

# **Solvency and financial condition report 2016**

**Standard Life Assurance Limited**

**Standard Life** 

# Contents

	<b>Summary</b>	<b>3</b>
<b>A</b>	<b>Business and performance</b>	<b>7</b>
A.1	Business	7
A.2	Underwriting performance	8
A.3	Investment performance	10
A.4	Performance of other activities	11
A.5	Any other information	11
<b>B</b>	<b>System of governance</b>	<b>12</b>
B.1	General information on the system of governance	12
B.2	Fit and proper requirements	18
B.3	Risk management system including the own risk and solvency assessment	18
B.4	Internal control system	20
B.5	Internal audit function	23
B.6	Actuarial function	24
B.7	Outsourcing	24
B.8	Any other information	24
<b>C</b>	<b>Risk profile</b>	<b>25</b>
C.1	Underwriting risk	25
C.2	Market risk	26
C.3	Credit risk	27
C.4	Liquidity risk	28
C.5	Operational risk	29
C.6	Other material risks	30
C.7	Any other information	30
<b>D</b>	<b>Valuation for solvency purposes</b>	<b>33</b>
D.1	Assets	37
D.2	Technical provisions	45
D.3	Other liabilities	55
D.4	Alternative methods for valuation	57
D.5	Any other information	61

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
--------------------------	----------------------	--------------	---------------------------------	--------------------	-------------------

<b>E</b>	<b>Capital management</b>	<b>62</b>
E.1	Own funds	62
E.2	Solvency capital requirement and minimum capital requirement	68
E.3	Use of the duration-based equity risk sub-module in the calculation of the solvency capital requirement	69
E.4	Differences between the standard formula and any internal model used	69
E.5	Non-compliance with the minimum capital requirement and non-compliance with the solvency capital requirement	71
E.6	Any other information	71
	<b>Other information</b>	<b>72</b>
	Statement of Directors' responsibilities	72
	Prudential Regulation Authority approvals and determinations	73
	Report of the external independent auditors to the Directors of Standard Life Assurance Limited	74
	Appendix 1 – Group structure	78
	Appendix 2 – Quantitative reporting templates (QRTs)	79
	S.02.01.02 – Balance sheet	80
	S.05.01.02 – Premiums, claims and expenses by line of business (unaudited)	82
	S.05.02.01 – Premiums, claims and expenses by country (unaudited)	85
	S.12.01.02 – Life and health SLT technical provisions	87
	S.22.01.21 – Impact of long term guarantees and transitional measures	88
	S.23.01.01 – Own funds	89
	S.25.02.21 – Solvency capital requirement - for undertakings using the standard formula and partial internal model (unaudited)	91
	S.28.01.01 – Minimum capital requirement – only life or non-life insurance or reinsurance activity	92
	<b>Glossary</b>	<b>94</b>

The Solvency and financial condition report for the Group and its other subsidiaries are available on our website [www.standardlife.com/SFCR](http://www.standardlife.com/SFCR)

The Group's Annual report and accounts 2016 is also available on our website [www.standardlife.com/annualreport](http://www.standardlife.com/annualreport)

*This document may contain certain 'forward-looking statements' with respect to Standard Life's plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. For example, statements containing words such as 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', 'intends', 'expects', 'plans', 'pursues', 'seeks', 'targets' and 'anticipates', and words of similar meaning, may be forward-looking. By their nature, all forward-looking statements involve risk and uncertainty because they are based on information available at the time they are made, including current expectations and assumptions, and relate to future events and circumstances which may be or are beyond Standard Life's control, including among other things: UK domestic and global political, economic and business conditions (such as the United Kingdom's exit from the European Union); market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the impact of inflation and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the impact of competition; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; default by counterparties; information technology or data security breaches; natural or man-made catastrophic events; the failure to attract or retain necessary key personnel; the policies and actions of regulatory authorities; and the impact of changes in capital, solvency or accounting standards, and tax and other legislation and regulations in the jurisdictions in which Standard Life and its affiliates operate. These may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. As a result, Standard Life's actual future financial condition, performance and results may differ materially from the plans, goals, strategy and expectations set forth in the forward-looking statements. Persons receiving this document should not place undue reliance on forward-looking statements. Standard Life undertakes no obligation to update any of the forward-looking statements contained in this document or any other forward-looking statements it may make. Past performance is not an indicator of future results and the results of Standard Life in this document may not be indicative of, and are not an estimate, forecast or projection of, Standard Life's future results.*

## Summary

This document sets out a Solvency and financial condition report for Standard Life Assurance Limited (SLAL or the Company) for 2016, to satisfy the requirements of Solvency II.

The purpose of the report is to assist policyholders and other stakeholders to understand the capital position under Solvency II of SLAL as at 31 December 2016.

On 1 January 2016, the Solvency II regulatory regime came into force for insurers across the European Union (EU). Under Solvency II, every insurer is required to identify its key risks – e.g. that equity markets fall - and hold sufficient capital to withstand adverse outcomes from those risks. The capital required to withstand these outcomes is the 'solvency capital requirement', or SCR. The SCR is calibrated so that the likelihood of a loss exceeding the SCR is less than 0.5% over one year. This ensures that capital is sufficient to withstand broadly a '1 in 200 year event'. The capital resources available to meet the requirements are called 'own funds'.



The main purpose of holding capital is to provide security to policyholders and other customers. The Company considers itself to be strongly capitalised under Solvency II, as own funds are significantly higher than the SCR as set out in Section c) of this summary.

### a) Capital management policies and risk management objectives

Managing capital is the ongoing process of determining and maintaining the quantity and quality of capital appropriate for the Company and ensuring capital is deployed in a manner consistent with the expectations of our stakeholders. For these purposes, the Board considers our key stakeholders to be the providers of capital (our equity holders, policyholders and holders of our subordinated liabilities) and the Prudential Regulation Authority (PRA).

The Company actively seeks to manage its capital position with the key aim of ensuring that our capital position can be maintained at a viable level to continue to operate the business under severe stress, in order to protect policyholders, customers and other key stakeholders. Within this overriding framework we then seek to optimise our use of capital to maximise returns for shareholders and policyholders at an appropriate level of rewarded risk, and to manage our operations effectively to minimise or eliminate unrewarded risk.

As part of our business planning we project forward capital projections under a range of scenarios. Alongside these projections we set out a forward looking capital plan, which identifies the key (or priority) capital actions proposed (whether for implementation or just further investigation) over the next 12 months and commentary on the wider range of potential actions which may be available to the Company to manage the capital position if required.

Our annual dividend proposal seeks to dividend to Standard Life plc the profits and cash generated over each 12 month period, subject to passing a range of capital and liquidity tests to ensure that any dividend paid is affordable and does not conflict with the requirement to maintain appropriate capital coverage.

Capital plans are ultimately subject to approval by the Company's Board.

### b) Regulatory capital

The Company's capital position under Solvency II is determined by aggregating the assets and liabilities of the Company recognised and measured on a Solvency II basis (being own funds) and comparing this to the Company's SCR to determine surplus capital.

The Company's Solvency II SCR is calculated on the basis of management's own regulator-approved partial **internal model**. The Solvency II capital resources are also subject to minimum capital requirements (MCRs).

#### Internal model

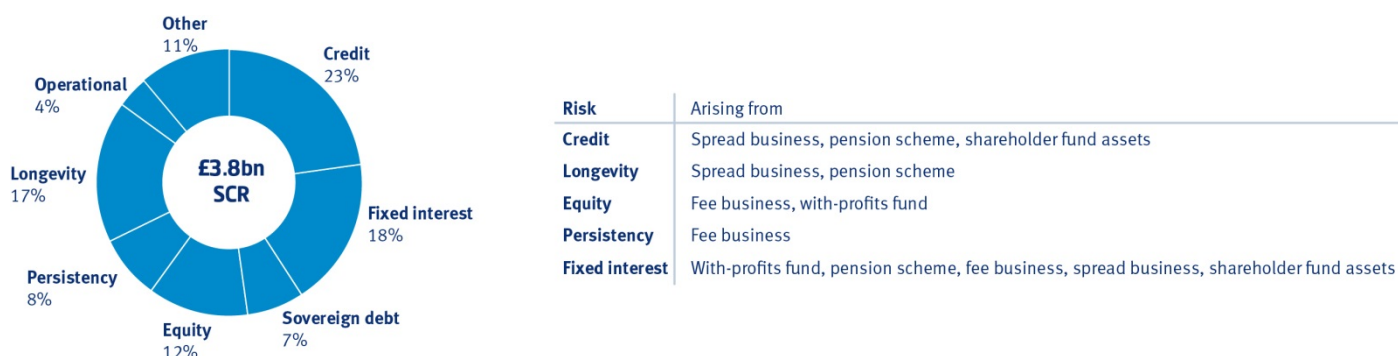
Companies can model features specific to their business

#### Standard formula

Capital requirements are formulaic, with a common set of rules

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Our solvency capital requirement reflects our well diversified set of risks as shown in the following diagram:



### c) Capital surplus

Our capital surplus is the amount of capital resources (referred to as own funds) that the Company holds in excess of its capital requirement. We are strongly capitalised with a Solvency II capital surplus of £2.9bn (2015: £2.2bn) representing a solvency cover of 176% (2015: 172%).

The Solvency II capital surplus of £2.9bn would change by £0.2bn\* or less following a:

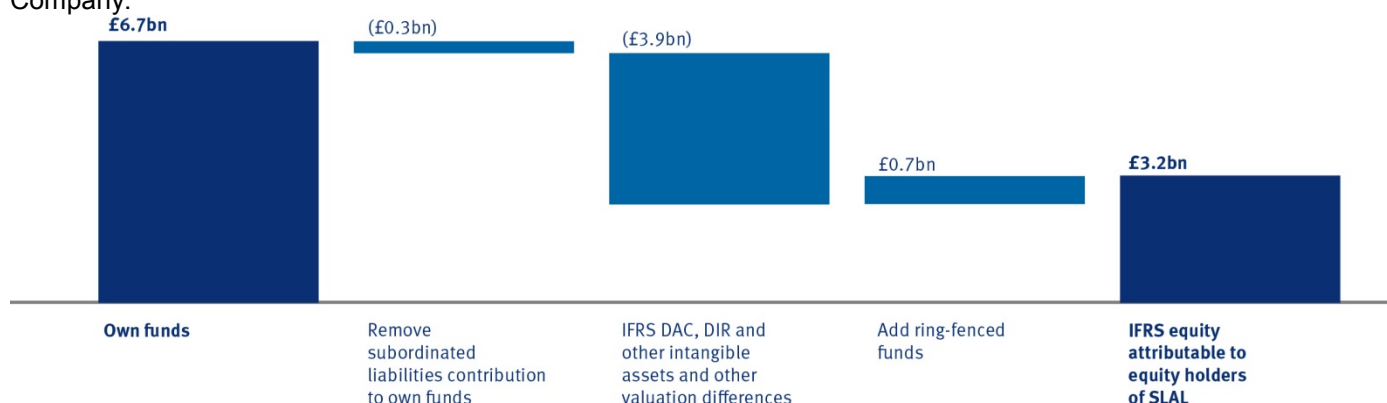
- 20% rise or fall in equities, or
- 100bps rise or fall in fixed interest yields, or
- 50bps rise or fall in credit spreads, or
- 5% increase or decrease in mortality rates, or
- One-off surrender experience of 10%

\*excluding any impact from the IFRS pension scheme surplus.

	31 Dec 2016	1 Jan 2016
Own funds	<b>£6.7bn</b>	£5.3bn
Solvency capital requirement (SCR)	<b>(£3.8bn)</b>	(£3.1bn)
Solvency II capital surplus	<b>£2.9bn</b>	£2.2bn
Solvency cover	<b>176%</b>	172%

At 1 January 2016 the own funds included a restriction to the IFRS pension scheme surplus. This restriction reduced the contribution of the pension scheme to own funds to a value equal to the contribution of the pension scheme to the Company's SCR i.e. the contribution of the pension scheme to excess own funds was zero. Following discussions with the PRA, this restriction at 31 December 2016 has been removed. This is a change to the SLAL Solvency II own funds previously reported in the 31 December 2016 report and accounts. The impact of the change is to increase own funds and capital surplus by c£0.7bn. It increases the solvency cover by 19%.

The chart below provides a reconciliation of Solvency II own funds to IFRS equity attributable to equity holders of the Company:



As shown in the chart above:

- Subordinated liabilities provide capital in Solvency II provided certain conditions are met
- Ring-fenced fund are surplus funds which have not been made available for distribution to policyholders or other beneficiaries due to their lack of transferability within the undertaking
- Certain items that are recognised as assets and liabilities under IFRS are not recognised as assets and liabilities in own funds, being the Company's deferred acquisition costs (DAC), deferred income reserve (DIR) and other intangible assets. Other valuation differences are mainly due to differences in the measurement of technical provisions for insurance business.

#### d) Format of the report and material changes

This report is prepared following the structure and headings set out in the Solvency II regulations. A brief outline of each section and details of any material changes in the year to 31 December 2016 are given below. Sections D and E are audited unless otherwise stated. For further details refer to the audit opinion.

<b>Section A Business and performance</b>  This section gives details on how the Company's performance is reported and managed, including details of current year performance	<p>IFRS profit from operations increased to £185m (2015: £156m) due to a 9% increase in operating profit, favourable movement in short-term fluctuations in investment return and economic assumption changes and reduced restructuring costs offset by a non-operating provision for annuity sales practices relating to the Financial Conduct Authority's enhanced annuity thematic review.</p> <p>There were no other material changes in relation to business and performance during the year.</p>
<b>Section B System of governance</b>  This section sets out the overall framework of policies, controls and practices we use to ensure we meet all of the requirements of sound, risk-based management.	<p>Material changes in relation to the system of governance during the year were:</p> <ul style="list-style-type: none"><li>• Restructuring of the SLAL Board - the restructuring included the appointment of an independent Chairman, who also sits on the Group Board, and two independent non-executive Directors. A third independent non-executive Director will be appointed once FCA approval has been granted.</li><li>• A SLAL Audit Committee and a SLAL Risk and Capital Committee were constituted (but were not operational in 2016). The non-executive Directors will be the members of the committees.</li></ul>
<b>Section C Risk profile</b>  This section sets out the material risks to which the Company is exposed and the techniques used to monitor and manage these risks.	<p>Material changes in relation to risk profile during the year were:</p> <ul style="list-style-type: none"><li>• The major political event for our business in 2016 was the UK's vote to leave the EU. We will be directly impacted by the outcome of the negotiations between the UK and EU, although the details may not be known for some time. We have a strong track record of successfully responding to changing circumstances and are ready to adapt our business as appropriate to any post-Brexit changes in regulations and markets.</li></ul>
<b>Section D Valuation for solvency purposes</b>  This section provides information on the valuation of assets and liabilities for the Company's Solvency II balance sheet, with particular focus on how technical provisions are valued.	<p>Material changes in relation to valuation for solvency purposes during the year were:</p> <ul style="list-style-type: none"><li>• The approval by the PRA in November 2016 for a second matching adjustment portfolio, relating to certain annuities that were sold prior to The Standard Life Assurance Company's demutualisation in July 2006 (this increased the Company's Solvency II surplus by £0.2bn).</li><li>• The recalculation of the transitional measure on technical provisions in June 2016, reflecting material changes in risk free rates, and again in December 2016 as a result of the matching adjustment approval in November (this increased the Company's Solvency II surplus by £0.3bn, which largely offset the adverse impact of the increased risk margin which arose from lower risk free rates).</li><li>• As discussed on the previous page, at 1 January 2016 the own funds included a restriction to the IFRS pension scheme surplus. Following discussions with the PRA, this restriction at 31 December 2016 has been removed. The impact of the change is to increase own funds and capital surplus by c£0.7bn. It increases the solvency cover by 19%.</li></ul>
<b>Section E Capital management</b>  This section gives details on the Company's approach to capital management, the composition of Solvency II capital and details of the SCR and MCR.	<p>There were no material changes in the period in relation to capital management.</p>

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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In addition to the above certain QRTs are included in Appendix 2. The Glossary at the end of the report defines the key terms and acronyms used throughout.

Parts of this document refer to sections of the Group's Annual report and accounts 2016, which is available to download from the Group's website **[www.standardlife.com/annualreport](http://www.standardlife.com/annualreport)**

Parts of this document refer to sections of the Company's Annual report and accounts 2016, which is available to download from the Group's website **[www.standardlife.com](http://www.standardlife.com)**

Comparison of information with previous reporting periods is not required in this first report in accordance with the regulations.



## **A. Business and performance**

### **A.1 Business**

The Company is an insurance undertaking and a wholly owned subsidiary of Standard Life plc. The Company's main activities consist of the provision of life assurance and pension products in the UK, Ireland and Germany, with the business written in Ireland and Germany through branches.

The Company is registered in Scotland (SC286833) and is regulated by UK legislation (e.g. including the Companies Act 2006). As a provider of financial services, the regulation of the Company is through the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).

The Company's parent is Standard Life plc, which is also registered in Scotland (SC286832) and is listed on the London Stock Exchange.

A list of the Company's related undertakings including the name, legal form, country and proportion of ownership interest held can be found in Note 45 on pages 102 to 108 of the Company's 2016 Annual financial statements 2016.

The supervisor of the Company and Standard Life plc is the PRA, 20 Moorgate, London, EC2R 6DA.

The Company's External auditor is PricewaterhouseCoopers LLP, Atria One, 144 Morrison St, Edinburgh, EH3 8EX.

#### **A.1.1 Company and Group structure**

The Company is a member of the Standard Life Group. See Appendix 1 for detail of the Company's position within the legal structure of the Group.

The results of the Company are reported within the Group's Annual report and accounts as part of the Pensions and Savings segment.

Our Pensions and Savings business is a leading provider of long-term savings and investment propositions. It is primarily based in the UK, with operations in Ireland and Germany and serves around 4.5 million customers and clients. Its main aim is to help people manage their money today and save for the future.

In the UK, through our Workplace channel, we offer pensions, savings and flexible benefits schemes to employees through their employers. Our Retail channel is a mix of intermediary relationships (financial advisers), direct customer relationships and our own financial planning business (1825).

Our mature book includes UK mature Retail as well as spread/risk products, such as annuities and protection. In Ireland and Germany, we offer savings and investment products to a variety of customers and clients.

Subsequent analysis of financial information in this Business and Performance section will relate to the Company only.

#### **A.1.2 Significant business events**

The non-operating loss in 2016 includes a £175m provision in relation to the FCA's enhanced annuity thematic review for an estimation of the redress payable to customers, the costs of conducting the review, and other related expenses. At this stage there is significant uncertainty relating to all of these elements. Note 36 on page 62 of the Company's Annual financial statements 2016 provides further background, and explains that we are seeking for up to £100m of the financial impact to be mitigated by insurance.

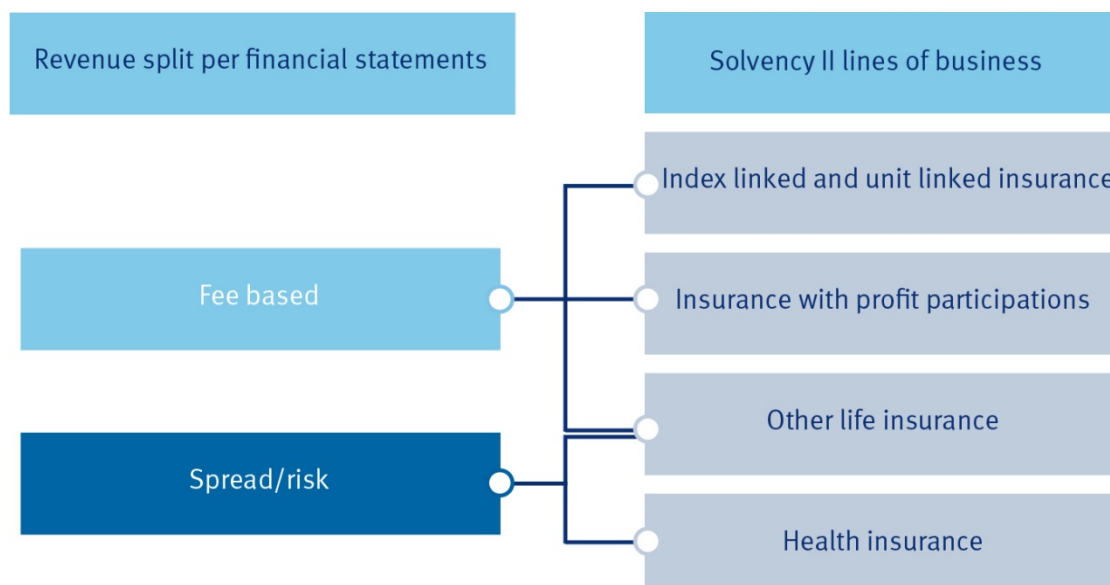
#### **A.1.3 Material lines of business**

In the Group's Annual report and accounts revenue is split between two material lines of business; fee based and spread/risk business.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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The following diagram shows how these splits map to the Solvency II defined lines of business:



Health insurance business is not material in the context of the Company's overall insurance business. Other life insurance mainly comprises annuity business which is reported within spread/risk.

#### Fee based business

The Company's fee based business is made up of products which generate revenue primarily from asset management charges (AMCs), premium based charges and transactional charges. AMCs are earned on products such as SIPP, corporate pensions and mutual funds, and are calculated as a percentage fee based on the assets held. Investment risk on these products rests principally with the customer, with the shareholder's major indirect exposure to rising or falling markets coming from higher or lower AMCs. Some of the fee business provides guarantees to policyholders, including some unitised with profits business in the Heritage With Profits Fund (HWPF) and unitised business in the German With Profits Fund (GWPF). The existence of guarantees is a key consideration in the way risk is managed.

#### Spread/risk business

The Company's spread/risk business mainly comprises of products that provide a guaranteed level of income for customers in return for an investment. The 'spread' referred to in the title primarily relates to the difference between the guaranteed amount paid to customers and the actual return on related assets over the period of the contract. Spread based business consists of annuities and risk based business consists of protection products.

#### A.1.4 Material geographical areas

The Company operates in the UK, in Ireland (through the SLAL Irish branch) and in Germany (through the SLAL German branch).

### A.2 Underwriting performance

Operating profit reporting provides further analysis of the results reported under IFRS and is consistent with the way that financial performance is measured and reported to the Company's Board and executive management. It is also a key performance indicator used to explain results in the Group Annual report and accounts. Operating profit (before tax) is therefore used below as a measure of the underwriting performance of the Company.

Operating profit excludes impacts arising from short-term fluctuations in investment return and economic assumption changes. Short-term fluctuations in investment return and economic assumption changes are discussed further in Section A.3. Operating profit also excludes the impact of the following items:

- Restructuring costs and corporate transaction expenses. Restructuring includes the impact of major regulatory change.
- Impairment of intangible assets acquired in business combinations
- Profit or loss arising on the disposal of a subsidiary, joint venture or associate
- Amortisation of intangibles acquired in business combinations and fair value movements in contingent consideration
- Items which are one-off in nature and, due to their size or nature, are not indicative of the long-term operating performance of the Company

The following table shows operating profit for the Company reconciled to total performance (IFRS profit before tax) and profit after tax for the year:

	2016 £m	2015 £m
<b>Operating profit before tax</b>	<b>355</b>	<b>326</b>
Adjusted for the following items		
Short-term fluctuations in investment return and economic assumption changes	25	(53)
Restructuring and corporate transaction expenses	(31)	(75)
Provision for annuity sales practices	(175)	-
<b>Non-operating items</b>	<b>(181)</b>	<b>(128)</b>
Dividends received from operating subsidiaries	19	15
Impairment of operating subsidiaries	-	(50)
Profit attributable to non-shareholders	34	34
<b>Profit before tax expense attributable to equity holders' profits</b>	<b>227</b>	<b>197</b>
<b>Total tax expense attributable to equity holders' profits</b>	<b>(42)</b>	<b>(41)</b>
<b>Profit for the year</b>	<b>185</b>	<b>156</b>

The operating profit of the Company split by material geographical area is as follows:

	UK £m	Ireland £m	Germany £m	Total £m
<b>31 December 2016</b>				
Fee based revenue	550	55	129	734
Spread/risk margin	119	10	5	134
<b>Total operating income</b>	<b>669</b>	<b>65</b>	<b>134</b>	<b>868</b>
Total operating expenses	(372)	(44)	(118)	(534)
Capital management	22	(1)	-	21
<b>Operating profit before tax</b>	<b>319</b>	<b>20</b>	<b>16</b>	<b>355</b>
<b>31 December 2015</b>				
Fee based revenue	535	47	120	702
Spread/risk margin	143	4	(2)	145
<b>Total operating income</b>	<b>678</b>	<b>51</b>	<b>118</b>	<b>847</b>
Total operating expenses	(386)	(38)	(109)	(533)
Capital management	14	(2)	-	12
<b>Operating profit before tax</b>	<b>306</b>	<b>11</b>	<b>9</b>	<b>326</b>

#### SLAL UK:

Operating profit before tax increased by £13m to £319m. Fee based revenue increased by £15m to £550m, benefiting from a combination of strong net inflows together with positive movement in market levels over the second half of the year.

Spread/risk margin decreased by £24m to £119m. Operating assumption and actuarial reserving changes provided a benefit of £38m (2015: £43m), primarily relating to future longevity assumption changes. Although we had expected fewer asset and liability opportunities to exist in the low yield environment, we took advantage of volatility in financial markets mainly in the first half of 2016 to deliver a benefit of £25m (2015: £30m). A number of other components contributed to a lower spread/risk margin than 2015 including adverse mortality experience and reduced new business. These reductions were partly offset by an £18m payment in 2016 from our main with profits fund relating to changes to the Scheme of Demutualisation in response to the transition to Solvency II. This effectively brings forward some of the payments expected in future years under the previous scheme rules.

Operating expenses reduced by £14m to £372m, impacted by the continued drive to scale our business. Ongoing investment in technology to reduce future customer operations and IT maintenance costs has allowed further process automation and customer self service.

#### SLAL Europe:

In our European branches operating profit increased by £9m to £20m in Ireland and by £7m to £16m in Germany. The 2015 result was lower due to the impact of the £9m one-off shareholder support provided to the German with profits business. In 2016 our German business benefited from a £5m reduction in actuarial reserves due to lower maintenance expenses. The 2016 spread/risk result includes the benefit of a £4m payment from our main with profits

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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fund relating to changes to the Scheme of Demutualisation in response to the transition to Solvency II. The 2016 result also benefited from favourable foreign exchange movements of £2m.

A breakdown of the Company's operating profit by Solvency II line of business is as follows:

	2016 £m
Index-linked and unit-linked insurance	131
Insurance with profit participations	102
Other life insurance	122
Health insurance	-
<b>Operating profit before tax</b>	<b>355</b>

Other life insurance mainly comprises annuity business which is reported within spread/risk and is driven by the spread/risk margin result less related expenses in the UK, Ireland and Germany. The index-linked and unit-linked insurance and insurance with profit participations lines of business are driven by the revenue and expenses of the Company's fee based business in the UK, Ireland and Germany.

Appendix 2 sets out the Company's QRT S.05.01.02 *Premiums, claims and expenses by line of business* which gives details of premiums and claims in the Company's insurance business. The majority of the Company's business is investment based and not considered insurance contracts under IFRS. It therefore does not give rise to premiums and claims for the purposes of this QRT. As a result the premiums and claims reported on S.05.01.02 give a limited view of the operating profit (and hence underwriting performance) of the Company.

### A.3 Investment performance

The Company uses investment return as a measure of investment performance. The following table shows the Company's investment return by asset class, including income and expense components, for the year ended 31 December 2016:

	2016 £m	2015 £m
<b>Financial instruments other than those at fair value through profit or loss (FVTPL)</b>		
<b>Interest income</b>		
Cash and cash equivalents	22	18
Loans	20	21
Other	6	7
	48	46
Impairment losses on subsidiaries	-	(50)
Foreign exchange gains on instruments other than FVTPL	(126)	9
<b>Gains/(losses) on financial instruments other than those at FVTPL</b>	<b>(78)</b>	<b>5</b>
<b>Financial instruments at FVTPL</b>		
Dividend income	2,194	2,081
<b>Gains/(losses) on financial instruments held at FVTPL</b>		
Investment in associates	(59)	189
Investment in subsidiaries	1,779	582
Equity securities and interests in pooled investment funds	6,004	666
Debt securities	3,998	23
Derivative financial instruments	209	69
Loans	9	3
Assets held for sale	1	-
	11,941	1,532
<b>Gains/(losses) on financial instruments held at FVTPL</b>	<b>14,135</b>	<b>3,613</b>
<b>Investment property</b>		
Rental income	286	265
Net fair value gains on investment property	(110)	377
	176	642
<b>Total investment return</b>	<b>14,233</b>	<b>4,260</b>

Total investment return in 2016 amount to £14,233m and was driven by gains from each of the material asset classes held by the Company's shareholder, with profits and unit-linked business categories. In the second half of 2016 equity markets rose and yields fell leading to significant gains on these holdings. In addition to the above the Company recognised gains of £5m (2015: £4m) in respect of owner occupied property directly in equity.

Investment management expenses in 2016 were £164m (2015: £169m).

Impacts arising from short term fluctuations in investment return and economic assumption changes are discussed further in Section A.4.

At 31 December 2016, the Company had investment in securitisations with a fair value of £342m. This comprised of 40 investments of which the largest was £32m.

## **A.4 Performance of other activities**

### **Non-operating items:**

Other activities which are not underwriting performance are non-operating items and are outlined below.

Short term fluctuations are calculated based on expected returns on investments backing equity holder funds, with consistent allowance for the corresponding expected movements in equity holder liabilities. Impacts arising from the difference between the expected return and actual return on investments, and the corresponding impact on equity holder liabilities except where they are directly related to a significant management action, are excluded from operating profit and are presented within profit before tax. These generated a profit of £25m (2015: loss £53m) mainly due to a narrowing of credit spreads and a fall in yields.

Restructuring and corporate transaction expenses reduced to £31m (2015: £75m).

The non-operating loss in 2016 includes a £175m provision in relation to the FCA's enhanced annuity thematic review for an estimation of the redress payable to customers, the costs of conducting the review, and other related expenses. At this stage there is significant uncertainty relating to all of these elements. Note 36 on page 62 of the Company's Annual financial statements 2016 provides further background, and explains that we are seeking for up to £100m of the financial impact to be mitigated by insurance.

### **Tax expense:**

The total tax expense attributable to shareholders' profits for the year ended 31 December 2016 was £42m (2015: £41m).

### **Leasing arrangements:**

The only material classes of assets subject to leasing arrangements are property, in relation to operating leases for investment property (where the Company is the lessor). Rental income from investment property during the year to 31 December 2016 was £286m (2015: £265m).

## **A.5 Any other information**

None.

## B. System of governance

### B.1 General information on the system of governance

#### B.1.1 Overview

Standard Life's system of governance is the overall framework of policies, controls and practices by which we meet all the requirements of sound, risk-based management are met.

Our system of governance comprises:

- **Governance framework** – how we manage our business including the role of the Board and its committees
- **Organisational and operational structure** – how we structure our business and define roles, responsibilities and reporting lines to ensure that appropriate spans of control operate throughout the organisation
- **Risk management system** – a risk-based approach to managing our business. It includes the methods and processes we use to manage risks consistently across Standard Life. We refer to our risk management system as the Enterprise Risk Management (ERM) framework.
- **Internal control system** – contains a range of processes which are captured under our 'Conduct and Operational Risk framework' and includes policies to manage risks at the highest level, how we assess impact and likelihood of risks and how we determine the effectiveness of our key controls.

An effectiveness review of the system of governance and ERM Framework is conducted annually. This process considers each key component of the system of governance in isolation and assesses its effectiveness.

In addition, the Group Chief Internal Auditor reviews, at least annually, the overall effectiveness of our system of governance, and risk and control framework and reports on this to the Group Audit Committee (in line with the Internal Audit Guidelines for Financial Services issued by the Chartered Institute of Internal Auditors).

The result of these reviews in 2016 concluded that the system of governance and ERM framework are effective taking into account the nature, scale and complexity of the risks inherent in the business.

The Group Audit Committee and Group Risk and Capital Committee had oversight of SLAL during 2016. A SLAL Audit Committee and a SLAL Risk and Capital Committee were constituted in 2016. Whilst not fully operational until 2017, the committees provided oversight, review and approval to the 2016 Solvency II and financial results. The introduction of these committees strengthens the governance and oversight of the UK and Europe Pensions and Savings business.

#### B.1.2 Governance framework

The governance framework provides a structure to support compliance with Standard Life's regulatory and UK Corporate Governance Code obligations. The governance framework is approved by the Standard Life plc Board, kept under regular review and documented in the Standard Life plc Board Charter. The Nomination and Governance Committee reviews the Standard Life plc Board Charter annually, taking into account developments in regulatory guidance and corporate governance best practice, and recommends any changes to the Board. The Standard Life plc Board Charter is available in the Our Company - governance section of the Standard Life website:

**[www.standardlife.com](http://www.standardlife.com)**

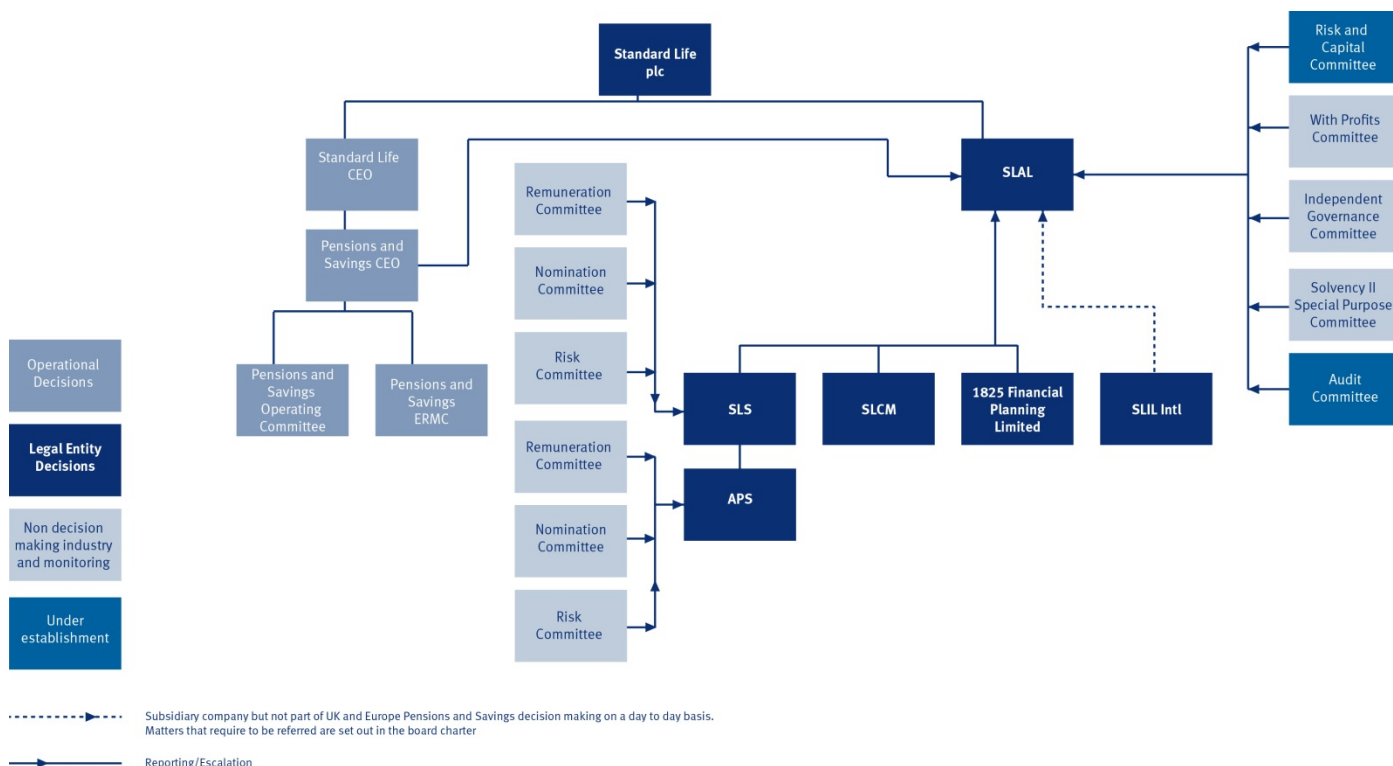
The framework consists of the following key elements which are discussed further below:

- Decision making structure
- The function of the SLAL Board
- The role of non-executive and executive Directors
- Board committees
- Executive and executive committees
- Scheme of Delegation
- Code of business conduct
- Prudent person principle
- Senior Insurance Managers Regime
- Remuneration

## Decision making structure

The diagram below provides an illustration of Standard Life and SLAL's decision making structure as at 31 December 2016.

This diagram also shows the Standard Life Savings Limited (SLS) and AXA Portfolio Services Limited (APS) Remuneration, Nomination and Risk committees.



## The function of the SLAL Board

SLAL is an insurance company and is operated in accordance with its Board Charter.

The Charter sets out the relationship between SLAL and Standard Life plc, its holding company, including the matters that must be referred to the SLAL Board (or the Standard Life plc Board) for approval, and any delegated authority.

The role of the SLAL Board is to organise and direct the affairs of SLAL in a manner that seeks to maximise the value of the Company for the benefit of its member while complying with relevant regulatory requirements, the Company's constitution, and relevant internal corporate governance standards.

The SLAL Board is collectively responsible for:

- determining, within the constraints imposed by the Group Holding Company, the Company's objectives and strategy
- ensuring, within the constraints imposed by the Group Holding Company, that the necessary financial and human resources are in place to allow the Company to achieve its objectives
- ensuring, within the constraints imposed by the Group Holding Company, that the necessary corporate and management structures are in place to allow the Company to achieve its objectives
- establishing and maintaining a framework of risk management and internal controls that enables the strategic, financial and operational risks of the Company to be assessed and managed
- reviewing and approving, within the constraints imposed by the Group Holding company, the Risk Appetite framework, including quantitative risk limits, ensuring its ongoing integrity and suitability to support the Board's strategic objectives in light of changing internal and external circumstances
- monitoring progress by the Company towards the achievement of its objectives and compliance by the Company with approved plans and policies
- reporting to relevant stakeholders on SLAL's activities
- appointing Board committees to meet the Company's requirements and relevant corporate governance standards
- delegating clearly defined responsibilities and authorities to the Chief Executive and Board committees and otherwise as appropriate.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## Board Committees

SLAL has established five permanent Board committees: the With Profits Committee, the Independent Governance Committee, Solvency II Special Purpose Committee, the Audit Committee and the Risk and Capital Committee.

### With Profits Committee

The role of the With Profits Committee is to consider the interests of with profits policyholders and exercise independent judgement in advising the Boards of Standard Life plc and SLAL on the achievement of fair treatment for those policyholders, reflecting a fair balance of interests amongst policyholders and between policyholders and shareholders in the ongoing management of with profits policies and with profits funds and in any proposed actions affecting those policyholders.

The Committee meets at least quarterly and otherwise as required. Membership is by appointment of the SLAL Board, on the recommendation of the Standard Life plc Nomination and Governance Committee in consultation with the Chairman of the With Profits Committee and the With Profits Actuary.

The Committee's advice is reported to the SLAL Board, with authority to report to with profits policyholders.

### Independent Governance Committee

The Independent Governance Committee's role is to advance the Financial Conduct Authority's (FCA) statutory objectives of securing an appropriate degree of protection for consumers by assessing the value for money of relevant schemes, raising concerns, where necessary, and reporting on the value for money of the relevant schemes operated by SLAL. The Committee acts solely in the interests of scheme members by providing credible and effective challenge on the value for money of workplace personal pension schemes.

### Solvency II Special Purpose Committee

The role of the Solvency II Special Purpose Committee is to secure Prudential Regulatory Authority (PRA) approval of:

- changes to the Company's internal model used for the calculation of Solvency II solvency capital requirement (SCR);
- Solvency II regulatory waivers;
- the Company's change log; and
- any Solvency II matters that require PRA approval

A SLAL Audit Committee and a SLAL Risk and Capital Committee were constituted (but were not fully operational in 2016). Details of these committees follows:

### Audit Committee

The role of the Audit Committee is to review and/or recommend to the Board:

- the draft financial statements, including significant financial reporting issues and judgements which they contain, of the Company. These financial statements shall include annual reports and any other formal financial reporting which may require to be produced in respect of the Company;
- the internal model methodology and assumptions, the basis for the technical provisions and the actuarial valuation, the application of the internal model in terms of calculating the own funds, the SCR and the surplus, the recalculation of the transitional measure on technical provisions (TMTP) and the summary of technical provisions, all Solvency II regulatory capital reporting and related messaging, the triennial solo Regulatory supervisory report, annual Solvency and financial condition report (SFCR) and quarterly and annual solo QRTs;
- the adequacy and effectiveness of the internal control and risk management framework and systems and of SLAL's implementation and compliance with them;
- SLAL's arrangements for employees and contractors to raise concerns, in confidence, about possible impropriety in financial reporting or other matters. The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action;
- the effectiveness of the Group's Internal audit function in the performance of its duties in relation to SLAL (including but not limited to the financial reporting of the Company without breaching its independence); and
- oversee SLAL's relationship with the External auditor.

The Committee shall meet at least five times a year at appropriate times in the financial reporting and audit cycle and otherwise, as required.

Members of the Committee shall be appointed by the Board, on the recommendation of and in consultation with the Chairman and with prior approval of the Board and the Nomination and Governance Committee of Standard Life plc. The Committee shall be made up of at least three members. All members of the Committee shall be non-executive Directors who are determined by the Board to be independent.



## **Risk and Capital Committee**

The role of the Committee is to provide oversight and challenge of, and advice to, the Board and, where appropriate, the Board of any Relevant Group Company on:

- the Group's current risk strategy, material risk exposures and future risk strategy (as the same apply to SLAL) and their impact on levels and allocation of capital and dividend paying capacity;
- the structure and implementation of the ERM framework in the context of SLAL and its suitability to react to forward-looking issues and the changing nature of risks;
- changes to the risk appetite framework and quantitative risk limits;
- the risk aspects of major investments, major product developments and other corporate transactions undertaken; and
- material risk and capital matters affecting the With Profits Fund.

The Committee shall meet at least four times a year at appropriate times and otherwise, as required.

Members of the Committee shall be appointed by the Board, on the recommendation of and in consultation with the Chairman and with prior approval of the Board and the Nomination and Governance Committee of Standard Life plc. The Committee shall be made up of at least three members. All members of the Committee shall be non-executive Directors who are determined by the Board to be independent.

Whilst the SLAL Audit Committee and Risk and Capital Committee were constituted in 2016 but not operational until 2017, they provided oversight, review and approval to the 2016 Solvency II and financial results.

## **Executive committees**

There are two Executive committees which have responsibilities in relation to SLAL: the Operating Committee and the Enterprise Risk Management Committee.

### **Operating Committee**

The principle role of the Operating Committee is to assist the Pensions and Savings CEO in the exercise of their duties. The Operating Committee is a key feature of the matrix organisation at Standard Life and acts as the balancing mechanism between the horizontal and vertical lines of the matrix and are responsible for the day to day running of the business while operating within the regulatory and risk framework and appetites.

The Operating Committee is a senior cross business leadership committee with a balanced representation of the key areas that impact upon the execution of the strategy. The Committee works to ensure connectivity and coordination in order to ensure successful delivery of the business plan. The Operating Committee takes an appropriate level of oversight of organisational risk, compliance, talent development and the financial position.

### **Enterprise Risk Management Committee (ERMC)**

The Committee's purpose is to support the Pensions and Savings CEO and Operating Committee to fully understand, make decisions and challenge actions in relation to the management of risks across the Pensions and Savings business in line with risk appetites and to oversee the Pensions and Savings business' compliance with the Standard Life ERM framework.

### **Code of Business Conduct**

Good governance within SLAL is predicated on the ethical behaviour of the organisation's staff. In recognition of this the Standard Life plc Board has developed, adopted and communicated a Code of Business Conduct which sets standards for employee behaviour in relation to operational excellence, compliance responsibilities, customer service, Standard Life's people and other stakeholders. The code is aligned to the Group's values and refreshed and approved by the Standard Life plc Board on a regular basis.

### **Prudent Person Principle**

The Prudent Person Principle is a set of qualitative requirements used to govern investment decisions and asset allocations. In particular, it sets out the expectation that insurers will exercise prudence in relation to the acquisition and holding of assets and places responsibility on the insurer to decide whether the nature of any investment is appropriate and to be able to show that it has systems and controls to hold and manage any such investments.

Standard Life policies state the standards that business units must comply with in managing the key risks that threaten the achievement of our strategy and business objectives. A range of these standards are directly relevant to the requirements of the Prudent Person Principle and are primarily contained in the following policies:

- Market Risk Management policy
- Credit Risk Management policy
- Demographic and Expense Risk Management policy
- Liquidity and Capital Management policy

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Business policy compliance reporting on our internal risk management system, called ORAC, demonstrates whether business units have been compliant with the relevant policy standards and, as a consequence, with the requirements of the Prudent Person Principle.

Further details on Prudent Person Principle compliance can be found in Section C.7.2 of this report.

### Senior Insurance Managers Regime

The Senior Insurance Managers Regime (SIMR) replaces the existing Approved Person Regime and came into force in March 2016 with the intention of strengthening individual accountability within the insurance industry. The regime seeks to ensure that senior individuals are responsible and accountable for the sound and prudent management of their firms, and behave with appropriate integrity, honesty and skill. Standard Life has implemented a framework to address the requirements of SIMR. Reflecting the key components of the regime, the framework is comprised of:

- **A governance map** – detailing senior manager roles and responsibilities, governance structures, matters reserved for the Board and the remit and function of committees;
- **Scope of responsibilities** – a summary of individual responsibilities for each key individual captured by the regime;
- **Prescribed responsibilities** – 11 PRA-specified responsibilities which have been allocated to particular individuals;
- **Conduct requirements** – rules and standards to be adhered to by all individuals within the scope of the regime;
- **Fitness and propriety** – Standard Life's requirement to assess the fitness and propriety of individuals holding key positions;
- **Reasonable steps** – guidance to help impacted individuals to record and evidence the discharge of their responsibilities; and
- **Support network** – how we support individuals in meeting these responsibilities.

The SIMR framework is applicable to SLAL and it applies to individuals who influence, manage, supervise or govern the activities of SLAL. Reflecting SLAL's management structure, members of the key governing bodies and heads of key functions are also included.

### Remuneration

SLAL adopts the Group's remuneration policy and principles which are detailed in the Section 2.9 of the Standard Life plc Board Charter. Details of the Remuneration Committee can also be found in Appendix III of the Standard Life plc Board Charter which is available in the Our company – governance section of [www.standardlife.com](http://www.standardlife.com)

The People Policy, which includes remuneration, is fully aligned to the strategic aims of the organisation. Its aim is to attract and retain leaders who are focused and capable of delivering business objectives whilst considering the interests of shareholders and other stakeholders.

The non-executive Directors who sit on the Remuneration Committee are responsible for determining appropriate levels of remuneration for the Chairman and the executive Directors. Deloitte LLP provides independent advice to the Committee throughout the year relating to executive remuneration and benefits. The link between reward and risk is managed by the Remuneration Committee seeking confirmation from the Risk and Capital Committee that past performance was not due to excessive risk taking and that future remuneration arrangements do not impact on Standard Life's risk profile.

- **Fixed and variable elements of remuneration:** employee remuneration is composed principally of fixed and variable elements of reward as follows:

Fixed reward:	Variable reward:
<ul style="list-style-type: none"> <li>• Fixed remuneration: salary (and cash allowances, if appropriate)</li> <li>• Benefits (including pension contributions)</li> </ul>	<ul style="list-style-type: none"> <li>• Bonus</li> <li>• Senior employees may also be awarded a long-term incentive award</li> </ul>

Appropriate ratios of fixed to variable remuneration are set so as to ensure that fixed and variable components of total remuneration are appropriately balanced; and the fixed component is a sufficiently high proportion of total remuneration to allow the Standard Life Group to operate a fully flexible policy on variable remuneration components including paying no variable remuneration component.

- **Share ownership:** in line with good corporate governance guidelines, there is a requirement that executive Directors, members of the Executive body, and certain senior management maintain a material long-term investment in Standard Life plc shares. The shares that an employee is required to hold to reach the shareholding requirement are agreed by the Remuneration Committee.

- **All employee share plans:** employee share ownership is promoted through two initiatives:
  - The Standard Life (Employee) Share Plan
  - Standard Life Sharesave Plan

Participation is voluntary and governed by the rules of the relevant plan.

Further details on remuneration including information on the individual and collective performance criteria on which any entitlement to share options, shares or variable components of remuneration are based can be found in the Overview of the remuneration policy section of the Directors Remuneration Report on pages 84 to 85, of the Group's Annual report and accounts 2016.

All UK employees are auto-enrolled into a defined contribution pension plan. Details of the main characteristics of the pension scheme and other post-retirement provisions can be found in Note 37 on page 168 of the Group's Annual report and accounts 2016. The pension policy for executive Directors can be found on page 84 of the Group's Annual report and accounts 2016 and includes an alternative cash allowance in lieu of pension of up to 30% of salary.

Details of transactions with related parties including key management personnel during the year can be found in Note 48 on pages 208 to 209 of the Group's Annual report and accounts 2016. There have been no material transactions during the reporting period with shareholders outwith the normal course of business.

### B.1.3 Overview of organisational and operational structure

Standard Life has an established and well-defined organisational and operational structure with clearly defined roles, responsibilities and reporting lines to ensure that appropriate spans of control operate throughout the organisation, in relation to its business activities and risk management.

Each business within Standard Life maintains a list of all of its decision making committees. Each committee operates under its own terms of reference, which sets out its authority, purpose, scope and quorum details. The purpose of a quorum rule is to give decisions made by a committee enough authority to allow binding action to be conducted.

Standard Life's governance functions include Risk and Compliance, Internal audit and Actuarial who have responsibility for monitoring, reviewing, challenging and reporting on the status of the Company's risks on an ongoing basis. Fit and proper checks are carried out on applicable staff from key functions to ensure that they possess the competency, expertise and integrity necessary for the performance of their duties.

Details of the Risk and Compliance function can be found in Section B.4.2, details of the Internal audit function can be found in Section B.5 and details of the SLAL Actuarial function can be found in Section B.6.

#### Three lines of defence

SLAL operates a 'three lines of defence' model of risk management, with clearly defined roles and responsibilities for committees and individuals:

First line	Second line	Third line
Day-to-day risk management is delegated from the Board to the Chief Executive and, through a system of delegated authorities and limits, to business managers.	Risk oversight is provided by the Chief Risk Officer and supported by the specialist Risk Management and Compliance functions across Standard Life as well as committees such as the ERM and with reporting to the Risk and Capital Committee (RCC). The majority of members of the ERM are senior first line representatives. Independent oversight is provided by non-executive Directors at the RCC.	Independent verification of the adequacy and effectiveness of the internal risk and control management systems is provided by our Internal audit function. This is independent from all other operational functions. It operates subject to supervision and challenge by the Audit Committee.

### B.1.4 Changes to the System of Governance and ERM framework during 2016

The key changes to the System of Governance and ERM framework for SLAL are as detailed below:

- Restructuring of the SLAL Board - the restructuring included the appointment of an independent Chairman, who also sits on the plc Board, and two independent non-executive Directors. A third independent non-executive Director will be appointed once FCA approval has been granted.
- A SLAL Audit Committee and a SLAL Risk and Capital Committee were constituted (but were not operational in 2016). The non-executive Directors will be the members of the committees. The changes strengthen the governance and oversight of the UK and Europe Pensions and Savings business and allow the plc Board to devote more time to its strategic oversight of the whole of Standard Life.
- On 15<sup>th</sup> August 2016, Barry O'Dwyer was appointed as CEO of SLAL and as CEO, Life Insurance.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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- On 26<sup>th</sup> January 2017, it was announced that Paul Matthews, CEO UK and Europe Pensions and Savings would be retiring from Standard Life on 1<sup>st</sup> March 2017. Barry O'Dwyer, CEO Life Insurance and SLAL CEO, will take on Paul's current responsibilities for the pensions and savings business and will also be appointed to the Board as an executive Director from 1st March 2017.

## B.2 Fit and proper requirements

Standard Life carries out initial 'fit and proper' checks before appointing new Directors (including non-executive Directors), executives, heads of function or other SIMR or PRA/FCA Approved Persons. These individuals are identified as Key Function Holders (KFHs) and the fit and proper checks require them to meet the standards expected of a 'fit and proper' person. This includes proving and maintaining certain standards of:

- Honesty, integrity and reputation;
- Competence and capability; and
- Financial Soundness

An assessment is carried out on a KFH's initial appointment and then repeated annually to ensure they continue to meet the fitness and propriety standards.

This assessment:

- Reviews competence, capability and experience to carry out the documented responsibilities of the role effectively;
- Ensures the KFHs have the relevant qualifications to perform the role;
- Ensures training to perform the function is undertaken;
- Checks current behaviour and past business conduct meets the required standard;
- Considers whether the KFHs have the appropriate personal characteristics to meet their responsibilities.

## B.3 Risk management system

Standard Life's risk management system is part of the wider system of governance and includes the ERM framework, the Own Risk and Solvency Assessment (ORSA) and the internal model, all of which have been adopted by SLAL.

### B.3.1 Enterprise Risk Management framework

A key part of Standard Life's system of governance is the ERM framework. The ERM framework includes the methods and processes used to manage risks, and identify and seize commercial opportunities related to the achievement of our objectives, protecting and enhancing value. It provides us with a framework for operating consistent risk management practices across Standard Life in a structured and forward-looking way that can be measured and repeated.

All of the ERM components are interconnected and work together to provide Standard Life with a holistic framework encouraging proactive and pre-emptive risk management across the Group.

#### Risk culture

Risk culture is a core component of the ERM framework, it is the way we think and act as individuals and as a business. It encompasses our attitudes, capabilities and behaviours. Our culture drives how we identify, understand and openly discuss, and act on, current and future risks.

#### Risk control process

The practices by which we manage financial and non-financial risks within Standard Life. They are used to identify, assess, control and monitor risk.

#### Strategic risk management

This forms an integral part of the strategic planning process and is directly linked to our corporate objectives. It supports the development of long-term value by ensuring that well informed risk-reward decisions are taken in pursuit of our business plan. It also helps to ensure that capital is distributed to the areas Where most value can be created from the risks taken.

#### Risk and capital models

The models that we use to measure our risk exposures and capital position and the work that we do to test and understand the sensitivity of these positions.

## Emerging risks

The aim of emerging risk management is to identify risks before they materialise. This gives us time to engage with the risk, understand it and respond accordingly. We use our emerging risk process to inform reverse stress testing and capital adequacy requirements across Standard Life. Our proactive screening process which looks across broad sources of risk including geopolitical, technological, environmental and societal, helps us to anticipate future threats.

### B.3.2 Own Risk and Solvency Assessment

The ORSA is a set of processes that underpin our ERM framework. The purpose of the ORSA is to inform and develop:

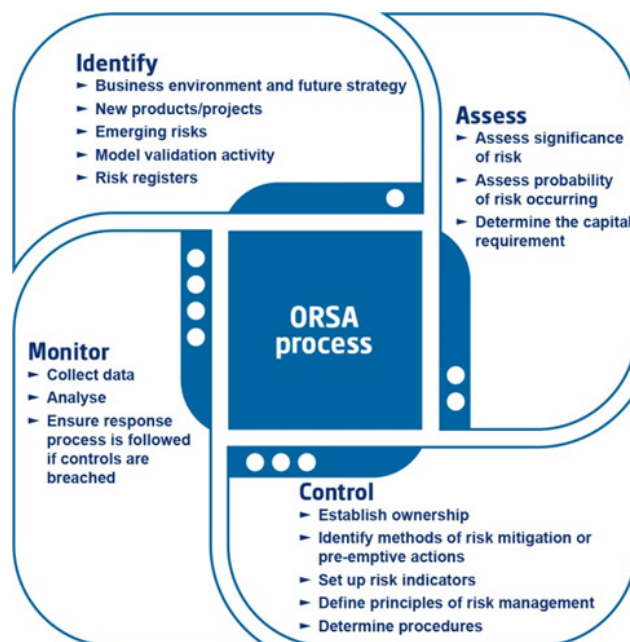
- Our understanding of the current and potential risks to the business over the product lifecycles. This includes both financial and non-financial risks including environmental, social and governance risks and their potential to affect both the long and short-term value of the business.
- Our appetite for these risks and how we manage them
- Our own assessment of current solvency and capital requirements with respect to the risks
- A forward-looking assessment of the risk and solvency needs of the Company over a multi-year time horizon in light of the business plans
- The ORSA plays a key role in supporting decision making and strategy development at our boards and risk committees

The ORSA comprises of all the processes that exist within the ERM framework and it is how we identify, assess, control and monitor risks that inform our capital requirements.

Capital and risk are managed within the Group to support the strategic objective of generating sustainable, high quality returns for shareholders. Risk and capital metrics support the delivery of the strategy and the objective of maintaining financial strength and security – underpinning customer, regulatory and analyst confidence.

The key processes are as follows:

- The strategy, capital and business planning process
- Business risk reviews
- The emerging risk process
- The validation activity and validation reporting process
- The customer proposition development process
- Stress and scenario programme
- Reverse stress testing
- The liquidity risk management process
- The identification of risk modules for the internal model
- Monthly management information monitoring and reporting process
- The processes within the Conduct and Operational Risk Framework
- The ORSA reporting process



These processes run concurrently and often operate continuously throughout the year. They underlie the identification, assessment, control and monitoring of risks. The ORSA is reviewed and approved by the SLAL Board at least annually.

Solvency needs are determined based on an understanding of the quantifiable and non-quantifiable risk profile and how this is managed. The ERM framework covers both quantifiable and non-quantifiable risks. A risk is quantifiable where measurable and objective data exists. The internal model therefore covers all material quantifiable risks for which it is appropriate to hold capital such that the SCR materially reflects the risk profile of the business. Some risks are not included in the coverage of the internal model because capital is not an appropriate mitigant for the risk or because the risk is not quantifiable and is more appropriately managed using other techniques. The internal model coverage review process ensures that the model continuously fits our risk profile and is based around changes in the risk and control information (risk registers, risk events and control self-assessments) maintained by the Risk and Compliance function as an integral component of the ERM framework's risk control processes. The independent



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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validation process includes a review of the risks to which the Group is exposed and whether the internal model covers all material and quantifiable risks of which we are aware based on the Company's risk registers.

The risk management system interacts with our capital management activities by ensuring that well informed risk-reward decisions are taken in pursuit of our business plan objectives, allowing capital to be delivered to areas where most value can be created from the risks taken. Our consistent application of effective and pre-emptive risk management across our business protects our short-term value while encouraging the development of long-term value. Oversight of risk within the business is delivered through the ORSA processes. The internal model is a key input to this interaction as its quantification of risk exposures provides valuable insight to support effective risk management and also influence the amount and location of capital.

### B.3.3 Internal model

Under the Solvency II Directive insurers were given the choice of using the standard model for determining SCR, or applying to use an internal model, which, if granted, allows insurers to tailor and build their own internal model to reflect the broad range and scale of their individual business.

Standard Life's internal model application has been approved by the PRA, which means that the capital we hold is directly related to the risks we are exposed to and takes account of the benefit of the risk management tools we have in place.

Within Standard Life's ERM framework, the responsibilities of the Risk and Compliance function in relation to the internal model are to:

- Design and implement the internal model
- Test and validate the internal model
- Document the internal model and subsequent changes to it
- Analyse and report on the internal model
- Inform/report to Board on the internal model

The governance in place for the internal model ensures that it remains up to date and appropriate for use, for example via regular assessments of our risk environment as reported in our half yearly ORSA summaries which are provided to the SLAL Board. Any major changes to the internal model will be approved by the Standard Life plc Board.

There has been one major change to the internal model during the reporting period which has been approved by the PRA.

The validation process which is used to monitor the performance and ongoing appropriateness of the internal model is carried out by the Risk and Compliance function. This process includes independent review and challenge by the Risk and Compliance function.

## B.4 Internal control system

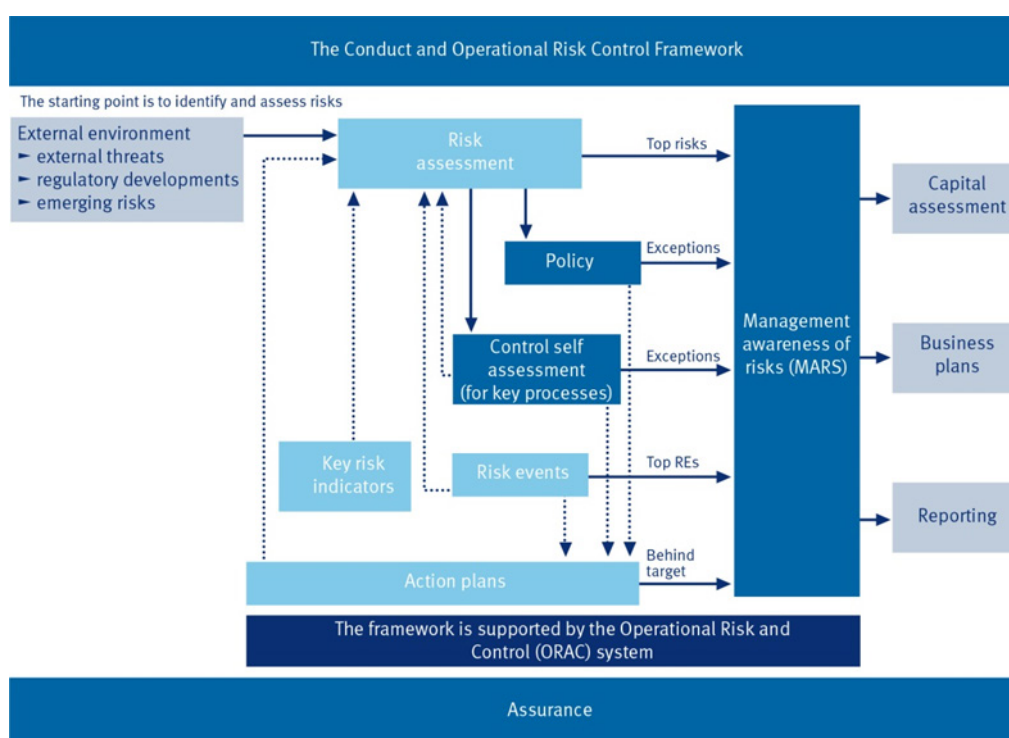
Our internal control system contains a range of processes which are captured under our Conduct and Operational Risk framework as part of the risk control process element of the ERM framework.

### B.4.1 Conduct and Operational Risk Framework

The Conduct and Operational Risk Framework comprises the following processes outlined below:

- Management awareness of risks
- Policy framework
- Risk assessment including risk registers
- Control self assessment
- Risk event management
- Action plan management
- Key risk indicators

The diagram below explains how the Conduct and Operational Risk framework fits together. All business units use this framework and the supporting ORAC system to ensure consistency of application and reporting.



### Management awareness of risks (MARs)

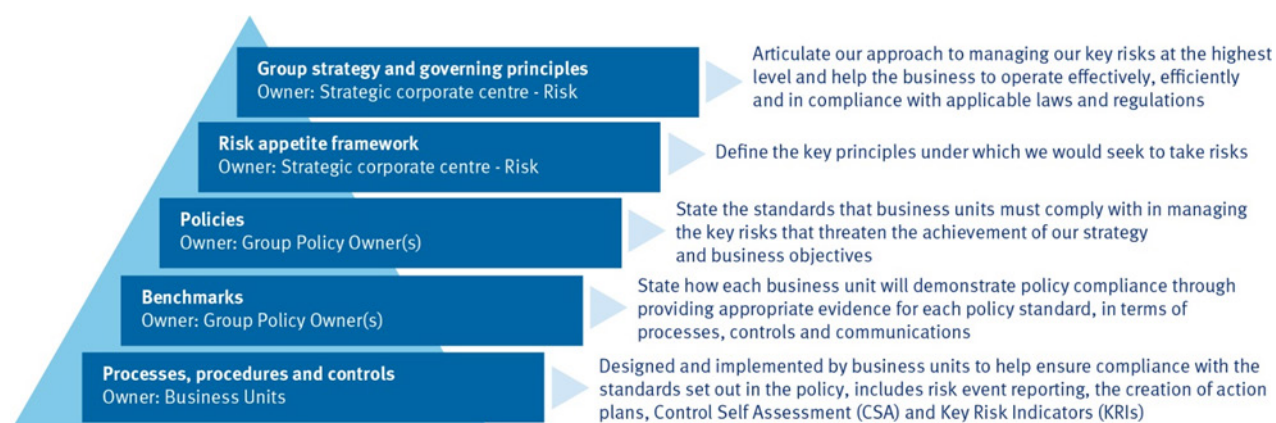
The objective of MARs is to increase accountability and ownership of risk management. MARs dashboards are created, using the underlying data from our ORAC system and the underlying processes and framework mentioned below to provide senior management with a holistic picture of their conduct and operational risk and control environment. The risk and compliance teams have discussions with business unit managers and challenge the MARs information. MARs is a forward looking proactive risk management process and is used at senior risk committees such as the ERMCS.

### Policy framework

The policy framework helps the Group to achieve the high level business objectives by providing a structure to help articulate how the code of conduct, governing principles and all of the policies and procedures fit together to make sure that the business and employees operate within approved limits and standards, as defined by the Standard Life plc Board.

The fair treatment of customers is integral to all of our business activities and of fundamental importance. As such, policies are implemented with their specific impact on the customer in mind.

This framework provides a structured process for developing and implementing policies consistently across the Group. It operates on five levels:



### Risk assessment including risk registers

Risk assessment is the process whereby operational risks which might adversely affect the Company's ability to meet its stated business objectives are identified, assessed and managed in order to minimise any adverse impact.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Conducting the risk assessment process increases the likelihood of meeting our business objectives and plans because we have identified up-front what can go wrong and taken action to prevent this.

It is mandatory for all business units to establish, own and operate risk assessment processes. The recording, ongoing monitoring and management of the risks identified through these processes is enabled through the use of 'risk registers' which are held on the ORAC system.

The registers detail a range of information captured through the risk assessment process including: a description of the risk; details of the likely causes and impacts; an assessment of the risk in impact and likelihood terms; details of the responses to the risk; and, details of the 'owner' for each risk. Responsibility for implementing a risk assessment process including appropriate responses, and the creation and ongoing management of a risk register rests with business unit leaders and managers. They will be supported in this by their business unit risk team.

### Control Self Assessment (CSA)

CSA is a self assessment tool, its purpose being to ensure that the primary controls within key processes (that help manage key risks) are documented and subject to regular assessment by business owners. The assessment includes a review of the adequacy of the design of the suite of controls, an assessment of the actual performance of those controls, evidence to support control performance and an overall effectiveness conclusion.

The results of the CSA certification process provides senior management with assurance over the effectiveness and quality of the control environment operated across the key business processes. CSA results may also lead to designing new procedures or changing existing procedures in order to reduce the probability of control failures.

### Risk event management

A risk event is a risk that has materialised as a result of a deficiency in our system of internal control or an external event. Since they can have a significant impact on the Company's reputation and performance, we aim to identify and understand them quickly to ensure that an appropriate response is taken.

The ORAC system is used to log any risk events that occur and ensure action plans are put in place for corrective action.

### Action plan management

Action plan management is an important aspect of the operational risk framework. Its purpose is to:

- Ensure that control improvement work is identified, what is required is clearly expressed, ownership is clear and target dates are set
- Demonstrate active management of the control environment
- Prioritise control improvement work
- Provide progress on work to allow source owners to determine impact of outstanding issue

### Key risk indicators

Our key risk indicators (KRIs) aim to identify potential issues before they materialise and are used as a monitoring tool to provide a snapshot of the current business exposure to specific risks.

KRIs is a blend of performance indicators, control indicators and other management information that is focused on a particular risk. The key differential of a KRI is that the metric has a direct correlation to an increase or decrease in probability, impact or exposure to a specific risk.

KRIs assist both business management and risk management functions by providing a tool to:

- Monitor risks by measuring trends or performance of KRIs
- Provide an early warning to enable proactive rectifying action and help to minimise exposure to losses
- Promote a proactive risk culture by providing a trigger for management action
- Bring objectivity to the risk process

All the outputs from our operational risk and conduct framework flow through to the other stages of the ERM framework, such as the risks being reflected in our risk and capital models.

## B.4.2 Risk and Compliance function

The Risk and Compliance function is a second line of defence function and is embedded into our strategic and operational decision making. The objective of the Risk and Compliance function is to understand and actively manage the sources and scale of uncertainty to which Standard Life's strategic objectives are exposed. The consistent application of effective and pre-emptive risk management across our business protects the value of Standard Life in the short-term while encouraging the development of long-term value.

The Risk and Compliance Function achieves this by ensuring that:

- Well informed risk-reward decisions are taken in pursuit of the Group's business plan objectives;
- Compliance activities are undertaken; and
- Capital is delivered to areas where most value can be created for the risks taken

This approach to risk management, delivered through our ERM framework, is well embedded in our business. The pace of change in the business and risk environment, and the threats and opportunities arising from it, mean we will continue to review and adapt our methods to ensure we are well placed to respond pre-emptively.

The Risk and Compliance function comprises of the following:

- Strategic Corporate Centre Risk
- Risk Centres of Excellence (COEs): Reporting and Analysis, Operational, Financial and Insurance, Business Risk Review, Conduct and Compliance, Standard Life Investments Risk and Compliance and Financial Crime

The risk COEs provide support across Standard Life.

### **B.4.3 Regulatory Compliance**

Standard Life's Regulatory Compliance policy requires the business units to provide assurance that they are complying with the relevant regulations.

The Regulatory Compliance policy sets out the standards the business units must adhere to in complying with the relevant regulations. These standards are in place to prevent non-compliance. The head of the Conduct and Compliance team is the Group policy implementation manager for this policy and is also responsible for the annual review of the standards and benchmarks for this policy.

The assessment of the adequacy of the measures adopted to prevent non-compliance is a continuous process and follows an annual cycle starting and ending at annual policy review. The assessment includes:

- Board review and approval of the policy standards (with benchmarks approved by the Chief Risk Officer) to apply in the following year
- A quarterly self assessment of compliance with the Board approved policy by the business units. Where this highlights areas of non-compliance, action plans are set up to ensure compliance (along with appropriate timescales).
- A review of the above assessment by the Group policy implementation manager. This review will consider the evidence provided to show compliance, the action plans and other information already reported in the ORAC system.
- A review of the policy standards and benchmarks by the Group policy implementation manager. This review takes into account the cases of non-compliance (or near misses) reported over the year and the adequacy of the current standards and benchmarks in reducing the numbers and controlling the impact of these cases.
- Board review and approval of the revised policy standards resulting from the above review.

## **B.5 Internal audit function**

Group Internal Audit (GIA) is a third line of defence function. Its primary role is to provide independent and objective assurance in order to help the Board and Executive team to protect the assets, reputation and sustainability of Standard Life. GIA operates under the Group Internal Audit Charter available in the Our Company - governance section of the Group's website [www.standardlife.com](http://www.standardlife.com). The Charter is reviewed and approved annually by the Group Audit Committee. There were no significant changes to the Charter during the reporting period.

Standard Life has adopted the ERM framework to provide the basis for ensuring that risks inherent in the design and execution of strategy and the operations of each of the businesses within the Group are adequately identified, assessed, controlled, monitored and communicated in accordance with the overall expectations of Standard Life's stakeholders. GIA provides independent verification of the adequacy and effectiveness of the internal risk and control management systems.

To deliver this assurance, GIA undertake a risk assessed programme of audits across the Company. This audit plan, which reflects their view of the organisation formed through business intelligence gathering and relationship management activities, is approved by the Audit Committee and is reviewed and updated on a quarterly basis.

The audit team is made up of general auditors and specialist auditors in actuarial, accountancy and, investment management. An external co-source partnership arrangement ensures the availability of additional expertise as and when required.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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GIA is free of influence by any element in Standard Life, including matters of audit selection, scope, procedures, frequency, timing and reporting. This maintains an independent and objective attitude necessary in rendering engagement conclusions.

## B.6 Actuarial function

The prominent actuarial function sits in the Pensions and Savings business unit and is a first line of defence function.

### Summary of the responsibilities of the actuarial function:

- **Technical provisions:** co-ordinate calculation of technical provisions; inform the Board of the adequacy of calculation; provide opinion on the adequacy of technical provisions
- **Underwriting:** prepare opinion on overall underwriting policy
- **Reinsurance:** prepare opinion on adequacy of reinsurance arrangements
- **Risk management:** contribute to effective risk management system; provide opinion to the Board on range of risks and adequacy of the scenarios considered as part of the ORSA

In addition to the above which are required by the Solvency II Directive, delegated acts and guidelines the Actuarial function also performs the following functions not required by Solvency II:

- **IFRS actuarial liabilities:** oversee and co-ordinate calculation of IFRS actuarial liabilities, recommend to the Board methodology and assumptions for the calculations of IFRS actuarial liabilities
- **Solvency capital requirement (SCR):** recommend results of the SCR to the Board, recommend methodology and assumptions used for the calculation of the SCR within the framework defined by the Risk function
- **Financial projections:** perform calculations of financial projections used in business planning, capital management and the Own Risk and Solvency Assessment
- **Capital and liquidity management:** monitor and manage capital and liquidity
- **With profits management:** recommend to the board actions and methodology around with profits business including level of with profits bonuses and managing the HWPF in line with the Scheme of Demutualisation
- **Investment strategy and investment guidelines:** recommend asset liability management strategy and investment guidelines for with profits and shareholder funds and oversee the implementation of the approved strategy

## B.7 Outsourcing

The Group's Outsourcing Policy sets the standards that business units must comply with for outsourcing arrangements. SLAL complies with the Group's Outsourcing Policy.

The policy highlights that Standard Life retains responsibility for meeting all relevant regulatory and legal requirements and includes the requirement for the implementation of appropriately robust governance structures. The policy also highlights that customer outcomes must be considered at the outset and throughout the lifecycle of any outsourcing arrangement.

For each critical or important outsourcing arrangement, an Executive Sponsor, Accountable Authority and Supplier Relationship Manager are appointed. Where the outsourced services relate to regulated activities, the Executive Sponsor must be an approved person/SIMR.

The Pensions and Savings ERM is responsible for reviewing all proposed outsourcing arrangements that are identified by the SLAL Chief Risk Officer (or nominated deputy) as potentially having a material impact on SLAL's risk profile and annually reviews the complete list of outsourcing arrangements for SLAL.

The Head of Risk (Regulator and Board) is responsible for contact with the regulator on all material outsourcing issues across Standard Life. All FCA and PRA regulated arrangements require written notification to the FCA and PRA.

Standard Life uses a number of outsourcing partners to operate and deliver core systems, capabilities and processes. Key relationships include Citigroup's with our investment business and FNZ's role in the delivery of our platform functionality for our insurance business. Both of these service providers' main operations are located within the UK.

Key material intra-group outsourcing arrangements include the provision of investment management services, investment administration and fund accounting services from Standard Life Investments to various members of the Group, and the provision of Information Technology and Information Systems support from Group Operations to various members of the Group.

## B.8 Any other information

None.

## C. Risk profile

The purpose of this section is to describe the material risks to which the Company is exposed and the techniques used to monitor and manage them.

Our principal risks and uncertainties are described in pages 38 to 41 of the Group's Annual report and accounts 2016. These are:

Risk	Description	More detail included in Section
<b>Strategic</b>	Risks which threaten the achievement of the strategy through poor strategic decision-making, implementation or response to changing circumstances.	C.6 Other material risks
<b>Conduct</b>	The risk that through our behaviours, strategies, decisions and actions the business, or individuals within the business, do not do the right things and/or do not behave in a manner which: <ul style="list-style-type: none"><li>- Pays due regard to treating our customers and clients fairly</li><li>- Is consistent with our disclosures and setting of customer and client expectations</li><li>- Supports the integrity of financial markets.</li></ul>	C.5 Operational risk
<b>Operational</b>	Risk of loss or adverse consequences resulting from inadequate or failed internal processes, people or systems, or from external events.	C.5 Operational risk
<b>Financial Market and Credit</b>	Risk or losses due to risks inherent in financial markets.	C.2 Market risk; C.3 Credit risk
<b>Demographic and Expense</b>	Risk that arises from the inherent uncertainties as to the occurrence, amount and timing of future cash flows due to demographic and expense experience differing from that expected.	C.1 Underwriting risk

These risks, along with liquidity risk, are covered in this section, which follows a prescribed format and order. Sections C.1 to C.6 provide information on specific material risks to which the Company is exposed. Section C.7 covers information which applies across these material risks.

There have been no material changes to measures used to assess the risks to which the Company is exposed over the reporting period.

Capital held in respect of these risks is described in Section E. Refer to QRT S.25.02.21 in Appendix 2 *SCR – for undertakings using the standard formula and partial internal model* to see the split of the solvency capital requirement (SCR) by risk category.

### C.1 Underwriting risk

The key material underwriting risks to which the Company is exposed are longevity risk and persistency risk. The Company's exposure to expense risk is less material, and there are also minor exposures to mortality (in respect of insurance business that pays benefits on death) and morbidity risk.

#### C.1.1 Longevity risk

Longevity risk is the risk that policyholders or members of the defined benefit pension scheme live longer than expected based on our best estimate assumptions, and therefore give rise to a loss to the Company. This risk is relevant for contracts where payments are made until the death of the policyholder, for example annuities, deferred annuities and guaranteed annuity options. This may arise from our actual experience being different from that expected, more volatility of our actual experience than expected, or the rate of improvement in mortality being greater than expected. Our actual experience can vary as a result either of statistical uncertainty or as a consequence of systemic and previously unexpected changes in the life expectancy of the insured portfolio.

In setting our best estimate assumptions there are three elements. Firstly we choose a base mortality table which we believe reflects the appropriate shape of current mortality experience across all ages for our annuitants and deferred annuitants. Then we consider our own current experience in relation to that table. Finally we factor in consideration of how mortality rates may change in the future. This then gives three elements to consider in determining longevity risk:

- Change in shape of the base mortality table
- Change in level of the base mortality table
- Change in assumed rates of future mortality improvement

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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### C.1.2 Persistency risk

Persistency risk is the risk that policyholders voluntarily discontinue their policies at a different rate than assumed. Discontinuance includes lapsing, becoming paid-up, retiring early, drawing down on funds or taking up options. This risk may arise if persistency rates are greater or less than assumed, or if policyholders selectively lapse when it is beneficial for them. This could adversely impact capital resources through:

- Lower than expected future charges being received if more policyholders disinvest than assumed, or
- Higher guarantee costs becoming payable if less policyholders disinvest than assumed

In setting our best estimate, we consider our own current experience and assess whether or not it is representative of expected future experience. If experience data is not believed to be reliable or representative, e.g. for a new product or when anticipating the effect of new regulations on policyholder behaviour, then other factors will be considered such as the pricing basis and experience for similar products.

Persistency risk is measured and modelled by considering *persistency mis-estimation* risk and *dependent persistency* risk separately:

**Persistency mis-estimation** – This captures the risk of mis-estimating the level of persistency rates

**Dependent persistency** – This captures the impact of a change in future persistency experience as a result of either a market event or an operational risk event

### C.1.3 Material underwriting risk concentrations

The Company has a diverse pool of underwriting risks which reduces our exposure to underwriting risk concentrations. We make use of insurance risk mitigation techniques, particularly reinsurance, to reduce concentrations to certain risks.

### C.1.4 Mitigation of underwriting risks

Reinsurance is used within the Company primarily to reduce longevity exposure on annuity business. The key arrangement used to do this is a reinsurance treaty with Canada Life International Re Designated Activity Company, which is by far the largest of the reinsurance treaties in place. This treaty cedes a significant part of the longevity and investment risk from immediate annuities relating to around £5bn of liabilities. In addition reinsurance is used to reduce mortality and morbidity exposure on protection business.

Underwriting risks are managed through the use of appropriate and active pricing and regular monitoring of experience. We also have a risk appetite framework which limits the amount of exposure we have to individual risks.

The Company actively monitors its actual experience on longevity and persistency, along with other underwriting risks. This identifies any significant divergence from long-term trends, which can enable the underlying causes to be identified and appropriate actions implemented.

## C.2 Market risk

The material market risks to which the Company is exposed are equity risk and interest rate risk. (Note credit risk is covered in Section C.3).

In relation to unit-linked business, charges linked to policyholder funds are exposed to market risks, in particular equity risk.

For with profits contracts, assets invested on behalf of policyholders give rise to additional market risk for the Company where those policies benefit from investment guarantees.

In respect to its annuity business, the Company is also exposed to fixed interest risk if there is a mismatch between future expected payments to policyholders and the cash flows on the fixed interest assets backing those liabilities. If fixed interest assets need to be traded in order to make payments to policyholders, there is a risk that this will be on worse terms than was assumed when the annuities were priced. There is a similar risk where the Company has written guaranteed annuity options, which give a policyholder the option to purchase an annuity at a future date on guaranteed terms. The cost of providing an annuity on guaranteed terms increases as the cost of the assets used to back such an annuity increases. This would typically happen when fixed interest yields fall.

As fixed interest yields have fallen over 2016 the Company's exposure to fixed interest risk has increased.

The following sections discuss the methods used and the key judgements applied to quantify the most material market risks to which the Company is exposed.



### **C.2.1 Equity value risk**

We calibrate different equity value distributions for different equity classes. Monthly log equity returns from the historic data available are used to fit a time series model for each equity class.

### **C.2.2 Interest rate risk**

Interest rate distributions are derived using principal components analysis, which breaks down total interest rate movements into a more granular level. Separate distributions are produced for the UK and Euro swap yield curves. Three principal components are used in both territories (UK and Euro).

### **C.2.3 Material market risk concentrations**

Market risk concentrations are minimised in the with profits funds by the use of index benchmarking with specific caps that limit the investment freedom away from these benchmarks and therefore limit the scope of individual market risk concentrations arising. We also have a risk appetite framework which limits the amount of exposure we have to individual risks.

We do not minimise concentrations in unit-linked business directly as the fund will be managed according to a fund mandate.

### **C.2.4 Mitigation of market risks**

A number of financial risk mitigation techniques are used throughout the Company. The most significant of these relates to an equity hedging programme in place within the Heritage With Profits Fund (HWPF) of SLAL. Derivatives are also used for managing fixed interest risk. These are regularly monitored with actions taken where required to ensure they operate as intended.

## **C.3 Credit risk**

The key material credit risk to which the Company is exposed is in respect of corporate bond holdings, being the risk that the issuers of those bonds fail to meet their contractual payments.

The Company is also exposed to the market risk of corporate bonds fluctuating in value as a result of changes in the market's perception of the credit worthiness and marketability of those bonds. This credit spread widening presents a risk to the Company in a similar way to fixed interest risk where there could be a mismatch between future expected payments to policyholders and the cash flows on the fixed interest assets backing those liabilities.

Other credit risks that the Company is exposed to are the risk of default from:

- Reinsurance counterparties
- Derivative counterparties
- Cash counterparties
- Other miscellaneous debtors such as intermediaries

To assess credit risk the following measures are used:

- Corporate bond spread widening (including the risk of transitions between credit ratings and the risk of default)
- Counterparty default risk relating to cash, reinsurance, derivatives and short-term loans to, for example, brokers and policyholders.

All of these aspects are stressed simultaneously in one risk module. The credit spread widening aspect is by some way the most material of these to our balance sheet.

### **C.3.1 Material credit risk concentrations**

The majority of our credit risk exposure lies in corporate bonds, with the majority being UK corporate bonds, with a small exposure to less liquid credit assets.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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### C.3.2 Mitigation of credit risks

We have a Credit Risk Management Policy in place to manage our credit risk exposure, which has a number of rules by which we mitigate credit risk, such as limiting the counterparties to which we can gain exposure, and limiting individual exposure levels. This is regularly monitored with actions taken where required to ensure the policy operates as intended.

There is a counterparty exposure to Canada Life International Re Designated Activity Company from the reinsurance arrangement which is mitigated through holding collateral. Refer to Section C.1.4.

## C.4 Liquidity risk

Liquidity risk is the risk that the Company is unable to realise investments and other assets in order to settle its financial obligations when they fall due, or can do so only at excessive cost.

Within our insurance business, liquidity risk is considered separately for annuities, with profits and unit-linked business.

For annuity contracts, assets are held which are specifically chosen with the intention of matching the expected timing of annuity payments. Liquidity risk is minimised through the process of asset and liability cash flow matching.

For with profits contracts, a portfolio of assets is maintained in the relevant funds appropriate to the nature and term of the expected pattern of payments of liabilities. Within that portfolio, liquidity is provided by substantial holdings of cash and highly liquid assets (principally government bonds). Where it is necessary to sell less liquid assets within the relevant portfolios, then any incurred losses are generally passed onto with profits policyholders in accordance with policyholders' reasonable expectations.

For unit-linked contracts, assets are invested in accordance with the mandates of the relevant unit-linked funds. Policyholder behaviour and the trading position of asset classes are actively monitored. The unit value and value of any associated contracts would reflect the proceeds of any sales of assets. If considered necessary to protect the interests of continuing customers, deferral terms within the policy conditions applying to the majority of the Company's unit-linked contracts can be invoked.

This liquidity risk increased significantly following the EU referendum and as a result deferral terms were applied from early July 2016 for some property funds. The deferral period ended for all of these funds by the end of November 2016 following property sales and a more stable property environment emerging.

In addition, the Company is exposed to:

- Refinancing risk i.e. not being able to refinance external debt when required or only able to do at excessive cost
- Risk that quantum and timing of subsidiary inflows are materially different from those expected

The Company undertakes periodic investigations into liquidity requirements, which include consideration of cash flows in normal conditions, as well as investigation of scenarios where cash flows differ markedly from those expected (primarily due to significant changes in policyholder behaviour). Liquidity risk is monitored, assessed and controlled in accordance with the relevant principles within the Company's policy framework.

### C.4.1 Material liquidity risk concentrations

There are no material concentrations of liquidity risk.

### C.4.2 Mitigation of liquidity risks

SLAL undertakes the following activities to mitigate liquidity risk:

- Co-ordinates strategic planning and funding requirements
- Monitors, assesses and oversees the investment of assets within the Company
- Monitors and manages risk, capital requirements and available capital on a group-wide basis
- Maintains a committed credit facility with a syndicate of banks

As a result of the policies and processes established to manage risk, the Company considers the extent of liquidity risk arising from its activities to be small.

### C.4.3 The total amount of the expected profit included in future premiums

The expected profit included in future premiums as calculated in accordance with Article 260(2) of Commission Delegated Regulation (EU) 2015/35 is £821m (gross of tax).



## C.5 Operational risk

Operational risk includes conduct risk. Conduct risk is considered in all areas of the operational risk framework, specifically through the 'Regulatory or Legal', 'Customer treatment' and 'Fraud or Irregularities' categories.

The key material operational and conduct risks that the Group is exposed to are captured within the following categories:

<b>Process execution</b>	Losses arising from failure to execute a process or control in accordance with its design, including administration, payment, manual data entry errors.
<b>Customer treatment</b>	Losses arising from inappropriately designed or delivered products or services, misinformed advice, failure to meet regulatory standards or requirements, failure to deal with customer complaints satisfactorily and within reasonable timescales, failure to meet the requirements of any other professional obligation to customers or clients. For example this may include impacts of regulator reviews, such as the enhanced annuity past business review.
<b>Fraud or Irregularities</b>	Losses arising from the embezzlement or misappropriation of funds or monetary assets by deliberate acts of deception and/or concealment, collusion, abuse of company or system knowledge, abuse of systems access. Also including failure to meet or comply with anti-money laundering regulations.
<b>Regulatory or Legal</b>	Losses arising from the inability to accurately interpret and/or comply with regulatory requirements.
<b>Security (including cyber risk)</b>	Losses arising from deliberate corruption, damage or theft of data and/or systems by external or internal parties or other criminal activities, failure to protect company property from theft or malicious damage, failure to safeguard the personal and physical security of staff during working hours.
<b>Business interruption and System management</b>	Losses arising from the inability to conduct normal business transactions e.g. money in or money out through loss or damage to premises, people or systems.
<b>Supplier failure</b>	Losses arising from the failure of outsource partners or other third party suppliers to deliver products or services in accordance with terms and conditions, through the fault of a party other than Standard Life.
<b>People</b>	Losses arising from the inability to adequately attract, retain and incentivise staff, the inability to adequately protect staff from injury or other harm, and any breakdown of employer-employee relations.
<b>Planning</b>	Missed opportunities or projected income as a result of planning process.

Risk control processes are the practices by which we manage financial and non-financial risks within our business. They are used to identify, assess, control and monitor risk.

We use a control framework which comprises of: control self-assessment (CSA), risk assessment, key risk indicators, risk event and action plan management. More information is provided in Sections B.3 and B.4.

As there is limited historical data on extreme operational losses, operational risks are assessed using bottom up scenario analysis. This approach blends the expert opinion of senior management with internal or external loss data to estimate loss impacts and likelihoods. Stochastic models are used to determine the amount of capital for low probability, high impact events.

### C.5.1 Material operational risk concentrations

The majority of our operational risk concentration exposure lies within the Regulatory or Legal and Process Execution categories.

### C.5.2 Mitigation of operational risks

Our aim is to minimise our exposure to operational risk, by use of our control framework as described in Section B. However, there is an acceptance that in order to achieve our business strategy we will be exposed to a certain amount of operational risk. A number of insurance policies are used to reduce operational risk exposures. The key policies are Group professional indemnity cover (across the Group) and employers liability cover for all employees.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## C.6 Other material risks

A business-wide review of risks is performed at Standard Life Group level to determine a list of Group specific risks. This assessment also considers the risks which are also present at individual level, but whose impact could be significantly different (which behave in a different way) at Group level. These could include:

- Reputational risk, including impacts from conduct risk, liquidity risk, the risk of a downgrade to our external credit rating and impacts on underwriting risks such as persistency and expenses
- Operational risk, as described in Section C.5
- Strategic risk, including impacts on underwriting risks such as persistency, expenses and new business levels. Our strategic objectives could be impacted by evolving customer preferences, our investment performance, and political and regulatory change. This also includes the risk that we are unable to successfully deliver our strategic objectives.
- Concentration risk, as described throughout Section C for each risk module

The approach taken to the assessment is a qualitative analysis of each of the risks in turn appropriate to the nature, scale and complexity of these exposures. The assessment described here has concluded that there are no other material risks that the Group and SLAL are exposed to. As a consequence:

- There is currently no requirement to hold additional capital in respect of these risks
- There are no other material risk concentrations to which the Company is exposed
- Other risks are not considered when investing assets according to the Prudent Person Principle
- No material other risks were identified through the sensitivity, scenario and stress tests described in Section C.7.1

During the year the UK voted to leave the EU. We have considered the impact of this decision and concluded that no additional risk capital was required at the end of 2016. This will be kept under review as the terms of the UK's exit becomes clearer.

## C.7 Any other information

### C.7.1 Risk sensitivity

Standard Life performs a range of sensitivity, scenario and stress tests as part of its established stress and scenario testing (SST) programme which is reviewed annually by the Risk and Capital Committee (RCC). These tests are mainly internally driven by management to improve our understanding of the sensitivity of our business model, supplemented by others that are externally driven, such as regulatory requests.

The 2016 SST programme covered a comprehensive range of stresses to explore a continuum of plausible stress environments. The SST programme included stresses to each of our main risk exposures:

- Financial – market, credit, liquidity
- Demographic – longevity, persistency, mortality, morbidity, expense
- Other – conduct, reputational, operational

The SST programme also included insight into relevant severe combinations of risk events. A variety of stresses were applied to the year end Solvency II balance sheet and calibrated at or in excess of a 1-in-200 year probability level.

The SST programme includes both combined and solo stress tests and forward-looking scenario projections to support the annual business planning process and reverse stress tests to consider circumstances or severe events that, if they emerged, could have the potential to cause the business plan to fail.

The scenario projections comprise five-year projections on base, down and severe downside scenarios. The projections are completed on the regulatory solvency position.

In addition, liquidity stress testing is performed to assess the ability of the balance sheet to support potential outflows under stress, and assess the effectiveness of our contingency funding plan, including circumstances in which market liquidity is stressed.

The sensitivity of SLAL's regulatory Solvency II surplus to changes in key assumptions is as follows:

Sensitivity		Solvency II Surplus (£m)	Change in Solvency II Surplus (£m) <sup>4</sup>
<b>Base</b>		2,878	
<b>Equities</b>	Up 20%	3,099	221
	Down 20%	2,679	(199)
<b>Fixed interest yields</b> <sup>1,2</sup>	Up 1.0%	2,831	(47)
	Down 1.0%	2,874	(4)
<b>Credit spreads</b>	Up 0.5%	2,860	(18)
	Down 0.5%	2,899	21
<b>Mortality rates</b>	Up 5%	3,070	192
	Down 5% <sup>3</sup>	2,678	(200)
<b>Surrenders</b>	10% one-off	2,736	(142)

<sup>1</sup> Interest rate sensitivities assume transitionals are recalculated (see Section D.2 for details on the transitionals)

<sup>2</sup> Assumes that yields do not fall below -0.30%

<sup>3</sup> 95% of actual rates, implies 5 month increase in life expectancy for 65 year old male

<sup>4</sup> Excluding any impact from pension scheme surplus

### C.7.2 Prudent Person Principle

The Prudent Person Principle (PPP) is a set of requirements which govern the investments that an insurer is allowed to make. For example insurers may only invest in assets and instruments whose risks they can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of their overall solvency needs. To avoid repetition we describe the PPP compliance of all asset classes together rather than individually.

The Company's investment risk management framework ensures that assets that are backing technical provisions are invested in accordance with the requirements of the PPP. These predominantly apply within SLAL.

The framework is underpinned by Standard Life's Group policy framework, which includes Market Risk Management, Credit Risk Management and Liquidity and Capital Management policies and requires that the risks associated with investments are identified, assessed, controlled and monitored.

Decisions on significant investment matters (including the types of asset that can be invested in) are the responsibility of the Company's Board. Any new proposals must follow robust governance and review processes to ensure that proper consideration of the risks, benefits, costs and other implications has been given.

The Company's shareholder and policyholder assets, other than those relating to unit-linked policies which have been invested in external fund options, are managed by Standard Life Investments. These assets must be managed in accordance with requirements that are set by the Company with reference to the nature, term and other relevant characteristics of the liabilities that they back, along with the risk characteristics of the assets. Compliance with these requirements is monitored on an ongoing basis and reviewed at least annually to ensure the ongoing appropriateness of existing asset allocations and constraints. Compliance with regulatory requirements such as the Financial Conduct Authority's (FCA) Conduct of Business rules and Standard Life's Principles and Practices of Financial Management (for with profits business) is also monitored.

The Company manages assets on behalf of with profits and unit-linked customers as well as assets backing non-profit business and shareholder assets. Further detail of the PPP compliance for these types of business is given in the sections below.

#### With profits business

Within our with profits business, we manage investments with the objective of balancing the level of risk taken to deliver growth over the long-term and the need to meet all contractual obligations to policyholders.

The with profits assets are managed in a collection of funds and are invested according to the currency, term and nature of the underlying liabilities. This includes some assets backing non-profit business that was written prior to The Standard Life Assurance Company's demutualisation and is owned by the SLAL HWPF. For all of these assets we seek to ensure the security, quality and liquidity of the portfolio of assets as a whole by predominantly investing in liquid securities that are listed or traded on regulated exchanges. Concentrations of assets are avoided by adhering to limits set by, for example, asset type, geography and counterparty.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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We aim to make with profits investment decisions in the best interests of all our with profits customers. It is the role of the With Profits Actuary to advise the Company's Board on their use of discretion for the with profits funds and on the reasonable expectations and fair treatment of policyholders in SLAL's with profits funds. The With Profits Actuary is supported in this aim by the With Profits Committee, which provides independent advice to the Company's Board in relation to matters affecting the fair treatment of policyholders within SLAL's with profits funds.

### Unit-linked

Within our unit-linked business we offer a wide range of funds which offer customers a choice of investment risk, asset classes and investment styles. These funds comprise both the Company's own funds (internal funds) and external fund links. Our internal funds are managed by Standard Life Investments.

There is a fund mandate for each of the Company's internal funds which details key aspects of how the fund is to be managed by Standard Life Investments, including the objective of the fund, its benchmark, and the assets that the fund is permitted to invest in including any restrictions.

We operate a governance framework covering all of our unit-linked funds (internal and external) to ensure that our unit-linked fund range is developed and managed appropriately on an ongoing basis. As part of this, all unit-linked funds are reviewed regularly to ensure that expectations set with customers remain aligned to how the funds are being managed by the investment manager. The effectiveness of the operation of this framework is regularly reported to the Company's Board.

To ensure the quality, security and liquidity of our funds, we predominantly invest in liquid securities that are listed or traded on regulated exchanges, or in daily priced funds that are authorised or recognised by the FCA. During significant market events we ensure our funds are priced appropriately and we may take other action as required to protect all customers in the fund. For example, we may place a fund into deferral in response to liquidity concerns until an appropriate level of liquidity is reached.

### Shareholder (including non-profit) funds

Shareholder funds are directly exposed to the investment profits and losses. The most significant funds are the assets backing annuities, subordinated debt and free surplus.

These funds are primarily invested in cash and fixed interest investments, with the objective of optimising the risk-adjusted return and ensuring the diversification of credit risk exposures.

The primary exposures arise from the assets supporting annuity business, which has a cash flow matched 'buy and maintain' investment strategy.

For the purposes of setting investment strategy, the financial strength of the Company is defined by its capacity to maintain the proposed investment strategy following defined adverse absolute scenarios as opposed to its prevailing financial strength. Consideration is also given to the capacity within the Company's approved quantitative risk exposure limits (within the risk appetite framework).

The investment strategy is operated within constraints set within the qualitative and quantitative requirements of the risk policies that relate to managing investments: Credit Risk, Market Risk, Liquidity Risk and Capital Management.

The investment constraints set may vary from time to time, but are designed to ensure that adequate levels of diversification and liquidity are maintained. Examples of the types of constraints include limits on permitted asset types and exposures to individual companies, market sectors and credit ratings.

This investment approach ensures the security, quality, liquidity and profitability of the portfolio as a whole.

### C.7.3 Use of special purpose vehicles

Throughout 2016 the Company has not owned any special purpose vehicles for the purpose of transferring risk.

## D. Valuation for solvency purposes

In accordance with Solvency II valuation regulations and unless expressly stated below, the Company has valued its assets and liabilities at fair value. In order to establish the fair value of assets and liabilities, the following principles have been applied:

- Assets have been valued at the amounts for which they could be exchanged between knowledgeable willing parties in an arm's length transaction
- Liabilities have been valued at the amounts for which they could be transferred or settled between knowledgeable willing parties in an arm's length transaction

The valuation of technical provisions is described in Section D.2.

Details on the methods and assumptions used to determine the fair values of assets and other liabilities are included in Section D.4.

The Company's Solvency II balance sheet is reported via QRT S.02.01.02 *Balance sheet*, a copy of which is included in Appendix 2. The balance sheet QRT shows assets and liabilities valued under Solvency II rules using Solvency II scope and balance sheet classifications. Valuation differences between Solvency II and International Financial Reporting Standards (IFRS) statutory accounts values for assets, technical provisions and other liabilities are explained in Sections D.1, D.2 and D.3 respectively.

### Reallocations

The structure of the Solvency II balance sheet is different to the structure of the statement of financial position in the Company's IFRS statutory accounts, and therefore reallocation adjustments are required between the two balance sheets.

The tables below set out reallocation adjustments which have been applied to assets and liabilities in the Company's IFRS statutory accounts balances at 31 December 2016. These adjustments are grouped into two types in the tables:

- 'Presentation adjustments (excluding unit/index-linked)' move other balances from the balance sheet line items used in the IFRS statement of financial position to the appropriate balance sheet line items used in the Solvency II balance sheet.
- 'Presentation adjustments (unit/index-linked)' move unit-linked fund balances from the relevant balance sheet line items used in the IFRS statement of financial position into the 'Assets held for index-linked and unit-linked contracts' line in the Solvency II balance sheet.

In addition to the above reallocations, some line items in the IFRS statement of financial position are named differently in the Solvency II balance sheet. The mappings from IFRS to Solvency II balance sheet lines are also shown in the tables below.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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IFRS statement of financial position headings Assets	IFRS £m	Presentation adjustments		IFRS statutory balance based on Solvency II presentation and scope £m	Solvency II balance sheet headings Assets
		unit/ index- linked £m	excluding unit/ index- linked £m		
Intangible assets	94	-	-	94	Intangible assets
Deferred acquisition costs	591	-	-	591	Deferred acquisition costs
Deferred tax assets	12	-	-	12	Deferred tax assets
Pension and other post-retirement benefit provisions	1,093	-	-	1,093	Pension benefit surplus
Property and equipment	7	-	8	15	Property, plant & equipment held for own use
Investment property	5,356	(4,472)	(8)	1,100	Property (other than for own use)
Assets held for sale	236	(12)	-		
Interests in listed pooled investment funds	17,790	(17,673)	(117)		
Investment in subsidiaries	57,044	(34,883)	(42)	22,932	Holdings in related undertakings, including participations
Investments in associates	5,575	(4,762)	-		
Listed equity investment securities at FV	30,745	(27,523)	25	3,247	Equities
Debt securities	34,221	(12,763)	(462)	20,996	Bonds
	-	-	92	92	Collective investments undertakings
Derivative financial assets	2,296	(109)	-	2,187	Derivatives
	-	-	99	99	Deposits other than cash equivalents
	-	99,649	-	99,649	Assets held for indexed-linked and unit-linked contracts
Loans and receivables	112	(60)	504	556	Loans and mortgages
Reinsurance assets	5,378	3,779	-	9,157	Reinsurance recoverables
Receivables and other financial assets	582	(300)	(174)	108	Insurance and intermediaries receivable
	-	-	240	240	Receivables (trade, not insurance)
Other assets	189	(125)	(64)	-	
Cash and cash equivalents	1,476	(1,301)	(99)	76	Cash and cash equivalents
<b>Total assets</b>	<b>162,797</b>	<b>(555)</b>	<b>2</b>	<b>162,244</b>	<b>Total assets</b>

IFRS statement of financial position headings Liabilities	IFRS £m	Presentation adjustments		IFRS statutory balance based on Solvency II presentation and scope £m	Solvency II balance sheet headings Liabilities
		unit/ index- linked £m	excluding unit/ indexed- linked £m		
Participating contract liabilities	31,237	-	(31,237)	-	Technical provisions – Life (excluding indexed-linked and unit- linked)*
Non-participating insurance contract liabilities	17,512	(1,563)	(15,791)	158	Technical provisions – Health (similar to life)*
Non-participating investment contract liabilities	101,889	(101,885)	47,028	47,032	Technical provisions – Life (excluding health indexed-linked and unit-linked)*
	-	103,448	-	103,448	Technical provisions – indexed- linked and unit-linked*
	-	-	185	185	Provisions other than technical provisions
Pension and other post retirement benefit provisions	55	-	-	55	Pension benefit obligations
Deposits received from reinsurers	5,093	-	-	5,093	Deposits from reinsurers
Deferred tax liabilities	231	(70)	-	161	Deferred tax liabilities
Derivative financial liabilities	111	(89)	-	22	Derivatives
	-	-	1	1	Debts owed to credit institutions
	-	-	46	46	Financial liabilities other than debts owed to credit institutions
Other financial liabilities	2,683	(309)	(2,024)	350	Insurance and intermediaries payables
Other liabilities	261	(33)	(222)	6	Reinsurance payables
Current tax liabilities	46	(54)	2,016	2,008	Payables (trade, not insurance)
Subordinate liabilities	318	-	-	318	Subordinate liabilities
Deferred income	195	-	-	195	Any other liabilities not elsewhere shown
<b>Total liabilities</b>	<b>159,631</b>	<b>(555)</b>	<b>2</b>	<b>159,078</b>	<b>Total liabilities</b>
<b>Total equity</b>	<b>3,166</b>	<b>-</b>	<b>-</b>	<b>3,166</b>	<b>Excess of assets over liabilities</b>

\* Risk margin and transitional measures within technical provisions are unaudited.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## Valuation adjustments

The following table summarises valuation adjustments at 31 December 2016 between IFRS and Solvency II for assets, technical provisions and other liabilities that are explained in subsequent sections.

Solvency II balance sheet headings	IFRS statutory balance based on Solvency II presentation and scope £m	Solvency II balance sheet £m	Valuation adjustments £m
<b>Assets</b>			
Intangible assets	94	-	(94)
Deferred acquisition costs	591	-	(591)
Deferred tax assets	12	17	5
Pension benefit surplus	1,093	1,093	-
Property, plant & equipment held for own use	15	15	-
Property (other than for own use)	1,100	1,100	-
Holdings in related parties, including participations	22,932	22,702	(230)
Equities	3,247	3,247	-
Bonds	20,996	20,996	-
Collective investments undertakings	92	92	-
Derivatives	2,187	2,187	-
Deposits other than cash equivalents	99	99	-
Assets held for indexed-linked and unit-linked contracts	99,649	99,649	-
Loans and mortgages	556	554	(2)
Reinsurance recoverables	9,157	8,896	(261)
Insurance and intermediaries receivable	108	108	-
Receivables (trade, not insurance)	240	240	-
Cash and cash equivalents	76	76	-
<b>Total assets</b>	<b>162,244</b>	<b>161,071</b>	<b>(1,173)</b>
<b>Liabilities</b>			
Technical provisions – Health (similar to life)*	158	155	(3)
Technical provisions – excluding health indexed-linked and unit-linked*	47,032	44,379	(2,653)
Technical provisions – indexed-linked and unit-linked*	103,448	100,775	(2,673)
Provisions other than technical provisions	185	185	-
Pension benefit obligations	55	55	-
Deposits from reinsurers	5,093	5,093	-
Deferred tax liabilities	161	651	490
Derivatives	22	22	-
Debts owed to credit institutions	1	1	-
Financial liabilities other than debts owed to credit institutions	46	46	-
Insurance and intermediaries payables	350	350	-
Reinsurance payables	6	6	-
Payables (trade, not insurance)	2,008	2,008	-
Subordinate liabilities	318	356	38
Any other liabilities not elsewhere shown	195	-	(195)
<b>Total liabilities</b>	<b>159,078</b>	<b>154,082</b>	<b>(4,996)</b>
<b>Excess of assets over liabilities</b>	<b>3,166</b>	<b>6,989</b>	<b>(3,823)</b>

\* Risk margin and transitional measures within technical provisions are unaudited.

## D.1 Assets

The total value of assets in the Company's Solvency II balance sheet at 31 December 2016 was £161,071m. An analysis of the Solvency II balance sheet by type of asset is provided in QRT S.02.01.02 *Balance sheet*, a copy of which is included in Appendix 2.

Solvency II regulations require that assets of insurers be valued on a basis that reflects their fair value, described as an 'economic valuation'. The valuation basis adopted should, as far as possible, be consistent with IFRS.

The following table gives the valuation bases used at 31 December 2016, along with a comparison between Solvency II and IFRS statutory accounts values. The IFRS statutory accounts values below reflect the IFRS statutory accounting values using Solvency II balance sheet presentation as set out earlier in the introduction to Section D.

Positive valuation differences are shown where Solvency II valuations are higher than IFRS.

Balance sheet caption	Description of basis and method of valuation		
Deferred acquisition costs	Under IFRS, some costs incurred in issuing certain contracts are deferred and amortised as Deferred Acquisition Costs (DAC). In accordance with the Solvency II valuation guidelines, nil value is attributed to DAC. Accordingly, the following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:		
	£m		
	DAC as per IFRS statutory accounts 591		
	DAC as per Solvency II balance sheet -		
	Valuation difference (591)		
Intangible assets	Under IFRS, intangible assets are recognised if it is probable that the relevant future economic benefits attributable to the asset will flow to the Company and they can be measured reliably and are either identified as separable or they arise from contractual or other legal rights, regardless of whether those rights are transferable or separable. The Company has recognised as intangible assets software which has been developed internally and other purchased technology which is used in managing and executing our business. Intangible assets are recognised at cost and charged to the income statement on a straight-line basis over the length of time the Company expects to derive benefits from the asset.		
	Under the Solvency II valuation guidelines, intangible assets are recognised and measured at fair value so long as they can be sold separately and fair value measurement using quoted prices in an active market is possible. When intangible assets cannot be sold separately or fair value measurement using quoted prices in an active market is not possible, such intangible assets are valued at nil. The Company's intangible assets do not meet the criteria for recognition and are therefore valued at nil.		
	Accordingly, the following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:		
	Software £m	Other £m	Total £m
	Intangible assets as per IFRS statutory accounts 94	-	94
	Intangible assets as per Solvency II balance sheet -	-	-
	Valuation difference (94)	-	(94)

Balance sheet caption	Description of basis and method of valuation								
<b>Deferred tax assets</b>	<p>The following section describes the valuation approach for both deferred tax assets and liabilities.</p> <p>Under IFRS, a deferred tax asset represents a tax deduction that is expected to arise in a future period. It is only recognised to the extent that there is expected to be future taxable profit or investment return to offset the tax deduction. A deferred tax liability represents taxes which will become payable in a future period as a result of a current or prior year transaction. All deferred tax liabilities are recognised.</p> <p>Where local tax law allows, deferred tax assets and liabilities are netted off on the statement of financial position. The tax rates used to determine deferred tax are those enacted or substantively enacted at the reporting date.</p> <p>Deferred tax is recognised on temporary differences arising from investments in subsidiaries and associates only when it is expected that the temporary difference will reverse in the foreseeable future and the timing of the reversal is not in our control.</p> <p>Shareholder deferred tax for Solvency II valuation purposes is determined by identifying temporary differences between the fair value of assets or liabilities on the Solvency II balance sheet and their equivalent tax base. The assessment is consistent with the IFRS approach. The expiry date of any timing differences is taken into account when assessing recoverability.</p> <p>The following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:</p> <table> <tr> <th></th><th>£m</th></tr> <tr> <td>Deferred tax assets as per IFRS statutory accounts</td><td>12</td></tr> <tr> <td>Deferred tax assets as per Solvency II balance sheet</td><td>17</td></tr> <tr> <td>Valuation difference</td><td>5</td></tr> </table> <p>Deferred tax valuation differences are primarily attributable to the different valuation methods applied for assets and liabilities between the Solvency II balance sheet and the IFRS statutory accounts.</p> <p>Due to uncertainty regarding recoverability, deferred tax has not been recognised in respect of the following assets:</p> <ul style="list-style-type: none"> <li>• Tax reserves of the Germany branch of SLAL of £20m</li> <li>• Unrealised investment losses of £12m</li> </ul>		£m	Deferred tax assets as per IFRS statutory accounts	12	Deferred tax assets as per Solvency II balance sheet	17	Valuation difference	5
	£m								
Deferred tax assets as per IFRS statutory accounts	12								
Deferred tax assets as per Solvency II balance sheet	17								
Valuation difference	5								
<b>Pension benefit surplus</b>	<p>The Company's Solvency II balance sheet at 31 December 2016 holds the pension scheme surplus at its IFRS value.</p> <p>Under IFRS, the statement of financial position must reflect assets or liabilities relating to each defined benefit pension plan as required by IAS 19 <i>Employee Benefits</i>. The liability recognised is the present value of the defined benefit obligation (estimated future cash flows are discounted using the yields on high quality corporate bonds) less the fair value of plan assets, if any.</p> <p>If the fair value of the plan assets exceeds the defined benefit obligation, a pension surplus is only recognised if the Company considers that it has an unconditional right to a refund. The amount of surplus recognised will be limited by tax and expenses.</p>								

Balance sheet caption	Description of basis and method of valuation
Pension benefit surplus <i>continued</i>	There are no valuation differences between the Solvency II balance sheet and the IFRS statutory accounts for the pension benefit surplus.
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Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Balance sheet caption	Description of basis and method of valuation				
Investments (other than assets held for index-linked and unit-linked contracts)	<p><b>Property (other than for own use)</b></p> <p>In the Company's IFRS statutory accounts, property held for long-term rental yields or investment gain that is not occupied by the Company and property being constructed or developed for future use as investment property are classified as investment property. Investment property is initially recognised at cost and subsequently measured at fair value.</p> <p>There are no valuation differences between the Solvency II balance sheet and the IFRS statutory accounts for property (other than for own use).</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Property (other than for own use) as per Solvency II balance sheet</td><td style="text-align: right;">1,100</td></tr> </table>		<b>£m</b>	Property (other than for own use) as per Solvency II balance sheet	1,100
	<b>£m</b>				
Property (other than for own use) as per Solvency II balance sheet	1,100				
Investments (other than assets held for index-linked and unit-linked contracts)	<p><b>Holdings in related undertakings, including participations</b></p> <p><u>Classification</u></p> <p>Under Solvency II, the Company has a participation in another undertaking when it has ownership, directly or indirectly, of 20% or more of the voting rights or capital of an undertaking. Undertakings will also be treated as participations where significant influence is effectively exercised by the parent. Where control exists, a participation is treated as a subsidiary, where significant influence exists without control, a participation is treated as an associate or joint venture.</p> <p>Joint ventures are strategic investments where the Company has agreed to share control of an entity's financial and operating policies through a shareholders' agreement and decisions can only be taken with unanimous consent.</p> <p>The concepts of participation and control under Solvency II are consistent with the approaches taken in identifying subsidiaries, associates and joint ventures in defining the scope of the Company's IFRS statutory accounts. The IFRS control assessment considers the rights of the Company to direct the relevant activities of the vehicle, its exposure to variability of returns and the ability to affect those returns using its power. Associates are entities where the Company can significantly influence decisions made relating to the financial and operating policies of the entity but does not control the entity. For entities where voting rights exist, significant influence is presumed where the Company holds between 20% and 50% of the voting rights. The Company also considers itself to have significant influence over investment vehicles where, through its role as investment manager, it has power over the investment decisions of the vehicle. As a result, the Company classifies as associates all Company managed investment vehicles which are not subsidiaries and in which the Company holds an investment, even though it may hold less than 20% of the voting rights of the investment vehicle.</p> <p>Under Solvency II, the Company classifies holdings in Collective Investments Undertakings which are subsidiaries and associates as participations. Collective Investments Undertakings comprise open ended funds (such as OEICs and unit trusts) and closed ended investment funds (such as private equity funds and investment trusts).</p> <p><u>Valuation</u></p> <p>In the Company's IFRS statutory accounts, subsidiaries and associates are disclosed on separate lines on the balance sheet. Under Solvency II, where the subsidiaries and associates are Standard Life investment funds, these are shown as investment funds, otherwise they are shown together as participations. Where participations are operating subsidiaries, they are valued using an adjusted equity approach.</p> <p>In the Company's IFRS statutory accounts, participations held for investment purposes are valued at fair value.</p> <p>Holdings in closed ended investment funds (private equity funds and investments trusts) are carried in both IFRS and Solvency II at fair value, valued using published prices where these are available.</p> <p>In the Company's IFRS statutory accounts, where the Company has an investment in an associate, a portion of which is held by, or is held indirectly through, a mutual fund, unit trust or similar entity, including investment-linked insurance funds, that portion of the investment is measured at fair value. The Solvency II valuation methodology is the same as for IFRS.</p>				

Balance sheet caption	Description of basis and method of valuation
Investments  (other than assets held for index-linked and unit-linked contracts)	<b>Holdings in related undertakings, including participations <i>continued</i></b> In the Company's IFRS statutory accounts, associates, other than those accounted for at fair value are accounted for using the equity method from the date that significant influence or shared control, respectively, commences until the date this ceases with consistent accounting policies applied throughout. Under the equity method, investments in associates and joint ventures are initially recognised at cost and include any goodwill identified on acquisition. The carrying value is adjusted for the Company's share of post-acquisition profit or loss and other comprehensive income of the associate or joint venture. The carrying value is also adjusted for any impairment losses. Under Solvency II, an adjusted equity approach is used.  For all related undertakings not valued using quoted market prices in an active markets or using the adjusted equity method, fair value is determined using alternative valuation methods as described in Section D.4. Such valuations are deemed to be consistent with economic value.  The following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:



Balance sheet caption	Description of basis and method of valuation
Investments (other than assets held for index-linked and unit-linked contracts)	<b>Participations <i>continued</i></b> <u>Joint ventures</u> The Company had no joint ventures during the year. <u>Associates</u> There are no differences between the IFRS and Solvency II values.
	<b>£m</b>
	Investments in associates as per Solvency II balance sheet 769
	<b>Equities</b> <u>Equities - listed</u> In the Company's IFRS statutory accounts, equity instruments listed on a recognised exchange are valued using prices sourced from the primary exchange on which they are listed. These instruments are generally considered to be quoted in an active market. The methodology used to value listed equities is consistent between the IFRS statutory accounts and the Solvency II balance sheet.
	<b>£m</b>
	Equities - listed as per Solvency II balance sheet 3,247
	<u>Equities - unlisted</u> At 31 December 2016, there is an immaterial value of unlisted equities.
	<b>Bonds</b> In the Company's IFRS statutory accounts, debt securities (referred to as bonds under Solvency II) are valued at fair value. There are no differences between the IFRS and Solvency II values.
	<u>Government Bonds</u> Government, including provincial and municipal, and supranational institution bonds.
	<b>£m</b>
	Government Bonds as per Solvency II balance sheet 10,070
	<u>Corporate Bonds</u>
	<b>£m</b>
	Corporate Bonds as per Solvency II balance sheet 10,705
	<u>Collateralised Securities</u> Collateralised securities are valued in the same way as non-collateralised bonds.
	<b>£m</b>
	Collateralised Securities as per Solvency II balance sheet 221
	<b>Collective Investments Undertakings</b> In the Company's IFRS statutory accounts, interests in pooled investment funds (referred to as Collective Investments Undertakings under Solvency II) that are subsidiaries are valued by looking through to the fair value of the underlying assets and liabilities held within each fund. For Solvency II, these holdings are held at fair value, valued using published prices where these are available. At 31 December 2016, there is no valuation difference between the Solvency II and IFRS accounting values of Collective Investments Undertakings.
	<b>£m</b>
	Collective Investments Undertakings as per Solvency II balance sheet 92

Balance sheet caption	Description of basis and method of valuation
<b>Investments</b>  (other than assets held for index-linked and unit-linked contracts)	<b>Derivatives</b> Derivative assets are held at fair value in the IFRS statutory accounts. There are no valuation differences between the Solvency II balance sheet and the IFRS statutory accounts.
	<b>£m</b>
	Derivatives as per Solvency II balance sheet 2,187
	<b>Deposits other than cash equivalents</b> Deposits other than cash equivalents are carried at amortised cost in the IFRS statutory accounts. It is a requirement of IFRS that the Company separately discloses the fair value of such assets in a note to the accounts, to the extent that this is materially different from the carrying value. At 31 December 2016, there is no valuation difference between the Solvency II balance sheet and the IFRS statutory accounts.
	<b>£m</b>
	Deposits other than cash equivalents as per Solvency II balance sheet 99
<b>Assets held for index-linked and unit-linked contracts</b>	In the Company's IFRS statutory accounts, assets held for index-linked and unit-linked contracts include some interests in pooled investment funds which are subsidiaries. These interests in pooled investment funds which are subsidiaries are valued by looking through to the fair value of the underlying assets and liabilities held within each fund. Solvency II valuations use published prices where these are available.  Other assets held for index-linked and unit-linked contracts are valued at fair value using prices sourced from the primary exchange on which they are listed where these are available or alternative valuation methods where published prices are not available.  For the Solvency II balance sheet, assets held for index-linked and unit-linked contracts are held at fair value, valued using published prices where these are available.  Despite the different valuation approach, there are no valuation differences between the IFRS and Solvency II values.
	<b>£m</b>
	Investment in Assets held for index-linked and unit-linked contracts as per Solvency II balance sheet 99,649
<b>Loans and mortgages</b>	Assets categorised as Loans and mortgages in the Solvency II balance sheet include Commercial Real Estate Loans (CREL), infrastructure loans, loans to individuals, intra-group loans and loans on policies. Valuation differences between the Solvency II balance sheet and the IFRS statutory accounts arise in respect of loans to individuals.  In the Company's IFRS statutory accounts, CREL and infrastructure loans are measured at fair value using valuation models. The same approach to calculating fair value is used in the Solvency II balance sheet and accordingly there are no valuation differences with the Solvency II value.  In the Company's IFRS statutory accounts, loans to individuals are initially measured at fair value and are subsequently measured at amortised cost, using the effective interest rate method, less any impairment losses. The fair value of these loans is disclosed in addition to their carrying value.  Loans not carried at fair value in the IFRS statutory accounts are restated to fair value in the Solvency II balance sheet. The following total difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:
	<b>£m</b>
	Loans and mortgages as per IFRS statutory accounts 556
	Loans and mortgages as per Solvency II balance sheet 554
	Valuation difference (2)
	The difference in valuation of Loans and mortgages relates to loans to individuals.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Balance sheet caption	Description of basis and method of valuation								
<b>Reinsurance recoverables</b>	<p>Under IFRS, reinsurance recoverables are measured using valuation techniques and assumptions that are consistent with the valuation techniques and assumptions used in measuring the underlying policy benefits and taking into account the terms of the reinsurance contract.</p> <p>For Solvency II balance sheet purposes, reinsurance recoverables are valued using the cash flow projection model that is used to calculate the best estimate liabilities. Refer to Section D.2 for details on calculation of best estimate of liabilities and to Section D.2.5 for details of the reinsurance arrangements in place. The reinsurance assets are adjusted for expected defaults. The payment pattern for reinsurance assets is assumed to be the same as the gross claims payment patterns for this purpose. Any short term variations in actual payments are reflected in the reinsurance recoverable.</p> <p>Accordingly, the following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Reinsurance recoverables as per IFRS statutory accounts</td><td style="text-align: right;">9,157</td></tr> <tr> <td>Reinsurance recoverables as per Solvency II balance sheet</td><td style="text-align: right;">8,896</td></tr> <tr> <td>Valuation difference</td><td style="text-align: right;">(261)</td></tr> </table>		<b>£m</b>	Reinsurance recoverables as per IFRS statutory accounts	9,157	Reinsurance recoverables as per Solvency II balance sheet	8,896	Valuation difference	(261)
	<b>£m</b>								
Reinsurance recoverables as per IFRS statutory accounts	9,157								
Reinsurance recoverables as per Solvency II balance sheet	8,896								
Valuation difference	(261)								
<b>Insurance and intermediaries receivables</b>	<p>Insurance and intermediaries receivables are stated at realisable value in the Solvency II balance sheet. This is consistent with the valuation approach followed in the IFRS statutory accounts.</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Insurance and intermediaries receivables as per Solvency II balance sheet</td><td style="text-align: right;">108</td></tr> </table>		<b>£m</b>	Insurance and intermediaries receivables as per Solvency II balance sheet	108				
	<b>£m</b>								
Insurance and intermediaries receivables as per Solvency II balance sheet	108								
<b>Reinsurance receivables</b>	<p>Reinsurance receivables are stated at realisable value in the Solvency II balance sheet. This is consistent with the valuation approach followed in the IFRS statutory accounts. At 31 December 2016, there is an immaterial value of reinsurance receivables.</p>								
<b>Receivables (trade, not insurance)</b>	<p>Trade and other receivables are stated at realisable value in the Solvency II balance sheet. This is consistent with the valuation approach followed in the IFRS statutory accounts.</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Receivables (trade, not insurance) as per Solvency II balance sheet</td><td style="text-align: right;">240</td></tr> </table>		<b>£m</b>	Receivables (trade, not insurance) as per Solvency II balance sheet	240				
	<b>£m</b>								
Receivables (trade, not insurance) as per Solvency II balance sheet	240								
<b>Cash and cash equivalents</b>	<p>Cash and cash equivalents comprise cash balances and demand deposits directly usable for making payments, which are valued at amounts receivable on demand.</p> <p>There is no difference between the valuation basis for the Solvency II balance sheet and the IFRS statutory accounts.</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Cash and cash equivalents as per Solvency II balance sheet</td><td style="text-align: right;">76</td></tr> </table>		<b>£m</b>	Cash and cash equivalents as per Solvency II balance sheet	76				
	<b>£m</b>								
Cash and cash equivalents as per Solvency II balance sheet	76								

### Lease arrangements

The only material class of assets subject to leasing arrangements are property, in relation to operating leases for property (where the Company is the lessor). Further information about operating leases for investment property is provided in Note 15 on page 40 of the Company's Annual financial statements 2016.

## D.2 Technical provisions

This section provides information on the valuation of technical provisions.

### D.2.1 Overview

The value of technical provisions corresponds to the amount to be paid if the Company's insurance obligations were immediately transferred to another insurance undertaking, making use of and consistent with information provided by the financial markets and generally available data on underwriting risks.

The value of technical provisions is determined as the sum of a best estimate and a risk margin.

The best estimate is a probability weighted average of future cash flows, taking account of the time value of money, using an appropriate risk free interest rate term structure. The calculation is based upon realistic assumptions, using appropriate actuarial and statistical methods and taking account of all future cash inflows and outflows required to settle the insurance obligations.

The risk margin is the additional amount required to ensure that the value of the technical provisions is equivalent to the amount that another insurance undertaking would be expected to require in order to take-over and meet the insurance obligations.

The best estimate and the risk margin are typically calculated separately. The exception is where the future cash flows can be replicated reliably using financial instruments for which a reliable market value is observable (such as unit-linked fund values), in which case the value of technical provisions equals the market value of those financial instruments ('technical provisions as a whole').

The Company's Solvency II technical provisions comprise the following three components, depending on the line of business:

- Technical provisions as a whole
- Best estimate liabilities
- Risk margin

In addition, the Company has approval from the Prudential Regulation Authority (PRA) to apply the transitional measure on technical provisions. This allows for a deduction from technical provisions which reduces to zero over the transitional period of 16 years.

The valuation approach is summarised in subsequent sections.

#### D.2.1.1 Segmentation

For the purpose of Solvency II reporting, lines of business are as follows:

- Insurance with profit participation – includes all conventional and unitised with profits business
- Index-linked and unit-linked insurance – unit-linked business, including the present value of future profits
- Other life insurance – immediate and deferred annuities; protection; other non-with profits business; also includes the non-investment component of with profits business written since demutualisation
- Health insurance - including permanent health insurance and income protection

At 31 December 2016, the contribution to technical provisions from the each line of business was as follows:

Line of Business	Technical provisions as a whole £m	Best estimate liability £m	Risk margin* £m	Amount of the transitional measure on technical provisions* £m	Total technical provisions £m
Insurance with profit participation	-	29,105	112	7	29,224
Index-linked and unit-linked insurance	103,428	(2,437)	487	(703)	100,775
Other life insurance	-	14,933	1,271	(1,049)	15,155
Health Insurance	-	155	-	-	155
Total	103,428	41,756	1,870	(1,745)	145,309

\*Unaudited

Within each of these groups, the valuation of cash flows is determined at policy level, except that similar policies are grouped together when appropriate for the purposes of the stochastic modelling of with profits liabilities.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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This business is written in the UK, Ireland and Germany, with cash flows denominated in Sterling for UK and Euro for Ireland and Germany (converted to Sterling for consolidation).

The following sections describe, for each line of business, the nature of cash flows and the valuation methodology. The description of the “Other life insurance” line of business is split into annuity business, and protection / other business. Health insurance is less significant than other lines and is valued in a similar way as protection business.

## D.2.1.2 Insurance with profit participation

### D.2.1.2.1 Nature of business

The Company has written a number of contract variations on a with profits basis – in the UK, Germany and Ireland. While these contracts may differ in certain aspects of the product features, they share the common feature that they offer a form of investment guarantee:

- UK and Ireland Conventional With Profits (CWP) – generally, a guaranteed benefit is set at the time the policy is issued to be paid on a date or events specified. Regular bonuses may be added to the guaranteed benefit over the term of the policy. In addition, a final bonus may be paid.
- UK and Ireland Unitised With Profits (UWP) – under this type of with profits policy contractual benefits are determined by reference to the number of units allocated under the relevant unitised with profits policy. The number of units allocated increases on payment of premiums. Typically, for this type of policy, unit prices grow at a guaranteed minimum growth rate (either 0%, 3% or 4% a year) plus any (additional) bonus growth rate. The unit value of a policy is normally guaranteed as a minimum payout in specific circumstances. In addition a final bonus may be payable when benefits are taken.
- Germany unitised with profits contracts – a nominal value of units, which can grow with declared bonuses, is guaranteed on death, maturity and in some cases surrender. There are also guaranteed amounts (based on specified growth rates applied to all past and future premiums; depending on the contract, the rate is 1.2%, 2.375%, 2.875% or 4.875% a year) payable at maturity and, in some cases, surrender and selected other dates; in some cases these guaranteed amounts may be payable as an annuity.

The ‘asset share’ is a measure of the with profits policy value at the valuation date.

In addition to the asset share, best estimate liabilities include an allowance for the following cash flows:

- Future cost of guarantees: The cost of investment guarantees (which can apply on maturity, death or surrender depending on the contract) is assessed relative to the asset share
- Guaranteed annuity rates and values: Costs can arise when the guaranteed annuity (available on some UK, Ireland and Germany contracts) is greater than the expected future market annuity rate
- Future guarantee deductions: Deductions are made from the asset share in respect of the expected future cost of guarantees, and are charged for by a percentage deduction applied to asset shares. The deductions vary between policy groups and over time.
- Future profits: PVIF in respect of UWP and CWP contracts, calculated in a manner consistent with unit-linked contracts

Additional liabilities arise in respect of the Company’s treatment of smoothing on with profits claims, with profits payout practice in respect of unitised pension business (‘vintage unit’ approach) and the Mortgage Endowment Promise relating to minimum payouts on endowments backing house purchase.

### D.2.1.2.2 Valuation approach

The best estimate liability corresponds to the probability weighted average of future cash flows, taking account of the time value of money (expected present value of future cash flows), using the relevant risk free interest rate term structure and taking account of all uncertainties in the cash flows.

In practice, these requirements are interpreted as being equivalent to a current value of the policy at the valuation date (asset share) plus a valuation of future guarantee (and other) costs calculated on a stochastic basis.

Therefore, depending on the contract type, the best estimate liability for with profits contracts is made up of the following components:

- Asset share

Less present value of:

- Deduction for guarantees
- Future profits

Plus present value of:

- Cost of guarantees

- Guarantee annuity costs
- Smoothing cost
- Mortgage Endowment Promise
- Vintage unit cost, and other non-contractual commitments

Asset shares are derived from a policy by policy retrospective roll-up of premiums allowing for investment returns on with profits assets backing this business, mortality charges, expenses and charges and tax. The Company adopts a range of methods to determine the asset share, as appropriate to the different types of contracts and the materiality, in a manner consistent with the approach used to determine asset shares for with profits payout purposes. A projection of the future value of the asset share is used in the valuation of future modelled cash flows (for example in the valuation of future cost of guarantees and future profits).

For this class of business, the policyholder payout is a function of investment performance and is subject to a financial guarantee. The effect of the guarantee is to render the possible future outcomes 'asymmetrical', and so the approach adopted considers deviations of future events from their expected values. The Company uses a simulation technique to place a value on cash flows that are subject to financial guarantees. This considers a wide range of investment performance scenarios (produced by an economic scenario generator or 'ESG') and calculates the cash flow amounts payable in each scenario, having regard to the guarantees.

The stochastic method adopted is consistent with generally accepted actuarial practice and will most appropriately allow for the possibility of an asymmetrical outcome (uncertainty of cash flows). The nature of the approach is summarised below:

- Takes into account all cash flows, notably any guarantees and options on the contracts and the likelihood that policyholders may exercise these options
- Costs calculated stochastically are: investment guarantees offered on contracts; annuity conversion offered on guaranteed terms; inability to recycle smoothing cost due to guarantees biting; minimum payouts in respect of endowments backing house purchase. These costs are offset by the value of: future deductions taken to cover investment guarantee costs; future contributions to capital (profits) accruing to the with profits funds.
- A large number of simulated future investment returns are generated by the ESG, cash flows projected, guarantee (and other) costs emerging on the contracts calculated and costs discounted to the balance sheet. The final cost is taken as the average value across these simulations.
- Provided the scenarios produced by the ESG satisfy certain conditions, the average across the scenarios of the discounted value of the cash flows gives the value of the liabilities allowing for the guarantee.
- Policy data applied in the cash flow projection is derived from core policy systems. Similar policies are grouped together for practical modelling reasons.
- The key assumptions used in the projection are the simulated investment returns, charges, expenses, best estimate persistency and mortality rates. The approach to determining the simulated future investment returns (ESG) and the best estimate persistency and mortality / longevity rates are covered in Sections D.2.1.9 and D.2.1.8 respectively.
- The projection makes an allowance for policyholder behaviour in light of the guarantees and options available.
- The projections simulate the management actions that are applied in the respective with profits funds. This includes the regular review of deductions for guarantees, the application of smoothing on payouts, management of with profits assets and determination of regular bonus rates.

### **D.2.1.3 Index-linked and unit-linked insurance**

#### **D.2.1.3.1 Nature of business**

The unitised contracts include the following policy types: UK unitised life, UK group unitised pensions, UK individual unitised pensions, UK Self Invested Personal Pensions (SIPP), Ireland unitised life, Ireland unitised pensions and Germany unit-linked.

The UK and Ireland life product types include bonds and endowments, and pension product types include group pensions, individual pensions, SIPP and stakeholder pensions.

Policies that have units in both unit-linked and unitised with profits (UWP) funds are referred to as 'hybrid' policies. The valuation of the UWP related cash flows are described in Section D.2.1.2.

The unit-linked product in Germany is a deferred annuity contract with an option to take the benefits in cash at retirement. A loyalty bonus may be payable.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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### D.2.1.3.2 Valuation approach

The non-with profits unit-linked fund values meet the requirements to be a replicating portfolio. Therefore the gross unit fund value including any allowance for outstanding charges in respect of initial expenses, with no associated risk margin, is treated as 'technical provisions as a whole'.

The overall technical provision for a unit-linked contract then comprises the following components:

- Technical provisions as a whole (unit fund)
- Best estimate liability component (present value of future profits or PVIF) plus risk margin on PVIF

The best estimate is required to be a probability weighted average of future cash flows. The PVIF is calculated deterministically.

To calculate the PVIF, best estimate charge income and expense cash flows are projected, with the unit fund rolled up at the same risk free interest rate term structure that is used for discounting the net cash flows. The projection is carried out using best estimate assumptions. The Solvency II yield curve and other best estimate assumptions are described in Sections D.2.1.8 and D.2.1.9.

Depending on the nature of the contract, the unit-linked PVIF valuation allows for the following cash flows:

- Inflows: fund management charge (net of large fund discounts), unallocated premiums, surrender penalties, policy fees, tax relief (on expenses and commission)
- Outflows: commission, initial expenses, renewal expenses, termination expenses, investment expenses, adviser payments, member fees, external fund manager charges, loyalty bonus

### D.2.1.4 Other life insurance – annuities

#### D.2.1.4.1 Nature of business

This category of business covers the following contract classes:

- Pensions Annuities – typically providing an income for life, with various policyholder options selected at outset (single / joint life, guaranteed period, escalation rate)
- Purchased Life Annuities – tax efficient lump sum investment contracts providing an income for life or over a selected period, again with policyholder options (guaranteed period, escalation rate)
- Deferred Annuities – pension savings products where the premiums paid purchase an annuity from a specified retirement date in the future

#### D.2.1.4.2 Valuation approach

The best estimate liability is derived using a deterministic discounted cash flow approach. The valuation approach projects the cash flows for each annuity contract and their underlying features, and the best estimate liability is equal to the annuity payments and expenses discounted using the Solvency II Sterling or Euro yield curve (with a matching or volatility adjustment as appropriate). The projection is carried out using best estimate assumptions, allowing for the relevant survival probabilities. The best estimate assumptions and Solvency II yield curve are described within Sections D.2.1.8 and D.2.1.9.

Annuity payments are calculated based on the specifics of each contract. The benefit payments projected reflect any guarantee period, whether the payment can step up or step down, the level of payment escalation (including RPI and LPI), payment frequency and dependant's benefits. Expenses include renewal, termination and investment expenses, allowing for expense inflation as appropriate.

Best estimate liabilities are calculated excluding any reinsurance cash flows, with a separate valuation of the reinsurance recoveries receivable performed on a consistent basis.

### D.2.1.5 Other life insurance – protection and other business (including health)

#### D.2.1.5.1 Nature of business

This category of business covers conventional non-participating savings, protection and health contracts. The protection products include term assurance, critical illness and protection riders on other policies such as pension policies. Savings products include endowment assurances, pension endowments and pure endowments. Health products include permanent health insurance and income protection.

The non-investment component of with profits business written since demutualisation is included within this line of business and is valued in the same way as unit-linked PVIF (covered in Section D.2.1.3).

#### **D.2.1.5.2 Valuation approach**

A cash flow approach is used to determine the best estimate liabilities as the expected present value of a contract, allowing for the following cash flows:

- Inflows (premiums, tax relief), less
- Outflows (claims, expenses, commission, investment expenses, tax payable)

Best estimate liabilities are calculated excluding any reinsurance cash flows, with a separate valuation of the reinsurance asset allowing for reinsurance recoveries receivable and reinsurance premiums payable.

These cash flows are discounted using the relevant Solvency II yield curve.

#### **D.2.1.6 Other technical provision considerations**

##### **D.2.1.6.1 Contract boundaries**

The boundary of an insurance contract (or reinsurance contract) defines the cash flows which must be taken into account when calculating the technical provision in respect of that contract. Only cash flows that relate to premiums payable up to and including the contract boundary should be taken into account. These cash flows include not only those premiums, but also benefit payouts, charges, expenses and other cash flows related to the premiums within the contract boundary. For the avoidance of doubt, all premiums which have been paid up to and including the reporting date are included in the boundary of the contract. That means that all the related cash flows in respect of premiums paid up to and including the reporting date are included in the calculation of technical provisions.

In general, future premiums on products with insurance cover and premiums invested into with profits funds or into unit-linked funds with a contractual cap on annual management fees are included within the contract boundary. Future premiums into funds with no guarantees and no cap on charges are not included within the contract boundary, even where the policyholder has the right to invest future premiums into with profits or a fund with a charge cap. In this case, the contract boundary is at the reporting date.

Contracts currently investing in a combination of with profits funds, funds with a charge cap and funds with no guarantee or charge cap are unbundled to allow for different contract boundaries on the different parts of the contract.

##### **D.2.1.6.2 Expenses**

The following best estimate expense provisions are held within the "Other life insurance" technical provisions:

- Where there are known mandatory requirements (e.g. regulatory development costs), provisions are held to cover the costs at an aggregate level
- Product development and exceptional costs that the Company has committed to incur in the year after the valuation date
- Ex-gratia payments if additional costs (e.g. legal) would be expected if the payments were not made
- Shared services costs which would fall to the Company if it operated as a standalone undertaking (excluding those costs currently recharged to the Company, as these are allowed for in the best estimate maintenance expense assumption)

##### **D.2.1.6.3 Residual estate**

The Scheme of Demutualisation requires that the residual estate of the Heritage With Profits Fund (HWPF) should be distributed to with profits policyholders of the fund in the form of enhancements to terminal bonuses. Under Solvency II, the residual estate is not included in technical provisions. Therefore, the residual estate forms part of the own funds of the HWPF.

##### **D.2.1.7 Risk margin (unaudited)**

The value of technical provisions is equal to the sum of a best estimate and a risk margin (plus technical provisions as a whole). The risk margin is held in respect of non-hedgeable risks and is required to ensure that the value of the technical provisions is equivalent to the amount that insurance undertakings would be expected to require in order to take over and meet the insurance obligations.

When calculated separately, the risk margin is calculated by determining the cost of providing an amount of eligible own funds equal to the solvency capital requirement (SCR) in respect of non-hedgeable risks necessary to support the insurance obligations over their lifetime. The cost of capital in this calculation is prescribed.

In theory, the calculation of the risk margin involves a projection of future SCRs. A simplified approach to determining these SCRs is permitted by the regulations and this has been implemented using a risk driver based approach. For each risk and product group, a risk driver is chosen that approximates the expected run off pattern of the capital relating to that risk. For example, the present value of future expenses at each future date will drive the expense risk capital at that date so this is selected as the risk driver for expense risk. The appropriate risk drivers are regularly

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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reviewed. This ensures that they accurately reflect the size of the risk exposure and that the run off of the risk driver is consistent with, and materially captures the run off of the underlying risk.

#### D.2.1.8 Non-economic bases

Non-economic assumptions are determined from annual experience investigations, are subject to detailed internal review and are approved by the Board. Best estimate assumptions are made in respect of future levels of longevity, mortality, surrenders, withdrawals, premium indexation and expenses. The assumptions vary depending on whether the business is written in the UK, Germany or Ireland. These assumptions reflect the Company's best estimates of likely future experience, based on recent experience and relevant industry data as appropriate. The approach is to treat the best estimate assumptions as the median of the range of possible assumptions.

Mortality / longevity assumptions are a combination of base mortality rates, which are set by reference to recent experience and, for annuities, expected future changes in mortality. The latter uses entity-specific considerations, along with data from external sources such as the Continuous Mortality Investigation Bureau (CMI) in the UK, which produces standard mortality tables and projection bases for mortality improvements.

Assumptions regarding surrender and withdrawal reflect recent experience, but the modelling additionally takes into account the risk of selective behaviour by individual policyholders in determining whether to lapse or retain a policy.

Best estimate expense assumptions on a per policy basis are derived from an analysis of management expenses. This allows for all expenses incurred in servicing policies, including overheads, assuming that the Company continues to write new business.

The investment management expense assumptions are derived as the best estimate of the future charges expected to be paid to Standard Life Investments, reflecting current investment management agreements, varying by the nature of assets backing technical provisions.

The main non-economic assumptions for each of the material lines of business are described below, with an indication of the factors that affect the assumption adopted.

##### D.2.1.8.1 Insurance with profit participation

<b>Persistency</b>	These assumptions cover lapse, retirement, withdrawal and paid-up rates. Depending on the assumption, they vary by: product type, duration of business, policyholder age, and territory. In addition, an allowance for dynamic policyholder behaviour is made, as described previously.
<b>Option take-up</b>	The valuation of guaranteed annuities requires assumptions about the future guaranteed annuity and tax free cash take-up rates. The assumption varies depending on country, product and the age at which the guarantee applies.
<b>Longevity</b>	This assumption is used to value guaranteed annuity terms, and varies by: gender, territory.
<b>Mortality</b>	Varies by: gender, product.
<b>Premium indexation</b>	With profits contracts in Germany give the policyholder the option of increasing their premium each year, subject to limits. Assumptions are required for both the future eligibility to premium increases, and the take-up rate. The assumption varies by: product, policy term, and maximum indexation level selected at policy outset.
<b>Expenses</b>	Some with profits contracts are written on an 'expense basis', where the asset share is determined with reference to incurred initial, renewal and termination expenses. Assumptions vary by: product, premium paying status.

##### D.2.1.8.2 Unit-linked

<b>Persistency</b>	These assumptions cover lapse, retirement, pension transfer and paid-up rates. Depending on the assumption, they vary by: product type, duration of business, policyholder age, and premium paying status.
<b>Drawdown and withdrawal rates</b>	Varies by: product and policyholder age.
<b>Maintenance expenses</b>	These include an allowance for both renewal and termination expenses, and vary by: product, premium paying status, drawdown status, and nature of investments (insured, self-invested, mutual funds).
<b>Investment expenses</b>	Varies by: product; long-term business fund, with profits or not.

<b>Mortality</b>	Varies by: gender, product.
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#### **D.2.1.8.3 Other life insurance**

<b>Longevity</b>	Varies by: gender, compulsory purchase or purchased life annuity, pre or post demutualisation, individual or group business, immediate or deferred annuity, and territory (UK, Germany, Ireland).
<b>Mortality and morbidity</b>	Varies by: gender, product, and territory.
<b>Proportions married</b>	Varies by: individual or group business, immediate or deferred annuity.
<b>Maintenance expenses</b>	These include an allowance for both renewal and termination expenses.
<b>Investment expenses</b>	Varies by long-term business fund.

#### **D.2.1.9 Economic bases**

The valuation of future policyholder liabilities requires best estimate economic assumptions, and in particular a future interest rate assumption (i.e. yield curve). The basic risk free yield curves are based on swap rates, include an adjustment for credit risk and are specified by EIOPA on a monthly basis. A different yield curve is used depending on the currency of the liabilities, which for the Company is Sterling and Euro. The curves specified by EIOPA are based on market data for the first 50 years for Sterling and 20 years for Euro, after which they converge to the ultimate forward rate which is set by EIOPA and is currently 4.2%.

For certain liabilities, a matching adjustment or volatility adjustment is added to the basic risk free yield curve.

##### **D.2.1.9.1 Matching adjustment**

The risk free yield can be adjusted to reflect where long-term liabilities (e.g. annuities) are backed by assets which closely match the cash flows and where these assets have yields in excess of risk free, reflecting an illiquidity premium. To the extent that the assets are expected to be held for the long term rather than sold short term, the additional yield can be taken into account when discounting long-term liabilities. This assumes that there is no situation which could give rise to the forced sale of assets at a loss when spreads are high.

The matching adjustment is a parallel shift to both the market and extrapolated segments of the risk free curve.

Having been granted approval by the PRA, the Company applies a matching adjustment in the valuation of UK immediate annuity liabilities. Further information on the matching adjustment is available in Section D.2.4.

##### **D.2.1.9.2 Volatility adjustment**

The volatility adjustment is designed to protect insurers with long-term liabilities from the impact of market volatility, by reducing the likelihood that insurers sell their risky assets when markets are falling.

The volatility adjustment is a parallel increase in the market segment of the risk free curve. There is no change to the ultimate forward rate. Having been granted approval by the PRA, a volatility adjustment is applied in the valuation of liabilities of all contract types where a matching adjustment is not used, except for unit-linked business. Further information on the volatility adjustment is available in Section D.2.4.

##### **D.2.1.9.3 Economic scenario generator**

The valuation of insurance with profit participation liabilities uses an economic scenario generator (ESG) to generate a large number of economic scenarios for a range of asset classes on a basis that is risk neutral under the Solvency II structure. This is used to value the cost of options and guarantees embedded in with profits policies.

The ESG can model a variety of asset classes and financial variables. The asset classes modelled and the models used are summarised in the table below:

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Asset Class	Model	Description
<b>Nominal interest rates</b>	Libor Market Model Plus (LMM+)	The LMM+ models the behaviour of risk free forward rates. The model ensures the volatility structure of the forward rates is consistent with the market swaption implied volatilities (IV). Volatilities are modelled stochastically to allow the skew and term structure of the market swaption IV surface to be captured.
<b>Equity</b>	Stochastic Volatility Jump Diffusion model (SVJD)	The SVJD model models the evolution of equity total returns. The volatility of future equity returns is implied from equity option prices from the market. Volatilities are modelled stochastically to allow the skew and term structure of market equity option IV surface to be captured.
<b>Property</b>	Fixed volatility model	Due to the lack of exchange traded property options, a simple fixed volatility model is adopted for modelling property returns.
<b>Credit</b>	Moody's G2 model (an extended Jarrow-Lando-Turnbull (JLT) model)	This models the evolution of credit spreads over time by modelling credit spreads, transitions, defaults and recoveries.
<b>Real interest rates</b>	Vasicek model (2-factor)	The 2-factor Vasicek model is a simpler interest rate model (than LMM+) which models the term structure of interest rates.
<b>Inflation</b>	n/a	Inflation is modelled implicitly by modelling the term structure of real interest rates. Inflation is implied by the difference between the real and nominal interest rates term structure.
<b>Foreign exchange</b>	Fixed volatility model	Exchange rates are modelled as a fixed volatility mean reversion process with GBP being the base economy.

The ESG models these asset classes simultaneously so it also requires correlation assumptions to model the dependence between returns in the different asset classes. These are specified as correlations between the stochastic shocks in the asset models.

## D.2.2 The level of uncertainty associated with the value of technical provisions

The level of uncertainty associated with the amount of technical provisions primarily relates to assumed future experience.

The valuation of liabilities requires assumptions about the future (e.g. longevity/mortality, persistency, option take-up, expenses, economic conditions, management actions), which are inevitably the source of some uncertainty. While the approach adopted by the Company leads to its best estimate of future expected experience, there can be a number of alternative similarly justifiable assumptions. For example, a range of assumptions regarding the rate of future improvements in longevity could be considered reasonable. This is also particularly relevant to the treatment of future policyholder behaviour, where there is limited reliable data to support a scale of dynamic lapse rates which would allow for rates to vary depending on projected economic conditions. Given this lack of data, the complexity that a model for dynamic persistency would entail and the uncertainty in the related assumptions, a simpler approach to modelling lapse behaviour is adopted, which appropriately takes into account anti-selective behaviour.

The modelling of management actions (notably guarantee deductions) requires that at future time steps the model makes an assessment of the present value of future costs and guarantee deductions. It is not practical to perform a full stochastic calculation at every time step for this purpose and instead mathematical formulae are used to estimate the required present values. A calibration process derives scaling factors to apply to the formulaic results to best match an equivalent stochastic approach.

Overall, the vast majority of the Company's business is explicitly modelled in the way summarised in previous sections. There is a small proportion of business which is not explicitly modelled, either because a minority of policy data has not passed data quality controls or because explicit modelling of the business would not be proportionate to the contribution to the overall balance sheet; in this case, the contribution to best estimate liabilities is derived by scaling from similar modelled business. In addition, a small proportion of liabilities are valued on a prudent basis consistent with the regulations in force prior to the commencement of Solvency II.

## D.2.3 Differences between the valuation of technical provisions for solvency purposes and that for financial statements (IFRS)

IFRS contract liability valuation depends on whether the contract is defined as 'insurance' or 'investment', 'participating' or 'non-participating' business. Insurance contracts are those that transfer significant insurance risk, and 'participating' contracts are those that contain discretionary features (notably with profits business). The IFRS valuation treatment is broadly as follows:

- Participating contracts – valued on the PRA Realistic Balance Sheet basis which applied before Solvency II came into force. This is a best estimate approach similar in manner to the valuation of with profits under Solvency II described above and uses the Solvency II risk free curves excluding the volatility adjustment. The IFRS liability also



includes the unallocated divisible surplus (UDS), which comprises the difference between the assets and all other recognised liabilities in the with profits funds.

- Non-participating insurance contracts – a discounted cash flow method, based on an assumed prudent rate of interest derived from yields on underlying assets in line with PRA requirements before the introduction of Solvency II and prudent non-economic assumptions
- Non-participating investment contracts – value of unit-linked funds

For the material lines of business, the table below reconciles the main difference between the IFRS contract liabilities and Solvency II technical provisions.

The IFRS figures shown represent the total insurance and investment (participating and non-participating) contract liabilities, including the UDS.

	Insurance with profit participation £m	Index-linked and unit- linked insurance £m	Other life insurance and health insurance £m	Total £m
IFRS value of liabilities (including UDS)	31,237	103,448	15,953	150,638
Remove HWPF surplus funds and UDS	(1,728)	-	-	(1,728)
Remove Sterling reserves on insurance business	-	(13)	(3)	(16)
Remove prudent margins in non-economic basis	-	-	(835)	(835)
Move from IFRS to Solvency II economic basis	(145)	-	(241)	(386)
Reallocate miscellaneous liabilities	-	22	(22)	-
Include present value of future profits not recognised in IFRS	(266)	(2,466)	40	(2,692)
Include risk margin*	112	487	1,271	1,870
Other technical provisions not recognised in IFRS	7	-	196	203
Transitional measure on technical provisions*	7	(703)	(1,049)	(1,745)
Solvency II technical provisions	29,224	100,775	15,310	145,309

\*Unaudited

#### D.2.4 Long-term guarantees package and transitional measures

The Company applies a matching adjustment (MA) when calculating technical provisions for UK immediate annuity liabilities. These include index-linked annuities and non-linked annuities. The MA for HWPF annuity liabilities is calculated separately from the MA for other annuity liabilities as they form separate MA portfolios.

The assets assigned to the MA portfolios include corporate bonds, commercial real estate loans, gilts and cash. Fixed rate (non index linked) assets have been selected to match the fixed rate nature of the non index-linked liabilities of the MA portfolios. Index-linked (inflation linked) assets have been selected to match the index-linked nature of index-linked liabilities of the MA portfolios.

Derivatives may be held in the MA portfolios for risk reduction and efficient portfolio management purposes.

Derivatives may be held to hedge the following risks:

- Interest rate risk (e.g. an interest rate swap to swap floating rate notes/loans to fixed rate)
- Currency risk (e.g. currency derivatives to hedge asset cash flows back to the currency of those liabilities they are matching)
- Inflation risk (e.g. inflation swaps)

The Company applies a volatility adjustment when calculating technical provisions for business other than unit-linked business, except where a matching adjustment is applied. The volatility adjustments used as at 31 December 2016 were 30bps for UK liabilities and 13bps for Euro liabilities.

The transitional risk free interest rate term structure referred to in Article 308c of Directive 2009/138/EC is not applied by the Company.

The Company applies the transitional measure on technical provisions for eligible business. This allows for a deduction from technical provisions which reduces to zero over the transitional period of 16 years. The transitional measure was recalculated at 31 December 2016, reflecting economic conditions at that date, and is net of the first of the 16-year annual deductions. This transitional measure provides a glidepath for business written before 1 January



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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2016 from the technical provisions under the previous solvency regime, and primarily represents the Solvency II risk margin of that business.

The impact of not applying a matching adjustment, volatility adjustment or the transitional measure on technical provisions is shown in the table below:

	Amount with long-term guarantee measures and transitionals £m	Impact of removing the transitional measure on technical provisions* £m	Impact of transitional measure on interest rates £m	Impact of removing the volatility adjustment £m	Impact of removing the matching adjustment £m
Technical provisions	145,309	1,745	-	260	1,055
Basic own funds	6,644	(1,481)	-	(142)	(694)
Eligible own funds to meet Solvency capital requirement	6,644	(1,481)	-	(142)	(694)
Solvency capital requirement	3,766	-	-	(28)	407
Eligible own funds to meet Minimum capital requirement	6,627	(1,481)	-	(142)	(694)
Minimum capital requirement	1,301	2	-	35	22

\*Unaudited

The long-term guarantee measures and technical provision transitionals are fundamental elements of the Solvency II regime and provide Tier 1 unrestricted capital (the tiering and quality of capital is described in Section E.1.3). The use of these measures has been supported by the PRA who recognise these items in full when considering companies' capital positions.

### D.2.5 Reinsurance recoverables and special purpose vehicles

Under Solvency II, reinsurance is defined as business where there is a transfer of risk.

The Company has entered into a number of external reinsurance arrangements set up by treaty or facultative agreements, covering UK, Ireland and Germany businesses. This includes external fund links (EFLs) set up via reinsurance.

The most significant reinsurance treaty is an arrangement with Canada Life International Re Designated Activity Company which covers the reinsurance of all UK single life annuities written prior to the demutualisation of the Company.

Reinsurance recoverables are calculated using the same models and assumptions as the corresponding best estimate liabilities. The valuation of reinsurance recoverables allows for the possibility of counterparty default. The value of reinsurance recoverables is shown in QRT S.12.01.02 *Life and health SLT technical provisions*, a copy of which included in Appendix 2.

The Company does not have any insurance special purpose vehicle arrangements.

### D.2.6 Material changes

Assumptions used in the valuation of technical provisions are reviewed regularly. The most significant changes during 2016 are as follows:

- The longevity basis has been affected by an increased number of deaths in recent experience, reducing technical provisions on annuity business.
- A matching adjustment is now used in the valuation of technical provisions for all UK immediate annuity liabilities. This was approved by the PRA on 30 November 2016.

### D.3 Other liabilities

This section provides information on the types and values of other liabilities in the Company's Solvency II balance sheet and a quantitative and qualitative explanation of any material differences with their IFRS statutory accounting valuation.

The total value of other liabilities in the Company's Solvency II balance sheet at 31 December 2016 was £8,773m. An analysis of the Solvency II balance sheet by type of other liability is provided in QRT S.02.01.02 *Balance sheet*, a copy of which included in Appendix 2.

Solvency II regulations require that other liabilities of insurers be valued on a basis that reflects their fair value (described as an 'economic valuation') with the exception that liabilities should not be adjusted to take account of an insurer's own credit standing. The valuation basis adopted should, as far as possible, be compatible with IFRS.

The following table gives the valuation bases and methods used at 31 December 2016 in valuing other liabilities for Solvency II balance sheet purposes along with a comparison between Solvency II and IFRS accounting values. Positive valuation differences are shown where Solvency II valuations are higher than IFRS.

Balance sheet caption	Description of basis and method of valuation				
<b>Contingent liabilities</b>	<p>In the IFRS statutory accounts, contingent liabilities are not recognised but disclosed within the notes. On the Solvency II balance sheet, contingent liabilities are valued based on the expected present value of future cash flows, required to settle the contingent liability over the lifetime of that contingent liability using the relevant risk free interest rate term structure. However, where it is not practicable to determine an estimate of the financial effect of a contingent liability under IFRS disclosure requirements, it follows that it is not possible to quantify a liability for Solvency II purposes.</p> <p>At 31 December 2016, it has not been possible to estimate the financial effect of contingent liabilities and there is therefore no valuation difference between the Solvency II and IFRS statutory accounts values.</p> <p>Further details of contingent liabilities are provided in Note 41 on page 98 of the Company's Annual financial statements 2016.</p>				
<b>Provisions other than technical provisions</b>	<p>Provisions are stated at the best possible estimate of the expenditure required to settle the present obligation at the Solvency II balance sheet date. This is consistent with the IFRS measurement basis under IAS 37. Accordingly, there is no valuation difference between the Solvency II and IFRS statutory accounts values.</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Provisions other than technical provisions as per Solvency II balance sheet</td><td style="text-align: right;">185</td></tr> </table> <p>Further details of provisions are included in Note 36 on pages 62 to 63 of the Company's 2016 Annual financial statements 2016.</p>		<b>£m</b>	Provisions other than technical provisions as per Solvency II balance sheet	185
	<b>£m</b>				
Provisions other than technical provisions as per Solvency II balance sheet	185				
<b>Pension benefit obligations</b>	<p>The Company's liability in respect of pension benefit obligations relates to defined benefit plans.</p> <p>Under IFRS, the statement of financial position must reflect assets or liabilities relating to each defined benefit pension plan. The liability recognised is the present value of the defined benefit obligation (estimated future cash flows are discounted using the yields on high quality corporate bonds) less the fair value of plan assets, if any.</p> <p>Further information about the Company's pension and other post-retirement benefit provisions, including the key assumptions and judgements used, is included in Note 32 on pages 56 to 61 of the Company's Annual financial statements 2016.</p> <p>The liability for pension benefit obligations in the Solvency II balance sheet is calculated using the IFRS valuation methodology. Accordingly, there is no valuation difference between the Solvency II and IFRS statutory accounts values.</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Pension benefit obligations as per Solvency II balance sheet</td><td style="text-align: right;">55</td></tr> </table>		<b>£m</b>	Pension benefit obligations as per Solvency II balance sheet	55
	<b>£m</b>				
Pension benefit obligations as per Solvency II balance sheet	55				

Balance sheet caption	Description of basis and method of valuation						
<b>Deposits from reinsurers</b>	<p>The main liability of this kind recognised by the Company relates to a deposit-backed arrangement relating to a portfolio of annuity contracts which the Company's HWPF reinsured to Canada Life International Re Designated Activity Company in 2008. This liability is valued in the IFRS accounts at amortised cost. This valuation is consistent with fair value. Accordingly, there is no valuation difference between the Solvency II and IFRS statutory accounts values.</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Deposits from reinsurers as per Solvency II balance sheet</td><td>5,093</td></tr> </table>	Deposits from reinsurers as per Solvency II balance sheet	5,093				
Deposits from reinsurers as per Solvency II balance sheet	5,093						
<b>Deferred tax liabilities</b>	<p>Refer to Section D.1 for a description of the valuation methodology for shareholder deferred tax assets and liabilities.</p> <p>The following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Deferred tax liabilities as per IFRS statutory accounts</td><td>161</td></tr> <tr> <td>Deferred tax liabilities as per Solvency II balance sheet</td><td>651</td></tr> <tr> <td>Valuation difference</td><td>490</td></tr> </table> <p>Deferred tax liability valuation differences are primarily attributable to the different valuation methods applied for assets and liabilities between the Solvency II balance sheet and the IFRS statutory accounts. The main difference relates to deferred tax liabilities in respect of future profits (PVIF).</p>	Deferred tax liabilities as per IFRS statutory accounts	161	Deferred tax liabilities as per Solvency II balance sheet	651	Valuation difference	490
Deferred tax liabilities as per IFRS statutory accounts	161						
Deferred tax liabilities as per Solvency II balance sheet	651						
Valuation difference	490						
<b>Derivatives</b>	<p>Derivative liabilities are held at fair value in the IFRS statutory accounts. There are no valuation differences between the Solvency II balance sheet and the IFRS statutory accounts.</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Derivatives as per Solvency II balance sheet</td><td>22</td></tr> </table>	Derivatives as per Solvency II balance sheet	22				
Derivatives as per Solvency II balance sheet	22						
<b>Debts owed to credit institutions</b>	<p>Debts owed to credit institutions are recorded under IFRS at amortised cost. This is consistent with the fair value valuation basis under Solvency II. Accordingly, there are no valuation differences between the IFRS statutory accounts and the Solvency II balance sheet.</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Debts owed to credit institutions as per Solvency II balance sheet</td><td>1</td></tr> </table>	Debts owed to credit institutions as per Solvency II balance sheet	1				
Debts owed to credit institutions as per Solvency II balance sheet	1						
<b>Financial liabilities other than debts owed to credit institutions</b>	<p>Financial liabilities other than debts owed to credit institutions are recorded under IFRS at amortised cost. This is consistent with the fair value valuation basis under Solvency II. Accordingly, there are no valuation differences between the IFRS statutory accounts and the Solvency II balance sheet.</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Financial liabilities other than debts owed to credit institutions as per</td><td>46</td></tr> </table>	Financial liabilities other than debts owed to credit institutions as per	46				
Financial liabilities other than debts owed to credit institutions as per	46						
<b>Insurance and intermediaries payable</b>	<p>Insurance and intermediaries payables are recorded under IFRS at amortised cost. This is consistent with the fair value valuation basis under Solvency II. Accordingly, there are no valuation differences between the IFRS statutory accounts and the Solvency II balance sheet.</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Insurance and intermediaries payable as per Solvency II balance sheet</td><td>350</td></tr> </table>	Insurance and intermediaries payable as per Solvency II balance sheet	350				
Insurance and intermediaries payable as per Solvency II balance sheet	350						
<b>Reinsurance payables</b>	<p>Reinsurance payables are recorded under IFRS at amortised cost. This is consistent with the fair value valuation basis under Solvency II. Accordingly, there are no valuation differences between the IFRS statutory accounts and the Solvency II balance sheet.</p> <p style="text-align: right;"><b>£m</b></p> <table> <tr> <td>Reinsurance payables as per Solvency II balance sheet</td><td>6</td></tr> </table>	Reinsurance payables as per Solvency II balance sheet	6				
Reinsurance payables as per Solvency II balance sheet	6						

Balance sheet caption	Description of basis and method of valuation								
<b>Payables (trade, not insurance)</b>	<p>Trade payables are recorded under IFRS at amortised cost. This is consistent with the fair value valuation basis under Solvency II. Accordingly, there are no valuation differences between the IFRS statutory accounts and the Solvency II balance sheet.</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Payables (trade, not insurance) as per Solvency II balance sheet</td><td style="text-align: right;">2,008</td></tr> </table>		<b>£m</b>	Payables (trade, not insurance) as per Solvency II balance sheet	2,008				
	<b>£m</b>								
Payables (trade, not insurance) as per Solvency II balance sheet	2,008								
<b>Subordinated liabilities</b>	<p>For the purposes of IFRS reporting, subordinated liabilities are initially recognised at the value of the proceeds received after deduction of issue expenses. Subsequent measurement is at amortised cost using the effective interest rate method.</p> <p>The Company's Solvency II valuation approach for subordinated liabilities uses a discounted cash flow technique, allowing for an illiquidity premium. Liabilities are not adjusted to take account of changes in the Company's own credit standing.</p> <p>Accordingly, the following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Subordinated liabilities as per IFRS statutory accounts</td><td style="text-align: right;">318</td></tr> <tr> <td>Subordinated liabilities as per Solvency II balance sheet</td><td style="text-align: right;">356</td></tr> <tr> <td>Valuation difference</td><td style="text-align: right;">38</td></tr> </table> <p>See Sections D.4.2.10 and E.1.8 for more information on the Company's subordinated liabilities.</p>		<b>£m</b>	Subordinated liabilities as per IFRS statutory accounts	318	Subordinated liabilities as per Solvency II balance sheet	356	Valuation difference	38
	<b>£m</b>								
Subordinated liabilities as per IFRS statutory accounts	318								
Subordinated liabilities as per Solvency II balance sheet	356								
Valuation difference	38								
<b>Any other liabilities not elsewhere shown</b>	<p>This balance sheet caption relates to deferred income balances. Under IFRS, front end fees on service contracts, including investment management service contracts, are deferred as a liability and amortised. In accordance with the Solvency II valuation guidelines, nil value has been allocated to deferred income balances. Accordingly, the following valuation difference can be observed between the Solvency II balance sheet and the IFRS statutory accounts:</p> <table> <tr> <td></td><td style="text-align: right;"><b>£m</b></td></tr> <tr> <td>Deferred income as per IFRS statutory accounts</td><td style="text-align: right;">195</td></tr> <tr> <td>Deferred income as per Solvency II balance sheet</td><td style="text-align: right;">-</td></tr> <tr> <td>Valuation difference</td><td style="text-align: right;">(195)</td></tr> </table>		<b>£m</b>	Deferred income as per IFRS statutory accounts	195	Deferred income as per Solvency II balance sheet	-	Valuation difference	(195)
	<b>£m</b>								
Deferred income as per IFRS statutory accounts	195								
Deferred income as per Solvency II balance sheet	-								
Valuation difference	(195)								

## D.4 Alternative methods for valuation

This section sets out the methods and assumptions used to determine the fair values of assets and other liabilities (other than technical provisions) and provides further information where alternative methods of valuation are used.

Where fair value is used under Solvency II, it is assessed in the same way (i.e. using the same methods and assumptions) as for IFRS, however, Solvency II valuation categories differ from IFRS fair value categories (referred to as the 'IFRS fair value hierarchy'). Solvency II valuation categories are described and analysed below.

### D.4.1 Fair value hierarchy

Investments carried at fair value in the Solvency II balance sheet are categorised based upon the valuation techniques used, as follows:

QMP – quoted market price in active markets for the same assets

QMPS – quoted market price in active markets for similar assets

AVM – alternative valuation methods

An active market exists where transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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For the material classes of assets and other liabilities carried at fair value, the following tables analyse the valuation techniques used at 31 December 2016:

Assets	Held at fair value		Other £m	Total £m
	QMP/QMPS £m	AVM £m		
Investments (other than assets held for index-linked and unit-linked contracts):				
Property (other than for own use)	-	1,100	-	1,100
Holdings in related undertakings, including participations	79	22,341	282	22,702
Equities - listed	3,247	-	-	3,247
Government bonds	10,037	33	-	10,070
Corporate bonds	10,332	373	-	10,705
Collateralised securities	221	-	-	221
Collective Investments Undertakings	-	92	-	92
Derivatives (assets)	469	1,718	-	2,187
Deposits other than cash equivalents	99	-	-	99
<b>Total investments (other than assets held for index-linked and unit-linked contracts)</b>	<b>24,484</b>	<b>25,657</b>	<b>282</b>	<b>50,423</b>
Assets held for index-linked and unit-linked contracts	41,789	57,860	-	99,649
Loans and mortgages	-	554	-	554

'Holdings in related undertakings, including participations' includes subsidiaries and associates carried at fair value. These participations are held for investment purposes and mainly comprise of open ended funds and listed and non-listed investment vehicles. Balances in the Other column are operating subsidiaries not held at fair value, valued using methods described in Section D.1.

At 31 December 2016, 96% of open ended funds reported as 'Holdings in related party undertakings, including participations' and 'Collective investment undertakings' were valued using daily prices. At 31 December, 2016, £53,226m of the £57,860m of assets held for index-linked and unit-linked contracts valued using AVM were open ended funds, of which 99% were valued using daily prices. The majority of the remaining balance of £4,634m were direct property investments.

At 31 December 2016, there were no restrictions due to market dislocation on transactions in daily priced property investments.

Liabilities	Held at fair value		Other £m	Total £m
	QMP/QMPS £m	AVM £m		
Deposits from reinsurers	5,093	-	-	5,093
Subordinated liabilities	-	356	-	356

## D.4.2 Methods and assumptions used to determine fair value of assets and liabilities

### D.4.2.1 Property

The fair value of property is based on valuations provided by external property valuation experts. The fair value is measured based on each property's highest and best use from a market participant's perspective and considers the potential uses of the property that are physically possible, legally permissible and financially feasible.

In the UK and Europe, valuations are completed in accordance with the Royal Institution of Chartered Surveyors (RICS) valuation standards. These are predominantly produced using an income capitalisation approach. The income capitalisation approach is based on capitalising an annual net income stream using an appropriate yield. The annual net income is based on both current and estimated future net income. The yield and future net income used is determined by considering recent transactions involving property with similar characteristics to the property being valued. Where it is not possible to use an income capitalisation approach, for example on property with no rental income, a market comparison approach is used by considering recent transactions involving property with similar characteristics to the property being valued. In both approaches where appropriate, adjustments will be made by the valuer to reflect differences between the characteristics of the property being valued and the recent market transactions considered.

As income capitalisation and market comparison valuations generally include significant unobservable inputs including unobservable adjustments to recent market transactions, property assets are categorised as AVM.

#### **D.4.2.2 Participations**

Holdings in participations held at fair value relate to holdings in open ended funds and holdings in closed ended investment vehicles. Open ended funds comprise holdings in indirect property funds and holdings in other pooled investment funds.

The fair value of daily priced pooled investment funds is calculated as equal to the observable unit price. Where the Company is responsible for calculating the unit price (Standard Life Investments managed funds) the price is derived from aggregating the fair values of underlying assets and liabilities held by the fund, divided by the total number of units at the valuation date. Where other investment managers are responsible for calculating unit prices, this is obtained from published information representing the value at which units could be redeemed via that manager. Unit pricing of both Standard Life Investments and non- Standard Life Investments managed funds does not meet the Solvency II criteria for QMP or QMPS categorisation since prices are not listed on a regulated market or multilateral trading facility.

There is no active market for units in indirect property funds. Most transactions are carried out by an investor contacting a fund manager to discuss and then agree a price on a deal by deal basis. Price discussions for prospective trades commence with net asset value (NAV). NAV is generally considered to be appropriate to be used as fair value. Where the fund manager considers that NAV does not represent fair value, they can propose an alternative valuation methodology, subject to internal governance.

The majority of close ended investments valued using AVM are private equity limited partnerships, which are non-listed investments. The majority of SLAL's private equity investments are carried out through European fund of funds structures, where SLAL receives valuations from the investment managers of the underlying funds on a quarterly basis. Internal governance is undertaken to gain assurance over the appropriate value, and adjustments are made where applicable to reflect the impact of changes in market conditions between the date of the valuation and the end of the reporting period. Valuations are prepared in accordance with International Private Equity and Venture Capital (IPEVC) valuation guidelines. The valuation of these securities is largely based on inputs that are not based on observable market data, and accordingly these instruments are categorised as AVM. Where appropriate, reference is made to observable market data.

#### **D.4.2.3 Equities**

Equity instruments listed on a recognised exchange are valued using prices sourced from the primary exchange on which they are listed. These instruments are considered to be quoted in an active market and are therefore categorised as QMP.

#### **D.4.2.4 Bonds**

For debt securities, the Group has determined a hierarchy of pricing sources. The hierarchy consists of reputable external pricing providers who generally use observable market data. If prices are not available from these providers or are considered to be stale, the Group has established procedures to arrive at an internal assessment of the fair value. These procedures are based largely on inputs that are not based on observable market data. A further analysis by category of debt security is as follows:

##### ***Government bonds (including provincial and municipal, and supranational institution bonds)***

These instruments are valued using prices received from external pricing providers who generally base the price on quotes received from a number of market participants. They are categorised as QMP or QMPS instruments depending upon the nature of the underlying pricing information used for valuation purposes.

##### ***Corporate bonds (listed or quoted in an established over-the-counter market including asset-backed securities)***

These instruments are generally valued using prices received from external pricing providers who generally consolidate quotes received from a panel of banks into a composite price. As the market becomes less active the quotes provided by some banks may be based on modelled prices rather than on actual transactions. These sources are based largely on observable market data, and therefore these instruments are categorised as QMPS. When prices received from external pricing providers are based on a single broker indicative quote the instruments are categorised as AVM.

For instruments for which prices are either not available from external pricing providers or the prices provided are considered to be stale, the Group performs its own assessment of the fair value of these instruments. This assessment is largely based on inputs that are not based on observable market data, principally single broker indicative quotes, and accordingly these instruments are categorised as AVM.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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### ***Other corporate bonds including unquoted bonds, commercial paper and certificates of deposit***

These instruments are valued using models. For unquoted bonds the model uses inputs from comparable bonds and includes credit spreads which are obtained from brokers or estimated internally. Commercial paper and certificates of deposit are valued using standard valuation formulas. The categorisation of these instruments will be either QMPS or AVM depending upon the nature of the underlying pricing information used for valuation purposes.

### ***Collateralised securities***

Collateralised securities are valued in the same way as non-collateralised bonds.

### **D.4.2.5 Collective investments undertakings**

Collective investments undertakings comprise daily priced pooled investment funds. Prices are obtained from published information representing the value at which units could be redeemed via the investment manager. Unit pricing does not meet the Solvency II criteria for QMP or QMPS categorisation since prices are not listed on a regulated market or multilateral trading facility. All collective investments undertakings are required by Solvency II guidance to be classified as AVM.

### **D.4.2.6 Derivative assets and derivative liabilities**

The majority of SLAL's derivatives are over-the-counter derivatives whose fair value is determined using a range of valuation models including discounting future cash flows and option valuation techniques. Since prices are not directly observable on a regulated market or multilateral trading facility, over-the-counter derivatives are categorised as AVM, however, inputs to valuation models are observable in the market.

The majority of SLAL's over-the-counter derivative investments are either interest rate swaps or swaption contracts. The valuation of interest rate swaps use discounted cash flow models to calculate the net present value of future cash flows. The valuation of swaption contracts uses the Black model.

Exchange traded derivatives are valued using prices sourced from the relevant exchange. They are considered to be instruments quoted in an active market and are therefore categorised as QMP.

### **D.4.2.7 Assets held for index-linked and unit-linked contracts**

Assets held for index-linked and unit-linked contracts comprise various types of investment assets valued in accordance with the methodologies described elsewhere in this section.

### **D.4.2.8 Loans and mortgages**

#### ***Commercial mortgages and infrastructure loans***

Commercial mortgages (CREL) and infrastructure loans are valued using models and therefore categorised as AVM. For CREL, valuation models use a discount rate adjustment technique which is an income approach. The key inputs are expected future cash flows, which are discounted using a discount rate that is determined by adding a spread to the current base rate. The spread is derived from a pricing matrix which incorporates data on current spreads for similar assets and which may include an internal underwriting rating. These inputs are generally observable with the exception of the spread adjustment arising from the internal underwriting rating.

Infrastructure loans are valued using a cash flow model which values expected cash flows by using the coupon attached to the investment as the initial discount rate and adjusting the discount rate in line with movements in spreads of an appropriate basket of comparable traded securities and the underlying risk free rates to create a fair value.

### **D.4.2.9 Deposits from reinsurers**

As described in Section D.3, deposits from reinsurers are valued at amortised cost, which is consistent with fair value.

### **D.4.2.10 Subordinated liabilities**

Subordinated liabilities are valued using a discounted cash flow model. Future liability cash flows are discounted using the spot rates of the basic risk free term structure plus an illiquidity premium plus an own credit risk premium ('OCR') appropriate to the currency in which the instrument is denominated. Both the illiquidity premium and OCR are constant over the term structure but the illiquidity premium may change over time, for example in response to changing market conditions. The illiquidity premium is derived using generally accepted actuarial practice with reference to similar market instruments. The OCR is calculated at the date of initial recognition and is constant over time.

### D.4.3 Significant unobservable inputs for AVM instruments

The table below presents information about the significant unobservable model inputs used for valuing instruments categorised as AVM. For each type of asset, the valuation technique, the key unobservable model inputs, the range of model inputs and the weighted average for that class of asset at 31 December 2016 is given.

31 December 2016	Fair value £m	Valuation technique	Unobservable input	Range (weighted average)
Property	5,542	Income capitalisation	Equivalent yield	3.6% to 9.1% (5.4%)
			Estimated rental value per square metre per annum	£34 to £2,422 (£349)
		Income capitalisation	Equivalent yield	4.6% to 7.1% (5.6%)
			Estimated rental value per hotel room per annum	£995 to £13,750 (£5,614)
Property	57	Market comparison	Estimated value per square metre	£2 to £12,807 (£4,202)
Private equity investments	366	Adjusted net asset value	Adjustment to net asset value	N/A
Government bonds (other)	33	Single broker	Single broker indicative price	N/A
Corporate bonds (unquoted corporate bonds)	373	Discounted cash flow	Credit spread	0.2% to 4.3% (1.9%)
Loans and mortgages (commercial mortgages)	451	Discounted cash flow	Credit spread	1.9% to 2.6% (2.1%)
Loans and mortgages (infrastructure loans)	11	Discounted cash flow	Credit spread	1.3%
Subordinated liabilities	356	Discounted cash flow	Own Credit risk premium	1.35%
			Illiquidity premium	0.49%

### D.4.4 Valuation uncertainty

Valuation uncertainty is the range of plausible values that could be attributed to an asset or liability at a point in time. Valuation uncertainty arises chiefly when using AVMs, i.e. when using models where market prices are not readily available, but valuation uncertainty arises for all classes of assets and liabilities that are measured at fair value.

At 31 December 2016, valuation uncertainty ranges resulting from unobservable inputs is most significant for valuations of directly held property and private equity investments. As explained in Section D.4.1 and D.4.2, there were no significant unobservable inputs at 31 December 2016 in relation to the valuation of derivatives and daily priced open ended funds.

The table below provides a range of plausible values at 31 December 2016 for investments in property and private equity investments:

	Base value (£m)	Valuation uncertainty (£m)
Property	1,115	1,059 - 1,193
Property balances reported in 'Assets held for index-linked and unit-linked contracts'	4,484	4,269 - 4,852
Private equity balances reported in 'Holdings in related undertakings, including participations'	366	329 - 458

Changing unobservable inputs in the measurement of the fair value of assets and liabilities to reasonably possible alternative assumptions would not have a significant impact on total own funds.

### D.5 Any other information

None.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## E. Capital management

### Standard Life Assurance Limited's approach to capital management

The Company adopts the liquidity and capital management policy of Standard Life Group (the Group). This is reviewed annual by the Group Board.

The Group's capital management approach seeks to ensure that the Group is appropriately capitalised under base and stress scenarios.

This section focuses on the capital management approach of the Company.

The Company has processes to manage and report its capital positions, and has capital framework policies that specify the buffer capital that the executive management believes is sufficient to hold within the Company. There is no additional explicit capital buffer held at Group in respect of the Company.

The Company closely monitors its current and projected solvency position and risk exposures, and has a series of triggers for further action. The Company's capital position is also tested under a series of stressed scenarios. The Company's capital needs and stresses are considered over a five year planning horizon on a rolling basis.

The Company actively seeks to ensure that its capital position can be maintained at a viable level to continue to operate the business under stress, in order to protect policyholders, customers and other key stakeholders. Within this overriding framework, the Company seeks to optimise its use of capital to maximise returns for shareholders and policyholders at an appropriate level of rewarded risk, and to manage its operations effectively to minimise or eliminate unrewarded risk.

The Company primarily manages its capital position by reference to its Capital Targets Framework. The key component of the Framework is the intention to maintain a minimum capital coverage under the most onerous of a range of plausible stress scenarios which are reviewed at least tri-annually. The Framework is used to inform all key board decisions with capital implications, in particular dividend proposals, investment strategy, capital planning and other management actions.

In addition to this, the Company defines limits for those risks which it actively seeks to manage. The risk limits are set with the overriding aim of supporting an overall suitable capital position under stress, with individual limits then set subject to this constraint in order to support the delivery of the business plan.

Alongside the above, the Heritage With Profits Fund (HWPF) Investment Risk Framework is used to determine appropriate levels of investment risk to be borne in the HWPF and investment risk levels in the German With Profits Fund (GWPF) are set consistently. The HWPF Investment Risk framework tests the capital coverage of the HWPF on defined absolute scenarios and where this is judged to be too low or too high under the framework, the Company would seek to reduce or increase investment risk in the funds as appropriate to deliver the best outcomes to policyholders.

The solvency position, risk exposures versus limits, and Capital Target Framework status is monitored on an ongoing basis with monthly reports produced for the Board. The report sets out a number of triggers for further action which are monitored and reported upon, many of which relate to capital coverage.

### E.1 Own funds

#### E.1.1 Own funds

Own funds are the regulatory capital resources of an insurance undertaking or group under Solvency II.

Own funds comprise on balance sheet items (referred to as basic own funds) and items that may be called up to absorb losses that are off balance sheet (referred to as ancillary own funds). Basic own funds consist of the excess of assets over liabilities (including technical provisions) and certain subordinated liabilities, all of which must be valued in accordance with Solvency II regulations and guidance. Ancillary own funds are subject to prior supervisory approval. The Company has not sought approval for any ancillary own funds as at 31 December 2016.

This section provides information on the structure, amount and quality of the Company's own funds, as well as a quantitative and qualitative explanation of any material differences between equity as shown in the Company's financial statements and the excess of assets over liabilities as calculated for solvency purposes.

### E.1.2 SLAL subsidiaries

In the calculation of the Company's own funds, those subsidiary companies which are insurance entities (Standard Life International Designated Activity Company (SL Intl), The Standard Life Assurance Company 2006 (SLAC 2006) and Standard Life Pension Funds Limited (SLPF)) are valued using their own funds value calculated in accordance with Solvency II regulations and guidance. Non insurance subsidiary companies are valued using their own equivalent calculations in accordance with their respective regulations. The Group structure showing major legal entities within the Group is included in Appendix 1.

### E.1.3 Composition and quality of own funds

Items of own funds vary in their ability to absorb losses both in the normal course of business and in times of stress. Items are graded into three tiers to reflect their quality (i.e. their ability to absorb losses), with Tier 1 being of the highest quality and Tier 3 the lowest.

The tiering of own funds is based on the extent to which own funds items possess the characteristics of permanent availability and subordination. A further four features also need to be taken into consideration, these are: sufficient duration, absence of incentives to redeem, absence of mandatory servicing costs and absence of encumbrances. Definitions of each of these characteristics are as follows:

- Permanent availability refers to whether an item is available, or can be called up on demand, to fully absorb losses on a going-concern basis, as well as in the case of a winding-up
- Subordination refers to whether, in the case of a winding-up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts, have been met
- Sufficient duration requires that consideration be given to the duration of the item, in particular whether the item is dated or not. Where an own fund item is dated, the relative duration of the item as compared to the duration of the insurance obligations should be considered.
- Absence of incentives to redeem refers to whether the item is free from requirements or incentives to redeem the nominal sum
- Absence of mandatory servicing costs refers to whether the item is free from mandatory fixed charges
- Absence of encumbrances refers to whether the item is free from encumbrances. Encumbrances include factors such as rights of set off, restrictions and charges or guarantees.

To be classified as Tier 1, an item of own funds must substantially possess the characteristics of permanent availability and subordination taking into consideration the additional four features described above. The exception to this is the reconciliation reserve which, in line with Article 70(3) of the delegated acts, is included in Tier 1 without consideration of availability and subordination features. This means the IFRS pension scheme surplus is included in the Company's own funds in full. The value of this at 31 December 2016 is £1,093m. In practice any surplus could only be transferred from pension scheme to the Company's shareholder fund after any outstanding liabilities to members had been settled. At Group level an availability assessment is performed and £715m\* of this is considered unavailable own funds for Group reflecting the unavailability of pension scheme surplus to absorb losses elsewhere. The restriction means that the contribution of the pension scheme surplus to Group own funds is equal to its marginal contribution to the SCR.

For an item of own funds to be classified as Tier 2, it must substantially possess the characteristics of subordination taking into consideration the additional four features. Where own funds do not meet the criteria to be classified as Tier 1 or Tier 2, the items will be classified as Tier 3.

Transitional provisions within the Solvency II regulations allow existing items qualifying as capital under the Solvency I regime to be 'grandfathered' into Tier 1 or Tier 2 when they do not meet the criteria for classification as own funds under Solvency II rules. These transitional provisions have been applied to certain of the Company's subordinated liabilities.

Based on the tiering classifications, there are certain regulatory limits regarding the eligibility of own funds to meet capital requirements. Limits are placed on Tier 2 and Tier 3 and hybrid/ restricted (e.g. subordinated liabilities) Tier 1 items to ensure that there is a sufficiently high proportion of highest quality own funds (non-restricted Tier 1) and that only higher quality own funds (Tier 1 and Tier 2 own fund items) cover the minimum capital requirement (MCR).

The key eligibility limits are as follows:

- At least 50% of the solvency capital requirement (SCR) must be covered by Tier 1 own funds (and no more than 20% of those Tier 1 items may be hybrid instruments such as subordinated liabilities) and a maximum of 15% may be covered by Tier 3

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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- At least 80% of the MCR must be covered by Tier 1 (and no more than 20% of those Tier 1 items may be hybrid instruments such as subordinated liabilities). Tier 3 own funds are not eligible to cover the MCR. This in effect means that Tier 2 basic own funds are eligible as long as they cover no more than 20% of the MCR.

The following table sets out the values of own funds of the Company as at 31 December 2016, shown after application of the tiering limits:

Description	Tier 1 unrestricted £m	Tier 1 restricted £m	Tier 2 £m	Tier 3 £m	Total £m
Ordinary share capital	21	-	-	-	21
Share premium	104	-	-	-	104
Surplus funds	1,431	-	-	-	1,431
Preference shares	-	486	-	-	486
Reconciliation reserve	4,229	-	-	-	4,229
Subordinated liabilities	-	356	-	-	356
Deferred tax assets	-	-	-	17	17
<b>Eligible own funds to meet the SCR</b>	<b>5,785</b>	<b>842</b>	<b>-</b>	<b>17</b>	<b>6,644</b>
<b>Eligible own funds to meet the MCR</b>	<b>5,785</b>	<b>842</b>	<b>-</b>	<b>-</b>	<b>6,627</b>

More detail on each of the items included in the previous table is provided in the following sections. A copy of the Company's own funds QRT S.23.01.01 *Own funds* is included in Appendix 2.

\*Unaudited

#### E.1.4 Ordinary share capital and share premium

The following table summarises the characteristics of the ordinary share capital and share premium issued by the Company, to support their classification into the appropriate tier of own funds:

Instrument	Tier	Duration	Subordination	Redemption incentives	Mandatory servicing costs	Encumbrances
Ordinary share capital	Tier 1	permanent	last upon winding up	none	none	none
Share premium	Tier 1	permanent	last upon winding up	none	none	none

The Company's articles of association allow cancellation of the payment of dividends (or other distributions) on ordinary shares prior to payment in certain circumstances, where it may be necessary or appropriate to do so because of legal, regulatory, capital or solvency requirements.

#### E.1.5 Surplus funds

Surplus funds relate to the Company's ring-fenced funds, being accumulated profits within ring-fenced funds which have not been made available for distribution to policyholders or other beneficiaries. Own funds include £1,431m in respect of surplus funds and the reconciliation reserve includes a (£701)m\* adjustment in respect of ring-fenced funds. This section describes the significant ring-fenced funds within the Company and explains why an adjustment to SLAL's own funds is required in respect of ring-fenced funds.

Ring-fenced funds are arrangements as a result of which certain items of own funds have a reduced capacity to fully absorb losses on a going concern basis due to their lack of transferability within the undertaking. In order to reflect these restrictions, a reduction to own funds is made via the reconciliation reserve for any restricted own funds items within a ring-fenced fund that exceed the notional SCR of that ring-fenced fund.

The Company has reviewed all types of arrangement that may be classified as ring-fenced under Solvency II regulations and guidance, including:

- Arrangements which give rise to participation in profits
- Legally binding arrangements or trusts created for the benefit of policyholders
- Restrictions arising on assets or own funds as a result of the articles, statutes or other document specifying the undertaking's organisation
- Restrictions specified by national law
- Arrangements falling within the scope of EU law, including Solvency II and the IORPS Directive



The significant ring-fenced funds which were identified by the review are the Company's HWPF and GWPF. The excess of assets over liabilities of the HWPF and GWPF (excluding risk margin and burnthrough) are reported as surplus funds

The HWPF and GWPF contribute to own funds through charges which the funds are required by the legal and contractual arrangements under which they are constituted to pass to shareholders, reduced to allow for the probability weighted value of any charges which may be withheld by the fund or additional assets which shareholders may be required to provide (burnthrough). Own funds representing the present value of future scheme transfers net of burnthrough are not attributed to the HWPF or GWPF but are attributed to the shareholder. These items of own funds are available to absorb losses and are therefore not restricted.

\*Unaudited

### E.1.6 Preference shares

As at 31 December 2016, the Company held subordinated guaranteed bonds, issued to Standard Life plc. They are perpetual securities and as such have no fixed redemption date.

In accordance with the requirements of IAS 32 *Financial instruments: Presentation*, the subordinated guaranteed bonds are classified as non-shareholders' equity. Under Solvency II, this cannot be classified as a subordinated liability as it is not a subordinated liability under IFRS. Since there is no separate line in QRT S.23.01.01 *Own funds* for this type of instrument, these have been shown as preference shares. The Company has no actual preference shares in issue and the entire balance in Section E.1.3 relates to subordinated guaranteed bonds.

This is classified as Tier 1 restricted in QRT S.23.01.01 *Own funds*. Treatment is consistent with transitional arrangements for subordinated liabilities set out in Section E.1.8.

Description	Nominal amount	Issue date	First call date	Maturity
6.75% Sterling fixed rate subordinated guaranteed bonds	£500m	12 July 2002	12 July 2027 and every 5 years thereafter	Perpetual

Description	Solvency II criteria		Classification under Solvency I	Transitional arrangements
	Tier 1	Tier 2		
6.75% Sterling fixed rate subordinated guaranteed bonds	Not met	Not met	Upper Tier 2	Tier 1

The instruments fail to satisfy the criteria to be classified as Tier 1 or Tier 2 under Solvency II for the same reasons as those for the subordinated liabilities described in Section E.1.8. Furthermore, the step-up in coupon at the first call date is not considered to meet the criteria to be classified as limited.

The instruments meet the criteria to be grandfathered as Tier 1. The classification under the transitional arrangements applies for up to 10 years after the date of implementation of Solvency II, i.e. 1 January 2026.

### E.1.7 Reconciliation reserve

The reconciliation reserve is the amount of excess assets over liabilities (valued in accordance with the Solvency II regulations and guidance) that remain once all the other identified elements of basic own funds have been deducted. As such, it serves to ensure that the total of all the individual basic own funds items are equal to the total excess of assets over liabilities and subordinated liabilities.

The following table analyses reconciliation reserve as at 31 December 2016:

	£m
Excess of assets over liabilities	6,989
Other basic own fund items (ordinary share capital, share premium, surplus funds and deferred tax assets)	(2,059)
Adjustment for restricted own fund items in respect of ring-fenced funds*	(701)
<b>Reconciliation reserve total</b>	<b>4,229</b>

\*Unaudited

The adjustment for restricted own fund items in respect of ring-fenced funds of £701m is described in Section E.1.5.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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The Company does not consider the final dividend for 2016 to be a 'foreseeable dividend' as at 31 December 2016, and therefore no deduction has been made from the reconciliation reserve in respect of this dividend.

### E.1.8 Subordinated liabilities

As at 31 December 2016, the Company acted as borrower in respect of a tranche of subordinated instruments issued to its parent, Standard Life plc. The table below provides a summary of the subordinated debt instruments:

Description	Nominal amount	Issue date	First call date	Maturity
6.546% Sterling fixed rate Mutual Assurance Capital Securities	£300m	4 November 2004	6 January 2020 and yearly thereafter	Perpetual

Further information about the terms and conditions of the Company's subordinated liabilities is provided in Note 31 on page 55 of the Company's Annual financial statements 2016. More detail on the valuation of the Company's subordinated liabilities is included in Sections D.3 and D.4.

The Company has provided a guarantee on a subordinated basis in certain circumstances in respect of the due and punctual payment of all principal, interest and any deferred interest that is due and payable on related instruments issued by Standard Life plc.

For a liability to be included in own funds it must, at a minimum, be subordinated to all claims of policyholders, beneficiaries and non-subordinated creditors. In order to be classified as the highest quality of own funds it must be part of the most deeply subordinated group of items. The following table summarises the own funds classification of subordinated liabilities issued by the Company:

Description	Solvency II criteria		Classification under Solvency I	Transitional arrangements
	Tier 1	Tier 2		
6.546% Sterling fixed rate Mutual Assurance Capital Securities	Not met	Not met	Innovative Tier 1	Tier 1

The instruments do not meet the criteria to be included outright as own funds under Solvency II regulations and guidance. However, they do meet the criteria to be grandfathered as Tier 1 under the transitional provisions.

The principal reasons for not meeting the own funds criteria outright are:

- The absence of any linkage of the solvency condition to the SCR (rather than the minimum capital requirement)
- The absence of a requirement for redemptions within five years upon tax/ capital disqualification events to be funded from new capital

An item that is eligible under the grandfathering rules can be classified as Tier 1 under transitional provisions if it meets the conditions set out below (otherwise it is classified as Tier 2):

- It would not otherwise qualify as Tier 1 or Tier 2 under Solvency II's requirements; and
- It could be used to meet up to 50% of the solvency margin under Solvency I's requirements

The instruments meet the criteria to be grandfathered as Tier 1. The classification under the transitional arrangements applies for up to 10 years after the date of implementation of Solvency II, i.e. 1 January 2026.

### E.1.9 Deferred tax

Under Solvency II regulations and guidance, the value of any net shareholder deferred tax assets must be deducted from Tier 1 own funds and recognised as Tier 3. Where local tax law allows, deferred tax assets and liabilities are netted off on the balance sheet.

### E.1.10 Reconciliation of IFRS accounting equity to own funds

The own funds position is different from the equity stated in the IFRS statutory accounts. The table below reconciles the financial statements to the Solvency II own funds position as at 31 December 2016:

31 December 2016	£m	£m
Equity attributable to equity holders per the financial statements on an IFRS basis		3,166
Valuation differences:		
In respect of assets	(1,173)	
In respect of technical provisions	5,329	
In respect of other liabilities	(333)	
		3,823
Inclusion of subordinated liabilities within own funds		356
Deductions to own funds to reflect fungibility and transferability restrictions*:		
In respect of ring-fenced funds	(701)	
		(701)
<b>Total basic own funds after adjustments</b>		<b>6,644</b>

\*Unaudited

### E.1.11 Movements in own funds during the reporting period

The following table sets out the movements on the Company's own funds, analysed by tier, during 2016:

Description	Tier 1 £m	Tier 2 £m	Tier 3 £m	Total £m
Opening own funds*	5,319	-	13	5,332
Opening eligibility restrictions*	-	-	-	-
<b>Opening eligible own funds to meet the SCR</b>	<b>5,319</b>	<b>-</b>	<b>13</b>	<b>5,332</b>
Movements in period:				
Own funds	1,308	-	4	1,312
Eligibility restrictions*	-	-	-	-
<b>Total movements in eligible own funds</b>	<b>1,308</b>	<b>-</b>	<b>4</b>	<b>1,312</b>
<b>Closing eligible own funds to meet the SCR</b>	<b>6,627</b>	<b>-</b>	<b>17</b>	<b>6,644</b>

\*Unaudited

There were no ancillary own funds at 1 January 2016 or 31 December 2016.

There were no eligibility restrictions at 1 January 2016 or 31 December 2016.

There were no material issues or redemptions of own fund items during the period.

The movement in unrestricted Tier 1 own funds relates mainly to an increase in the excess of assets over liabilities.

Tier 3 items relate to deferred tax assets, the value of which has not changed materially during the period.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## E.2 Solvency capital requirement and minimum capital requirement

### E.2.1 SLAL's solvency capital requirement (unaudited)

The Company's capital position is governed by the Solvency II regulatory regime. Under Solvency II, every insurer is required to identify its key risks – for example that equity markets fall – and hold sufficient capital to withstand adverse outcomes from those risks. The capital required to withstand these outcomes is the SCR. The SCR is calibrated so that the likelihood of a loss being greater than the SCR in one year is less than 1 in 200.

The Company's SCR at the 31 December 2016 was £3,766m.

Refer to QRT S.25.02.21 *SCR – for undertakings using the standard formula and partial internal model* in Appendix 2 to see the split of the SCR by risk category.

The solo SCR of the Company is calculated using a 'partial internal model'. For SLAL, the units of the partial internal model consist of all assets and liabilities of the Company with the exception of its equity interest in SL Intl.

The contribution of SL Intl is determined on a standard formula basis.

The results of the partial internal model for the Company are combined with the standard formula results for SL Intl by adding the two capital requirements together. This approach does not make any allowance for the effects of diversification between the Company and SL Intl.

The Company's SCR is greater than the minimum capital requirement (see Section E.2.3).

Diversification benefits between risks within the Company's internal model are described in Section E.4.8.

The Company's solo SCR does not include a capital add-on and does not include any impact from the use of undertaking-specific parameters. In addition, no simplified calculations have been used. The final SCR is not subject to supervisory assessment.

The SCR has increased since 1 January 2016, mainly due to market changes which have increased the with profits funds and pension scheme SCR's which are offset in full by corresponding increases in own funds.

### E.2.2 Scope of the internal model (unaudited)

The Company uses a partial internal model to calculate the SCR. The approved internal model is used for the Company, SLPF and SLAC 2006. SLPF and SLAC 2006 were allocated to the Company's HWPF under the Scheme of Demutualisation and as such contribute to the SCR through ring-fenced funds.

### E.2.3 SLAL's minimum capital requirement

The MCR applies to EEA-based insurance undertakings. The MCR represents an absolute floor to the level of eligible own funds that the insurance undertaking is required to hold under Solvency II. If the level of own funds falls below the MCR, the national regulator would intervene. The MCR should correspond to the amount of capital needed to ensure that the insurance undertakings will be able to meet their obligations over the next 12 months with a probability of at least 85%. It is bound between 25% and 45% of the insurance undertaking's SCR.

The calculation of the MCR for the Company requires a split of technical provisions between guaranteed and discretionary benefits for with profits business. To achieve this, scaling factors are applied to the overall technical provision for with profits business split by product group. The scaling factors are derived by considering the split of projected claims between:

- The amount of claim that is completely guaranteed and cannot be reduced by management actions
- The amount of claim that is discretionary and can be reduced

The Company's MCR was £1,301m at 31 December 2016.

The non-life insurance element of the MCR calculation is zero for SLAL, as it does not have any business covered by the non-life insurance calculation.

The MCR for SLAC 2006 and SLPF are both based on the minimum amount of €3.7m.

### E.3 Use of the duration-based equity risk sub-module in the calculation of the solvency capital requirement (unaudited)

The Company is not using the duration-based equity risk sub-module for the calculation of its SCR.

### E.4 Differences between the standard formula and any internal model used (unaudited)

#### E.4.1 Purposes for which SLAL is using its internal model

The internal model output is used in the following Own Risk and Solvency Assessment processes:

- **Insight and Reporting** – regular monitoring of key risk and capital metrics
- **Business cycle decision making** – supports key business decisions through our stress and scenario testing programme and the setting of quantitative risk limits and investment benchmarks
- **Strategic decision making** – supports the longer terms strategic decisions in running our business, including customer proposition development
- **Business planning support** – assists in developing our annual business plan by analysing the resilience of our balance sheet to economic scenarios and point in time stresses

#### E.4.2 Scope of the internal model in terms of business units and risk categories

See Appendix 1 for a diagram showing the structure of Standard Life broken down by entities (including SLAL), with each business unit colour coded depending on their treatment under Solvency II.

The coverage of the internal model risk categories is based on the risks included in Standard Life's Enterprise Risk Management framework (ERM framework). The Group's partial internal model covers the subset of risks identified in the ERM framework which are quantifiable and material.

In addition to the risks covered by the ERM framework, sovereign debt basis risk is also included in the internal model as required by the Prudential Regulation Authority's Supervisory Statement SS30/15.

The risk categories used in the internal model include:

- Equity (including equity implied volatility)
- Basis risk
- Property (including property implied volatility)
- Currency
- Interest rates
- Swaption implied volatility
- Credit (bonds, asset-backed securities, counterparty)
- Longevity (including proportions married for joint-life annuities)
- Persistency mis-estimation and dependent persistency
- Company specific and economic expense risk
- Mortality mis-estimation and mortality catastrophe
- Morbidity mis-estimation and catastrophe
- Operational risk
- New business risk (adverse variation in business mix or volume over the next year)

A fuller description of material risks is included in Section C. The internal model does not include liquidity risk, as described in Section C.4, given that this risk is more appropriately considered using qualitative techniques.

#### E.4.3 Integration of the internal model into the standard formula

As described in Section E.2.1, the results of the partial internal model for the Company are combined with the standard formula results for SL Intl by adding the two capital requirements together. This approach does not make any allowance for the effects of diversification between the Company and SL Intl.

#### E.4.4 Methods used in the internal model for the calculation of the probability distribution forecast and the solvency capital requirement

The Company's approach is to calculate the SCR directly from the probability distribution forecast as the value at risk of own funds at a 99.5% confidence level over a one year time horizon, in line with Solvency II requirements.

The probability distribution forecast of changes in value of own funds is determined by simulating the joint distribution of changes in the individual risk factors and calculating the change in own funds in each simulation. The model consists of a set of functions which describe changes in own funds as a function of changes in risk factors. These

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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functions are calibrated using changes in the values of assets and liabilities obtained by modelling a large number of scenarios using the full actuarial model suite.

#### E.4.5 Main differences in the methodologies and underlying assumptions used in the standard formula and in the internal model

The methods used to calibrate the distributions for the internal model have been developed independently from the standard formula. As a result there are differences in each of these from the standard formula, in terms of both the granularity of the stress and the level of the stress.

As an internal model firm, we have designed our model around the risks to which we are exposed, ensuring that each risk module is constructed with these exposures in mind. This will therefore include risks that are not included in the standard formula (see Section E.4.9) and the data used to calibrate our stresses (and to help set our correlations) is in line with risks we are exposed to. The granularity of each of the risk modules has also been chosen considering our risk exposures and therefore in many instances the granularity of our stresses is different to that of the standard formula.

Our overall approach to aggregating the risk modules to calculate our capital requirements is also different to that used by the standard formula; where the standard formula approach uses a correlation matrix approach, our internal model uses a simulation approach which is described further in Sections E.4.6 and E.4.8.

The key differences between the methodologies and underlying assumptions used in the standard formula and in the internal model are as follows for the key risk modules:

Risk	Key Differences
<b>Equity</b>	<ul style="list-style-type: none"> <li>The internal model equity stress is calibrated at a more granular level, using market data</li> <li>Standard formula equity stress includes a dampener to reduce pro-cyclicality</li> </ul>
<b>Credit (spread risk)</b>	<ul style="list-style-type: none"> <li>Internal model stresses are calibrated using market data, and include a split by sector (financial / non-financial) which is not included in standard formula stresses</li> </ul>
<b>Longevity</b>	<ul style="list-style-type: none"> <li>The standard formula longevity stress is a 20% reduction in mortality rates</li> <li>Our internal model stress is calibrated using relevant experience and explicitly allows for future mortality improvements.</li> </ul>
<b>Fixed interest</b>	<ul style="list-style-type: none"> <li>Standard formula stresses are a proportion of the base yield curve.</li> <li>Internal model stresses are absolute stresses which capture changes in level, shape and curvature of the yield curve</li> </ul>
<b>Lapse risk</b>	<ul style="list-style-type: none"> <li>The standard formula mass lapse stress reflects an instantaneous lapse rate of either 40% or 70%, depending on the nature of the product</li> <li>The internal model dependent persistency stress incorporates market and operational risk elements and is applied as a multiple of base persistency rates</li> </ul>
<b>Operational</b>	<ul style="list-style-type: none"> <li>The standard formula uses a factor based approach, with weightings applied to different metrics, such as expenses on unit-linked business</li> <li>The internal model capital requirement is derived using input from business subject matter experts to determine the frequency and severity of operational risk events</li> </ul>

#### E.4.6 Internal model approach

The Company's approach is to calculate the SCR as the Value-at-Risk of its own funds subject to a confidence level of 99.5% over a one-year period. This is the same as the risk measure and time period required in Solvency II regulations. To calculate this, we use a simulation approach and look at each of the individual risks and combinations of the risks at multiple probability levels.

#### E.4.7 Nature and appropriateness of the data used in the internal model

A range of information is used within the internal model; this includes the relevant market data (both current for the valuation date, and the historic data to calibrate stresses), and internal policyholder data used to calculate our liabilities as well as historic policyholder experience to calibrate our underwriting risk stresses. The sources used in each instance have been chosen considering the range of options available and the appropriateness of the data sets for the purpose for which they're used. Where external data is used, this is sourced from reputable suppliers (e.g. Office for National Statistics, Bank of England, Continuous Mortality Investigation). We also have an internal data governance framework, which sets the standard to which the data we use must meet, and is used as a means to escalate any issues appropriately.

#### E.4.8 Aggregation methodologies and diversification effects used in the internal model

Mathematical formulae are fitted to the balance sheet impact of these selected stresses which allows us to describe the behaviour of the balance sheet under a wide range of scenarios.

We then simulate a large number of possible future scenarios and assess the impact on the balance sheet – allowing for the diversification between risks – with the 99.5<sup>th</sup> percentile balance sheet loss being our capital requirements.

The diversification between risks is set using a combination of analysis of historic data (using consistent datasets to that used to calibrate the individual risk distributions) and expert judgement.

#### E.4.9 Risks not covered by the standard formula but covered by the internal model

The additional risks that are covered by Standard Life's internal model, but not by the standard formula are:

Risk	Description
Equity implied volatility risk	The risk that the expected volatility of equity markets increases.
Property implied volatility risk	The risk that the expected volatility of property markets increases.
Swaption implied volatility risk	The risk that the expected volatility of interest rates increases.
Sovereign spread risk	The risk that AAA rated government bonds fall in value without a corresponding change in swap rates.
Equity basis risk	The risk that the value of our equity investments move out of line with the equity indices used to price the equity derivatives that we have in place (in particular to hedge the equity risk on with profits policyholder guarantees).
Proportion married risk	The risk of mis-estimating the proportion of reversionary annuities where there is a spouse who would be eligible to receive an annuity (if the main life died).
New business risk	The risk that adverse deviations in volume and mix of new business impact the capital position over the one-year time horizon of the capital assessment.

#### E.5 Non-compliance with the minimum capital requirement and non-compliance with the solvency capital requirement (unaudited)

Throughout 2016 own funds have at all times exceeded both the MCR and the SCR.

#### E.6 Any other information

None.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## Statement of Directors' responsibilities

The Directors are responsible for the preparation of the Solvency and financial condition report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations, which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under Section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed in the PRA approvals and determinations section of this document.

The Directors are satisfied that:

- (a) throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA rules, including Solvency II regulations as applicable to the Company; and
- (b) it is reasonable to believe that the Company has continued so to comply subsequently, and will continue so to comply in future.

The SFCR was approved by the Board and signed on its behalf by the following Director



Mark Hesketh  
Director  
18 May 2017

## Prudential Regulation Authority approvals and determinations

The approvals and determinations in the table below apply to Standard Life Assurance Limited (SLAL) (firms reference 439567) and the following regulated insurance undertakings held by SLAL:

The Standard Life Assurance Company 2006 (SLAC 2006), firms reference number 110464

Standard Life Pension Funds Limited (SLPF), firms reference number 110466

Applicable to	Description	Reference	Date of Waiver	Applicable from
SLAL	Approval to apply a volatility adjustment to the relevant risk-free interest rate term structure	2211564	18 November 2015	1 January 2016
SLAL, SLAC 2006, SLPF	Approval to use a partial internal model for the calculation of its SCR Approval of policy for changing an approved internal model.	2247359 2247366 2247363	5 December 2015	1 January 2016
SLAL	Vary the transitional measure on technical provisions approved in the written notice – transitional measure on technical provisions dated 18 November 2015 (reference 2244402) (the 'Original Notice') to subject that approval to a condition limiting the amount of the approved deduction.	2458679	23 February 2016	23 February 2016
SLAL	Permission to recalculate transitional deduction to its technical provisions as at 30th June 2016	2794590	22 July 2016	22 July 2016
SLAL, SLAC 2006, SLPF	Approve the major model change to the Standard Life group internal model approved in the written notice - Internal model approval dated 5 December 2015 (reference 2247359, 2247366, 2247363) (the 'Original Notice'), on the basis of the application for a major model change submitted on 29 June 2016 and the addendum submitted on 11 November 2016 (the 'Proxy Model Application').	3802824 3802826 3802827	30 November 2016	31 December 2016
SLAL	Permission to recalculate its transitional deduction to its technical provisions as at 31 December 2016.	3446680	30 November 2016	31 December 2016
SLAL	Approval to apply a matching adjustment to the risk-free interest rate term structure in order to calculate the best estimate of the following portfolio of insurance/reinsurance obligations: Heritage With Profits Fund UK MA Portfolio.	2794732	30 November 2016	31 December 2016
SLAL	Approval to apply a matching adjustment to the risk-free interest rate term structure in order to calculate the best estimate of the following portfolio of insurance/reinsurance obligations: Proprietary Business Fund UK MA Portfolio. Revoke the firm's existing matching adjustment approval (reference 2231579).	2794671	30 November 2016	31 December 2016

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## Report of the external independent auditors to the Directors of Standard Life Assurance Limited

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

Report on the Audit of the relevant elements of the Solvency and financial condition report

### Opinion

Except as stated below, we have audited the following documents prepared by the Company as at 31 December 2016:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and financial condition report of the Company as at 31 December 2016, ('**the Narrative Disclosures subject to audit**'); and
- Company templates S.02.01.02, S.12.01.02, S.22.01.21, S.23.01.01 and S.28.01.01 ('**the Templates subject to audit**').

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**relevant elements of the Solvency and financial condition report**'.

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

- Information contained within the relevant elements of the Solvency and financial condition report set out above which are, or derive from the Solvency capital requirement, as identified in the Appendix to this report;
- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and financial condition report;
- Company templates S.05.01.02, S.05.02.01, and S.25.02.21;
- Information calculated in accordance with the previous regime used in the calculation of the transitional measure on technical provisions, and as a consequence all information relating to the transitional measure on technical provisions as set out in the Appendix to this report;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and financial condition report ('**the Responsibility Statement**').

To the extent the information subject to audit in the relevant elements of the Solvency and financial condition report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

In our opinion the information subject to audit in the relevant elements of the SLAL Solvency and financial condition report of the Company as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & I)), International Standard on Auditing (UK) 800 and International Standard on Auditing (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and financial condition report* section of our report.

## **Emphasis of Matter**

### **Basis of Accounting**

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

### **Responsibilities of Directors for the Solvency and financial condition report**

The Directors are responsible for the preparation of the Solvency and financial condition report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under Section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed in the PRA approvals and determinations section of this document.

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

### **Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and financial condition report**

It is our responsibility to form an independent opinion, in accordance with applicable law, ISAs (UK & I) and ISAs (UK) 800 and 805 as to whether the information subject to audit in the relevant elements of the Solvency and financial condition report is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based. ISAs (UK & I) require us to comply with the Auditing Practices Board's Ethical Standard for Auditors.

An audit involves obtaining evidence about the amounts and disclosures in the relevant elements of the Solvency and financial condition report sufficient to give reasonable assurance that the relevant elements of the Solvency and financial condition report are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the relevant elements of the Solvency and financial condition report. In addition, we read all the financial and non-financial information in the Solvency and financial condition report to identify material inconsistencies with the audited relevant elements of the Solvency and financial condition report. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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

### **Other Matter**

The Company has authority to calculate its Solvency capital requirement using a partial internal model ('the Model') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## Report on Other Legal and Regulatory Requirements

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



### PricewaterhouseCoopers LLP

Chartered Accountants  
Edinburgh  
18 May 2017

- The maintenance and integrity of the Standard Life plc website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Solvency and financial condition report since it was initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of Solvency and financial condition reports may differ from legislation in other jurisdictions.

## **Appendix – relevant elements of the Solvency and financial condition report that are not subject to audit**

The relevant elements of the Solvency and financial condition report that are not subject to audit comprise:

a) The following elements of template S.02.01.02:

- Row R0550: Technical provisions - non-life (excluding health) - risk margin
- Row R0590: Technical provisions - health (similar to non-life) - risk margin
- Row R0640: Technical provisions - health (similar to life) - risk margin
- Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
- Row R0720: Technical provisions - Index-linked and unit-linked - risk margin

b) The following elements of template S.12.01.02:

- Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
- Rows R0110 to R0130 – Amount of transitional measure on technical provisions

c) The following elements of template S.22.01.21:

- Column C0030 – Impact of transitional on technical provisions
- Row R0010 – Technical provisions
- Row R0090 – Solvency capital requirement

d) The following elements of template S.23.01.01:

- Row R0580: SCR
- Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring-fenced funds

e) The following elements of Company template S.28.01.01:

- Row R0310: SCR

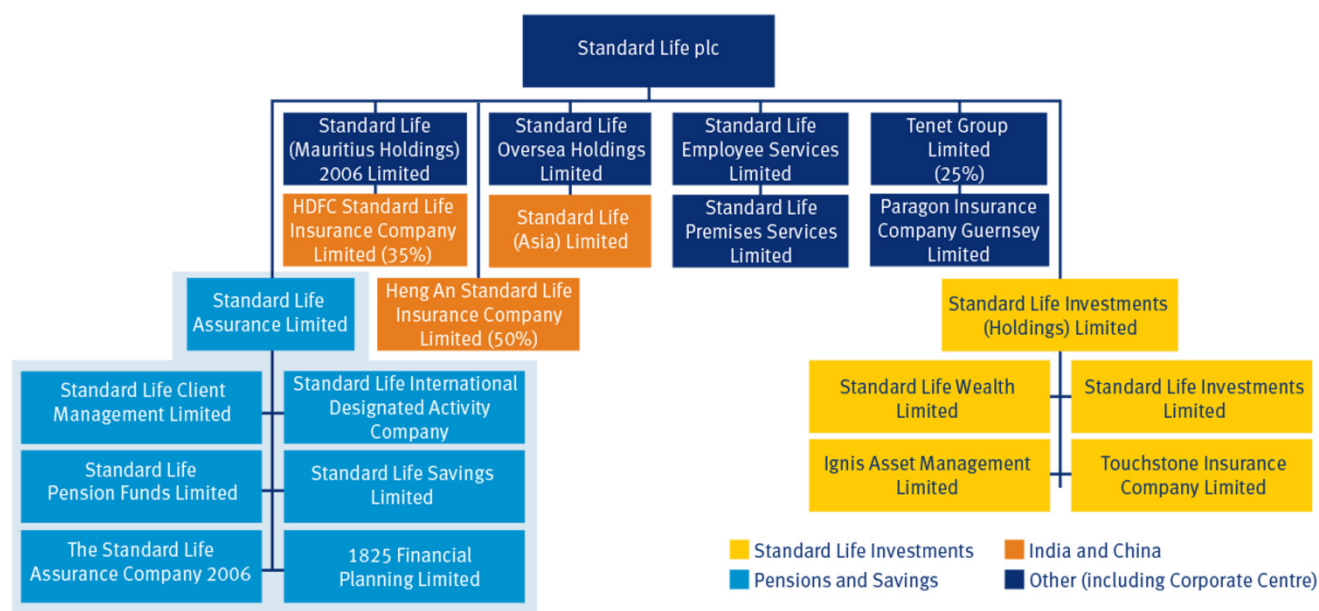
f) Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.



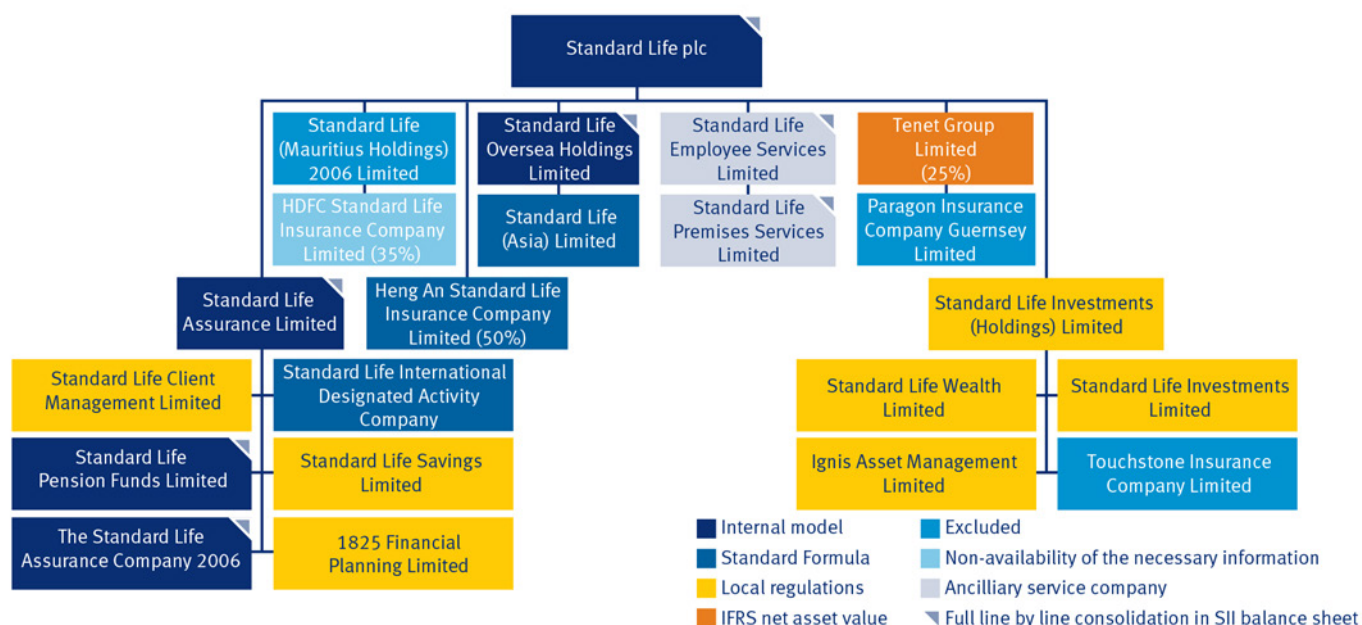
Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## Appendix 1 – Group structure

### Group structure by operating segment



### Group structure by regulatory framework



<b>Appendix 2 – Quantitative reporting templates (QRTs)</b>	
<b>S.02.01.02</b>	<b>Balance sheet 80</b>
<b>S.05.01.02</b>	<b>Premiums, claims and expenses by line of business (unaudited) 82</b>
<b>S.05.02.01</b>	<b>Premiums, claims and expenses by country (unaudited) 85</b>
<b>S.12.01.02</b>	<b>Life and health technical provisions 87</b>
<b>S.22.01.21</b>	<b>Impact of long term guarantees and transitional measures 88</b>
<b>S.23.01.01</b>	<b>Own funds 89</b>
<b>S.25.02.21</b>	<b>Solvency capital requirement - using the standard formula and partial internal model (unaudited) 91</b>
<b>S.28.01.01</b>	<b>Minimum capital requirement for life or non-life insurance 92</b>

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## S.02.01.02 Balance sheet

		Solvency II value C0010 £000s
<b>Assets</b>		
Intangible assets	R0030	-
Deferred tax assets	R0040	17,264
Pension benefit surplus	R0050	1,093,004
Property, plant & equipment held for own use	R0060	14,621
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	50,422,173
Property (other than for own use)	R0080	1,100,321
Holdings in related undertakings, including participations	R0090	22,701,218
Equities	R0100	3,246,613
Equities - listed	R0110	3,246,596
Equities - unlisted	R0120	17
Bonds	R0130	20,995,955
Government Bonds	R0140	10,070,306
Corporate Bonds	R0150	10,704,886
Structured notes	R0160	-
Collateralised securities	R0170	220,763
Collective Investments Undertakings	R0180	92,392
Derivatives	R0190	2,186,555
Deposits other than cash equivalents	R0200	99,119
Other investments	R0210	-
Assets held for index-linked and unit-linked contracts	R0220	99,648,923
Loans and mortgages	R0230	553,747
Loans on policies	R0240	2,151
Loans and mortgages to individuals	R0250	47,076
Other loans and mortgages	R0260	504,520
Reinsurance recoverables from:	R0270	8,896,729
Non-life and health similar to non-life	R0280	-
Non-life excluding health	R0290	-
Health similar to non-life	R0300	-
Life and health similar to life, excluding health and index-linked and unit-linked	R0310	5,127,770
Health similar to life	R0320	103,951
Life excluding health and index-linked and unit-linked	R0330	5,023,819
Life index-linked and unit-linked	R0340	3,768,959
Deposits to cedants	R0350	-
Insurance and intermediaries receivables	R0360	107,618
Reinsurance receivables	R0370	342
Receivables (trade, not insurance)	R0380	240,100
Own shares (held directly)	R0390	-
Amounts due in respect of own fund items or initial fund called up but not yet paid in	R0400	-
Cash and cash equivalents	R0410	76,186
Any other assets, not elsewhere shown	R0420	-
<b>Total assets</b>	<b>R0500</b>	<b>161,070,707</b>

		Solvency II value C0010 £000s
<b>Liabilities</b>		
Technical provisions – non-life	R0510	-
Technical provisions – non-life (excluding health)	R0520	-
TP calculated as a whole	R0530	-
Best Estimate	R0540	-
Risk margin	R0550	-
Technical provisions - health (similar to non-life)	R0560	-
TP calculated as a whole	R0570	-
Best Estimate	R0580	-
Risk margin	R0590	-
Technical provisions – life (excluding index-linked and unit-linked)	R0600	44,534,560
Technical provisions - health (similar to life)	R0610	155,451
TP calculated as a whole	R0620	-
Best Estimate	R0630	155,451
Risk margin	R0640	-
Technical provisions – life (excluding health and index-linked and unit-linked)	R0650	44,379,109
TP calculated as a whole	R0660	-
Best Estimate	R0670	44,355,641
Risk margin	R0680	23,468
Technical provisions – index-linked and unit-linked	R0690	100,774,387
TP calculated as a whole	R0700	103,427,660
Best Estimate	R0710	(2,678,513)
Risk margin	R0720	25,240
Contingent liabilities	R0740	-
Provisions other than technical provisions	R0750	185,082
Pension benefit obligations	R0760	54,989
Deposits from reinsurers	R0770	5,092,991
Deferred tax liabilities	R0780	651,712
Derivatives	R0790	22,423
Debts owed to credit institutions	R0800	1,356
Financial liabilities other than debts owed to credit institutions	R0810	45,720
Insurance & intermediaries payables	R0820	348,985
Reinsurance payables	R0830	6,047
Payables (trade, not insurance)	R0840	2,007,337
Subordinated liabilities	R0850	355,545
Subordinated liabilities not in BOF	R0860	-
Subordinated liabilities in BOF	R0870	355,545
Any other liabilities, not elsewhere shown	R0880	-
<b>Total liabilities</b>	R0900	154,081,134
<b>Excess of assets over liabilities</b>	R1000	6,989,573

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## S.05.01.02 Premiums, claims and expenses by line of business

Line of Business for: non-life insurance and reinsurance obligations  
(direct business and accepted proportional reinsurance)

		Medical expense insurance C0010 £000s	Income protection insurance C0020 £000s	Workers' compensation insurance C0030 £000s	Motor vehicle liability insurance C0040 £000s	Other motor insurance C0050 £000s	Marine, aviation and transport insurance C0060 £000s	Fire and other damage to property insurance C0070 £000s	General liability insurance C0080 £000s	Credit and suretyship insurance C0090 £000s
<b>Premiums written</b>										
Gross - Direct Business	R0110	-	-	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0120	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0130									
Reinsurers' share	R0140	-	-	-	-	-	-	-	-	-
Net	R0200	-	-	-	-	-	-	-	-	-
<b>Premiums earned</b>										
Gross - Direct Business	R0210	-	-	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0220	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0230									
Reinsurers' share	R0240	-	-	-	-	-	-	-	-	-
Net	R0300	-	-	-	-	-	-	-	-	-
<b>Claims incurred</b>										
Gross - Direct Business	R0310	-	-	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0320	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0330									
Reinsurers' share	R0340	-	-	-	-	-	-	-	-	-
Net	R0400	-	-	-	-	-	-	-	-	-
<b>Changes in other technical provisions</b>										
Gross - Direct Business	R0410	-	-	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0420	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0430									
Reinsurers' share	R0440	-	-	-	-	-	-	-	-	-
Net	R0500	-	-	-	-	-	-	-	-	-
Expenses incurred	R0550	-	-	-	-	-	-	-	-	-
Other expenses	R1200									
Total expenses	R1300									

Note: This page is blank as SLAL does not have any non-life insurance business.

		Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)			Line of business for: accepted non-proportional reinsurance				Total
		Legal expenses insurance	Assistance	Miscellaneous financial loss	Health	Casualty	Marine, aviation, transport	Property	
		C0100 £000s	C0110 £000s	C0120 £000s	C0130 £000s	C0140 £000s	C0150 £000s	C0160 £000s	C0200 £000s
<b>Premiums written</b>									
Gross - Direct Business	R0110	-	-	-					-
Gross - Proportional reinsurance accepted	R0120	-	-	-					-
Gross - Non-proportional reinsurance accepted	R0130				-	-	-	-	-
Reinsurers' share	R0140	-	-	-	-	-	-	-	-
Net	R0200	-	-	-	-	-	-	-	-
<b>Premiums earned</b>									
Gross - Direct Business	R0210	-	-	-					-
Gross - Proportional reinsurance accepted	R0220	-	-	-					-
Gross - Non-proportional reinsurance accepted	R0230				-	-	-	-	-
Reinsurers' share	R0240	-	-	-	-	-	-	-	-
Net	R0300	-	-	-	-	-	-	-	-
<b>Claims incurred</b>									
Gross - Direct Business	R0310	-	-	-					-
Gross - Proportional reinsurance accepted	R0320	-	-	-					-
Gross - Non-proportional reinsurance accepted	R0330				-	-	-	-	-
Reinsurers' share	R0340	-	-	-	-	-	-	-	-
Net	R0400	-	-	-	-	-	-	-	-
<b>Changes in other technical provisions</b>									
Gross - Direct Business	R0410	-	-	-					-
Gross - Proportional reinsurance accepted	R0420	-	-	-					-
Gross - Non- proportional reinsurance accepted	R0430				-	-	-	-	-
Reinsurers' share	R0440	-	-	-	-	-	-	-	-
Net	R0500	-	-	-	-	-	-	-	-
<b>Expenses incurred</b>	R0550	-	-	-	-	-	-	-	-
<b>Other expenses</b>	R1200								
<b>Total expenses</b>	R1300								

Note: This page is blank as SLAL does not have any non-life insurance business.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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Line of Business for: life insurance obligations							Life reinsurance obligations		Total	
		Health insurance C0210 £000s	Insurance with profit participation C0220 £000s	Index-linked and unit-linked insurance C0230 £000s	Other life insurance C0240 £000s	Annuities stemming from non-life insurance contracts relating to health insurance obligations C0250 £000s	Annuities stemming from non-life insurance contracts relating to health insurance obligations C0260 £000s	Health re-insurance C0270 £000s	Life-re-insurance C0280 £000s	C0300 £000s
Premiums written										
Gross	R1410	2,585	840,799	298,106	226,198	100	-	-	-	1,367,788
Reinsurers' share	R1420	1,922	18,525	13	25,202	31	-	-	-	45,693
Net	R1500	663	822,274	298,093	200,996	69	-	-	-	1,322,095
Premiums earned										
Gross	R1510	-	-	-	-	-	-	-	-	-
Reinsurers' share	R1520	-	-	-	-	-	-	-	-	-
Net	R1600	-	-	-	-	-	-	-	-	-
Claims incurred										
Gross	R1610	202	2,354,734	909,518	1,168,239	2,635	-	-	-	4,435,328
Reinsurers' share	R1620	123	6,903	10	483,446	590	-	-	-	491,072
Net	R1700	79	2,347,831	909,508	684,793	2,045	-	-	-	3,944,256
Changes in other technical provisions										
Gross	R1710	15,178	131,552	8,867,810	1,117,630	-	-	-	-	10,132,170
Reinsurers' share	R1720	13,055	(74,948)	-	(64,626)	-	-	-	-	(126,519)
Net	R1800	2,123	206,500	8,867,810	1,182,256	-	-	-	-	10,258,689
Expenses incurred	R1900	69	132,418	578,307	230,044	6	-	-	-	940,844
Other expenses	R2500									-
Total expenses	R2600									940,844

## S.05.02.01 Premiums, claims and expenses by country

		Home country	Top 5 countries (by amount of gross premiums written) - non-life obligations					Total Top 5 and home country
R0010		C0010	C0020	C0030	C0040	C0050	C0060	C0070
		GB	IE	DE	AT	LU		
		C0080	C0090	C0100	C0110	C0120	C0130	C0140
		£000s	£000s	£000s	£000s	£000s	£000s	£000s
<b>Premiums written</b>								
Gross - Direct Business	R0110	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0120	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0130	-	-	-	-	-	-	-
Reinsurers' share	R0140	-	-	-	-	-	-	-
Net	R0200	-	-	-	-	-	-	-
<b>Premiums earned</b>								
Gross - Direct Business	R0210	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0220	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0230	-	-	-	-	-	-	-
Reinsurers' share	R0240	-	-	-	-	-	-	-
Net	R0300	-	-	-	-	-	-	-
<b>Claims incurred</b>								
Gross - Direct Business	R0310	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0320	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted	R0330	-	-	-	-	-	-	-
Reinsurers' share	R0340	-	-	-	-	-	-	-
Net	R0400	-	-	-	-	-	-	-
<b>Changes in other technical provisions</b>								
Gross - Direct Business	R0410	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	R0420	-	-	-	-	-	-	-
Gross - Non- proportional reinsurance accepted	R0430	-	-	-	-	-	-	-
Reinsurers' share	R0440	-	-	-	-	-	-	-
Net	R0500	-	-	-	-	-	-	-
<b>Expenses incurred</b>	R0550	-	-	-	-	-	-	-
<b>Other expenses</b>	R1200							-
<b>Total expenses</b>	R1300							-

Note: This page is blank as SLAL does not have any non-life insurance business.

SCLAL solvency and financial condition report								
	Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information		
		Home country C0150	Top 5 countries (by amount of gross premiums written) - life obligations					Total Top 5 and home country C0210
	R1400		C0160	C0170	C0180	C0190	C0200	
			DE C0230	C0240	C0250	C0260	C0270	C0280
		£000s	£000s	£000s	£000s	£000s	£000s	£000s
<b>Premiums written</b>								
Gross	R1410	478,192	870,483	-	-	-	-	1,348,675
Reinsurers' share	R1420	21,814	23,637	-	-	-	-	45,451
Net	R1500	456,378	846,846	-	-	-	-	1,303,224
<b>Premiums earned</b>								
Gross	R1510	-	-	-	-	-	-	-
Reinsurers' share	R1520	-	-	-	-	-	-	-
Net	R1600	-	-	-	-	-	-	-
<b>Claims incurred</b>								
Gross	R1610	3,532,386	792,631	-	-	-	-	4,325,017
Reinsurers' share	R1620	483,357	7,121	-	-	-	-	490,478
Net	R1700	3,049,029	785,510	-	-	-	-	3,834,539
<b>Changes in other technical provisions</b>								
Gross	R1710	9,992,969	214,155	-	-	-	-	10,207,124
Reinsurers' share	R1720	(66,964)	(59,043)	-	-	-	-	(126,007)
Net	R1800	10,059,933	273,198	-	-	-	-	10,333,131
<b>Expenses incurred</b>	R1900	745,587	128,840	-	-	-	-	874,427
<b>Other expenses</b>	R2500							-
<b>Total expenses</b>	R2600							874,427

## S.12.01.02 Life and health SLT technical provisions

Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance, incl. unit-linked)											
Other life insurance											
Index-linked and unit-linked insurance											
Insurance with profit participation											
C0020 £000s											
C0030 £000s											
C0040 £000s											
C0050 £000s											
C0060 £000s											
C0070 £000s											
C0080 £000s											
C0090 £000s											
C0100 £000s											
C0150 £000s											
Total (life insurance obligations other than health insurance, incl. unit-linked)											
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Total (life insurance obligations other than health insurance, incl. unit-linked)											

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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		Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (health similar to life insurance)
		C0160 £000s	Contracts without options and guarantees C0170 £000s	Contracts with options or guarantees C0180 £000s			
<b>Technical provisions calculated as a whole</b>							
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	R0210	-			-	-	-
<b>Technical provisions calculated as a sum of BE and RM</b>	R0220	-			-	-	-
<b>Best Estimate</b>							
<b>Gross Best Estimate</b>	R0030		-	155,451	-	-	155,451
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080		-	103,951	-	-	103,951
Best estimate minus recoverables from reinsurance/SPV and Finte Re – total	R0090		-	51,500	-	-	51,500
<b>Risk Margin</b>	R0100	-		-	-	-	-
<b>Amount of the transitional on Technical Provisions</b>							
Technical provision calculated as a whole	R0110	-		-	-	-	-
Best estimate	R0120		-	-	-	-	-
Risk Margin	R0130	-		-	-	-	-
<b>Technical provisions - total</b>	R0200	155.451		-	-	-	155.451

## S.22.01.21 Impact of long term guarantees and transitional measures

		Amount with LTG measures and transitionals	Impact of transitional on technical provisions	Impact of transitional on interest rate	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
		C0010 £000s	C0030 £000s	C0050 £000s	C0070 £000s	C0090 £000s
Technical provisions	R0010	145,308,947	1,745,047	-	260,084	1,055,274
Basic own funds	R0020	6,644,394	(1,480,973)	-	(141,608)	(694,339)
Eligible own funds to meet SCR	R0050	6,644,394	(1,480,973)	-	(141,608)	(694,339)
SCR	R0090	3,765,837	-	-	(28,091)	407,236
Eligible own funds to meet MCR	R0100	6,627,130	(1,480,973)	-	(141,608)	(694,339)
<b>Minimum capital requirement</b>	R0110	1,301,083	1,694	-	34,557	22,353

## S.23.01.01 Own funds

		Total C0010 £000s	Tier 1 - unrestricted C0020 £000s	Tier 1 - restricted C0030 £000s	Tier 2 C0040 £000s	Tier 3 C0050 £000s
<b>Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation (EU) 2015/35</b>						
Ordinary share capital (gross of own shares)	R0010	21,054	21,054		-	
Share premium account related to ordinary share capital	R0030	104,349	104,349		-	
Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings	R0040	-	-		-	
Subordinated mutual member accounts	R0050	-		-	-	-
Surplus funds	R0070	1,430,975	1,430,975			
Preference shares	R0090	486,392		486,392	-	-
Share premium account related to preference shares	R0110	-		-	-	-
Reconciliation reserve	R0130	4,228,815	4,228,815			
Subordinated liabilities	R0140	355,545		355,545	-	-
An amount equal to the value of net deferred tax assets	R0160	17,264				17,264
Other items approved by supervisory authority as basic own funds not specified above	R0180	-	-	-	-	-
<b>Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds</b>						
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	R0220	-				
<b>Deductions</b>						
Deductions for participations in other financial undertakings, including non-regulated undertakings carrying out financial activities	R0230	-	-	-	-	
<b>Total basic own funds after deductions</b>	R0290	6,644,394	5,785,193	841,937	-	17,264
<b>Ancillary own funds</b>						
Unpaid and uncalled ordinary share capital callable on demand	R0300	-			-	
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	R0310	-			-	
Unpaid and uncalled preference shares callable on demand	R0320	-			-	-
A legally binding commitment to subscribe and pay for subordinate liabilities on demand	R0330	-			-	-
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	R0340	-			-	
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	R0350	-			-	-
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0360	-			-	
Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0370	-			-	-
Other ancillary own funds	R0390	-			-	-
<b>Total ancillary own funds</b>	R0400	-			-	-
<b>Available and eligible own funds</b>						
Total available own funds to meet the SCR	R0500	6,644,394	5,785,193	841,937	-	17,264
Total available own funds to meet the MCR	R0510	6,627,130	5,785,193	841,937	-	
Total eligible own funds to meet the SCR	R0540	6,644,394	5,785,193	841,937	-	17,264
Total eligible own funds to meet the MCR	R0550	6,627,130	5,785,193	841,937	-	
<b>SCR</b>	R0580	3,765,837				
<b>MCR</b>	R0600	1,301,083				
<b>Ratio of eligible own funds to SCR</b>	R0620	1.76439				
<b>Ratio of eligible own funds to MCR</b>	R0640	5.09355				



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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			C0060 £000s		
<b>Reconciliation reserve</b>					
Excess of assets over liabilities	R0700	6,989,573			
Own shares (held directly and indirectly)	R0710	-			
Foreseeable dividends, distributions and charges	R0720	-			
Other basic own fund items	R0730	2,060,035			
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring-fenced funds	R0740	700,724			
<b>Reconciliation reserve</b>	R0760	4,228,814			
<b>Expected profits</b>					
Expected profits included in future premiums (EPIFP) - Life business	R0770	821,418			
Expected profits included in future premiums (EPIFP) - Non- life business	R0780	-			
<b>Total EPIFP</b>	R0790	821,418			

## S.25.02.21 Solvency capital requirement – for undertakings using the standard formula and partial internal model

Unique number of component C0010	Components description C0020	Calculation of the solvency capital requirement C0030 £000s	Amount modelled C0070 £000s	USP C0080	Simplifications C0090
1	Market risk	48,551	-	-	-
2	Counterparty default risk	3,796	-	-	-
3	Life underwriting risk	64,342	-	None	-
4	Health underwriting risk	-	-	None	-
5	Non-life underwriting risk	-	-	None	-
6	Intangible asset risk	-	-	-	-
7	Operational risk	1,308	-	-	-
8	Loss absorbing capacity of technical provisions	-	-	-	-
9	Loss absorbing capacity of deferred taxes	(11,256)	-	-	-
100	Partial Internal Model: Market risk	2,821,884	2,821,884	-	-
300	Partial Internal Model: Life underwriting risk	1,959,878	1,959,878	-	-
701	Partial Internal Model: Operational risk	509,153	509,153	-	-
801	Partial Internal Model: Other risks	96,883	96,883	-	-
804	Partial Internal Model: Other adjustments	-	-	-	-

### Calculation of solvency capital requirement

		C0100 £000s
Total undiversified components	R0110	5,494,539
Diversification	R0060	(1,728,702)
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	R0160	-
<b>Solvency capital requirement excluding capital add-on</b>	R0200	3,765,837
Capital add-ons already set	R0210	-
<b>Solvency capital requirement</b>	R0220	3,765,837
<b>Other information on SCR</b>		
Amount/estimate of the overall loss-absorbing capacity of technical provisions	R0300	(1,791,796)
Amount/estimate of the overall loss-absorbing capacity of deferred taxes	R0310	(321,696)
Capital requirement for duration-based equity risk sub-module	R0400	-
Total amount of notional solvency capital requirements for remaining part	R0410	2,296,514
Total amount of notional solvency capital requirements for ring-fenced funds (other than those related to business operated in accordance with Art. 4 of Directive 2003/41/EC (transitional))	R0420	775,466
Total amount of notional solvency capital requirements for matching adjustment portfolios	R0430	693,857
Diversification effects due to RFF nSCR aggregation for article 304	R0440	-

Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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## 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 £000s		
MCR <sub>NL</sub> Result	R0010	-		
			Net (of reinsurance/SPV) best estimate and TP calculated as a whole C0020 £000s	Net (of reinsurance) written premiums in the last 12 months C0030 £000s
Medical expense insurance and proportional reinsurance	R0020	-	-	-
Income protection insurance and proportional reinsurance	R0030	-	-	-
Workers' compensation insurance and proportional reinsurance	R0040	-	-	-
Motor vehicle liability insurance and proportional reinsurance	R0050	-	-	-
Other motor insurance and proportional reinsurance	R0060	-	-	-
Marine, aviation and transport insurance and proportional reinsurance	R0070	-	-	-
Fire and other damage to property insurance and proportional reinsurance	R0080	-	-	-
General liability insurance and proportional reinsurance	R0090	-	-	-
Credit and suretyship insurance and proportional reinsurance	R0100	-	-	-
Legal expenses insurance and proportional reinsurance	R0110	-	-	-
Assistance and proportional reinsurance	R0120	-	-	-
Miscellaneous financial loss insurance and proportional reinsurance	R0130	-	-	-
Non-proportional health reinsurance	R0140	-	-	-
Non-proportional casualty reinsurance	R0150	-	-	-
Non-proportional marine, aviation and transport reinsurance	R0160	-	-	-
Non-proportional property reinsurance	R0170	-	-	-

Note: This page is blank as SLAL does not have any non-life insurance

# Linear formula component for life insurance and reinsurance obligations

		C0040 £000s	
MCR <sub>L</sub> Result	R0200	1,301,083	

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole C0050 £000s	Net (of reinsurance/SPV) total capital at risk C0060 £000s
Obligation with profit participation – guaranteed benefits	R0210	21,635,875	
Obligation with profit participation – future discretionary benefits	R0220	7,542,841	
Index-linked and unit-linked insurance obligations	R0230	96,980,204	
Other life (re)insurance and health (re)insurance obligations	R0240	9,886,617	
Total capital at risk for all life (re)insurance obligation	R0250		9,004,712

## Overall MCR calculation

		C0070 £000s	
Linear MCR	R0300	1,301,083	
SCR	R0310	3,765,837	
MCR cap	R0320	1,694,627	
MCR floor	R0330	941,459	
Combined MCR	R0340	1,301,083	
Absolute floor of the MCR	R0350	3,332	
		C0070	
Minimum capital requirement	R0400	1,301,083	

## Glossary

### Annuity

A periodic payment made for an agreed period of time (usually up to the death of the recipient) in return for a cash sum. The cash sum can be paid as one amount or as a series of premiums. If the annuity commences immediately after the payment of the sum, it is called an immediate annuity. If it commences at some future date, it is called a deferred annuity.

### Asset share

The asset share of a policy is the accumulation of premiums (less any amounts in respect of withdrawals) at the investment returns on the with profits assets, less deductions for expenses and charges (including any deductions for guarantees or contributions to the capital of the HWPF), tax and any other experience adjustments.

### Assumptions

Variables, which can be economic or non-economic in nature, used in actuarial models to project expected policy cash flows.

### Best estimate liability

The part of technical provisions representing a probability weighted average of future cash flows, taking account of the time value of money, using an appropriate risk-free interest rate term structure. The calculation is based upon realistic assumptions, using appropriate actuarial and statistical methods and taking account of all future cash inflows and outflows required to settle the insurance obligations.

### Board

The Board of Directors of Standard Life Assurance Limited (the Company).

### Burnthrough

According to the Scheme of Demutualisation, in certain circumstances the HWPF may withhold transfers to shareholders and requires that, in extremis, shareholders contribute additional assets if the fund is unable to meet its obligations to policyholders. This is known as burnthrough.

### Capital resources

Capital resources include the assets in excess of liabilities, valued on a regulatory basis, and certain other components of capital.

### Company

Standard Life Assurance Limited.

### Contract boundary

The boundary of an insurance contract (or reinsurance contract) defines the cash flows which must be taken into account when calculating the technical provision in respect of that contract.

### Conventional with profits (CWP)

A form of with profits contract where the benefit is expressed in terms of sum assured, regular (or reversionary) bonuses and final (or terminal) bonus.

### Cost of guarantees (COG)

This is the expected cost of providing investment guarantees (e.g. guaranteed minimum level of unit growth) to with profits policyholders. A guarantee has a cost if the guaranteed amount is greater than the payout (which is generally based on asset share) would otherwise have been.

### Deterministic model

An actuarial projection model in which the input variables are defined in terms of a single best estimate value leading to a point estimate of the value of future cash flows. In comparison, stochastic models use a range of input variables (e.g. future investment returns) in the form of probability distributions leading to a number of modelled outcomes.

### Director

A Director of the Company.

### Discounting

This is the process of reducing a future cash flow back to present value terms, by way of an assumed future interest (discount) rate.

### Economic assumptions

Assumptions in relation to future interest rates, investment returns, inflation and tax.

### **Economic scenario generator (ESG)**

An ESG generates a large number of economic scenarios which are used to value insurance liabilities.

### **EIOPA**

European Insurance and Occupational Pensions Authority

### **Estate or Residual estate**

The excess of assets available to the with profits fund over the value of liabilities.

### **Executive management**

The executive management team is responsible for the day-to-day running of the business of the Group and the Company and comprises at 31 December 2016: the Chief Executive, Chief Executive – Life Insurance, Chief Executive – Pension and Savings, the Chief Operating Officer, Chief Financial Officer and the Chief Risk Officer.

### **External fund links (EFL)**

These are unit-linked fund options on Standard Life products, where the funds are not managed by Standard Life.

### **FCA**

Financial Conduct Authority.

### **German With Profits Fund (GWPF)**

This fund contains the investment element of the post-demutualisation German with profits business written in the Proprietary Business Fund (PBF).

### **Group Board**

The Board of Directors of Standard Life plc.

### **Group, Standard Life Group, Group Holding Company or Standard Life**

Prior to demutualisation on 10 July 2006, SLAC and its subsidiaries and, from demutualisation on 10 July 2006, Standard Life plc and its subsidiaries.

### **Guaranteed benefits**

Any minimum benefits guaranteed to be paid on dates or events specified under the relevant policy.

### **Heritage With Profits Fund (HWPF)**

This fund contains most of the business written by Standard Life before demutualisation.

### **Implied volatility**

Reflects the financial market's view of the probabilities of a range of future market scenarios. It is a key assumption in a market consistent valuation.

### **Large fund discounts**

The practice of reducing the effective annual management charge applied to a policy depending on the size of the unit fund.

### **Maintenance expenses**

Expenses relating to the ongoing maintenance of business. This would include customer service costs, for example.

### **Market consistency**

A market consistent value is the market value if the instrument is readily traded. In the context of liabilities, a market consistent value is a valuation that is consistent with the prices of assets with similar characteristics to those liabilities. For liability cash flows with option-like features e.g. guarantees, these values should be consistent with market option prices.

### **Matching adjustment**

An adjustment to the risk free yield used to calculate the best estimate to reflect where long-term liabilities are backed by assets which closely match the cash flows, where these assets have yields in excess of risk free and the extent that the assets are expected to be held long term.

### **Mature book/business**

Mature books are expected to provide a stable and consistent contribution to our profit. This includes UK mature Retail books and spread/risk based business. It also includes the with profits business in Germany which closed to new business in April 2015.



Business and performance	System of governance	Risk profile	Valuation for solvency purposes	Capital management	Other information
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### Minimum capital requirement (MCR)

The MCR represents an absolute floor to the level of eligible own funds that the insurance undertaking is required to hold under Solvency II.

### Non-economic assumptions

Assumptions in relation to future expenses and future lapse, withdrawal, retirement, mortality and morbidity rates.

### Own funds

Under Solvency II, the capital resources available to meet solvency capital requirements are called own funds.

### Option (insurance policy feature)

A benefit feature of an insurance contract that may be selected at the discretion of the policyholder e.g. right to convert a maturity value into an income for life at guaranteed terms.

### PRA

Prudential Regulation Authority.

### Present value of future shareholder transfers (PVST)

A balance sheet liability to transfer the profits arising from the PVIF of some business to shareholders when it has arisen. The products this relates to were specified in the Scheme of Demutualisation. It is largely unitised with profits and unit-linked business (so excludes immediate annuities and conventional with profits business).

### Present value of in-force business (PVIF)

The expected future profits (usually excess of charges over expenses) on existing business.

### Principles and Practices of Financial Management

Public document that sets out the basis on which with profits business will be managed.

### Quantitative Reporting Template (QRT)

Templates used for the supervisory reporting and public disclosure of quantitative data under Solvency II.

### Reinsurance

Process whereby one entity takes on all or part of the risk covered under a policy issued by an insurance company in return for a premium payment.

### Ring-fenced funds

Ring-fenced funds are arrangements as a result of which certain items of own funds have a reduced capacity to fully absorb losses on a going concern basis due to their lack of transferability within the undertaking.

### Risk margin

The part of technical provisions in addition to the best estimate liability required to ensure that the value of the technical provisions is equivalent to the amount that insurance undertakings would be expected to require in order to take over and meet the insurance obligations.

### Scheme of Demutualisation or the Scheme

The scheme pursuant to Part VII of, and Schedule 12 to, the Financial Services and Markets Act 2000, under which substantially all of the long-term business of SLAC was transferred to Standard Life Assurance Limited on 10 July 2006.

### SLAC

The Standard Life Assurance Company (renamed The Standard Life Assurance Company 2006 on 10 July 2006).

### SLAL

Standard Life Assurance Limited.

### SLCM

Standard Life Client Management Limited.

### SLI

Standard Life Investments Limited.

### SL Intl

Standard Life International Designated Activity Company.

## **Smoothing**

The practice of smoothing can help to reduce the effects of fluctuations in investment returns on with profits payouts. SLAL aims to operate smoothing of payouts in such a way as to be neutral for with profits policyholders as a whole over time. This practice can lead to a balance sheet smoothing cost where it is expected that past smoothing losses cannot be recovered due to guarantees biting.

## **Solvency II Directive**

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

## **Solvency capital requirement (SCR)**

The economic capital to be held by an insurer in order to ensure that it will still be in a position to meet their obligations to policyholders over the following 12 months, with a probability of at least 99.5% (i.e. limit probability of failure to less than 1 in 200 years).

## **Spread/risk business**

Spread/risk business mainly comprises products where we provide a guaranteed level of income for our customers in return for an investment, for example, annuities. The 'spread' referred to in the title primarily relates to the difference between the guaranteed amount we pay to customers and the actual return on the assets over the period of the contract.

## **Stochastic modelling**

An actuarial projection model in which the input variables (e.g. future investment returns) are defined in terms of a range of values in the form of probability distributions, reflecting the volatility of those variables. This leads to a range of modelled outcomes. This approach is useful when a policy provides a guarantee e.g. a minimum rate of investment return. A deterministic model would not allow for the volatility of future investment returns and hence is a less appropriate way of estimating the cost of providing the guarantee.

## **Technical provisions**

The value attributed to future insurance obligations determined in line with Solvency II regulations, comprising a best estimate liability plus risk margin.

## **Technical provisions as a whole**

The best estimate and the risk margin are typically calculated separately. Where the future cash flows can be replicated reliably using financial instruments for which a reliable market value is observable (such as unit-linked fund values) then the value of technical provisions equals the market value of those financial instruments ('technical provisions as a whole').

## **Unit-linked**

Unit-linked refers to a proposition or fund where the customer will buy 'units' of the fund. The value of a unit changes based on the performance of underlying assets, and the number of units in the fund will change depending on the size of the fund.

## **Unit-linked policy**

A policy where the benefits are determined by reference to the investment performance of a specified pool of assets referred to as the unit-linked fund.

## **Unitised with profits (UWP)**

A form of with profit contract where the benefit is expressed in terms of a unit fund (with a guaranteed minimum level of growth), and a final (or terminal) bonus.

## **Vintage units**

A vintage unit method is used in practice for calculating terminal bonus rates on policyholder payouts in respect of UWP pensions business. Regular premium policies are effectively considered as if they were a series of single premium policies, with a terminal bonus rate being calculated separately for each year of payment. The same terminal bonus rates are used for regular and single premium policies, and the terminal bonus rate cannot be negative.

## **Volatility adjustment**

An adjustment made to the liquid part of the risk free interest rate in order to reduce the impact of short term market volatility on the balance sheet.

## **With profits policy**

A policy where, in addition to guaranteed benefits specified in the policy, additional bonuses may also be payable.



Please remember that the value of shares can go down as well as up and you may not get back the full amount invested or any income from it. All figures and share price information have been calculated as at 31 December 2016 (unless otherwise indicated).

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