Aioi Nissay Dowa Europe Limited

Group Solvency and Financial Condition Report

Year ended 31 December 2018

Table of contents

Summary

This is the Group Solvency and Financial Condition Report ("SFCR") for Aioi Nissay Dowa Europe Limited ("ANDEL", "the Company", or "the Group" when referring to the Group as a whole), as at 31 December 2018. It is prepared in accordance with the Solvency II Regulations.

1. Legal disclaimer

This SFCR has been prepared solely to fulfil the obligations arising from the supervisory reporting requirements (Solvency and Financial condition Report under Articles 51 et seq. of the SII Directive 2009/138/EC in conjunction with Articles 290 et seq. of Delegated Regulation (EU) 2015/35 of the Commission of 10 October 2014 and Articles 82 et seq. of the local Law of 7 December 2015 on the insurance sector).

Unless otherwise indicated in this SFCR, all statements and information contained herein are based on facts and knowledge as at the reference date of this report (3 June 2019). The same applies to all forward-looking statements and information contained in this report, such as forecasts, expectations, developments, plans, intentions, assumptions, beliefs or outlooks. Forward-looking statements are subject to many factors and no assurance, warranty or guarantee is given that the forward-looking statements will take place or be fulfilled as expected. Furthermore, new factors with a significant impact on forward-looking statements may arise at any time. It cannot be predicted what these factors are and what influence they have individually or in combination with other circumstances. It is not intended to update any of these forward-looking statements and information due to changed circumstances or new knowledge unless expressly required by applicable laws or regulations.

2. Group restructure

The Group currently relies on so-called "passporting" permissions to function across the European Economic Area ("EEA"), either through freedom of establishment or freedom of services. Since the referendum in June 2016 when the United Kingdom ("UK") voted to leave the European Union ("EU"), the possibility of a so-called "hard Brexit", with no transitional arrangements in place for trading in the EEA after the date when the UK leaves the EU and no passporting in either direction, posed a threat to this operating model.

The Group prepared for this scenario by reorganising its corporate structure. This consisted of:

- Creating a new entity, ANDEL, to act as the new holding company for the Group. ANDEL became the Group's holding company on 11 April 2018;
- Converting the Group's non-life insurance company ANDIE and its insurance intermediary Toyota Insurance Management ("TIM") to "Societas Europaea" ("SE") form and re-domiciling them to Luxembourg. The re-domicile of both companies occurred on 1 March 2019; and
- Applying for authorisation for a new insurance company in the UK, Aioi Nissay Dowa UK Limited ("AND UK"). This regulatory application is in the process of being finalised.

The conversion to SE form and the re-domicile to Luxembourg of ANDIE and TIM has enabled the existing business model in the European Union and the EEA to continue largely unaffected, with the European branch structures of the two companies preserved during the process. Following the migration to Luxembourg, ANDIE and TIM have also set up freedom of establishment branches in the UK. With the UK branches in place, the two companies will either be able to continue to operate in the UK through passporting – if there is a Brexit transition agreement – or under the "temporary permissions regime" in the event of a "no deal" Brexit. The temporary permissions regime is designed to allow firms which passport in to the UK to continue the existing scope of activities (including new business) for a period of up to three years in the event that the UK leaves the EU with no deal.

ANDEL became the Group's holding company on 11 April 2018. This was achieved by ANDEL issuing £350m of shares to its Japanese parent company Aioi Nissay Dowa Insurance Company ("ADJ") in exchange for ADJ's shares in the ANDIE group. Subsequently, ANDIE made distributions in specie of all its subsidiaries other than ANDLIE and Top Class Insurance Srl ("Top Class") to ANDEL. ANDLIE continued as a subsidiary of ANDIE in order to enable its parent to convert to an SE legal form; the Group intends to move ANDLIE under the holding company ANDEL in due course. A voluntary liquidation of Top Class, meanwhile, was completed in December 2018.

While ANDIE can serve existing and new UK customers through its UK branch, the Group's intention is to write new business in the UK through a new UK insurance company, AND UK. The Group is currently finalising its application to the UK regulators, the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") for a new insurance company licence. It expects to begin to write through the new company later during 2019, at which point it will be re-named Aioi Nissay Dowa Insurance UK Limited ("ANDI UK").

The aim of the Group's Brexit contingency project was to ensure that there would be no disruption to the Group's ability to serve its customers or to the level of cover, expertise and service that those customers received. The Group is pleased to have delivered on this objective and to be able to continue to operate across both the UK and the EEA.

The Company's non-life insurance company subsidiary ANDIE is a Luxembourg-registered company (registered no. B232302). ANDIE's registered office is: 4 Rue Lou Hemmer, L-1748 Senningerberg, Luxembourg. ANDIE is authorised by the Commissariat aux Assurances ("CAA"), 7 Boulevard Joseph II, L-1840 Luxembourg. ANDIE's independent auditor is KPMG Luxembourg Société coopérative, 39 Avenue John F. Kennedy, L-1855 Luxembourg.

During the reporting period of 1 January 2018 – 31 December 2018 ANDIE's registered office was 7th Floor, 52 - 56 Leadenhall Street, London EC3A 2BJ, before it migrated to Luxembourg on 1 March 2019. During the reporting period, ANDIE was authorised by the Prudential Regulation Authority ("PRA"), 20 Moorgate, London EC2R 6DA and regulated by the Financial Conduct Authority ("FCA"), 25 North Colonnade, London, E14 5HS and the Prudential Regulation Authority. The independent auditor during the reporting period was KPMG LLP, 15 Canada Square, London E14 5GL.

Following ANDIE's migration to Luxembourg on 1 March 2019 the Group currently has two regulated insurance entities, ANDIE in Luxembourg and ANDLIE in Germany. As noted above, the Group is currently in the process of applying for a non-life insurance licence in the UK for AND UK; this process is expected to be concluded shortly. When this licence is granted, it is expected that the PRA will revert to the role of group supervisor of the ANDEL Group. As at the date of this report, however, the CAA in Luxembourg is the group supervisor.

As explained above, following the Group restructure ANDEL is now the Group's holding company and this Group SFCR is that of ANDEL, which has taken the place of the previous group company ANDIE in the Group's structure. This transaction occurred through a 'contribution in kind', whereby ANDEL issued shares to the Group's parent ADJ in exchange for the full issued share capital of ANDIE. The accounting treatment adopted for this transaction (merger accounting) means that in the IFRS consolidated accounts the results and cash flows of all the combining entities are brought into the ANDEL consolidated results from the beginning of 2018, with the Group's corresponding figures for 2017 being set out as if ANDEL had always been the Group's holding company. The Group SFCR adopts the same approach; this means that the figures for 2018 can be compared on a like-for-like basis with the prior year comparatives, recognising that despite the Group's restructure its overall business is fundamentally the same as it was in the prior year.

S&P Global ratings has assessed the long-term financial strength of the Group's main operating subsidiary ANDIE as "A+ / Stable".

3. Changes to the Group's Solvency II narrative reporting

The Group's main operating subsidiary Aioi Nissay Dowa Insurance Company of Europe SE ("ANDIE") migrated to Luxembourg on 1 March 2019. This was due to the Group's Brexit-mitigation restructure, described in further detail during the course of this SFCR. As a result of the migration, ANDIE itself has not been required to prepare a solo SFCR for the year ended 31 December 2018. The solo SFCR for the Group's life insurance subsidiary, Aioi Nissay Dowa Life Insurance Company of Europe AG ("ANDLIE") has been prepared as in previous years.

In addition, the migration of ANDIE to Luxembourg has meant that the Luxembourg regulator, the Commissariat Aux Assurances ("CAA") is the regulator of both ANDIE and also of the ANDEL Group, albeit it is expected that the UK regulator the Prudential Regulatory Authority ("PRA") will resume its role as the Group's regulator once all elements of the Group's Brexit-driven restructure are complete. Unlike in the UK, in Luxembourg there are no requirements for either the SFCR or any of the Solvency II quantitative reporting templates to be audited by an external statutory auditor. This means that this Group SFCR has not been subject to audit. In all other respects, however, the Group SFCR has been prepared on a consistent basis with the prior year.

4. Business and performance summary

The Company's principal activity is that of a holding company for insurance and insurance-related businesses. The Company's key operating subsidiaries focus on motor insurance and other auto-centric insurance products. Through its subsidiary companies, the Group operates as a general insurer in the UK and Europe and also in Europe as a credit life insurer. The Company also has an insurance intermediary and a managing general agent subsidiary.

ANDEL is a private company incorporated, domiciled and registered in the United Kingdom. The registered number is 11054298 and the registered address is: 7th Floor, 52-56 Leadenhall Street, London, EC3A 2BJ. The independent auditor of the Company is KPMG LLP, 15 Canada Square, London E14 5GL.

ANDEL is a wholly-owned subsidiary of Aioi Nissay Dowa Insurance Company Limited ("ADJ"), a company incorporated in Japan. MS&AD Insurance Group Holdings, Inc., a company incorporated in Japan, is the ultimate parent company and ultimate controlling party. The MS&AD Insurance Group is Japan's largest non-life insurer and one of the largest non-life insurance groups in the world.

The Group's key business is the provision of auto-centric insurance products either directly or on behalf of its strategic partners, with telematics or related offerings expected to be an increasingly important part of the business over time. The Group's strategic relationship with Toyota is key and the Group's subsidiary TIM, which is part-owned by Toyota Financial Services (UK) PLC ("Toyota Financial Services"), provides Toyota's insurance expertise and works in support of Toyota across Europe. In 2018 the Group completed the acquisition of the remaining 24.99% of the shares in Box Innovation Group Limited ("BIGL") that it did not already own. The BIGL group has provided telematics expertise and access to the UK telematics auto insurance market. Telematics or related offerings are expected to be an increasingly important part of the Company's strategy over time, as telematics becomes more established across European markets and with the Company's key strategic partner Toyota.

The Group continues to provide some insurance to Japanese-related business in Europe, (known as Japanese Interests Abroad ("JIA") business). This has diminished as much of this business has been transferred to Mitsui Sumitomo Insurance Co Ltd of Japan and its subsidiaries ("Mitsui Sumitomo"). The majority of the JIA business that remains within the Group is focused on motor fleet cover, so closely linked to the Group's core business of automotive insurance.

The Group made a pre-tax loss for the year ended 31 December 2018 of £(40.5)m (2017: loss of £(99.8)m). As in the prior year, the loss included the impact of write-downs of intangible assets associated with the acquisition of BIGL in April 2015. The Group's underlying performance, however, was an improvement from the result recorded in 2017, as it made significant progress towards integrating the Insure the Box ("ITB") business and improving the Group's underwriting result.

The Group's result excluding exceptional items was as follows:

	2018 £'000	2017 £'000
Pre-tax loss per IFRS accounts	**(40,451)**	**(99,833)**
One-off costs		
- **Net impact of purchases of minority interests in BIGL**	-	16,862
- **Impairment of intangible assets – software**	(8,435)	(10,551)
- **Impairment of intangible assets – customer relationships**	(1,791)	(22,534)
- **Write-down of goodwill**	-	(47,817)
Loss prior to one-off costs	**(30,225)**	**(35,793)**

The Group's Toyota-branded business had a strong year in 2018, with a record result in the Group's main overseas market, Germany. Pleasingly, the quality of the Toyota Insurance Germany offer is also well-recognised in the industry, having won once again the industry award for the best motor insurer from AutoHaus Monitor. The award "VersicherungsMonitor" was established in 2009 in order to analyse the procurement of insurance within the automotive insurance industry. Toyota Insurance Germany has now won the award for insurance provision for large overseas brands on eight occasions. The results for Toyota-branded insurance in the UK and Italy were also good, with the Group's Toyota UK business successfully completing a move to a new servicing provider.

Within the UK, the largest element of the Company's underwriting is the Insure The Box portfolio ("ITB"). For this area of the business the underwriting result was in line with expectations for the full year. 2018 was a difficult year for the UK telematics and young driver market, characterised by lower average premiums, a declining share of telematics as a proportion of the market as a whole and fierce competition. These market pressures were felt not just by the Group but by many of its peers. In this context, the ITB underwriting result was an improvement, continuing the better performance which started in 2017, albeit on lower than anticipated business volumes.

The Group is intending to grow in the next five years as it aims to capitalise on the opportunities presented by telematics. For 2018, however, the Group's gross written premiums for fell from £372.5m to £338.1m. General insurance premiums generated by the Group's subsidiary ANDIE reduced from £353.4m to £316.2m, while the premiums written by ANDLIE increased from £19m to £21.9m. The main area of reduction was ITB underwriting, which contributed a significantly lower £86.8m (2017: £136.3m) to the Group's gross written premiums. Nonetheless the Group expects to return to growth in future years, as the ITB underwriting volumes stabilise and the Group seeks to expand in European markets.

The Group's parent company ADJ continues to show its support for these growth ambitions. On 5 April 2018 ADJ injected £180m of equity capital into the Company. This capital injection is designed to support both the Group during a period of growth and in order to address the additional capital requirements resulting from the need to restructure the Group for Brexit.

5. System of governance summary

The system of governance is considered to be appropriate for the Group taking into account the nature, scale and complexity of the risks inherent in the business. There were no material changes in the system of governance during the reporting period.

After the period ended, however, the Group's main operating subsidiary the non-life insurance company ANDIE and its insurance intermediary TIM re-domiciled to Luxembourg. This report describes the system of governance in place during the reporting period. The changes to the system of governance as a result of the move to Luxembourg are not expected to be material as regards the Group's overall operations. This is because the two companies which have migrated to Luxembourg will continue to be part of the Group's risk management system and the Group's Three Lines of Defence Model remains in place. Details of the changes to the Group's system of governance as they pertain to ANDEL are described in Section B of this SFCR.

The Board is ultimately responsible and accountable for the performance and strategy of the Group and for ensuring that the Group complies with all legal, statutory, regulatory and administrative requirements. To support the efficient management of the Group the Board has delegated certain functions to committees, though by doing this the Board does not absolve itself of its ultimate responsibility for the Group.

The Board has delegated responsibilities to the Corporate Governance committees and the Business committees. During the reporting period the Corporate Governance committees were: the Audit and Compliance Committee, the Risk Committee, the Investment Committee, the Risk Modelling Committee (a sub-committee of the Risk Committee) and the Remuneration Committee. The main Business committee is the Executive Directors' Committee, which has three sub-committees, the Outwards Reinsurance Committee, the Reserving Committee and the Underwriting and Pricing Committee.

The Group operates an enterprise-wide risk management framework that is designed to identify, evaluate, manage and monitor exposure to risk. The process is subject to continuous review and development. The risk management system must comply with regulatory standards at all times.

The Group operates a Three Lines of Defence Model as part of its overall control environment and its risk management system. The main elements of the Three Lines of Defence Model may be summarised as follows:

- First line: the first level of the control environment is the business operations which perform the day-to-day risk management activity.
- Second line: these are the oversight functions of the Group, such as Risk and Compliance, and also include financial controls. These functions set direction, define policy and provide assurance.
- Third line: internal audit is the third line of defence. Internal Audit offers independent challenge to the levels of assurance provided by business operations and oversight functions.

The Group has established Compliance, Risk, Internal Audit and Actuarial functions.

The Group considers outsourcing arrangements for an activity when it is not cost-effective or possible to carry out the activity internally. The Group recognises that it remains responsible for discharging all legal and regulatory responsibilities relating to the outsourced activity. In order to reduce the risks associated with outsourcing, the Group has an established outsourcing policy.

6. Risk profile summary

Overall responsibility for the management of the Group's exposure to risk lies with the Board. To support it in its role, the Board has established an enterprise risk management framework comprising risk identification, risk assessment, control and reporting processes. The Board is assisted in its oversight of the risk management framework by the Corporate Governance and Business committees.

The following table sets out the standard formula risk capital components of the Group's consolidated Solvency Capital Requirement ("SCR") and its Minimum Capital Requirement ("MCR") as at 31 December 2018:

Component	2018 £'000	2017 £'000
Non-life underwriting risk	66,116	68,080
Health underwriting risk	9	9
Life underwriting risk	4,434	3,670
Market risk	18,946	9,725
Counterparty default risk	17,761	22,416
Diversification credit	(22,911)	(18,632)
Operational risk	13,354	13,600
SCR	**97,710**	**98,868**
MCR	**40,050**	**43,271**

The largest component of the SCR is non-life underwriting risk. This is the risk that arises from the inherent uncertainty as to the occurrence, amount and timing of insurance liabilities. It manifests itself in variability in the contribution towards expenses and profits.

Market risk is the risk of external market influences affecting the Group's net asset value, for example changes in interest rates affecting the value of assets, changes in the levels of investment return, changes in exchange rates, etc.

Counterparty default risk is the risk that counterparties will be unable to pay amounts in full when due. Key areas where the Group is exposed to counterparty (or credit) risk are:

- exposure to corporate bonds;
- exposure to the failure of bank counterparties;
- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- amounts due from insurance contract holders; and
- amounts due from insurance intermediaries.

Operational risk is the risk that errors caused by people, processes or systems lead to losses to the Group, or the risk that arises from unanticipated or poorly anticipated external events.

Other important risks managed by the Group are strategic risk and reputational risk. Strategic risk is the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions and the lack of responsiveness to changes in the business environment. Reputational risk is a form of strategic risk within the Group's risk taxonomy. Reputational risk is defined as the risk of losses as a result of damage to the reputation and brands of the Group or of other companies on which the Group's fortunes depend.

7. Valuation for solvency purposes summary

ANDEL's valuation for solvency purposes is derived from the balance sheet in the Group's IFRS financial statements, which is then adjusted in accordance with Solvency II regulations. The Group has used the accounting consolidation-based method to prepare its Group Solvency II balance sheet, which is the default method prescribed by the regulations. The consolidation-based method differs from the IFRS consolidation used in the Group financial statements because only the holding company, the insurance undertakings (ANDIE and ANDLIE) and the ancillary services undertaking, Aioi Nissay Dowa Insurance Management Limited ("ANDIM"), are fully consolidated, with intra-group transactions between these four entities eliminated, while the Group's non-insurance subsidiaries are treated as participations, with the net asset value (calculated in accordance with Solvency II valuation rules) included in the Group's balance sheet. Intra-group transactions with the non-insurance subsidiaries are not eliminated.

Other significant adjustments between the IFRS balance sheet and the valuation for solvency purposes are: the elimination of goodwill and intangibles, the revaluation of technical reserves to Solvency II technical provisions and the elimination of deferred acquisition costs (replaced by future cash flows in the Solvency II technical provisions).

These differences can be summarised as follows:

	2018 £'000	2017 £'000	Reason
Net asset value per IFRS	303,232	173,804	Per accounts
Revaluation of net technical reserves	70,852	68,172	Differing reserving basis under Solvency II
Deferred acquisition cost	(76,112)	(76,458)	No DAC for Solvency II
Goodwill and intangibles	(15,332)	(29,729)	Written off for Solvency II
Holdings in related undertakings	(6,309)	(10,894)	Non-consolidated subsidiaries have a negative impact on Solvency II own funds
Other assets and liabilities	(5,138)	4,332	Net impact of adjustments to fair value
Own funds under Solvency II	271,193	129,227	Solvency II own funds

8. Capital management summary

The SCR coverage ratio as at 31 December 2018 was 278% (2017: 131%), with eligible own funds of £271.2m (2017: £129.2m) and an SCR of £97.7m (2017: £98.9m). The MCR coverage ratio as at 31 December 2018 was 677% (2017: 299%), with eligible own funds of £271.2m (2017: £129.2m) and an MCR of £40.1m (2017: £43.3m). The Group completed its previous Solvency II filing as at 31 December 2017 and quarterly reporting throughout 2018 and these have shown that the Group has complied continuously with both the MCR and the SCR throughout the reporting period.

The Group is funded only by share capital, which, together with a Solvency II reconciliation reserve, comprise Solvency II "own funds". The capital management objective of the Group is to maintain sufficient own funds to cover the SCR and the MCR with an appropriate buffer which takes account of the Group's growth ambitions as set out in its business plan. The Board and the Board Committees consider regularly the ratio of eligible own funds over the SCR and MCR. The Group prepares solvency projections over a five year period as part of the business planning process.

A. Business and Performance

A1. Information regarding our business

As noted in the "Business and Performance Summary" the Group's principal activity is insurance and its main business is retail general insurance, with a focus on auto-centric products. The Group's main strategic relationship is with Toyota, and the Group's subsidiary Toyota Insurance Management Limited, which is part-owned by Toyota Financial Services, provides Toyota's insurance expertise and works in support of Toyota across Europe. The Group's main line of business is the provision of Toyota-branded motor insurance and this is likely to remain the case for the foreseeable future. The geographical split of gross written premium by country for 2018 with a comparison with the prior year is as follows:

Country	2018 gross written premium £'000	2017 gross written premium £'000	2018 % of total GWP (2017 %)
United Kingdom	145,514	195,746	43% (53%)
Germany	100,929	89,865	30% (24%)
Italy	48,462	45,060	14% (12%)
France	33,469	29,860	10% (8%)
Spain	8,545	7,306	3% (2%)
Belgium	1,178	4,666	0.3% (1%)
Total	**338,103**	**372,503**	

The Group's financial year end is 31 December each year. The Group reports its results in Pounds Sterling.

Supervisory authorities

For the reporting period, the supervisory authority of the Group was the UK Prudential Regulation Authority ("PRA"). The Group was also regulated by the Financial Conduct Authority ("FCA"). Contact details for the PRA and the FCA can be found on their respective websites: www.bankofengland.co.uk/pra and www.fca.org.uk

Following the migration of ANDIE to Luxembourg, the Group and ANDIE itself are now regulated by the Commissariat Aux Assurances ("CAA"). Contact details for the CAA can be found on its website: www.caa.lu

The responsible supervisory authority for ANDLIE is BaFin in Germany. Contact details for BaFin can be found on its website, www.bafin.de

Auditor

The independent auditor of the Group is KPMG LLP, 15 Canada Square, London E14 5GL.

Credit rating

S&P Global ratings has assessed the long-term financial strength of the Group's main operating subsidiary ANDIE as "A+ / Stable".

Group structure

ANDEL is the holding company for the Aioi Nissay Dowa Europe Group. The Group operates as a general insurer in the UK and Europe through its Luxembourg-incorporated subsidiary ANDIE and as a life insurer in Europe through its Germany-incorporated subsidiary ANDLIE During the reporting period the ANDIE was authorised by the PRA and regulated by the FCA and the PRA in the UK, while the PRA was also the Group's supervisor. During the reporting period the Group operated as a non-life insurer in the UK through ANDIE and through ANDIE's branches in Belgium, France, Germany, Italy and Spain. The Group's life insurer ANDLIE operated in Germany and in a number of other continental European countries through freedom of services arrangements. On 1 March 2019 both ANDIE and the Group's insurance intermediary TIM migrated to Luxembourg. At this date the Group set up a freedom of establishment branch in the UK to continue to serve the Group's UK customers.

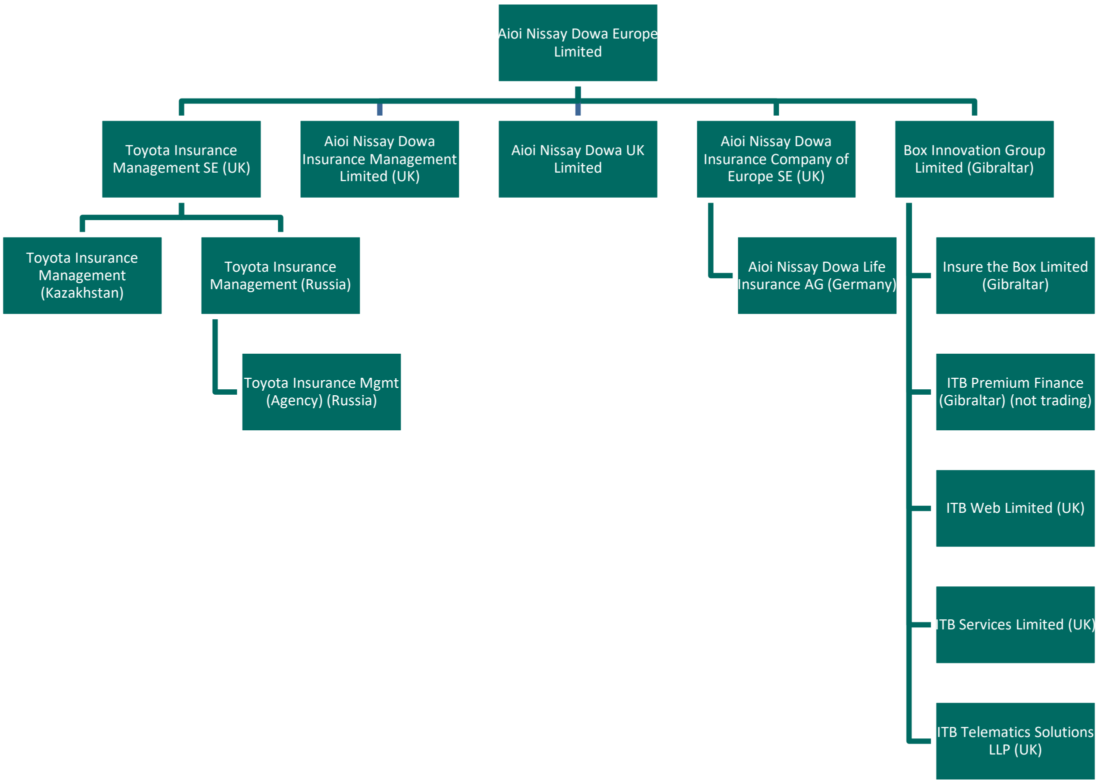
At the year-end, ANDEL had five subsidiaries:

- Aioi Nissay Dowa Insurance Management Ltd, which is incorporated in the United Kingdom and supplies insurance management services to the Company and the Group (100% owned) ("ANDIM");
- Aioi Nissay Dowa Insurance Company of Europe SE, incorporated in the UK (100% owned) ("ANDIE"). On 1 March 2019 ANDIE migrated to Luxembourg and is now Luxembourg-registered and regulated by the CAA;
- Aioi Nissay Dowa UK Limited, incorporated in the UK and which is expected to be the Group's UK insurance carrier following receipt of its insurance licence from the UK regulatory authorities (100% owned) ("AND UK");
- Toyota Insurance Management SE, incorporated in the United Kingdom and is a provider of insurance consultancy services (75% owned) ("TIM"). On 1 March 2019 TIM migrated to Luxembourg and is now Luxembourg-registered and regulated as an insurance agent by the CAA; and
- Box Innovation Group Ltd, which is incorporated in Gibraltar and is a holding company (100% owned) ("BIGL").

Through its subsidiaries, the Group had an interest in the following entities:

- Aioi Nissay Dowa Life Insurance of Europe AG, which is incorporated and regulated in Germany and is a credit life insurance company (100% owned by ANDIE; 100% effective interest) ("ANDLIE");
- Toyota Insurance Management (Insurance Brokers) LLC, which is incorporated in Russia and is a provider of insurance consultancy services (100% owned by TIM; 75% effective interest);
- Toyota Insurance Management (Insurance Brokers) LLP, which is incorporated in Kazakhstan and is a provider of insurance consultancy services (100% owned by TIM; 75% effective interest);
- LLC Toyota Insurance Management (Insurance Agency), which is incorporated in Russia and is a provider of insurance consultancy services (99.9% owned by TIM and 0.1% owned by ANDIM; 75% effective interest);
- ITB Web Ltd, which is incorporated in the United Kingdom and is a provider of insurance consultancy services (100% effective interest);
- Insure The Box Ltd, which is incorporated in Gibraltar and is a managing general agent (100% effective interest);
- ITB Services Ltd, which is incorporated in the United Kingdom and is a provider of insurance management services (100% effective interest);
- ITB Telematics Solutions LLP, which is incorporated in the United Kingdom and is a provider of insurance consultancy services (100% effective interest); and
- ITB Premium Finance Ltd, which is incorporated in Gibraltar and which is not currently trading (100% effective interest).

As at the year-end, the Group's structure was as follows:



Since the year end Aioi Nissay Dowa Insurance Company of Europe SE and Toyota Insurance Management SE redomiciled from the UK to Luxembourg. Other than this the structure as presented as above is unchanged.

Scope of the Group used for consolidated financial statements and scope for the Group for Solvency II purposes

The consolidated financial statements incorporate the financial statements of the holding company ANDEL and entities controlled by ANDEL (its subsidiaries). Intercompany transactions and balances and between Group companies are eliminated in the consolidated financial statements.

For Solvency II purposes, the Group has used the accounting consolidation-based method to prepare its Group balance sheet, which is the default method prescribed by the regulations. The consolidation-based method differs from the IFRS consolidation used in the Group financial statements because only the holding company itself (ANDEL), its insurance undertakings (ANDIE and ANDLIE) and the ancillary services undertaking ANDIM are fully consolidated, with intra-group transactions between these four entities eliminated, while the Group's non-insurance subsidiaries are treated as participations, with the net asset value (calculated in accordance with Solvency II valuation rules) included in the Group's balance sheet. Intra-group transactions with the non-insurance subsidiaries are not eliminated.

Any significant business or other events that have occurred over the year that have had a material impact on the undertaking

Group reorganisation

The Group currently relies on so-called "passporting" permissions to function across the European Economic Area ("EEA"), either through freedom of establishment or freedom of services. The possibility of a "hard Brexit", with no transitional arrangements in place for trading in the EEA after the date when the UK leaves the European Union ("EU") and no passporting in either direction, posed a threat to this operating model.

The Group prepared for this scenario by reorganising its corporate structure. This consisted of:

- Converting ANDIE and TIM to "Societas Europaea" ("SE") form and re-domiciling them to Luxembourg. The re-domicile of both companies occurred on 1 March 2019;
- Creating a new entity, ANDEL, to act as the new holding company for the Group. ANDEL became the Group's holding company on 11 April 2018; and
- Applying for authorisation for a new insurance company in the UK, Aioi Nissay Dowa UK Limited ("AND UK"). This regulatory application is in the process of being finalised.

The conversion to SE form and the re-domicile to Luxembourg of ANDIE and TIM has enabled the existing business model in the EU and the EEA to continue largely unaffected, with the European branch structures of the two companies preserved during the process. Following the migration to Luxembourg, ANDIE and TIM have also set up freedom of establishment branches in the UK. With the UK branches in place, the two companies will either be able to continue to operate in the UK through passporting – if there is a Brexit transition agreement – or under the "temporary permissions regime" in the event of a "no deal" Brexit. The temporary permissions regime is designed to allow firms which passport in to the UK to continue the existing scope of activities (including new business) for a period of up to three years after the date when the UK leaves the EU.

ANDEL became the Group's holding company on 11 April 2018. This was achieved by ANDEL issuing £350m of shares to its Japanese parent company ADJ in exchange for ADJ's shares in the ANDIE group. Subsequently, ANDIE made distributions in kind of its material subsidiaries other than ANDLIE. ANDLIE continued as a subsidiary of ANDIE in order to enable its parent to convert to an SE legal form; the Group intends to move ANDLIE under the holding company ANDEL in due course. The liquidation of ANDIE's other remaining subsidiary, which was not material to the Group or its solvency position, was completed in December 2018.

While ANDIE can serve existing and new UK customers through its UK branch, the Group's intention is to write new business in the UK through a new UK insurance company, AND UK. The Group is currently finalising its application to the UK regulators, the PRA and the FCA, for a new insurance company licence. It expects to begin to write through the new company later during 2019, at which point it will be re-named Aioi Nissay Dowa Insurance UK Limited ("ANDI UK"). The Group is committed to the UK market and to its UK operations, customers and staff, and the Group's headquarters remains in London.

The aim of the Group's Brexit contingency project was to ensure that there would be no disruption to the Group's ability to serve its customers or to the level of cover, expertise and service that those customers received. The Group is pleased to have delivered on this objective and to be able to continue to operate across both the UK and the EEA.

Box Innovation Group Limited

In December 2017, the Group agreed with the minority shareholders of BIGL to purchase the remaining 24.99% of shares that it did not already own. This transaction was completed on 3 April 2018, when ANDIE purchased the shares held in BIGL by minority interests. Subsequently ANDIE distributed 100% of its investment in BIGL to its parent company, ANDEL.

Capital injection

The Group's parent company ADJ made a capital injection of £180m in April 2018. Although the Group has continued to be loss-making the capital injection means that the Group's solvency position is very comfortable, with Solvency II own funds comfortably in excess of its SCR. The capital injection has greatly strengthened the Group's position as it seeks to meet its ambitious business plan and to develop the opportunity presented by telematics, not just in the UK but also in Europe. In the future, the Group will also need to hold more capital across its insurance companies (ANDIE, ANDLIE, and, subject to authorisation, AND UK) than has been the case in the past, these increased capital requirements being a direct consequence of the Brexit-enforced restructuring undertaken by the Group.

Change in UK service provider

In November 2018, the Group changed its UK service provider from Ageas Retail Limited to the Lloyd Latchford Group (for sales and service) and FMG Limited (for claims). There were no changes to service levels provided to customers as a result of this change.

A2. Underwriting performance

The following table summarises the underwriting performance of the Group as per the Group's financial statements:

	2018 £'000	2017 £'000
Gross written premiums	338,103	372,503
Net earned premiums	209,720	208,610
Net claims incurred	124,679	142,055
Loss ratio	59.5%	68.1%

The Group's gross written premium ("GWP") for general insurance reduced from £353.4m to £316.2m during the year, while the GWP of the credit life insurance business of its German subsidiary ANDLIE increased, from £19m to £21.9m.

General insurance premium income includes retail motor and related products, the ITB portfolio and a motor fleet and motor-related commercial Japanese Interests Abroad ("JIA") business. Retail motor and JIA (excluding ITB) grew by 5.6% from £217.2m to £229.4m due to strong performances in several markets, particularly Germany. Generally sales across the Group's pre-ITB business were in line with expectations.

Life GWP grew to 6.5% of the Group's GWP (2017: 5.1%). The business is simple life assurance policies, sold as part of the financing of new car sales. Most of the current business remains in Germany, although the business has grown significantly in France and in Spain.

ITB underwriting contributed £86.8m (2017: £136.3m) to the Group's GWP during the year. Premium for the full year was significantly lower than expected; market conditions were difficult and the Group chose to maintain underwriting discipline rather than seeking to preserve volume.

The performance by the main geographical regions is summarised in the tables below:

	United Kingdom	Germany	Italy	France	Spain	Belgium
	2018 £'000	2018 £'000	2018 £'000	2018 £'000	2018 £'000	2018 £'000
Gross written premiums	145,520	100,929	48,462	33,469	8,545	1,178
Net earned premiums	82,023	61,382	34,547	24,408	7,362	-
Net claims incurred	63,646	31,511	14,004	10,103	5,415	-
Loss ratio	77.6%	51.3%	40.5%	41.4%	73.6%	-

	United Kingdom 2017 £'000	Germany 2017 £'000	Italy 2017 £'000	France 2017 £'000	Spain 2017 £'000	Belgium 2017 £'000
Gross written premiums	195,746	89,865	45,060	29,860	7,306	4,666
Net earned premiums	97,242	55,598	31,137	18,421	6,212	-
Net claims incurred	82,844	27,327	14,206	9,364	4,954	-
Loss ratio	85.2%	49.2%	45.6%	50.8%	79.7%	-

A3. Investment performance

The Group invests principally in high quality corporate, agency and supra-national fixed income securities. ANDLIE has a small equity portfolio, but this is not a major part of the Group's holdings. The Group also has significant money market holdings with high quality investment managers. The overall portfolio is highly liquid. The Group has outsourced the management of its bond and equity portfolios, through managers in the UK (for the Group, including ANDIE) and in Germany (for ANDLIE).

Within the Group's financial statements, the fixed income and equity securities are treated as "available for sale" ("AFS") financial assets. All unrealised gains and losses on AFS financial assets are recognized through other comprehensive income, so do not directly affect the Group's reported income statement result. The money market holdings are treated as cash equivalents as they are short-term, highly liquid investments which are subject to insignificant changes in value and are readily convertible into known amounts of cash.

	2018 £'000	2017 £'000
Income from AFS debt securities	8,179	7,090
Income from AFS equity securities	37	49
Cash and cash equivalents interest income	1,006	197
Exchange gains / (losses)	714	1,520
Income from investment property	(6)	(3)
Realised losses	(35)	-
Total investment income	**9,895**	**8,853**

A4. Performance of other activities

The other income and expenses of the Group are as follows:

	2018 £'000	2017 £'000
Service fees	3,417	3,384
Commissions	9,084	17,722
Ancillary income	1,752	1,084
Staff costs	40,388	38,912
Other operating expenses	72,574	67,748
Lease costs	2,387	2,201

The Group's service fee income derives from the provision of administrative services to Toyota. Commissions and ancillary income are generated from two sources: first, from the Group's broking and managing general agent subsidiaries, which receive commission from third parties either for the placing of insurance business or where the Group sells insurance products when it is not acting as underwriter. Secondly, the Group receives overrider commission income where it has agreed quota share arrangements with reinsurers (often the parent company ADJ), whereby the reinsurer pays the Group a commission. Staff costs relate to staff salaries, bonuses and social security costs. Operating expenses are business expenses which are not directly related to the settlement or handling of claims. Lease costs are mainly for the rental of office space.

A5. Other information

No other information.

A6. Group's business and performance

The Group's legal and organisational structure is set out above in section A1. The governance structure which operates at Group level is set out in section B.

Other than the subsidiaries listed in section A1, the key related party for the Group is the Company's parent company (and main reinsurer) ADJ.

Excluding transactions between ANDEL, ANDIE, ANDLIE and ANDIM (eliminated within the Solvency II data used for consolidation), the significant related party transactions are:

	Type of transaction	2018 £'000	2017 £'000
ADJ	Reinsurance transactions (net)	10,207	(18,022)
TIM	Commission payments	(12,301)	(11,364)
BIGL	Intra-group funding	(3,000)	(2,000)
ITB	Commission payments	(23,282)	(36,037)

B. System of Governance

B1. General governance arrangements

The system of governance, which is set out below, is considered to be appropriate for the Group taking into account the nature, scale and complexity of the risks inherent in the business. There were no material changes in the system of governance during the reporting period.

After the period ended, however, the Group's main operating subsidiary the non-life insurance company ANDIE and its insurance intermediary TIM re-domiciled to Luxembourg. This section describes the system of governance in place during the reporting period. The changes to the system of governance as a result of the move to Luxembourg are not expected to be material as regards the Group's overall operations. This is because the two companies which have migrated to Luxembourg will continue to be part of the Group's risk management system and the Group's Three Lines of Defence Model remains in place.

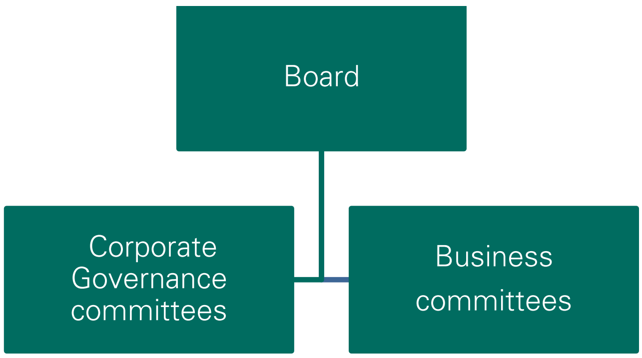
An overview of the changes to the Group's general governance arrangements as a result of the migration of ANDIE and TIM are described below on page 22, as they pertain to ANDEL.

Changes to the membership of the Board are set out below.

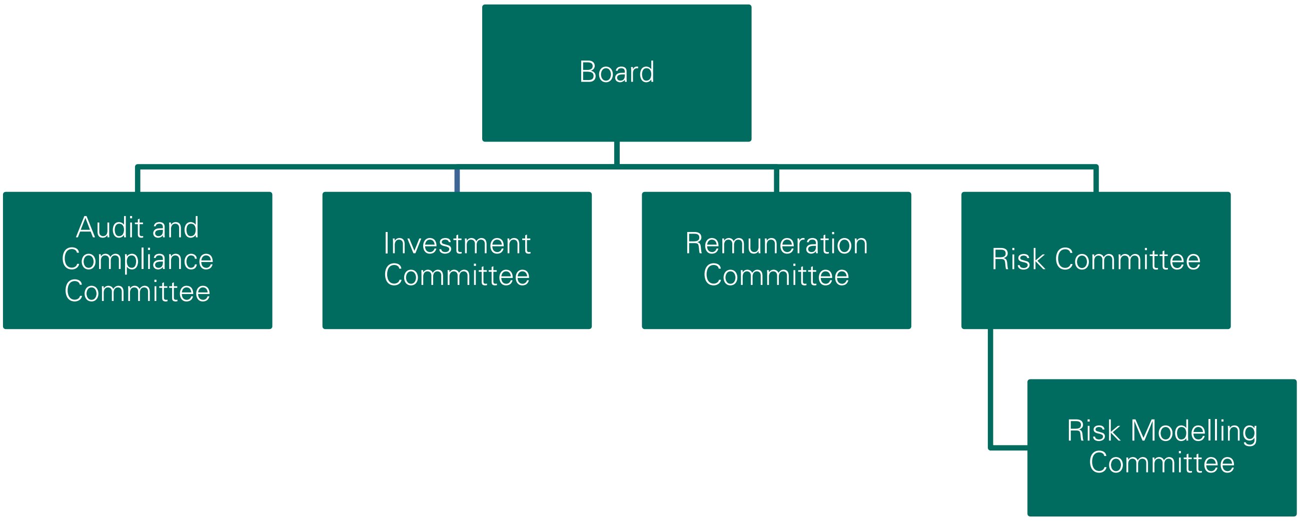
<u>Overview of the Board and its committees</u>

The Board is ultimately responsible and accountable for the performance and strategy of the Group and for ensuring that the Group complies with all legal, statutory, regulatory and administrative requirements. To support the efficient management of the Group the Board has delegated certain functions to committees, though by doing this the Board does not absolve itself of its ultimate responsibility for the Group.

The established corporate governance framework is as follows:



The Corporate Governance committees are structured as follows:



The Business committees are structured as follows:

The Board

The Board functions as the corporate decision-making body and provides entrepreneurial leadership of the Group within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets the strategic aims of the Group and ensures that the necessary resources, both financial and staff, are in place to allow the Group to meet its objectives. The Board is collectively responsible for the long-term success of the Group and delivery of sustainable value to its shareholder. The Board sets the strategy and risk appetite for the Group and approves capital and operating plans presented by management for the achievement of the strategic objectives it has set. Implementation of the strategy set by the Board is delegated to the Executive Directors' Committee which is led by the Chief Executive Officer.

The Board meets at least four times a year. It comprises of executive members (the Chief Executive Officer, the Chief Operating Officer and the Deputy Chief Executive Officer), independent non-executives, including the Chairman, and non-executive members who are employees of the Company's parent ADJ and who act as shareholder representatives.

As at 31 December 2018, the members of the Board are as follows (all were appointed 8 November 2017 unless stated):

- R McCorriston — Chairman
- M Swanborough — Chief Executive
- H Clarke — Independent non-executive director
- J Crotty — Independent non-executive director (appointed 8 October 2018)
- M Kainzbauer — Chief Operating Officer
- M Kitahara — Non-executive director, shareholder representative (appointed 8 October 2018)
- H Matsui — Non-executive director, shareholder representative
- K Ohnishi — Deputy Chief Executive
- M Yamaguchi — Non-executive director, shareholder representative (appointed 8 October 2018)

Previously M Umezu, K Asai and H Doisaki were directors of ANDEL, having been appointed on 8 November 2017. They resigned on 30 April 2018.

Audit and Compliance Committee

The Audit and Compliance Committee is a key element of the Group's internal control framework. The Committee controls and monitors the activities of the Group's audit and compliance activities, which are the key oversight and assurance functions at the core of the Group's second and third lines of defence. The Committee is responsible for Internal Audit, the Group's audited accounts and financial and other statutory and regulatory reporting, oversight of the relationship with the Group's external auditors, and Compliance.

The Audit Committee is responsible for assessing the performance, quality and remuneration of the Internal Audit provider. The CEO will advise and consult with the Audit Committee on the appointment of or any change to, outsource service providers undertaking Internal Audits and obtain their agreement prior to their appointment.

To ensure independence, the Internal Audit function is directly accountable to the Chairman of the Audit Committee but reports on a daily basis to the Chief Executive Officer through the Risk and Audit Manager.

Under guidance from the Board the Committee is responsible for reviewing and if deemed suitable recommending that the Group's statutory accounts be placed before the Board for signing. The committee will receive the report of the independent auditors. Furthermore, the non-executive members of the committee will have the opportunity to discuss in private with the external auditors any matters arising, or any matters the auditors feel should be brought to their attention.

The Committee meets at least four times a year. It comprises of the Group's non-executive directors, with other directors and members of the executive management attending as appropriate.

Investment Committee

The Investment Committee is responsible for the management and administration of the Group's investments, for oversight of all treasury activity and the funding of all operating units. The Committee considers the investment and treasury strategies of the Group, translates the investment risk appetite of the Group into an investment policy, and monitors the cash flow and working capital of the Group. The Committee also oversees the performance of the Group's outsourced investment management provider.

The Committee meets at least four times a year. The Committee is chaired by the Group's Chief Executive Officer. In addition to the Chief Executive Officer, the Committee's members are the Group's Chairman, the Deputy Chief Executive Officer and three members of executive management, including the Group's Chief Financial Officer and the Chief Actuary.

Remuneration Committee

The Remuneration Committee is responsible for considering and approving the remuneration and benefits of all locally employed executive directors of the Group. The Committee comprises the Group's Chairman and one non-executive director who is employed by the Company's parent ADJ. The Committee is chaired by the Group's Chairman. The Committee meets at least once per year.

Risk Committee

The Risk Committee is responsible for providing focused support and advice on risk governance to the Board, for ensuring that material risks facing the Group have been identified and that appropriate arrangements are in place to manage those risks effectively in accordance with the risk appetite set by the Board.

The Committee meets at least four times a year. It is chaired by an independent non-executive director. There are two further independent non-executive director members of the Committee, including the Group's Chairman. Other members of the Committee are the Chief Executive, the Chief Operating Officer, the Deputy Chief Executive and the Company's Head of Risk Management.

Risk Modelling Committee

The Risk Modelling Committee is a sub-committee of the Risk Committee. Its responsibility is to propose, for approval by the Risk Committee, policies, specifications and schedules of activity relating to the appropriate modification, application and validation of risk modelling techniques utilised by the Company and its subsidiaries (collectively, the "adopted risk modelling approach") and to provide oversight of risk modelling activity relative to that adopted approach.

The Committee meets at least four times a year. The Committee is chaired by an independent non-executive director. In addition to the non-executive director, the Committee's members are the Chief Executive Officer and three members of executive management, including the Group's Chief Actuary.

Executive Directors' Committee

The purpose of the Executive Directors' Committees is to manage generally the business of the Group within the agreed financial limits and risk parameters set by the Board. Subject to these financial limits, the Committee has primary authority for the day to day management of the Group's operations save for those matters which are reserved for the Board and the Board's committees.

The Committee comprises three members, the Chief Executive Officer, the Chief Operating Officer and the Deputy Chief Executive Officer. The Committee is chaired by the Chief Executive Officer. Meetings take place at least eleven times a year. Members of executive management are typically invited to attend the meetings.

Reserving Committee

The purpose of the Reserving Committee is to set the reserving policy for the Group and to monitor ongoing compliance with that policy. The Committee receives reserve reports from the Actuarial function, covering best estimates and risks and provides input and challenge to the best estimates and the risk assessment. The Committee determines the amount of reserves to be booked in the Group's IFRS accounts and the level of Solvency II technical provisions. It provides a quarterly written report to the Risk Committee on the current level of reserving risk faced by the Group, the Group's adherence to reserving risk appetite and the reserving risks which may arise in the future.

The Committee meets at least six times a year. The Chair of the Committee is the Chief Executive Officer. In addition to the Chief Executive Officer, the Committee members are the Deputy Chief Executive Officer, the Chief Operating Officer and three members of executive management: the Group's Chief Actuary, the Chief Financial Officer and the Group Head of Claims.

ANDLIE has its own actuarial function, which is responsible for calculating ANDLIE's actuarial reserves in accordance with legal and regulatory requirements. The monitoring of ANDLIE's reserves is carried by ANDLIE's own board of directors and ultimately by the ANDIE Board.

Outwards Reinsurance Committee

The purpose of the Committee is to ensure that the Company's outwards reinsurance programme is enacted correctly and in line with the Board approved risk appetite and other relevant policies. The Committee is charged with formulating and placing the most appropriate reinsurance programme and monitoring the programme to ensure the company remains protected.

The Committee reports to the Executive Directors' Committee and the Risk Committee and meets at least four times a year. The Committee is chaired by the Chief Executive Officer. Members of the Committee include the Chief Financial Officer, the Group Head of Claims and the Chief Actuary.

Underwriting and Pricing Committee

The Committee is responsible for putting in place the pricing and underwriting policies for the Group and for monitoring compliance with those policies. The Committee agrees performance benchmarks for the Group's insurance portfolios and monitors compliance with those benchmarks. It also reviews and approves new underwriting products or portfolios. The Committee provides a written report to the Risk Committee on the current underwriting risks faced by the Group, the Group's adherence to underwriting risk and the underwriting risks which may arise in the future.

The Committee meets at least four times a year. Membership of the Committee comprises at least one representative from each of the Company's branches or underwriting business units and one representative from each of the Finance, Actuarial and Pricing functions. The Committee is chaired by the Group's Chief Actuary.

ANDLIE has its own actuarial function, responsible for overseeing the underwriting policy and reinsurance. The monitoring of ANDLIE's underwriting is undertaken by ANDLIE's own board of directors and ultimately by the ANDIE Board.

Remuneration Policy

The Group remuneration policy is designed so as to attract and retain suitable employees to assist the Group in meeting its aims. The Group seeks to provide a base salary together with a benefits package that will ensure the long-term security and health of its employees. Salaries and benefits are reviewed regularly to take account of the performance of the Group and the latest employment trends. The Group is committed to being a fair and equal employer and the remuneration policy is designed in order to support this objective. In the UK, there are two employing entities, ANDEL as the Group's holding company and regional headquarters and ANDIM as the management services company. In those countries where the Group has branches, the branches themselves (of either ANDIE or TIM) are the employing entities, while ANDLIE also has employees.

The most important element of remuneration for the Group's employees is base salary. The Group considers that its base salaries are competitive in the market and appropriate for attracting and retaining the right staff. All salaries are reviewed in accordance with market practice and with any statutory, regulatory or taxation requirements in the individual country.

Depending on local market practice, the Group operates an annual bonus plan based on business unit and individual employee performance. The objective of the bonus scheme is to offer participants an incentive to contribute to the Group's performance by linking pay to performance in areas within the employee's influence and control. The bonus amount payable for each employee depends on the achievement of set financial objectives, evaluation of performance against a competency matrix and evaluation on the contribution to the Group's performance through the successful completion of individual objectives. The variable element of remuneration is capped at a percentage of fixed salary, such as to promote sound and effective risk management and to avoid excessive risk taking.

The Group also offers a range of benefits to employees, which vary by individual country. In the UK, where the majority of the Group's employees are based, the Group operates a company pension scheme and pays contributions to the scheme on behalf of employees based on a percentage of salary. The scheme is a defined contribution scheme and the assets of the scheme are held separately from the Group in independently administered funds. Employees contribute additional voluntary contributions to suit their circumstances. Pension arrangements also exist in other countries. The Group has no defined benefit pension liabilities.

Other benefits depend on the country in question and vary according to local custom and practice, statutory and regulatory requirements, taxation treatments and individual employee needs. Among the benefits offered are life assurance, private medical insurance, permanent health insurance, company car, sports club memberships, salary sacrifice options and long service awards.

The Group does not operate any share option schemes and no shares in the Group are held by employees. There is a cash-based long-term incentive plan for local executive directors. This is capped at a level well within regulatory codes. From time to time there may be specific project-based bonuses for staff involved in critical multi-year projects.

<u>The Group's system of governance from 1 March 2019</u>

There have been a number of changes to the Group's system of governance as a result of the migration of ANDIE and TIM to Luxembourg and the fact that ANDEL now exists as a distinct holding company.

The key changes are:

- Each of ANDIE and (once licensed) AND UK has their own Underwriting and Pricing Committee.
- Each of ANDIE and (once licensed) AND UK has an Audit, Risk and Compliance Committee.
- ANDEL itself has a Group Risk Assurance Committee, replacing the Group Audit and Compliance Committee and the Group Risk Committee which existed previously.
- There will continue to be a Group Outwards Reinsurance Committee, which will oversee the reinsurance arrangements for the Group as a whole, including the insurance subsidiaries ANDIE and AND UK.
- The Group Executive Directors' Committee will consider those matters which pertain to the Group as a whole or are sufficiently material to require a Group-level discussion. Each of ANDIE and (once licensed) AND UK has its own monthly management committee, which will consider matters which pertain to that entity specifically.

Overall these changes are not anticipated to have a material impact on the way that the Group operates or on its system of governance.

B2. Fit and proper policy

The Group is committed to ensuring that all its staff have the appropriate skills, knowledge and experience to perform their roles and this is set out in the Group's governance manual and in its policies and procedures.

<u>Assessment of fitness and propriety</u>

When appointing any member of staff, including members of the Board, senior management and other key functions, as part of the process the Group considers whether the candidate is fit and proper to undertake the required role. This means that the following in particular are considered:

- Professional qualifications, knowledge and experience, and whether these are appropriate for performance of the role; and
- Good reputation and integrity.

In addition staff should be sufficiently qualified to enable them to discharge their duties. In significant areas of responsibility, senior management and those undertaking other key functions should be qualified to provide sound and prudent management of the Group.

Appropriate policies and processes have been established for assessing and ensuring ongoing compliance with fitness and propriety requirements.

Technical and professional development

All employees' training needs are assessed upon joining and at regular intervals thereafter (including if their role changes). Appropriate training and support is provided to ensure that any relevant training needs are satisfied. The quality and effectiveness of such training is reviewed by the Human Resources department.

All employees' competence is reviewed on a regular and frequent basis and appropriate action is taken to ensure that they remain competent for their role. Maintaining competence will take into account, where relevant, such matters as:

- Technical knowledge and its application;
- Skills and expertise; and
- Changes in the market to products, legislation and regulation.

"Competence" means having the skills, knowledge and expertise needed to discharge the responsibilities of an employee's role. This includes achieving a good standard of ethical behaviour.

B3. Risk Management System, including the Own Risk and Solvency Assessment

As an insurance group, the Group is fundamentally concerned with the management of risk and the Group maintains a risk management system.

Enterprise risk management framework

The Group operates an enterprise-wide risk management framework that is designed to identify, evaluate, manage and monitor exposure to risk. The process is subject to continuous review and development. The risk management system must comply with regulatory standards at all times.

The risk management systems and processes are required to cover all risks included in the calculation of the SCR, and so must cover the following areas:

- Underwriting and reserving;
- Asset-liability management;
- Investment activity;
- Liquidity and concentration risk;
- Operational risk; and
- Reinsurance and other risk mitigation techniques.

Group, branch and departmental management are required to identify, assess, manage and monitor their key risks, within the risk management framework overseen by the Risk Committee. The Head Office risk management team is responsible for making available appropriate risk management tools to support the business in the evaluation and reporting of risks. Risk management tools are designed to be easy to understand and capable of being applied consistently at all levels of the organisation. The overall risk management system provides for the aggregation of risk management information as required by the Board and the Board committees.

The risk management framework covers the management of the risk categories and sub-categories as detailed in the Board's Risk Appetite Statement.

The high level risk categories currently set out in that document are:

- Strategic risk (including reputational risk);
- Insurance risk;
- Credit risk;
- Market risk;
- Operational risk;
- Liquidity risk; and
- Financial risk.

The assessment of capital requirements (for both internal and regulatory capital measures) is based explicitly on the risks identified and evaluated through the processes. For regulatory purposes, the Group uses the standard formula without undertaking-specific parameters to assess the solvency capital requirements and an internal model is not used.

The risk management framework supports the achievement of the Group's objectives by providing a structured mechanism for assessing the impact of decisions on capital requirements and capital efficiency, and the range of outcomes from each potential decision.

Risk and capital management principles are required to be embedded into a number of business processes and decision frameworks, including pricing assessment, asset allocation, reinsurance purchase, counterparty selection, reserve assessment and capital planning.

Business change initiatives that require senior manager or Board level approval are required to include an assessment of the inherent risks involved and any anticipated change to the Group's overall risk profile. The Group Project Management Office also reports to the Risk Committee on business change initiatives.

Three Lines of Defence Model

The Group operates a Three Lines of Defence Model as part of its overall control environment and its risk management system. The main elements of the Three Lines of Defence Model may be summarised as follows:

- First line: the first level of the control environment is the business operations which perform the day-to-day risk management activity.
- Second line: these are the oversight functions of the Group, such as Risk and Compliance, and also include financial controls. These functions set direction, define policy and provide assurance.
- Third line: internal audit is the third line of defence. Internal Audit offers independent challenge to the levels of assurance provided by business operations and oversight functions.

There is a regular flow of information across the three lines of defence and from the three lines to the governing bodies (Board and Committees). Likewise, executive decisions and directions flow in the opposite direction from the governing bodies.

Own Risk and Solvency Assessment

The Own Risk and Solvency Assessment ("ORSA") process is part of the Group's risk management system. Insurance undertakings are required to assess their own short- and long-term risks and the amount of own funds necessary to cover them. The ORSA is the process used to assess the Group's overall solvency needs based on a forward-looking assessment of the Group's risk profile, risk tolerance and business plan. It is used to identify, quantify, monitor, manage and report on the risks that the Group may face.

The Group has not completed a full capital model which combines its non-life and life insurance subsidiaries. While there is a theoretical additional level of precision which could be derived from combining the ANDIE and ANDLIE figures, the benefit would be marginal compared to the level of effort required to model risks fully on a combined basis. Instead, the Board has approved an approach which, for ORSA purposes, combines the capital requirements calculated on a solo basis for ANDIE but with a recalculation of the diversification benefit.

For the Group standard formula SCR, however, the Group has performed a full consolidation of the data of ANDEL, ANDIE, ANDLIE and ANDIM, as required by the Solvency II regulations (see section E4 for further details).

The ORSA considers all the key risks that face the business including those not in the SCR such as liquidity, group, reputational and regulatory risks, as well as those in the SCR. Both internal and external risks are considered.

The full ORSA process is performed at least annually, and a report is produced by the Risk Management function on the results. Many of the structures and analyses which underlie the ORSA process are on-going parts of the risk management framework; nonetheless the Board considers that an annual review cycle is proportionate to the nature and scale of the risks which the Group faces. In addition, a full ORSA process would be run and a report produced as soon as practically possible following any significant change in the Group's risk profile. These changes could affect both the internal and external risk environment. These changes could include, but are not limited to the following events, where they have the potential to significantly alter the Group's overall risk profile:

- The start of a new line of business;
- A change in risk tolerance limits;
- A change to reinsurance or other risk mitigation arrangements;
- A portfolio transfer;
- Major changes in asset mix;
- Changes to our business or capital plans;
- Occurrence of risk events leading to a significant change in available capital and solvency; and
- An external change which significantly affects the risk profile of either the Group or the markets in which it operates.

The Risk Management function will assess the impact of a change in risk profile and advise the Board whether a full ORSA process needs to be run and a full set of documentation produced. The Board can request that the ORSA process is run even if the Risk Management function determines it is not necessary.

The Board reviews the ORSA report and uses this to guide key decisions for the business, such as:

- Deciding the Group's strategy and setting the risk appetite;
- Agreeing the business plan for the Group;
- Any necessary risk mitigation actions;
- Forward looking identification and assessment of material risks arising from the business strategy or in the business plan;

- Challenging the results of the standard formula SCR calculation; and
- Assessing the Group's short- and long-term capital position.

In relation to the SCR, the Group produces a five-year projection of the Group's SCR position in line with the Group's business plan horizon. The ORSA, which is prepared on a three-year basis, is compared to the results of the SCR projection at the three-year point to determine whether additional solvency cover is required. The outcome of this assessment is recorded in the ORSA report and shared with the regulator.

B4. Overview of Internal Control System

Internal controls are the processes established by the Board to provide reasonable assurance of effectively and efficiently meeting, inter alia, the Group's various operational, financial and compliance objectives.

The system of internal control includes all policies and procedures adopted by management to assist in achieving the Group's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business.

The system of internal control relates to every aspect of the Group's operations, including but not limited to the:

- Adherence to management policies;
- Safeguarding of assets;
- Prevention and detection of fraud and error;
- Accuracy and completeness of accounting records; and
- Timely preparation of reliable financial information.

System of internal control objectives

Senior managers (who typically attend the Executive Directors' Committee) are charged with the responsibility for designing, implementing and communicating a network of procedures and processes. These have the objective of controlling the operations of the Group in a manner which provides the Board with reasonable assurance that:

- Data and information published either internally or externally is accurate, reliable, complete and timely;
- The actions of all employees follow the Group's policies, standards, plans and procedures, and all relevant laws and regulations;
- The Group's resources (including its people, systems, data / information bases, and client goodwill) are adequately protected; and
- The Group's internal controls promote the achievement of the Group's plans, programs, goals and objectives.

Components of internal control

The following components make up the Group's system of internal control and help to achieve the objectives of controlling the operations of the Group:

a) Control Environment
b) Risk Assessment
c) Control Activities
d) Information and Communication
e) Monitoring

a. Control Environment

The control environment is set by the Board and senior management in line with the Group's risk appetite as well as its priorities and direction. The control environment sets the tone for the Group. It provides discipline and structure and strongly influences the control consciousness of all staff. Key factors in the control environment include the integrity, ethical values and competence of all personnel.

The Board is responsible for:

- Approving and periodically reviewing the overall business strategies and significant policies of the Group;
- Understanding the major risks run by the Group, setting acceptable levels for these risks and ensuring that senior management takes the steps necessary to identify, measure, monitor and control these risks;
- Approving the organisational structure; and
- Ensuring that senior management is monitoring the effectiveness of the internal control system.

The Board is ultimately responsible for ensuring that an adequate and effective system of internal control is established and maintained.

Senior management is responsible for:

- Implementing the strategies and policies approved by the Board;
- Developing processes that identify, measure, monitor and control risks incurred by the Group;
- Maintaining an organisational structure that clearly assigns responsibility, authority and reporting relationships;
- Ensuring that delegated responsibilities are effectively carried out;
- Setting appropriate internal control policies; and
- Monitoring the adequacy and effectiveness of the internal control system.

Both the Board and senior management are responsible for promoting high ethical and integrity standards, and for establishing and communicating a culture within the Group that emphasises and demonstrates to all levels of personnel the importance of internal controls.

b. Risk Assessment

Risk assessment is the identification and analysis of relevant risks which may prevent the Group or a specific business unit from meeting its operational, financial and compliance objectives. The Risk Committee identifies risks affecting the Group, both internally and externally, and recommends risk strategy to the Board.

c. Control Activities

Control activities are the policies and procedures established to ensure that Board and senior management's directives are implemented, and risks identified are mitigated. All employees need to be aware of the Group's policies and procedures. Managers should supplement these with departmental guidance where necessary.

Control is a function of management and is an integral part of the overall process of managing operations. As such, it is the responsibility of managers at all levels of the Group to:

- Identify and evaluate the exposures to loss relating to their sphere of operations;
- Specify and establish policies, plans, and operating standards, procedures, systems, and other disciplines to be used to minimise, mitigate, and/or limit the risks associated with the exposures identified;

- Establish practical controlling processes that require and encourage all employees to carry out their duties and responsibilities in a manner that achieves the control objectives outlined above; and
- Maintain the effectiveness of the controlling processes established and foster continuous improvement to these processes.

d. Information and Communication

Pertinent information must be identified, captured and communicated in a form and timeframe that enables staff to carry out their responsibilities. Continuous communication is essential to the effectiveness of the system of internal control and reaching its objectives.

e. Monitoring

Monitoring is the process that assesses the quality of the internal control system and follows the three lines of defence philosophy. The Group requires the following monitoring to take place:

- Managers are responsible for monitoring activities performed within their department;
- The Compliance function assesses the appropriateness of and compliance with the Group's policies and procedures;
- Internal Audit is responsible for examining and evaluating the functioning and adequacy of the internal controls and compliance with policies and procedures; and
- The Audit and Compliance Committee reviews the effectiveness of monitoring actions.

<u>Compliance Function</u>

The Compliance Function is responsible for:

- Ensuring that the Group complies with all applicable laws and regulatory requirements as well as with all internal policies, processes and procedures; and
- Reporting to management and the Audit and Compliance Committee on the appropriateness of the Group's compliance procedures; following up identified deficiencies and suggesting improvements as necessary.

The Compliance Function comprises the Head of Compliance supported by two employees in the UK, while there are also employees in the overseas branches who have specific compliance responsibilities. The Compliance Function reports to the Chief Executive Officer and has independent access to the Audit and Compliance Committee. The Head of Compliance also attends the Executive Directors' Committee and acts as Secretary to the Board.

As noted above on page 22, the changes to the Group's system of governance following the Brexit-driven restructure mean that there is no longer a Group Audit and Compliance Committee. An Audit, Risk and Compliance Committee now exists for each of ANDIE and AND UK, and each of these entities will have its own Head of Compliance. The Head of Compliance for each entity reports to the relevant company committee and on a day-to-day basis to the Group Risk Assurance Director, who attends the Group Risk and Assurance Committee.

B5. Internal Audit Function

The Board has established an Internal Audit Function, which is the third line of defence in the Group. Internal Audit is independent from all operational activities.

The Internal Audit Function is charged with the responsibility for:

- Ascertaining that the ongoing processes for controlling operations throughout the Group are adequately designed and are functioning in an effective manner; and

- Reporting to management and the Audit and Compliance Committee of the Board on the adequacy and effectiveness of the Group's systems of internal control, together with recommendations to improve the systems.

The Internal Audit Function at the Group is overseen by the Audit and Compliance Committee. In this capacity, the Audit and Compliance Committee is responsible for agreeing an annual programme of internal audit activity, overseeing the performance of internal audits and determining that all major issues reported by the Internal Audit function have been satisfactorily addressed.

On a day-to-day basis the internal audit activity is overseen by the Director of Internal Audit. The Group uses third-party providers for the performance of internal audits as required. The use of third-party providers of internal audit skills helps to ensure the independence of the function and provides the business with a wider range of skills for carrying out audit activities than might be available if the Function was staffed internally. Internal Audit reports through the Audit and Compliance Committee quarterly but also has a regular reporting line to the Chief Executive Officer. Internal Audit is also able to report directly to the Audit and Compliance Committee outside the regular committee meetings.

B6. Actuarial Function

After the reporting period, the Group has made changes to its arrangements for actuarial function holders. These changes have been to meet the challenge of having three licensed insurance carriers once its Brexit-driven restructure is complete:

- Once AND UK has received its insurance licence, the Group is intending that the role of actuarial function holder of AND UK will be outsourced to a specialist third party provider. The individual in the role will have a direct reporting line to the Chief Executive Officer. The day-to-day actuarial work in support of the holder of the function will be carried out by the Group's internal actuarial resources.
- The role of actuarial function holder for ANDIE will be carried out by one of the Group's qualified actuaries, who possesses the relevant qualifications, skills and experience to undertake the role.
- ANDLIE will continue to have its own actuarial function holder, a qualified actuary who is a member of the ANDLIE board of directors.

The Group will continue to ensure that the holders of the actuarial function for the Group's three insurance entities have suitable ability, experience, resources and independence to carry out the prescribed tasks, as set out in the Solvency II legislation.

During the reporting period, the Group had an internal Actuarial Function. The head of the Actuarial Function, the Chief Actuary (SIMF20), is a member of the Institute and Faculty of Actuaries, holds a relevant Practising Certificate and has complied continuously with the specific professional obligations that this requires. The wider actuarial function is made up of members and trainees of the Institute and Faculty of Actuaries, members of equivalent international actuarial bodies, analysts and data management specialists, all of whom comply with relevant professional obligations. The Chief Actuary attends the Executive Directors' Committee and reports directly to the Company's Chief Executive Officer. The Chief Actuary has suitable ability, experience, resources and independence to carry out the prescribed tasks of the function holder.

The Actuarial Function is responsible for:

- Co-ordinating the calculation of technical provisions;
- Reviewing the appropriateness of the models and assumptions and considering the sufficiency and quality of data used in the Group's risk and solvency assessments;
- Providing an opinion to the Risk Committee on the Group's underwriting policy and effectiveness of reinsurance; and
- Producing the annual actuarial report.

In addition to the prescribed responsibilities, the Chief Actuary exercises oversight of the Underwriting and Pricing Committee the Reserving Committee.

B7. Outsourcing

The Group considers outsourcing arrangements for an activity when it is not cost-effective or possible to carry out the activity internally. The Group recognises that it remains responsible for discharging all legal and regulatory responsibilities relating to the outsourced activity.

To reduce the risks associated with outsourcing, the Group has an established outsourcing policy. This policy covers the following:

- Assessment of outsourcing risks;
- Choice of outsource service provider;
- Definition of contractual requirements and confidentiality arrangements; and
- Audits and monitoring of controls.

The Executive Directors' Committee is responsible for designating suitable owners for each outsourced arrangement, overseeing the outsourced activities and ensuring that the outsourcing policy is followed. Each outsourced business process has an owner, responsible for ensuring that appropriate controls to manage the risks from outsourcing are in place and that there is regular monitoring of performance. Outsourced business process owners work in conjunction with Risk Management, Compliance and other functions including IT, Legal and Human Resources.

The Group is currently using several service providers to undertake critical or important functions on its behalf. Details of these are as follows:

a. Underwriting

The Group has engaged with third party organisations, typically through delegated underwriting authority, for the underwriting of certain products and / or business lines. Outsourced underwriting is performed in several countries, the most significant of which are with the Group's subsidiary Insure the Box in the UK, with Lloyd Latchford (previously Ageas) in the UK, with Liberty Seguros in Spain, with Gjensidige in Norway and Codan in Denmark.

b. Claims

There are outsourced claims handling and settlement arrangements, again typically through delegated claims authority, for claims for certain products and / or business lines. Outsourced claims handling is performed in France, Belgium, Germany, Holland, Norway, Finland, Denmark, Italy, Spain and the UK. The most significant of these arrangements are with the Group's subsidiary Insure the Box and FMG Group (previously Ageas) in the UK, with Liberty Seguros in Spain, with Gjensidige in Norway and Codan in Denmark.

c. Audits

The Group uses outsourced claims audit providers in the UK and France. The Group also uses third-party providers for the performance of internal audits as required.

d. Business continuity planning

The Group has a reciprocal premises agreement with its sister company Mitsui Sumitomo Insurance Europe in the UK.

e. Human Resources

The Group uses outsourced payroll services providers in several the countries in which it operates. The UK was previously the most significant user of outsourced payroll services. This function is now carried out by Insure the Box Limited, the Group's 100% owned subsidiary.

f. Investment management

The Group has outsourced the management of its bond portfolio to Goldman Sachs Asset Management, based in London, and to DEVK Asset Management GmbH in Germany (for ANDLIE only).

B8. Other information

No other information.

B9. Group's system of governance

The Group operates an enterprise-wide risk management framework, and this is applied consistently across all the Group undertakings within the scope of group supervision. The risk management framework is described in section B3.

The Group's management services provider, ANDIM, provides management services to ANDIE and TIM within the UK. In the European branches of ANDIE, the employees are employed by ANDIE itself. The employees of ANDIE provide management services (including IT, facilities, finance and risk) to ANDLIE, with these arrangements being governed by service level agreements.

The sum of the SCRs for the insurance entities within the Group (ANDIE and ANDLIE) is greater on an aggregation and deduction basis (the alternative method for calculating group solvency) than it is using the accounting consolidation approach, the default method and the one used by the Group. On an aggregation and deduction basis, the combined solo SCRs of ANDIE (£98.9m) and ANDLIE (£6.5m) are £105.4m, whereas the Group SCR calculated on a consolidation basis is £97.7m. The difference is due to several diversification effects of calculating a consolidated Group SCR using the standard formula. More detail on the diversification effects is provided in Section E4.

C. Risk Profile

Overall responsibility for the management of the Group's exposure to risk lies with the Board. To support it in its role, the Board has established an enterprise risk management framework comprising risk identification, risk assessment, control and reporting processes. The Board is assisted in its oversight of the risk management framework by the Corporate Governance and Business committees.

The Group's risk profile is not expected to change materially because of its Brexit-driven restructure.

C1. Insurance risk

Nature of the risk

This is the risk that arises from the inherent uncertainty as to the occurrence, amount and timing of insurance liabilities. It manifests itself in variability in the contribution towards expenses and profits.

The risk arises both from current year activity (premium risk) and the run-off of claims which occurred in prior years (reserving risk).

Methods used to assess and quantify the risk

The Group also assesses its underwriting risk through experience analysis (analysis of actual performance against the performance expected according to the Group's business plan) and through its reserving process, which is overseen by the Reserving Committee.

Insurance risks are quantified using a simulation model which is used to assess variability of the contribution compared to the business plan.

Risk parameters are selected for the following variables, for each portfolio individually, and the simulation model is used to create a distribution of values for each portfolio to identify the portfolios with the greatest contribution to the overall insurance risk:

- Volume of business;
- Current year loss ratio
- Reserve run-off.

a. Volume of business

The risk of the volume of business being higher or lower than expected, for example due to higher or lower levels of new business, or changes in the rate at which customers renew their policies.

b. Current year loss ratio

The risk of the current loss ratio being different from the expected level, due to market wide trends or company specific variability.

Some examples of market-wide trends are claims inflation, changes in the level of competition, etc. In effect this represents the variability that exists within each market's insurance cycle.

Separate risk parameters are selected for frequency and severity of small, large and natural catastrophe claims. Deviation from plan can occur due to natural random variability but can also be because of variation in the Company's success at achieving planned claims savings. The most significant natural catastrophe exposures faced by the Group are hail in Germany and Italy, windstorm in Germany, and UK and flood in Germany and UK.

The mitigating impact of excess of loss and quota-share reinsurance is incorporated into the model, to ensure that the result net of reinsurance can be estimated appropriately.

c. Reserve run-off

The risk of changes in the estimated ultimate cost of claims, for example due to unexpected levels of incurred cost development, unexpected levels of late-developing large claims, higher than expected inflation, emergence of new information that, if known earlier, would have led to the selection of a different ultimate cost, etc.

Risk mitigation

Disciplined underwriting including appropriate risk management and pricing control is essential to the Group's success. The Group maintains underwriting and claims policies which define the approach in respect of risk selection and management and each underwriter has an individual mandate governing the acceptance of risks based on their competence. The Group makes use of its own data in making such decisions supplemented by data and advice from expert third parties and insurance partners. In addition, the Group has a centrally managed forum reviewing underwriting issues and performance, including the approval of new products.

Reinsurance is used to manage insurance risk. Much of the reinsurance is placed with the Company's parent, ADJ, which is A+ rated. The Group also enters into quota share and co-insurance arrangements with third parties. These arrangements vary depending on the product and country in question. The Group also places an excess of loss programme with a high-quality panel of reinsurers, including its parent company. The risk of default by reinsurers is discussed in the section on Credit risk.

Risk sensitivity for underwriting risks

The risk sensitivity for underwriting risks can be considered by assessing the impact of an increase in the Group's net loss ratio. For each 1% increase in the net loss ratio the Group's year-end solvency would be reduced by £2.0m. We anticipate a 15% or greater deterioration in net loss compared to plan, equivalent to a £25m reduction in solvency, on average 1 in 10 years.

The Group holds sufficient assets above the SCR to absorb a loss at this level.

C2. Market risk

Nature of the risk

This is the risk of external market influences affecting the Group's net asset value, for example changes in interest rates affecting the value of assets, changes in the levels of investment return, changes in exchange rates, etc.

At the end of 2018, the Group's investments consisted of £308.4m in bonds, £1.2m in equities and £214.4m in cash, deposits and money market funds. The Group also has subsidiary companies as detailed in the group structure chart in Section A1 and there is a risk that the valuations of these companies (treated as participations within the Solvency II balance sheet) will change because of their performance.

The bond portfolio is expected to be held until maturity. As mark-to-market pricing is required when drawing up the Solvency II balance sheet day-to-day market values have an effect on the available Solvency II capital. However, the mark-to-market movements do not affect the Group's cash flows from investments. The risk of being required to sell bonds at a loss to cover unexpected liabilities is considered under liquidity risk.

An alternative to investing in fixed income bonds is to invest in cash or money market funds. As at the end of 2018 the Group's cash holdings were £48.8m and money market fund holdings of £142m. Cash, deposits and money market funds are not typically affected by market value fluctuations and are therefore more secure from a capital point of view. However, investing in cash and money market funds introduces greater uncertainty as to the level of income that can be achieved, as this is affected by fluctuating (and persistently low) interest rates.

Other than subsidiaries held for strategic purposes, the Group's investment policy is to limit the amount of equities it holds. This is subject to ongoing review. Currently only ANDLIE has non-subsidiary equity investments, and these amount to £1.2m.

The Group has assets and liabilities in three main currencies: GBP, EUR and NOK. The Company also has some assets and liabilities in other currencies, but these are not material. Where there is a requirement to hold a certain level of capital in local currency for an overseas subsidiary (other than GBP, EUR and NOK) the approach is to hold the minimum required plus sufficient for projected operating cash flow requirements. As a result, Group's exposure to movements in currencies other than EUR and NOK is not significant.

Methods used to assess and quantify the risk

Market risks are quantified using a simulation model, separate from that used for insurance risks. Variability parameters for interest rates, bond yields and exchange rates for each currency are selected and the model is then used to create a distribution of the change in net asset and liability values due to each risk, from which the capital requirement can be measured.

- Bond yields – a range of potential movements in yields are chosen and the model calculates for each movement the impact on the value of each bond held;
- Exchange rates – a range of potential movements in exchange rates is chosen and the model calculates for each movement the impact on the GBP value of the Group's net assets; and
- Risk-free yields – a range of risk-free yields is chosen, and the model calculates the impact on the value of technical provisions and on investments.

Risk mitigation

The Group manages its market risk in several ways, among which the following can be highlighted:

- The Group has an asset liability management ("ALM") framework that has been developed to achieve investment returns in excess of obligations under insurance contracts. The principal technique of the ALM framework is to match assets to the liabilities arising from insurance contracts by reference to the expected timing of settlement of liabilities. The assets of ANDLIE, are managed separately from the general business but according to the same principles. The ALM framework is integrated with the management of the financial risks associated with the Group's other financial assets and liabilities not directly associated with insurance and investment liabilities;
- The Group monitors interest rate risk by calculating the mean duration of the investment portfolio and of the policyholder liabilities. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates. Any gap between the mean duration of the assets and the estimated mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations;
- The Group has a defined investment policy which sets limits on exposure to securities both in aggregate terms and by geography, industry and counterparty. Investment management meetings are held quarterly. The Group invests principally in high quality corporate bonds in the UK and Europe, with the average rating of the bond portfolio of A and duration of 3.9 years, as at the end of 2018. Corporate bonds below investment grade are not permitted.
- ANDIE maintains the outsourced management of its bond portfolio with Goldman Sachs Asset Management, while ANDLIE uses DEVK Asset Management.

- The Group seeks to mitigate the risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

The Group does not use derivative financial instruments.

Risk sensitivity for market risks

The Group's SCR is sensitive to movements in underlying foreign currency exchange rates. The Group is exposed to currency risk to the extent that the foreign currency denominated assets it holds do not match its liabilities in those currencies. The Group seeks to minimise this risk by matching its assets and liabilities by currency. The Group does not use hedging instruments to control the foreign exchange risk. At the balance sheet date, the Group had exposures in the following currencies:

	2018		2017	
	€'000	NOK'000	€'000	NOK'000
Assets	270,109	105,364	226,367	99,108
Liabilities	284,236	79,379	230,343	73,414
Unmatched exposure	14,127	25,985	3,976	25,694
Sterling equivalent	12,680	2,356	3,530	2,322

The impact of a 10% change in the value of Euros to Sterling is £1.2m and the impact of a 10% change in the value of NOK to Sterling is £0.2m.

The Group is exposed to movements in interest rates, which affect the value of the Group's mark-to-market financial investment holdings and the value of its technical provisions. The standard formula SCR calculation includes upward and downward interest rate shock scenarios. Neither the upward nor the downward shock has a material effect on the Group's SCR.

C3. Credit risk

Nature of the risk

Credit risk is the risk that counterparties will be unable to pay amounts in full when due. Key areas where the Group is exposed to credit risk are:

- exposure to corporate bonds;
- exposure to the failure of bank counterparties;
- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- amounts due from insurance contract holders; and
- amounts due from insurance intermediaries.

Methods used to assess and quantify the risk

The Group measures the capital requirement for credit risk using a simulation model to determine the distribution of the total amount of defaults. For each exposure, a probability of default, based on credit rating, is assumed and there is an assumed recovery percentage on default. We also make assumptions about the correlation between exposures, for example allowing for a 50% positive correlation between reinsurance counterparties due to the interconnected nature of the reinsurance market in which one event can hit many reinsurers simultaneously. Some debts are with counterparties which do not have credit ratings – for example, overdue premiums owed by insurance customers or intermediaries – and in this case the assumed default probabilities are higher, albeit the risk is diversified due to the number of policyholders and intermediaries. For the purposes of the Solvency II balance sheet, premium debtors over three months past due are written off in accordance with the requirements.

Risk mitigation

The Group's risk appetite places limits on credit risk by specifying the minimum credit rating that counterparty must have for us to do business with them. Reinsurers must have a credit rating of at least A-, and investment counterparties must have a rating of at least A- with the exception that the risk appetite permits a limited exposure to BBB bonds. In some cases, a counterparty's credit rating changes after a debt has been accrued, and the Group considers the appropriate response to this occurrence on a case by case basis. Typically, balances are minimised in response to a downgrade, and in some cases, we would no longer allow debt to accrue with a counterparty. The Group also considers the advice of its investment managers Goldman Sachs Asset Management and DEVK Asset Management (for ANDLIE).

The Group places limits on its exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments. The Group does not have an explicit limit on reinsurance with its parent ADJ. However, all intra-group reinsurance transactions are conducted on an arm's length basis and as such counterparty credit risk is assessed and managed.

The existence of reinsurance arrangements does not discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on an annual basis by reviewing their financial strength prior to finalisation of any contract. In addition, the recent payment history of reinsurers is used to update the reinsurance purchasing strategy. Much of the reinsurance is placed with the parent company, which is A+ rated.

Risk sensitivity for credit risks

The Group's largest single exposure is to its parent ADJ, which is A+ rated.

The Group has some exposure to BBB rated bonds. The total amount is not permitted to be more than 15% of the ANDIE bond portfolio and individual holdings in BBB investments are typically restricted to 1.25% of the ANDIE bond portfolio. All BBB investments are closely monitored with the assistance of Goldman Sachs Asset Management. As at the balance sheet date, the total BBB investment exposure was £40.5m (2017: £24.9m) which equates to approximately 13% of the total Group bond portfolio (2017: 12%). ANDLIE did not hold any fixed income investments with a rating below A-.

C4. Liquidity risk

Nature of the risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of borrowing facilities that should be in place to cover anticipated liabilities and unexpected levels of demand. The Group's portfolio is kept in highly liquid marketable securities to meet liabilities as they fall due.

Liquidity risk affects the Group in two main ways:

- Cash flow uncertainty. There can be an uncertainty in the liability, either in terms of its value or its timing. In either case, insufficient funds would be available to meet the requirement. This can arise because of claims (the most significant area), through a mismatch between the timing of gross claims being paid and reinsurance recoveries collected, from creditor invoices and expenses and from country risk and currency controls (where a sovereign may restrict the cross-border movement of cash).
- Asset values. There are several circumstances which can prevent or restrict the sale of an asset or access to liquid funds. These include the downgrade or failure of a counterparty, bank

failure or market or segment downturn. However, given the nature of the Group's investment portfolio this risk is deemed to be low.

Methods used to assess and quantify the risk

Liquidity risk is not considered to be a significant risk for the Group. Although there are scenarios in which the Group would not be able to meet its cash flow requirements as they fall due these are considered extreme.

Risk mitigation

The Group carries out the following to mitigate liquidity risk:

- Cash flow forecasting. The Group monitors its cash flows closely across all branches to ensure they are correctly funded and matches the cash flow of its assets and liabilities.
- A significant proportion of liquid assets are always held to meet expected liabilities.
- The investment policy has been set to avoid concentration risk and to ensure high quality liquid assets.
- Liquidity is regularly monitored by the Finance department and quarterly by the Investment Committee.

Risk sensitivity for liquidity risks

Cash, deposits and money market funds at the year-end totalled £214.4m. The insurance business is broadly cash neutral, with some fluctuations over the year. There are also £308.4m of fixed income bonds which are highly liquid in most market circumstances. It would therefore require an extreme cash flow shock for a material liquidity risk to arise.

C5. Operational risk

Nature of the risk

This is the risk that errors caused by people, processes or systems lead to losses to the Group, or the risk that arises from unanticipated or poorly anticipated external events.

Among the most important contributors to operational risk considered by the Group are:

- Internal and external fraud;
- Legal action against the Group;
- Significantly higher than expected inflation of costs;
- Changes in employment law;
- Improper market practices'
- Failure to comply with regulations;
- Project overruns or failures;
- Poor performance or failure of an outsourced provider;
- Business disruption and system failures;
- Damage to physical assets (e.g. due to natural catastrophe);
- Loss of key personnel;
- Pandemic; and
- Unexpected subsidiary funding requirements.

Methods used to assess and quantify the risk

The Group maintains a record of significant materialised risk events and takes account of materialised risk events within the wider market.

The Group maintains risk registers for each significant business function and unit. These are used to inform the approach for modelling operational risk, which relies on expert judgement on the likelihood and severity of various scenarios. The resulting risk profile for operational risk is assessed quantitatively and is incorporated in the assessment of solvency requirements.

Risk mitigation

The Group manages operational risk mainly through the use of detailed procedure manuals and a structured programme of testing of processes and systems, carried out by Internal Audit and by the parent company's Compliance and Internal Audit departments. The Group's enterprise risk management framework also requires all key functions and units to maintain risk registers, which are reviewed and challenged by the Risk Management Function, with a process of escalation of key issues to the Group's Risk Committee.

Risk sensitivity for operational risks

The operational risk per the SCR standard formula calculation is 13.7% (2017: 13.8%) of the Group SCR as at the balance sheet date. However, the Group's ORSA includes a higher amount for operational risk to reflect management and the Board's view that the Group's operational risk is higher than the SCR standard formula indicates. The increased operational risk derives from the recent large acquisition (of BIGL), the ongoing work on the integration of BIGL, the increased exposure of the business to the UK since the BIGL acquisition and the potential disruptions to the Group's business model because of Brexit. The analysis of operational risk carried out for the ORSA completed in September 2018 (based on data as at 31 December 2017) has arrived at an operational risk of £20m, which is 46% higher than the amount calculated according to the SCR standard formula. The SCR coverage ratio would be sufficient to absorb a loss at this level.

C6. Other risks

Strategic risk

Strategic risk is the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions and the lack of responsiveness to changes in the business environment.

Much of the Group's business relies on the parent company's relationship with Toyota. This mono-customer strategy (which applies to much of the business other than that written through the Insure The Box subsidiary) is the Group's most significant strategic risk, as according to our reverse stress testing exercise it is considered to be the risk that is most likely to render the business model unviable. While the Group has diversified its product base and its business lines the relationship with Toyota is likely to remain the largest single distribution channel for some time. This risk is mitigated by the close relationship at all levels with Toyota and in the medium-term by the diversification in our client base and distribution channels.

Reputational risk

Reputational risk is a form of strategic risk within the Group's risk taxonomy. Reputational risk is defined as the risk of losses because of damage to the reputation and brands of the Group or of other companies on which the Group's fortunes depend.

The main forms of reputational risk affecting the Group are:

- Damage to the Toyota brand, as much of the Company's business is Toyota branded;
- The Group's own reputation with Toyota and credibility as an insurance partner;
- Reputational damage to the Insure The Box brand; and
- Damage because of failures by out-sourced providers, co-insurance partners of problems in the wider MS&AD Insurance Group.

Issues from a Toyota perspective are largely confined to reductions in car sales and hence lower levels of new insurance business. This has been demonstrated by the effect on the business of various safety recalls that have been instigated by Toyota over the past few years. Retention was unaffected across all countries as customers were able to distinguish between the issues relating to the safety recall and the insurance product. In these circumstances the short-term financial impact is small, growing only over an extended period. The Group uses a wide range of outsourced suppliers, including co-insurance arrangements. Brand damage to a co-insurer would potentially be more visible and could have an impact on our operations although the focus of the branding is Toyota. Problems at other MS&AD group entities could also potentially affect relationships with regulators or other partners.

In terms of our own competitiveness and customer service the most important mitigation is to promote strong relationships at all levels to ensure problems are addressed and explained at an early stage to prevent escalation into more serious issues. This starts with regular reviews of key performance indictors and complaints to external management meetings at various levels to ensure that we are strategically and operationally aligned with Toyota.

With regard to the Insure The Box brand, specific actions have been taken to strengthen the management, governance and control structures since the acquisition and to begin to align the control environment with that of the Group. These changes are likely to help mitigate the potential for reputational damage.

C7. Other information

No other information.

C8. Group's risk profile

There are no other significant risk concentrations at the level of the Group beyond those detailed above.

D. Valuation for Solvency Purposes

The following table sets out the Group's assets and liabilities as at 31 December 2018:

	Statutory Accounts value	Reclassification/ valuation	Solvency II value
Assets:	**£'000**	**£'000**	**£'000**
Deferred acquisition costs	76,112	(76,112)	-
Intangible assets	15,332	(15,332)	-
Property, plant & equipment	6,983	(5,072)	1,912
Holdings in related undertakings	-	(6,309)	(6,309)
Equities	1,248	22	1,270
Bonds	308,384	3,818	312,202
Collective investment undertakings	-	142,044	142,044
Reinsurance recoverables	244,656	(28,933)	215,723
Insurance receivables	66,745	(11,633)	55,112
Cash and cash equivalents	214,425	(165,577)	48,848
Other assets	22,936	(10,324)	12,613
Total assets	**956,822**	**(173,407)**	**783,414**
Liabilities:			
Technical provisions – non-life	563,046	(101,053)	461,993
Technical provisions – health and life	11,857	146	12,003
Provisions other than technical provisions	-	1,120	1,120
Deferred tax	-	3,766	3,766
Insurance payables	16,105	(9,130)	6,976
Reinsurance payables	18,813	(14,692)	4,120
Other liabilities	43,769	(21,526)	22,244
Total liabilities	**653,590**	**(141,368)**	**512,221**
Excess assets over liabilities	**303,232**	**(32,039)**	**271,193**

D1. Assets

Below is set out the Solvency II valuation basis for each class of asset. Any significant differences in the valuation under Solvency II and the valuation under IFRS are explained for the class of asset in question. Technical provisions are discussed in section D2 and liabilities are considered in section D3.

<u>Deferred acquisition costs</u>

Under IFRS, deferred acquisition costs are earned over the term of the policy, in proportion to the earning of premium. Deferred acquisition costs are shown separately as an asset. Under Solvency II, however, there is no concept of deferred acquisition costs and the asset is written off. This is because although the amounts may not yet have been earned under IFRS they related to acquisition cash flows that have already been paid.

<u>Intangible assets</u>

Under Solvency II intangible assets are assigned a value only when they can be sold separately and a valuation can be derived from an active market for a similar intangible. As the intangibles of the Group do not meet these requirements no value is assigned to them for Solvency II reporting.

<u>Property, plant and equipment</u>

The Group's plant and equipment is held in the IFRS accounts at cost less depreciation. Solvency II requires them to be held at fair value. As active market valuations for the assets in question could not easily be obtained, the Group has written these assets off for the purposes of Solvency II. The remaining amount of £1.9m (2017: £0.7m) relates to property, which is held at fair value in the IFRS accounts and has been maintained at this value in the Solvency II balance sheet.

Holdings in related undertakings, including participations

The Group's IFRS consolidated financial statements consolidate the assets and liabilities of ANDEL and its subsidiaries. ANDEL directly owns 100% of the issued share capital of ANDIE, ANDIM, AND UK, BIGL and 75% of the issued share capital of TIM. ANDIE, BIGL and TIM have subsidiaries, so that the Group has an indirect investment in these subsidiary entities. Within the IFRS consolidation, ANDEL's investments in subsidiaries (both direct and indirect) are replaced by the underlying assets and liabilities of these subsidiaries.

The Group has used the accounting consolidation-based method to prepare its Group Solvency II balance sheet, which is the default method prescribed by the regulations. The consolidation-based method differs from the IFRS consolidation used in the Group financial statements because only the holding company itself (ANDEL), its insurance undertakings (ANDIE and ANDLIE) and the ancillary services undertaking ANDIM are fully consolidated, with intra-group transactions between these four entities eliminated, while the Group's non-insurance subsidiaries are treated as participations, with the net asset value (calculated in accordance with Solvency II valuation rules) included in the Group's balance sheet. Intra-group transactions with the non-insurance subsidiaries are not eliminated.

The holdings in AND UK, TIM and BIGL are valued using the adjusted equity method referred to in Article 13(b) of the Delegated Regulation as valuation in accordance with Article 10(2) of the Delegated Regulation is not possible:

- The valuation of ANDEL's 75% holding in TIM per the adjusted equity method is £(0.3)m (2017: £(0.2)m).
- The valuation of ANDEL's 100% holding in BIGL is £(5.8)m (2017: £(10.3)m). The negative valuation for BIGL is due to the removal of intangible assets and those fixed assets which cannot quickly be converted into cash, leaving BIGL with net liabilities on a Solvency II valuation basis.
- The valuation of ANDIE's 100% holding in AND UK is £0.1m (2017: £nil).

Equities

As at the reporting date the Group held equity investments of £0.8m (2017: £0.8m). The equity investments are held at fair values. Fair values are quoted prices, unadjusted, in active markets for identical assets ("Level 1 inputs"). The Group can access these quoted prices at the measurement date.

Bonds

As at the reporting date the Group held investments in fixed income securities of £312.2m (2017: £201m). The holdings are split between the asset classes government bonds, corporate bonds and collateralised securities. As at the reporting date, the balance held in each of these asset classes is £52.9m in government bonds (2017: £32.0m), £257.7m in corporate bonds (2017: £167.1m) and £1.6m in collateralised securities (2017: £1.7m).

The bond portfolio is valued at fair value based on the market price as at the reporting date, which are either Level 1 inputs or quoted prices for similar assets in active markets ("Level 2 inputs"). Quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The appropriate quoted market price for an asset held is usually the current bid price. Changes in the market value of the bonds are included in the reported value. There are no material estimates, assumptions or judgements made when reporting the value of the bonds. Under Solvency II the value reported includes any interest accrued on each holding as at the reporting date. Under IFRS this accrued interest is reported as a separate asset under "Other Assets".

The proportion of the bond portfolio valued using Level 1 inputs is 25% (2017: 14%) and the proportion valued using Level 2 inputs is 75% (2017: 86%).

Collective investments undertakings

Under IFRS assets held in short term deposits or collective investment schemes are reported as a component of cash and cash equivalents. Under Solvency II these are reported separately as collective investments undertakings.

As at the reporting date, the Group had £142m held in collective investments undertakings (2017: £122.7m). The collective investments undertakings are valued at fair value based on the market price as at the reporting date, which are quoted prices in active markets for identical assets. Quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The appropriate quoted market price for an asset held is usually the current bid price. Changes in the market value of the collective investments undertakings are included in the reported value. There are no material estimates, assumptions or judgements made when reporting the value of the collective investments undertakings.

Reinsurance recoverables

As at the balance sheet date the Group had reinsurance assets totalling £215.7m (2017: £210.0m). Technical provisions include the cash flows from amounts recoverable under programmes of reinsurance. The Group uses quota-share (proportional) reinsurance and excess of loss reinsurance:

- For the quota-share reinsurance arrangements, the cash flows are the relevant percentage of the gross cash flows. Where actuarial methods have been used for the gross best estimates, these are implicitly used to calculate quota share recoveries. A delay is included between the gross cash flows and the corresponding reinsurance recoveries; and
- For our excess of loss treaty, the expected recoveries are not determined using traditional actuarial methods. They are based on an individual assessment of each large claim by the relevant Branch claims manager with the cash flows modelled from the terms of the applicable reinsurance treaty.

Allowance has also been made for the possible default of a reinsurer, as prescribed under Solvency II, using the second highest credit rating for each reinsurance counterparty.

The reinsurance recoverables calculated as part of the Solvency II technical provisions replace the IFRS reinsurance recoverables, which are valued in accordance with the reinsurers' share of the IFRS insurance liabilities. Please refer to the technical provisions section D2 for further details.

Insurance and intermediaries receivables

As at the reporting date, the Group had £55.1m (2017: £52.1m) in insurance and intermediaries receivables. Insurance and intermediaries receivables comprise mostly of insurance premiums past due from policyholders or amounts due from intermediaries in relation to amounts collected from policyholders. The Group maintains a provision for doubtful debts, based on prior loss experience.

Receivables are initially recognised at transactional value plus directly related costs. They are subsequently measured at amortised cost using the effective interest rate method. As the majority of receivables are short-term in nature (and doubtful balances are provided for) the carrying value in the IFRS accounts is considered to approximate to fair value. Any discounting for the time value of money would not have a material effect. There are no material estimates, assumptions or judgements when reporting the value.

Cash and cash equivalents

As at the reporting date, the Group had £48.8m (2017: £47.8m) held as cash and cash equivalents. Cash and cash equivalents are valued at fair value as reported to the Group by the relevant financial institutions as at the reporting date. As these are cash amounts held in bank accounts the valuation does not rely on market prices. There are no material estimates, assumptions or judgements when reporting the value of cash and cash equivalents.

Any other assets, not elsewhere shown

As at the reporting date, the Group had £12.6m (2017: £16.5m) of other assets. As the majority of these assets are short-term in nature the carrying value in the IFRS accounts is considered to approximate to fair value. Any discounting for the time value of money would not have a material effect. There are no material estimates, assumptions or judgements when reporting the value of these assets.

D2. Technical provisions

The technical provisions comprise the claims technical provision, the premium technical provision (which together form the best estimate liability) and the risk margin. They are set in accordance with Solvency II regulations. As at 31 December 2018, the technical provisions were:

Class of business	2018 Net best estimate £'000	2018 Risk Margin £'000	2017 Net best estimate £'000	2017 Risk margin £'000
Motor third party liability	146,952	14,001	160,742	11,200
Motor other	58,714	2,922	59,219	2,944
Other life insurance	11,258	599	10,668	576
Other	22,066	1,762	21,788	1,562
Total	**238,990**	**19,284**	**252,417**	**16,282**

The technical provisions are split into the two largest Solvency II classes of business (both motor), the other life business (written by ANDLIE), with all other business (ANDIE and ANDLIE) grouped together in "Other". The majority of the business grouped into "Other" is the Solvency II class "Miscellaneous non-life insurance", which includes Guaranteed Asset Protection cover and Extended Warranty.

The basis on which the technical provisions is calculated is outlined below. While premium and claims patterns have been updated for another year's worth of business, there have been no material changes in assumptions made in the technical provisions calculation since the prior year. There are no material differences in bases, methods or assumptions for the different classes of business set out above.

Under Solvency II, the provision for outstanding claims is the best estimate of the cost of all existing open cases and all possible future claims. This contrasts with the value for technical provisions in the IFRS financial statements which is the undiscounted best estimate of all open cases plus future claims as far as they are represented in the claims history (or market history, depending on the method).

The difference between these two bases has been termed "Events Not In Data" or ENIDs by EIOPA. An allowance for ENIDs has been added to the Solvency II technical provisions by loading each future cash flow by a percentage which increases as the length of time to the cash flow increases. Due to the inherent difficulty of estimating the impact of events which have not occurred in the past and which have an extremely low likelihood, these percentages are extremely subjective. However, a recent benchmarking exercise carried out by an independent third party indicated that the Group's approach to ENIDs was broadly in line with that of peer entities.

The undiscounted best estimates in both cases (IFRS and Solvency II) have been calculated using standard deterministic actuarial models. For most classes, development factor (or "chain-ladder") methods have been used. For some liability classes, Bornheutter-Ferguson models (or similar methods which combine our own experience with an average market claims experience) have been used.

Future inflation is implicitly assumed to follow historic inflation except in the case of models based on market average experience where inflation is explicitly considered.

For each homogenous underwriting risk group, a premium payment pattern has been derived using historical data about policy lengths and frequency of premium payments. Future premium payments are calculated by applying these patterns to anticipated gross written premium.

The premium provision includes not only the unearned exposures at the balance sheet date but also the value of policies the Group has committed to writing at a future date but that have not incepted at that date. The contracts written by the Group are non-life business, do not include guaranteed renewals (either explicit or implicit), neither do they include any options or guarantees with a significant financial impact on the company. The contract boundary used is usually one year after inception, although there are contracts with shorter or longer terms. There is allowance for ENIDs for future claims in the premium provisions in the same way as for the outstanding claims provisions.

In some cases, there is insufficient historical data to derive the necessary cash-flow patterns for both premiums and claims. In these cases, cash flows are modelled in proportion to similar accounts where we do have sufficient data. These classes do not make up a significant proportion of the net best estimate as at 31 December 2018.

The technical provisions include a risk margin. A simplification has been used for the calculation of the margin, as permitted, by approximating the whole SCR for each future year using a ratio to technical provisions. This simplification is deemed appropriate because there are no negative best estimates at the valuation or subsequent dates, the Group's reinsurers are A rated or better and there are no unavoidable market risks.

Technical provisions include the cash flows from amounts recoverable under programmes of reinsurance. The Group uses quota-share (proportional) reinsurance and Excess of Loss reinsurance.

- For the quota-share reinsurance arrangements, the cash flows are the relevant percentage of the gross cash flows. Where actuarial methods have been used for the gross best estimates, these are implicitly used to calculate quota share recoveries. A delay is included between the gross cash flows and the corresponding reinsurance recoveries.
- For our excess of loss treaty, the expected recoveries are not determined using traditional actuarial methods. They are based on an individual assessment of each large claim by the relevant branch claims manager with the cash flows modelled from the terms of the applicable reinsurance treaty.

Allowance has also been made for the possible default of a reinsurer, as prescribed under Solvency II, using the second highest credit rating for each reinsurance counterparty.

For the life business underwritten by ANDLIE, the actuarial reserves are calculated separately for each insurance contract, considering the month of commencement. The calculation is carried out prospectively. The best estimate of the value of the reserves is calculated using the best estimate of the value of the termination rates and recovery rates. The risk-free yield curve is used for discounting. Costs that can be directly allocated to insurance obligations and allocated overheads are incorporated into the projection of the future costs. The risk margin is calculated as per section 58(b) of the Delegated Regulation, using the duration approach (level 3 in the hierarchy of simplifications for the calculation of the risk margin).

D3. Other liabilities

The following table sets out the Group's liabilities (other than technical provisions) as at 31 December 2018:

	2018 £'000	2017 £'000
Provisions other than technical provisions	1,119	864
Deferred tax	3,766	3,100
Insurance and intermediaries payable	6,976	8,239
Reinsurance payables	4,120	477
Any other liabilities	22,244	32,043

Below is set out the Solvency II valuation basis for each material class of liability. Any significant differences in the valuation under Solvency II and the valuation under IFRS is explained for the class of liability in question.

The Group does not have any material leasing arrangements.

Provisions other than technical provisions

Includes a provision for profit commission for reinsurance programmes and miscellaneous expense accruals.

Deferred tax

The deferred tax liability arises on temporary timing differences on the valuation of assets and liabilities under Solvency II. The liability has been calculated with reference to applicable regulations, tax laws and applicable tax rates.

Insurance and intermediaries payable

As at the reporting date, the Group had £7m (2017: £8.2m) of insurance and intermediaries payable. These comprise of direct insurance creditors £6m and other insurance payables of £1m. The insurance payables are valued in the IFRS accounts initially at fair value and subsequently at amortised cost using the effective interest rate method. However, as these liabilities represent the amounts to be paid to insurance claimants these amounts are not revalued to amortised cost as they are typically settled in the short-term, with the settlement amount rarely differing from the initial valuation. The IFRS valuation therefore substantially equates to fair value and there is no adjustment made for Solvency II valuation purposes. Similarly, there is no adjustment for the valuation of other insurance payables between the IFRS accounts and Solvency II. There are no material estimates, assumptions or judgements when reporting the value of insurance and intermediaries payable.

Reinsurance payables

As at the reporting date, the Group had £4.1m (2017: £0.5m) of reinsurance payables. Reinsurance payables represent premiums due to reinsurers. They are valued initially at transaction value plus attributable costs. They are subsequently measured at amortised cost using the effective interest rate method. As the majority of payables are short-term in nature the carrying value in the IFRS accounts is considered to approximate to fair value. Any discounting for the time value of money would not have a material effect. There are no material estimates, assumptions or judgements when reporting the value.

Any other liabilities, not elsewhere shown

As at the reporting date, the Group had £22.2m (2017: £32.0m) of other liabilities, not elsewhere shown. These amounts represent accruals and other liabilities. Accruals are recognised in line with IFRS, so the Group accrues when it is probable that the Group will be required to settle an obligation and a reliable estimate can be made of the amount of the obligation. Other liabilities are recognised initially at transaction value plus directly attributable costs. As the majority of liabilities are short-term in nature the carrying value in the IFRS accounts is considered to approximate to fair value. Any discounting for the time value of money would not have a material effect. There are no material estimates, assumptions or judgements when reporting the value.

D4. Alternative methods for valuation

There are no alternative methods of valuation employed.

D5. Other information

No other information.

D6. Group's valuation for solvency purposes

There are no differences between the valuation for solvency purposes used at group level for the valuation of the Group's assets, technical provisions and other liabilities and those used by the Group's subsidiaries. The valuations used for ANDIE's assets, technical provisions and other liabilities for group solvency purposes are the same as those used on a solo (company-only) basis. The valuations used for ANDLIE's assets, technical provisions and other liabilities are also consistent with the ANDLIE solo basis. The assets and liabilities of the other entities within the Group are valued in accordance with Solvency II valuation principles for both the solo and the group reporting.

E. Capital Management

E1. Own funds

The capital management objective of the Group is to maintain sufficient own funds to cover the SCR and the MCR with an appropriate buffer which takes account of the Group's growth ambitions as set out in its business plan. The Board and the Board Committees consider at least quarterly the ratio of eligible own funds over the SCR and MCR. The Group prepares solvency projections over a five-year period as part of the business planning process. The ORSA, which is prepared on a three-year basis, is compared to the results of the SCR projection at the three-year point to determine whether additional solvency cover is required. The outcome of this assessment is recorded in the ORSA report and shared with the regulator.

Own funds are the regulatory capital resources of an insurance undertaking or group under Solvency II. Own funds for the Group consist of the excess of assets over liabilities (including technical provisions), all of which are valued in accordance with Solvency II regulations.

As described in section D1, the Group has used the accounting consolidation-based method to calculate group solvency. Using this method, the own funds of the Group are calculated on the basis of consolidated data, being the line-by-line aggregation of the assets and liabilities of ANDEL, ANDIE, ANDLIE and ANDIM. The Group's non-insurance and non-regulated undertakings are consolidated as single-line participations. Details of the contributions of these participations to the Group's own funds are provided in section D1.

The Group's own funds comprise of paid in ordinary share capital and the reconciliation reserve. The share capital as at 31 December 2018 is fully paid up and comprises 350,010,000 ordinary shares with a par value of £1 each. There is a negative reconciliation reserve of £78.8m (2017: positive reconciliation reserve of £89.4m) as noted below:

	2018 £'000	2017 £'000
Excess of assets over liabilities	271,193	129,227
Less: ordinary share capital	(350,010)	(39,782)
Reconciliation reserve	(78,817)	89,445

The difference in the ordinary share capital and the reconciliation reserve from the prior year is partly due to the change in the Group's structure, with ANDEL now the Group's holding company whereas it was ANDIE in the previous year, and partly due to the Group's loss during the year.

All the Group's capital is tier one. The entirety of the Group's own funds are eligible to cover the SCR and the MCR. None of the Group's own funds are subject to transitional arrangements and the Group has no ancillary own funds. No deductions are applied to own funds and no own shares held. There are no significant restrictions affecting the availability and transferability of own funds within the Group, to cover either the SCR or the MCR. More detail on the transferability and fungibility of the Group's own funds is provided in section E4.

As at 31 December 2018, the net asset value of the Group as calculated under IFRS for statutory reporting purposes was £303.2m. This is a £129.4m increase since 31 December 2017. The table below shows the IFRS movement in net asset value:

	2018 £'000	2017 £'000
Brought forward 1 January	173,803	272,232
Capital increase	180,000	-
Result for the year	(45,844)	(94,419)
Movement in reserves	(4,726)	(4,009)
Carried forward 31 December	303,233	173,803

E1. Own funds (continued)

For Solvency II purposes, eligible own funds to meet the MCR and SCR were £271.2m (2017: £129.2m). The main differences between eligible own funds and the net asset value under IFRS are set out below.

	2018 £'000	2017 £'000	Reason
Net asset value per IFRS	303,232	173,804	Per accounts
Revaluation of net technical reserves	70,852	68,172	Differing reserving basis under Solvency II
Deferred acquisition cost	(76,112)	(76,458)	No DAC for Solvency II
Goodwill and intangibles	(15,332)	(29,729)	Written off for Solvency II
Holdings in related undertakings	(6,309)	(10,894)	Non-consolidated subsidiaries have a negative impact on Solvency II own funds
Other assets and liabilities	(5,138)	4,332	Net impact of adjustments to fair value
Own funds under Solvency II	271,193	129,227	Solvency II own funds

The movement of own funds on a Solvency II basis during 2018 was as follows:

	2018 £'000	2017 £'000
Own funds brought forward 1 January	129,227	161,221
Capital injection	180,000	-
Movement in year	(38,034)	(31,994)
Own funds as at 31 December	271,193	129,227

The SCR coverage ratio as at 31 December 2018 was 278%, with eligible own funds of £271.2m and an SCR of £97.7m. The MCR coverage ratio as at 31 December 2018 was 677%, with eligible own funds of £271.2m and an MCR of £40.0m. Annual and quarterly reporting throughout 2017 and 2018 have shown that the Group has complied continuously with both the MCR and the SCR throughout the reporting period.

E2. Solvency Capital Requirement and Minimum Capital Requirement

The standard formula is used to calculate the SCR, without modification for undertaking specific parameters. Other than the calculation of the risk margin in ANDLIE (which is not material to the Group, see section D2 for further details), the Group has not used any simplifications permitted by the regulations.

The table below shows the components of the SCR as at 31 December 2018:

Component	2018 £'000	2017 £'000
Non-life underwriting risk analysed by:		
- **Premium and reserve risk**	64,577	67,181
- **Catastrophe risk**	1,992	2,085
- **Lapse risk**	11,526	6,866
- **Diversification credit**	(11,979)	(8,052)
Health underwriting risk	9	9
Life underwriting risk analysed by:	-	
- **Mortality risk**	1,500	1,022

- **Disability risk**	1,873	1,843
- **Life expense risk**	373	318
- **Lapse risk**	210	106
- **Catastrophe risk**	2,508	1,983
- **Diversification credit**	(2,031)	(1,602)
Market risk analysed by:	-	
- **Interest rate risk**	5,161	134
- **Equity risk**	279	173
- **Property risk**	478	185
- **Spread risk**	15,588	8,774
- **Currency risk**	4,808	1,889
- **Concentration risk**	-	89
- **Diversification credit**	(7,369)	(1,519)
Counterparty default risk	17,761	22,416
Diversification credit	(22,911)	(18,632)
Operational risk	13,354	13,600
SCR	**97,710**	**98,868**
MCR	**40,050**	**43,271**

The inputs used to calculate the MCR are the net technical provisions and the net written premiums in the last twelve months. The Group's SCR is the sum of the MCR's for ANDIE and ANDLIE.

E3. Any other information

The Group does not use the duration-based equity risk sub-module in the calculation of the SCR.

The Group applies the standard formula and does not use an internal model for the purposes of calculating the SCR.

The Group has complied continuously with both the MCR and the SCR throughout the reporting period.

No other information.

E4. Group's capital management

The Group has used the accounting consolidation-based method to calculate the group solvency, which is the default method prescribed by the regulations. The consolidation-based method includes ANDEL, ANDIE, ANDLIE and ANDIM within the data on which the Group's SCR is calculated. Intra-group transactions between these three entities are eliminated. In effect, this method treats the insurance entities within the Group as if they were a single economic unit and allows for diversification benefits based on the consolidated data. The Group's non-insurance subsidiaries are treated as participations and intra-group transactions with them are not eliminated.

The Group has performed an analysis of the fungibility and transferability of the own funds within the Group. In order to be considered available to the Group, an item of own funds of a related insurance undertaking must be fungible (able to absorb any kind of loss wherever it arises in the Group) and transferable (capable of being transferred from one undertaking to another in the Group). The own funds must also be fungible and transferable within a maximum period of nine months.

Following this analysis, the Group does not consider that there are any significant restrictions to the fungibility and transferability of own funds eligible for covering the Group SCR or the MCR. In the event of needing to transfer own funds between entities in the Group, the Group would, in the case of ANDLIE and ANDIM, be able to pay dividends up to the parent entity, either ANDEL or ANDIE.

Moreover, the Group carries a negative charge for its investments in BIGL and TIM because these entities have net liabilities on a Solvency II basis. In practice, however, were capital to be needed elsewhere in the Group, the Group would not need to provide own funds to these entities as they are not subject to Solvency II capital requirements and they have net assets on an IFRS basis.

Treating ANDEL, ANDIE, ANDLIE and ANDIM as a single economic unit has some diversification effects on the Group SCR. There are no diversification effects on underwriting risk because ANDIE writes non-life business whereas ANDLIE is a life insurer. However, there are diversification effects on market risk, particularly on spread risk, concentration risk, counterparty default risk and the related diversification credits, as including the assets of ANDEL, ANDLIE and ANDIM alongside those of ANDIE means that the Group's assets are spread over a wider range of investments and counterparties than those of ANDIE are alone. Nonetheless, the impact of including ANDEL, ANDLIE and ANDIM in the calculation of the Group SCR only has a small effect on ANDIE's Solo SCR; ANDIE's Solo SCR is £98.9m while the Group SCR is £97.7m, reflecting the fact that ANDEL, ANDLIE and ANDIM are relatively small entities in comparison with ANDIE.

F. Templates

The following reporting templates are provided as appendices to this document, as required by the regulations:

Template name	Template code
Balance sheet	S.02.01.02
Premiums, claims and expenses by line of business	S.05.01.02
Premiums, claims and expenses by country	S.05.02.01
Own funds	S.23.01.22
Solvency capital requirement – on standard formula	S.25.01.22
Undertakings in the scope of the Group	S.32.01.22