency II
Investments – Cash	1,755	1,385	3,225	3,238
Investments - Bond and Deposits	2,807	2,807	3,081	3,081
Assets held to cover linked liabilities	342,266	333,926	266,311	261,801
Debtors	1,184	1,051	1,031	1,030
Other assets	6	8,472	7	4,485
Prepayments and accrued income	32	32	24	11
Total assets	**348,050**	**347,673**	**273,679**	**273,646**

The figure for "Assets held to cover linked liabilities" is greater in the GFRS102 figures than the Solvency II assets. The reason for this difference is the treatment of the assets left when an annuitant dies and the policy ceases. In the Solvency II balance sheet these assets are removed from "Assets held to cover linked liabilities" and included in "Other assets" whereas for the GFRS 102 figures they remain in "Assets held to cover linked liabilities".

Fair value measurement

In accordance with the Delegated Regulation, Solvency II figures are based on fair value. Where applicable, the Company measures the fair value of a financial instrument using the quoted price in an active market for that instrument.

Bonds – including Government bonds, Corporate bonds and Collateralised securities.

Government bonds consist of UK government gilts and treasury bonds. The valuation of gilts is based on level 1 methodology of the fair value hierarchy, whilst the valuation of treasury bonds and other fixed-interest securities (including corporate bonds and collateralised securities) are based on the level 2 methodology of the fair value hierarchy.

Deposits other than cash equivalents

Deposits other than cash equivalents consist of cash held on fixed term-deposits with a maturity date greater than 3 months and cash held with investment managers for investment purposes. The valuation of this is the total cash balances held and includes the interest accrued on the deposits up until the balance sheet date.

Assets held for index-linked and unit-linked contracts

The valuation of these assets is consistent with the fair value hierarchy.

Insurance and intermediaries' receivables

The valuation of these assets follows the Solvency II fair value hierarchy.

Property, plant & equipment held for own use

Property, plant & equipment are held at fair value following the Solvency II level 2 and level 3 of the fair value hierarchy.

Cash and cash equivalents

This consists of highly liquid cash holdings held and valued at their actual balances.

Receivables (trade, not insurance)

The valuation of these assets follows the Solvency II fair value hierarchy.

Any other assets, not elsewhere shown

The valuation of these assets follows the Solvency II fair value hierarchy.

D.2 Technical Provisions

Analysis of Technical Provisions

The table below shows the technical provisions split by line of business and between the best estimate liability and risk margin as at 31 December 2018.

Analysis of Technical Provisions (£000s)	Solvency II 2019	Solvency II 2018
Unit Linked liabilities (BEL)	333,926	261,685
Non-unit liabilities (BEL)	(9,589)	(6,086)
Risk Margin	1,967	1,579
Total	**326,304**	**257,178**

Overall technical provisions have increased by £69.1m over the year mainly as a result of the policies novated from STM Life during 2019.

The non-unit reserve is lower (i.e. a larger negative) by £3.5m whilst the risk margin is £0.4m higher. These two changes are mainly as a result of the novated policies and a change in the assumption on "per-policy" expenses.

The best estimate Solvency II cash flows are valued on a market consistent basis using UK specific risk-free discount rates prescribed by EIOPA.

Where the best estimate of liabilities for a group of similar contracts is negative, this has been allowed in the Solvency II technical provisions.

An additional risk margin is required under the Solvency II regulations. This represents the cost of capital that another insurance undertaking would require to take on the Company's insurance liabilities using the 6% EIOPA cost of capital rate.

Main Assumptions

Discount Rates

The valuation interest rates used to discount the best estimate liability and risk margin is the relevant basic sterling risk free term structure of interest rates as at 31 December 2019 and provided by the European Insurance and Occupational Pensions authority ("EIOPA").

Discount rates fell by about 0.4% during 2019 reflecting the change in the EIOPA term structure of risk-free interest rates in the year.

Expenses

Best estimate "per-policy" expenses have been derived from the latest analysis of actual recurring maintenance expenses and actual volumes and mix of business as at 31 December 2019. The expenses allow for direct and outsourced servicing costs.

Salary related expenses are assumed to inflate in line with the Consumer Price Index and other expenses in line with general inflation expectations using the Retail Price Index as a benchmark.

The "per-policy" expense assumption reduced as at 31 December 2019 as covered in more detail in **Section C.1.1** above.

Lapses

Lapse assumptions are derived using actual experience and have regard to current trends in experience and, where appropriate the duration of the contract.

Lapse rates were reviewed to reflect relevant actual experience over recent years and the result was no change in the lapse assumptions for the old LCA policies. The surrender rates for the novated policies from STM life reduced compared to year end 2018 following a detailed lapse analysis.

Mortality Assumptions

Mortality assumptions are set based on standard actuarial tables of mortality rates. Different rates are assumed for males and females.

Methodology

Technical Provisions are defined as the sum of the Best Estimate of Liabilities and the Risk Margin. The best estimate and risk margin are calculated separately.

Best Estimate of Liabilities

The Company has a data warehouse from which individual policy data is extracted and validated for completeness and accuracy. This data is used to calculate the Technical Provisions and Solvency Capital Requirement and has passed an appropriate level of control.

The best estimate of insurance liabilities is calculated on a policy by policy basis for all contracts accepted on risk at the valuation date using a cash flow approach and generally accepted actuarial practices. The calculations generate probability weighted cash flows for each monthly time period within a policy's contract boundary. The cash flows are discounted using the EIOPA risk free yield curve and thus allow appropriately for the time value of money.

If the present value of future cash flows on a contract gives rise to a negative best estimate of liabilities, this has been allowed.

Risk Margin

The total risk margin is calculated as the sum of the present values of the cost of capital rate applied to the SCR of a reference undertaking, willing to take on the Company's insurance portfolio, in each future year until the obligations are extinguished and there is no remaining SCR. The future SCRs are modelled using a permitted simplification whereby the SCR is assumed to be proportional to the projected best estimate of liabilities for each group of similar contracts. If a contract has a negative best estimate of liabilities, projected policy volumes are used to run off the SCR.

The risk margin has been calculated by applying the Company's capital requirements arising under the standard formula SCR Life Risk Module as well as a subset of the Counterparty Risk Module directly to the reference undertaking without adjustment. Market Risk and remaining Counterparty Risk are assumed to be fully hedged.

Uncertainty in the Technical Provisions

Uncertainty arises from actual experience being different to the assumptions used in the calculation of the best estimate of liabilities. The most significant source of uncertainty is lapse rates. In particular this affects the BEL non-unit reserve.

GAAP reserves versus Solvency II Technical Provisions

All figures in £s

	GAAP Reserves	Solvency II TPs
Unit Reserve for UL business	333,925,709	333,925,709
Non-unit Reserve for UL business	0	(9,589,295)
Risk Margin	0	1,967,321
Total reserves	**333,925,709**	**326,303,735**

Unit Linked liabilities are the same for GAAP reserves and Solvency II TPs. For the GAAP reserves non-unit reserves cannot be negative. Solvency II Best Estimate Liabilities can be negative and hence there is a negative non-unit reserve. There is also a Risk Margin in the Solvency II Technical Provisions.

Independent Peer Review

Since July 2018 all actuarial figures have been subject to an independent peer review by an external actuary, Philip Whitefield.

D.3 Other Liabilities

The other liabilities are mainly payments to be made to the estate after the death of a policyholder. Once a policyholder dies the policy terminates and any residual value in the policy is transferred to shareholder funds. When a policy was incepted the policyholder was given a preference share which carries rights to any assets remaining on the death of the policyholder. The assets are transferred from the life fund to the shareholder fund and an associated liability arises.

"Other liabilities" also includes Insurance & Intermediary payables, Other creditors (mainly payments for outsourced services and accruals.

E. Capital Management

E.1 Own funds

Objective, policies and processes for managing own funds

LCA aims to maintain a strong capital base supporting the business plan and meeting the regulatory capital requirements on an ongoing basis.

The Company is managing its funds such that there is an appropriate margin of own funds over the solvency capital requirement at all times. This is monitored formally through the Risk and Compliance Committee on a quarterly basis and more regularly through review of key market and demographic assumptions.

Own funds represent the excess of assets over liabilities and are invested in cash and other assets, fixed interest sovereign and corporate debt. Overall, the assets aim to generate positive returns for shareholders subject to an acceptable level of risk, compliance with regulatory requirements and the required level of liquidity.

Own Funds classified by tiers

The majority of LCA's Own Funds are made up of Tier 1 capital. Tier 1 is the highest quality capital, which is able to absorb losses under all circumstances, including on a going-concern, run-off and winding-up basis. Preference shares represent Tier 2 capital and hence only 50% of the value of these assets are eligible to be included as Own Funds.

Eligible Own Funds are shown in the table below:

Solvency II Balance Sheet (£m)	2019	2018
Total Assets	**347.7**	**273.5**
Best Estimate Liabilities	324.3	255.6
Risk Margin	2.0	1.6
Other liabilities	8.5	4.5
Total Liabilities	**3345.8**	**261.7**
Ineligible preference share capital	0.4	0.4
Eligible Own Funds to cover SCR and MCR	**12.5**	**11.4**

E.2 Solvency and Capital Requirement and Minimum Capital Requirement

The amount of Solvency Capital Requirement ('SCR') and Minimum Capital Requirement ('MCR') are shown in the table below.

	2019 £m	2018 £m
Solvency Capital Requirement	6.59	5.50
Minimum Capital Requirement*	3.19	3.29

* The MCR 31 at December 2019 was equal to £3,186,810 being the absolute minimum capital requirement.

LCA is not subject to any capital add-on at the end of the reporting period.

Solvency Capital Requirement Split by Risk Module

The Company uses the standard formula as set out in the Solvency II Directive Article 230 to calculate the SCR and does not use any undertaking specific parameters.

The table below sets out the net basic SCR for each of the risk modules after diversification within risk module. The risk module capital requirements are calculated without using simplifications.

Solvency Capital Requirement	**2019** £'000	**2018** £'000
Market Risk	2,753	1,908
Counterparty Risk	266	215
Underwriting Risk (Life)	4,939	4,378
Diversification Benefit	(1,645)	(1,238)
Basic SCR	**6,315**	**5,264**
Operational Risk	272	191
SCR	**6,587**	**5,455**

The SCR has increased by £1.1m over the year mainly as a result of the 277 novated policies from STM Life. **Section C. Risk Profile** provides additional information on the key risk drivers for each type of risk.

Minimum Capital Requirement

The components of the MCR calculation are shown below. The absolute floor of the MCR is prescribed by EIOPA as €3.7M for an insurer with long term liabilities. This equates to £3.189m in UK sterling using the exchange rate for 31 December 2019 as advised by the GFSC.

Overall MCR calculation	**£m**
SCR	6.587
MCR cap (45% of SCR)	2.964
MCR floor (25% of SCR)	1.647
Absolute floor of the MCR	3.189
MCR	**3.189**

Solvency Position

	Capital Requirement	Eligible Capital	Solvency Ratio %
SCR	£6.59m	£12.5m	190.3%
MCR	£3.19m	£12.5m	393.3%

The solvency ratio of 190.3% is lower than the ratio as at 31 December 2018 which was 210.7% mainly as a result of £2.4m of dividend payments made during 2019.

E.3 Use of Standard Equity Risk Sub-module

Not Applicable for LCA.

E.4 Differences between Standard Formula and internal model

The Company uses the Standard Formula to assess its Solvency Capital Requirement.

E.5 Compliance with MCR and SCR

The Company has performed a full valuation at the end of each quarter during 2019. In the intervening periods, key risk factors are regularly monitored to identify whether they remain within tolerance levels.

Appendix 1 Quantitative Reporting Templates

The following Quantitative Reporting Templates (QRTs) are required for the SFCR. These files are published on the Company's website. All figures are presented in thousands of pounds with the exception of ratios that are in decimal. Please note that totals may differ from the component parts due to rounding.

QRT Ref	QRT Template name
S.02.01.02	Balance Sheet
S.05.01.02	Premiums, claims and expenses
S.05.02.01	Premiums, claims and expenses by country
S.12.01.02	Life and Health SLT Technical Provisions
S.23.01.01	Own Funds
S.25.01.21	Solvency Capital Requirement – for undertakings on Standard Formula
S.28.01.01	Minimum Capital Requirement – Only Life or only non-life insurance or reinsurance activity

Disclaimer

Some of the statements in this report may refer to LCA's future expectations based on the information available to us at the time of writing the report. LCA does not make any representation or warranty as to the accuracy and completeness of such statements, nor is any representation or warranty made that they will be reviewed, amended or brought up to date.

There are many factors and conditions (economic or financial, owing to market conditions or other external events), that may cause actual results to be significantly different from those that may be anticipated.

LCA does not accept any liability for any decision made, or action taken or not taken, in connection or conjunction with, directly or indirectly, the information and/or statements contained in this solvency and financial condition report.

The SFCR and attached QRTs have not been subject to external audit as this has not been required by the GFSC.

Approval by the Board of Directors of the Solvency and Financial Condition Report

Financial period ended 31 December 2019.

We certify that:

1. The Solvency and Financial Condition Report ('SFCR') has been properly prepared in all material respects in accordance with the Gibraltar Financial Services Commission ("GFSC") rules and Solvency II Regulations; and
2. We are satisfied that:
    a. Throughout the financial year in questions, the Company has complied in all material respects with the requirements of the GFSC rules and Solvency II Regulations as applicable to the Company: and
    b. It is reasonable to believe that, at the date of publication of the SFCR, the Company has continued so to comply, and will continue so to comply in future.

Approval by the Board of the SFCR and reporting templates

David Easton

Managing Director

For and on behalf of the Board

Date: 29th May 2020