

# AVIVA INVESTORS PENSIONS LIMITED

## 2016 SOLVENCY AND FINANCIAL CONDITION REPORT (SFCR)



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## Summary

### Executive Summary

The purpose of the Solvency Financial and Condition Report (SFCR) is to provide information about the capital position at 31 December 2016 of Aviva Investors Pensions Limited (AIPL, 'the Company') based on the Solvency II requirements.

This report sets out different aspects of AIPL's business and performance, system of governance, risk profile, valuation methods used for solvency purposes and its capital management practices.

### Business and performance

AIPL is a limited company incorporated and domiciled in the UK, which provides customers with long-term life insurance services in the form of a unit-linked pensions business and an annuities business.

In 2016, operating profit increased 29% to £1.8 million (2015: £1.4 million), mainly due to a one-off reinsurance premium payment of £0.5 million made in 2015. This payment was made in order for the annuities business reinsurance asset to rank *pari passu* with other liabilities of the reinsurer. There was no change in the operation of the business in the year.

Section A of this report sets out further details about AIPL's business structure, key operations, market position and financial performance over the reporting period, split by underwriting performance, investment performance, and performance from other activities.

### System of governance

The AIPL Board's (the Board) responsibility includes ensuring that an appropriate system of governance is in place throughout the Company. To discharge this responsibility, the Board has established frameworks for risk management and internal control using a 'three lines of defence' model and sets the Company's risk appetite. A strong system of governance throughout the Company aids effective decision-making and supports the achievement of the Company's objectives for the benefit of customers, shareholders and the UK regulators.

Section B of this report describes the system of governance in place throughout AIPL by which the operations of the Company are overseen, directed, managed and controlled, and explains how it complies with the requirements of Solvency II. It describes the following key features:

- The role and responsibility of the Board, its sub-committees and key management committees, and delegation of authority to senior management;
- The role and responsibilities of the four key control functions – Risk management, Actuarial, Compliance and Internal Audit – and how they are implemented within the Company;
- The remuneration policy, skills requirements and procedures for assessing fitness and propriety for senior management and key function holders;
- AIPL's Risk Management Framework (RMF) and its codification through risk policies and business standards, which sets out the risk strategy, appetite, framework and minimum requirements for AIPL's operations, and includes the Company's approach to its Own Risk and Solvency Assessment (ORSA) and governance over its capital model for Solvency II under the Standard Formula (SF) approach;
- How AIPL adheres to the Aviva Group (the Group) business standards which set out mandated control objectives and controls that mitigate operational risks faced by the Group, collectively providing the Group's framework of internal control; and

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- AIPL's outsourcing policy and information on important outsourced operational functions, including any intra-group outsourcing arrangements.

## Risk Profile

AIPL seeks to optimise its business performance subject to remaining within risk appetite and meeting the expectations of stakeholders. This is achieved by embedding rigorous and consistent risk management within the business.

The Board meets at least four times per annum and is responsible for the identification of AIPL's full spectrum of risks facing the business whilst achieving its strategic objectives as well as those risks to which it is not yet exposed, but may be in the future. The Board is responsible for the identification, measurement, management, monitoring and reporting of key, material, proximate and emerging risks which it does at least annually.

The types of risk to which AIPL is exposed have not changed significantly over the year and remain credit, market, lapse, expense, operational and liquidity risks. For those risk types managed through the holding of capital, AIPL measures and monitors risk profile on the basis of the Solvency Capital Requirement (SCR). As a result of EIOPA guidance issued in August 2016, a change was made to the application of contract boundaries in the year (section D 'Alternative methods of valuation'), which changed the proportional mix and overall quantum of capital held against the aforementioned risks (section E 'Capital management').

Some categories of risk are not measured and managed by holding capital, principally liquidity risk, which is measured through an absolute level target based on stress testing and the operational needs of the business.

In addition, through the ORSA process, management consider whether there are any risks not captured in the SCR for which AIPL should hold additional capital.

Section C of this report further describes the risks to which AIPL is exposed and how the Company measures, monitors, manages and mitigates these risks, including any changes in the year to risk exposures and specific risk mitigation actions taken.

## Valuation for Solvency Purposes

Assets, technical provisions and other liabilities are valued in AIPL's Solvency II balance sheet according to the Solvency II regulations. The principle that underlies the valuation methodology for Solvency II purposes is the amount for which they could be exchanged, transferred or settled by knowledgeable and willing third parties in an arms length transaction.

At 31 December 2016, AIPL's excess of assets over liabilities was £12.5 million on a Solvency II basis, which is £1.3 million higher than the value under International Financial Reporting Standards (IFRS). The difference is primarily driven by the difference in valuation of technical provisions and the consequent impact of tax. The value of technical provisions under Solvency II is equal to the sum of a best estimate liability and a risk margin.

Section D of this report provides further description of the bases, methods and main assumptions used in the valuation of assets, technical provisions and other liabilities for each material asset/liability class. In addition, it also provides an explanation of the material differences between the IFRS and Solvency II bases of valuation.

## Capital management

AIPL manages own funds in conjunction with solvency capital requirements as defined by the Solvency II framework. In the calculation of the SCR, management has chosen to implement the SF approach.

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In managing capital, AIPL seeks to, on a consistent basis:

- Maintain sufficient, but not excessive, financial strength in accordance with risk appetite and satisfy the requirements of the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), the dual regulators of the Company, and other stakeholders giving both customers and shareholders assurance of the Company's financial strength;
- Retain financial flexibility by maintaining strong liquidity; and
- Repatriate excess capital where appropriate.

At 31 December 2016, the total eligible own funds of £12.5 million was represented by unrestricted tier 1 capital. The SCR at 31 December 2016 was £7.4 million. This resulted in the overall AIPL surplus position of £5.1 million, which translates to a regulatory cover ratio of 170%.

Section E of this report further describes the objectives, policies and procedures employed by AIPL for managing its own funds. The section also covers information on structure and quality of own funds and calculation of SCR.

# Section A

## Business and Performance

### In this Chapter

A.1 Business

A.2 Underwriting performance

A.3 Investment performance

A.4 Performance of other activities

A.5 Any other information

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## SECTION A: BUSINESS AND PERFORMANCE

The 'Business and Performance' section of the report sets out Aviva Investors Pensions Limited's (hereafter AIPL or 'the Company') business structure, key operations and financial performance over the reporting period.

### A.1 Business

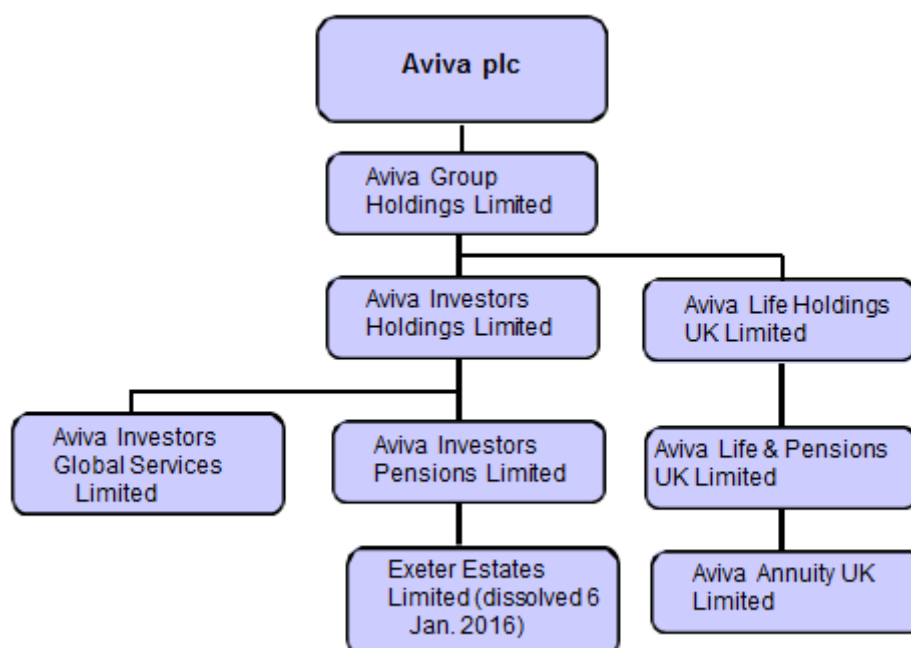
#### A.1.1 Business Overview

AIPL is a limited company incorporated, domiciled and operating in the United Kingdom (UK). Its principal activity is the provision and administration of unit-linked pension business in the UK. In addition to this, the Company holds a small annuity book, which is fully reinsured. AIPL is a wholly owned subsidiary within Aviva Investors, which, in turn, is part of the Aviva plc group (the Aviva Group).

AIPL manages eight unit-linked funds across fixed income, equities, property and multi-asset. The largest fund is the Property Fund which represent c.65% of the assets under management (AUM) in the fund range.

#### A.1.2 Organisational structure of the Group

The following chart shows, in simplified form, an extract of the Company's position within the structure of the Group and specific subsidiaries with whom AIPL has key relationships at 31 December 2016. Aviva plc is the ultimate parent of the Company and Aviva Investors Holdings Limited (AIHL) is the immediate parent and holding company of the Aviva Investors group of companies. AIPL had one wholly owned subsidiary at the start of the year (Exeter Estates Limited) which was dissolved on 6 January 2016.



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## A.1.3 Significant events in the reporting period

### Property fund

At the time of approving the Company's financial statements on 24 April 2017, the property fund was deferring redemption requests on a short term basis, with encashment of all redemptions in 2017 occurring the month following receipt of the redemption request. The Company is closely monitoring the deferral process.

### Change in contract boundaries

As a result of EIOPA guidance issued in August 2016, AIPL revised its approach to the use of contract boundaries for estimating the Solvency II technical provisions (both best estimate liabilities and risk margin) effectively removing the short contract boundary assumption. The Company issued £2 million in December 2016 of share capital to ensure that the business remained above its internal solvency risk appetite at all times following this change.

#### A.1.3.1 Subsequent events

##### Part VII transfer

As part of a proposal to rationalise the business the Company petitioned the High Court on 27 April 2017 to sanction an insurance business transfer scheme pursuant to Part VII of the Financial Services and Markets Act 2000 by which all of the in-force annuities business (with annuity liabilities of £8.7m on an International Financial Reporting Standards (IFRS) basis at 31 December 2016) would be transferred to Aviva Life and Pensions UK Limited, a fellow group company which currently fully reinsures the annuity policies and administers the annuity payments issued by the Company. The matter will be heard before a High Court Judge on 13 September 2017 and it is intended that the transfer will become effective on 1 October 2017.

## A.1.4 Other information

### Qualifying holdings

AIPL is a 100% subsidiary of AIHL and is a member of the Aviva plc group of companies. AIHL is the only qualifying holding as defined by Article 13(21) of Directive 2009/138/EC as AIHL has 100% of the voting rights and interest in AIPL.

### Supervisor

The Company is authorised by the Prudential Regulatory Authority (PRA) and regulated by the Financial Conduct Authority (FCA) in the UK. The PRA is part of the Bank of England. Contact details for the PRA are as follows:

Address	20 Moorgate, London, EC2R 6DA.
Telephone number	+44 (0) 20 7601 4444

### External auditor

The Company's external auditor is PricewaterhouseCoopers LLP. Contact details are as follows:

Address	7 More London Riverside, London, EC2R 6DA.
Telephone number	+44 (0) 20 7583 5000



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## A.2 Underwriting Performance

The Company charges unit-linked policyholders fees for policy administration, investment advisory for a range of pooled investment funds, and other contract services. The Company then delegates investment management to a fellow subsidiary, Aviva Investors Global Services Limited (AIGSL), on an arms length basis, for which it is charged a management fee. The excess of asset management charges over management fees payable to AIGSL is the principal profit generating activity of the Company.

Operating profit is the key performance metric used to manage performance within the Aviva Group. This is a non GAAP measure and in the case of AIPL is an appropriate measure of underwriting performance.

Operating profit is defined across Aviva Group as profit before income taxes, excluding the following items: investment return variances and economic assumption changes on long-term business, impairment of goodwill, associates, and joint ventures and other amounts expensed, amortisation and impairment of acquired value of in-force business, amortisation and impairment of other intangibles, profit or loss on the disposal and remeasurement of subsidiaries, joint ventures and associates, integration and restructuring costs and other items.

For AIPL, operating profit is aligned to profit before income taxes as outlined in Section A.2.1, 'Performance from underwriting and other activities'.

The annuity book closed to new business in July 2001 and as such there has been no premium income recognised in the Company's financial statements since this date.

### A.2.1 Performance from underwriting and other activities

Profit before tax as disclosed in the AIPL financial statements for full year 2016 represents the Company's overall performance over the reporting period. As noted earlier in this report, this metric represents the excess of asset management charges (revenue) paid by the policyholders of the unit-linked business over the underlying management fees paid to the AIGSL (administrative expenses) for management of the policyholder assets. The following table presents profit before tax for the year ended 31 December 2016 along with comparatives for 2015.

Statement of Comprehensive Income		
For the year ended 31 December 2016		
	2016	2015
	£m	£m
Income		
Revenue	8.8	9.2
Net investment income	74.3	151.7
Other income	0.1	0.3
	83.2	161.2
Expenses		
Claims payable	(0.5)	(0.5)
Less: reinsurer's share	0.5	0.5
Change in investment contract provisions	(73.8)	(150.5)
Administrative expenses	(7.2)	(8.1)
Other operating expenses	(0.4)	(1.2)
	(81.4)	(159.8)
Profit before tax	1.8	1.4
Tax expense	(0.4)	(0.3)
Profit for the year and total comprehensive income for the year	1.4	1.1

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Net investment income is attributable to policyholders and so is offset by corresponding changes in investment contract provisions and other operating expenses. Liabilities for unit-linked investment contracts have decreased to £1,571 million at 31 December 2016 (2015: £1,743 million) primarily due to redemptions of £256 million across 8 funds offset by net investment income of £74 million. As a result, asset management charges have decreased to £8.8 million for the full year 2016 (2015: £9.2 million). Management fees and other variable administrative costs paid to AIGSL have decreased accordingly to £7.2 million in the year (2015: £8.1 million). The 2015 administrative expenses balances also included an additional one off reinsurance premium of £0.5 million paid to Aviva UK Annuity Limited (UKA), a fellow subsidiary of Aviva plc, thereby increasing the year-on-year reduction in this balance. As a result, the 2016 profit before tax increased by £0.4 million to £1.8 million.

AIPL also has operating and finance lease arrangements within the Property Fund of the unit-linked pensions business. Further information regarding lease arrangements can be found in Section D.3.2, 'Lease arrangements'.

## A.3 Investment Performance

Net investment income as disclosed in the Company's financial statements represents the Group's overall investment performance for both policyholders and shareholders. Investment income consists of dividends, interest and rents receivable for the year, realised gains and losses, and unrealised gains and losses on investments held at fair value.

### Long-term insurance and savings business

Policyholders and shareholder funds are invested in order to generate a return for both policyholders and shareholders. The financial strength of the Company and both the current and future operating results and financial performance are, therefore, in part dependent on the quality and performance of these investment portfolios.

As different products vary in their cash flows and in the expectations placed upon them by policyholders, the Company may need to hold different types of investments in the different fund ranges to meet these different cash flows and expectations. With the unit-linked business, the primary objective is to maximise investment returns, subject to following an investment policy consistent with representations made to unit-linked policyholders. Shareholder exposure to loss on policyholder assets is limited to the extent that income arising from asset management charges is based on the value of assets in the funds.

### Annuity and other non-profit

The Company has transferred all risk and rewards associated with the annuities book of business to UKA via a reinsurance arrangement. As such, there is currently no investment risk to AIPL associated with the annuities and no matching assets on which investment returns are generated.<sup>1</sup>

#### A.3.1. Investment performance by asset class

Net investment income represents the Company's overall investment performance for both policyholders and shareholders. The following section summarises the Company's net investment income and provides an analysis of net investment income by fund type.

<sup>1</sup> On 1 January 2017, the annuity business reinsurance and policy administration transferred from Aviva UK Annuity Limited (UKA) to Aviva Life and Pensions UK Limited (UKLAP).

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## Net investment income – Total

2016 Net Investment Income – Total (£k)	Debt Securities	Equity Securities	Other financial investments	Investment property	Total
Dividends	319	1,816	1,121	-	3,256
Interest	7,180	1,444	589	-	9,213
Net realised gains	32,931	2,562	3,418	-	38,911
Net unrealised gains	15,591	14,111	5,832	-	35,534
Rental income less expenses	-	-	-	48,366	48,366
Realised losses on disposal of investment property	-	-	-	(1,112)	(1,112)
Unrealised losses on investment property	-	-	-	(59,945)	(59,945)
<b>Total</b>	<b>56,021</b>	<b>19,933</b>	<b>10,960</b>	<b>(12,691)</b>	<b>74,223</b>

Of the net investment income in the table above, £29,315 relates to the shareholder interest income on cash deposits (held in other financial assets above). The remainder relates to unit-linked policyholder assets. These assets are invested in line with the fund choices made by our unit-linked policyholders and the investment risk is borne by the policyholder. This results in a high allocation to long term investments such as debt and property.

### A.3.2 Gains and losses recognised directly in equity

AIPL has no gains or losses recognised directly in equity.

### A.3.3 Investments in securitisations

AIPL has no investments in securitisation vehicles.

## A.4 Performance of other activities

AIPL has no other material income and expenses in the year. In 2015, the Company paid an additional one-off reinsurance premium of £0.5 million to UKA (see Section A.2.1, 'Performance from underwriting and other activities') in order for the annuities business reinsurance asset to rank *pari passu* with other liabilities of the reinsurer (see section A.1.3 'Significant events in the reporting period').

## A.5 Any other information

There is no other material information regarding the business and performance of the Company during the year.

# Section B

## System of Governance

### In this Chapter

- B.1 General information on the system of governance
- B.2 Fit and proper policy
- B.3 Risk management system including the Own Risk and Solvency Assessment
- B.4 Internal control system
- B.5 Internal audit function
- B.6 Actuarial function
- B.7 Outsourcing
- B.8 Any other material information

## SECTION B: SYSTEM OF GOVERNANCE

This section of the report sets out information regarding the 'System of Governance' in place within AIPL. Details of the structure of AIPL's "administrative, management or supervisory body" (defined as including the Board and Board committees) are provided. The roles, responsibilities and governance of AIPL's key control functions (the Risk, Compliance, Internal Audit, Actuarial, People, Non-executive, Investment Management, Capital Management and Finance functions) are also provided. Other components of the system of governance are also outlined, including the risk management system and internal control system implemented across the business.

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

#### B.1.1 Overview of AIPL's system of governance

AIPL is a wholly owned subsidiary of Aviva Investors Holdings Limited (AIHL). AIHL is the holding company of the Aviva Investors business and is wholly owned by Aviva Group Holdings Limited which is in turn wholly owned by Aviva plc. The Aviva Group's system of governance is applied across the Aviva group therefore including AIPL, AIHL and the other companies within Aviva Investors.

The operating activities of the unit-linked business, which include product development; distribution and marketing; client relationship management; back-office administration services; matched bargains; fund accounting; actuarial services; transfer agency services and custody relationship oversight, have been outsourced to a fellow subsidiary, AIGSL, under service agreements on an arms length basis.

AIGSL is also the nominated investment manager for the AIPL fund range.

The annuity book of business is fully reinsured to UKA. In addition, UKA provide policy administration services to AIPL under a service agreement.

#### Role and responsibilities of the Board

The Board is responsible for ensuring that an appropriate system of governance is in place for the Company, that the Company is appropriately managed and that it achieves its objectives. A strong system of governance aids effective decision-making and supports the achievement of business objectives for the benefit of customers, the shareholder and the regulators.

The specific duties of the Board are set out in its terms of reference. The terms of reference list those items that are specifically reserved for decision by the Board. All director appointments are approved by the Aviva Group CEO.

The Board comprises a Chairman, a Chief Executive Officer (CEO) and two further Executive Directors. In February 2017, the Chief Financial Officer (CFO) resigned as a director. In April 2017, a new CFO was appointed. The Board has delegated to the CEO the approval of specific issues within certain limits, above which matters must be escalated to the Board for determination.

The CEO fulfils his responsibilities in relation to the culture in the firm through his membership of the Aviva Investors Executive as culture is addressed at an Aviva Investors level given the level of interconnectedness in the business.

#### Board committees

The Board has established and delegated responsibilities to two committees to assist in its oversight of investment performance and operations. Each committee provides regular reports to the Board. The Board has established the AIPL Investment Committee (Investment Committee) and AIPL Operations & Controls Committee (OCC), to oversee

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the activities of AIPL. The OCC was previously named the Business Management Group (BMG). The duties of the Company's Board and of each of its committees are set out in the terms of reference. The terms of reference list both those items that are specifically reserved for decision by the Board and those matters that must be reported to the Board.

## AIPL Operations & Controls Committee

The Board has delegated the 'day-to-day' management of AIPL to the OCC, subject to matters reserved for decision by the Board.

The OCC is primarily responsible for providing oversight of key business initiatives and activities; monitoring and overseeing services provided by its outsourced providers (refer to section B.7 'Outsourcing'); updating and refreshing the AIPL Risk Management Framework (RMF); monitoring adherence to AIPL's risk appetite as approved by the Board; reviewing and refreshing AIPL's risk profile and emerging risk register; ensuring adherence to regulatory responsibilities, Aviva Investors and Aviva Group requirements; and defining and agreeing matters that may trigger an out-of-cycle ORSA.

Risk events impacting AIPL are reviewed by the OCC, which is authorised to agree mitigation and action plans with its outsource providers to remedy certain identified errors and breaches. The OCC is required to escalate any significant matters to the Board.

Representatives from the outsource provider, such as Finance, Operations and Client Solutions are required to provide reports and metrics to demonstrate the effective management of AIPL's risks and controls within their business activities.

## AIPL Investment Committee

The Board has established an Investment Committee, to which it has delegated, amongst other matters reviews of fund performance and fund risk. The Investment Committee requires investment reports and presentations from its asset manager, AIGSL, which allows it to regularly review and monitor the security, quality, liquidity and profitability of the portfolio as a whole.

The Investment Committee is chaired by an AIPL Board director. The Aviva Investors Investment Risk team provides additional review and challenge of investment risk, both within asset classes and at a total fund level, and provides risk analysis and recommendations to the fund managers, as well as to the Investment Committee. Its objective is to ensure that each portfolio's risk profile is consistent with the funds' objectives and the stated investment process.

## The "three lines of defence model" and roles and responsibilities of key functions

Roles and responsibilities for risk management are based around the 'three lines of defence model' where employees are involved in the management and mitigation of risk. The roles of the three lines of defence each contribute to embedded risk management.

The frameworks for risk management and internal control play a key role in the management of risks that may impact the fulfilment of the Board's objectives. They are designed to identify and manage, rather than eliminate, the risk of AIPL failing to achieve its business objectives and can only provide reasonable and not absolute assurance against material misstatement or losses.

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## First line of defence: management monitoring

Management are responsible for the application of the RMF, for implementing and monitoring the operation of the system of internal control and for providing assurance to the Board.

## Second line of defence: Risk Management, Compliance and Actuarial functions

The Risk Management function is accountable for the quantitative and qualitative oversight and challenge of the identification, measurement, monitoring and reporting of principal risks and for developing the RMF. The Risk Management function regularly monitors the appropriateness of the Aviva Group risk policies and the RMF to provide assurance to the Board that the processes for managing risk are understood and followed consistently.

The Actuarial Function is accountable for Group wide actuarial methodology, reporting to the relevant governing body on the adequacy of reserves and capital requirements, and on the adequacy of underwriting and reinsurance arrangements.

The Compliance Function supports and advises the business on the identification, measurement and management of its regulatory, financial crime and conduct risks. It is also accountable for monitoring and reporting on the compliance risk profile.

The Aviva Investors Chief Risk Officer, Head of Compliance and the UK Life Chief Risk Actuary or their delegates attend the Board meetings and provide their respective reports to the Board.

Refer to sections B.3.2, B.4.2 and B.6 for further details on the roles, responsibilities, authorities, resources, independence and reporting lines of the Risk, Compliance and Actuarial functions respectively.

## Third line of defence: Internal Audit

AIPL Internal Audit is part of the Aviva plc Group Audit function. It has a dedicated audit team who are specialised in fund management, led by an Audit Director who reports to the Chief Audit Officer (Group CAO) of Aviva plc and the Aviva Investors' Audit Committee. Refer to section B.5 of this report for details on the roles, responsibilities, authority, resources, independence and reporting lines of the Internal Audit Function.

## Implementation and assessment of adequacy of the system of governance

The Company implements its risk management framework and system of internal controls and associated reporting procedures via group-wide risk policies and business standards. To support an assessment of the effectiveness of the governance, internal control and risk management requirements, the Chief Executive Officer (CEO) of Aviva Investors is required to certify twice a year that:

- there are sound risk management and internal control systems that are effective and fit for purpose in place across the business; and
- material existing or emerging risks within the business have been identified and assessed and the business operates in a manner which conforms to the minimum requirements outlined in the risk policies and business standards.

Linked to this, the Chief Risk Officer (CRO) of Aviva Investors must certify that:

- the Risk function has reviewed and challenged the process supporting the Chief Executive Officer's certification and is satisfied that it can provide reasonable assurance of the material accuracy and completeness of the Chief Executive Officer's assessment; and
- no material gaps exist in the RMF as it applies to the Company.

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Any material risks not previously identified, control weaknesses or non-compliance with the risk policies and business standards or local delegations of authority, must be highlighted as part of this process.

## Material changes in the System of Governance during 2016

There have been no material changes in the system of governance during the year. The OCC was constituted as a formal Committee of the Board during the year.

### B.1.2 Remuneration policy

There are no employees of the Company. Directors are remunerated for their roles as employees of the Aviva Group but are not remunerated directly for their services as directors of AIPL.

### B.1.3 Material transactions with management, shareholders and persons with significant influence on the Group

On 16 December 2016 there was a capital injection by the shareholder of £2 million into AIPL in return for an allotment of 2 million ordinary shares of £1 each at par value. There were no other material related party transactions reported.

AIPL directors may from time to time purchase insurance, savings, asset management or annuity products marketed by Group companies on equivalent terms to all employees of the Group.

## B.2 Fit and Proper Policy

The Group has the following policies in place to ensure that individuals acting on behalf of the Company are both "fit" and "proper" in line with the Prudential Regulation Authority's Fit and Proper requirements for individuals subject to the Senior Insurance Manager Regime and the Financial Conduct Authority's requirements for Approved Persons:

- Fit - As part of recruitment and employee screening, an individual's career history will be assessed and validated to establish whether an individual's skills and knowledge are appropriately matched to the role.
- Proper – checks are in place to ensure that an individual is honest, of good reputation, has integrity and is financially sound.

The governance over the fitness and propriety of individuals spans across the employee lifecycle including recruitment, performance management and training. To ensure the Group protects itself against employing individuals who potentially could threaten our people, customers, properties, facilities or reputation, the majority of Fit and Proper activities take place within recruitment and more specifically in pre-employment screening.

A policy to apply a minimum set of basic screening requirements has been agreed and implemented in order to support the recruitment activity for all staff across the Aviva Group. Additional enhanced screening requirements and ongoing Fit and Proper requirements are also applied for individuals who fall within Solvency II requirements; the directors, Solvency II mandated Key Function role holders and other Key Function role holders of AIPL.

For persons responsible for running the undertaking or responsible for key functions this assessment must consider their allocated responsibilities and skills and experience across a skills matrix covering the following areas:

- Insurance and financial markets;
- Business strategy and business models;
- Systems of governance;
- Financial and actuarial analysis; and
- Regulatory framework and requirements.



The AIHL Nomination committee identifies the skills and experience that it would like to have at both Board and subsidiary level for Aviva Investors companies (including AIPL). These qualities are recorded into a skills matrix. The Committee uses the skills matrix as part of the process to identify suitable candidates to join the Boards of AIHL and its subsidiaries including AIPL. The Committee will consider the skills and experience of the Board that have been identified, taking into account all relevant aspects of diversity, to ensure a good balance is maintained on the Board that supports the wider Aviva Group values and culture.

Prior to appointing an individual into an AIPL Key Function role, the People Function ensures that the relevant skills and experience have been identified and agreed for the role. This is achieved by engaging with internal subject matter experts to define the skills and experience required for each Key Function role. In all cases the team ensures that all skills and experience requirements have been identified, including any specific qualifications required to carry out the role. The individual Key Function role skills and experience requirements and qualifications are, where applicable, captured within individual role descriptions for each Key Function role.

Compliance with the initial and ongoing Fit and Proper minimum requirements is reported on a half yearly basis as part of the People Business Standard attestation by the People Director on behalf of the Chief Executive Officer to the Group HR function.

## B.3 Risk management system including the Own Risk and Solvency Assessment

This section provides an overview of the Company's RMF. It describes how the Company's RMF has been implemented and integrated into the decision making process. It also describes the Company's process for conducting its ORSA.

### B.3.1 AIPL Risk Management Framework

The RMF is designed to identify, measure, manage, monitor and report the principal risks to the achievement of the Company's business objectives. It is codified through business standards which set out the risk strategy, appetite, framework and minimum requirements for the Company's operations. The RMF is supported by the Company's staff having clear roles and responsibilities, the right skills and capabilities, and the right incentives and rewards. The Company has embedded a risk-aware culture in its business through employee training and communications.

The RMF is in compliance with AIPL's regulatory requirements and Aviva Investors' RMF insofar that it aligns with regulatory requirements.

The RMF is reviewed and challenged on an annual basis (and with every significant change in the business) by the OCC. The finalised document is reviewed, challenged and approved by the Board on an annual basis (and with every significant change in the business).

### B.3.2 Risk management system: Own Risk and Solvency Assessment (ORSA)

AIPL's ORSA comprises all processes and tools that underpin the consideration of risk and capital implications in key decisions, including business planning. The goal of the ORSA is to provide a continuous and forward-looking assessment of the short-term and long-term risks that AIPL faces, or may face, and ensuring that the company's solvency requirements are met at all times.

The ORSA comprises a number of elements of the risk management framework reflected in the Aviva Group Risk policies and Business standards, specifically:

- The risk strategy and risk appetite, which is set by the Board and then used to inform business planning;

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- Capital and liquidity management information which enables the monitoring of up-to-date capital and liquidity levels;
- The identification, measurement, monitoring, managing and reporting principles (outlined in the Aviva Group Risk Management Framework Policy), which communicate the requirements for each of these activities to those who have responsibility for carrying them out;
- Stress and scenario testing, which helps simulate the likely impact of risks on the business (outlined in the Stress and Scenario Testing Business Standard);
- The explicit consideration of risk in the development of the business plans and strategy, and in performance reporting (outlined in the Strategy and Planning Business Standard); and
- The risk register and risk spectrum, which record all quantifiable and non-quantifiable risks identified via top-down and bottom-up processes (outlined in the Risk and Control Self-Assessments, the Top Down Risk Assessment, and the ORSA Reporting Business Standards).

In combination, these elements create a holistic overview of the elements of risk that may impact the business, and which is taken into account in day-to-day decision-making. These ORSA processes provide the Board with insights on the key risks and current and future capital requirements of the company.

The Board approved that, from 1 January 2016, for the purpose of the ORSA, capital resources and requirements are measured on the basis of Solvency II Standard Formula requirements for determining Solvency II Own Funds and SCR.

The ORSA reporting processes help to connect the strategy and business plans with the forward-looking assessment of risks as well as capital and liquidity requirements over the business planning horizon. They also provide the Board and management with the means to assess and challenge the risks and capital requirements associated with the execution of the business plan and key decision-making, including under stressed conditions. Key ORSA reports provided to the Board are:

- Quarterly Finance Report including capital & liquidity information: Provide an assessment, for the Board's review and approval, of the company's capital and liquidity resources and needs (measured by the Solvency II SCR) projected over a 1-year horizon;
- Quarterly CRO Report: Provide an update on the Company's risk profile, external and internal risk environment and emerging risks; and
- Annual ORSA Report: Summarises in a single report a high level description of the key components of the ORSA and key developments and outcomes during the year. The ORSA Report and accompanying ORSA Policy is reviewed and approved by the Board at least annually.

The second line Risk function reports to the Aviva Investors CRO. The AI CRO, in turn, reports to the Board on the overall risk profile (key risks), material, proximate and emerging risks of AIPL and all risk monitoring activities and business decisions as well as the effect of those risk monitoring activities and business decisions on the key, material, proximate and emerging risks of AIPL.

### B.3.3 Integration of risk management into the decision making processes

Our risk management system and processes enable the identification, measurement, management, monitoring and reporting of risks. The current risk exposures of the Company are assessed against the Board-approved risk appetites. Changes in the risk profile are assessed against the Board-approved risk appetites before business decisions are made, to ensure that the Company remains within appetite.

## B.4 Internal control system

### B.4.1 Description of the internal control system

Internal controls facilitate effective and efficient business operations, the development of robust and reliable internal reporting and compliance with laws and regulations.

The internal control business standard sets out Aviva's required controls for effective internal control across the Group which are applied directly by the Company or via the outsourcing arrangement with AIGSL. These required controls are split along five principles:

- Appropriate tone from the top: Businesses are to ensure that there is an appropriate culture ("tone from the top"). An appropriate culture includes the effective management of exposures, adequate resourcing, effective communication, malpractice reporting, a business ethics code that is annually signed up to by employees, and a commitment to integrity, ethical behaviour and compliance;
- An organisational structure exists that supports the systems of internal control: Businesses are to implement an organisational structure which facilitates the system of internal control. This includes the effective operation of an adequately resourced three lines of defence model, appropriate and proportionate segregation of duties, a clear system of delegated authorities, clearly defined roles and responsibilities for staff, and the consideration of risk management and control responsibilities when setting objectives for and reviewing the performance of all staff;
- Implementation of a risk management framework: Businesses implement Aviva's risk management framework including:
  - Implementation of the applicable risk policies;
  - Implementation of the applicable business standards;
  - Consistent identification, measurement, management, monitoring and reporting of all key risks;
  - Documentation of agreed action plans for risks out of tolerance / appetite; and
  - Consideration of alternative responses where risks are not directly controllable by management actions.
- Effective controls and monitoring: Businesses are to ensure that there are effective controls for each core business process and that these processes are monitored and reported on regularly. The controls should be proportionate to manage risks, be adequately documented, maintained and reviewed, and the results of that review reported; and
- Risk oversight: A risk oversight process should be established that provides adequate challenge to the completeness and openness of internal control and risk assessment. Where a committee structure is put in place to support this work, all committees must have defined terms of reference and appropriate membership, with proceedings adequately recorded and actions followed up.

### B.4.2 Compliance function

AIPL is authorised and regulated by the Prudential Regulation Authority for prudential matters and regulated by the Financial Conduct Authority for all conduct matters.

The Compliance Function is part of Aviva Investors Risk Team and constitutes a key part of the firm's control environment. The function is a critical contributor to the safe and sound operation of the business and supports the achievement of the firm's strategy and business goals.

The primary purpose of the Compliance function is advising and overseeing the business's exposure to regulatory risk, including the following core areas of regulatory risk:

- Conduct of business and systems of control;
- Prudential regulatory risk management;
- Prevention of financial crime and anti-money laundering;
- Interpretation and application of current rules and regulatory guidance;

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- Monitoring regulatory developments and supporting regulatory change management programmes;
- Managing a compliance related training framework; and
- Developing, implementing and overseeing compliance related policies and procedures.

The structure of the Compliance team is as follows: the Aviva Investors' Global Head of Compliance reports to Aviva Investors' Chief Risk Officer and to the Aviva Group Head of Compliance. Accordingly, the Chief Risk Officer has a dual reporting line into Aviva Investors' Chief Executive Officer and to the Chief Risk Officer for the Aviva Group.

The Compliance team is responsible for identifying compliance risks in Aviva Investors (including both AIPL and the outsourced provider AIGSL) and working with senior management to ensure that appropriate policies, procedures and guidance exist to manage such risks. The compliance policies apply to Aviva Investors globally, including AIPL.

## B.5 Internal audit function

The Aviva Investors Internal Audit function is part of the Aviva plc Group Audit function and provides independent and objective assessment on the robustness of the RMF and the appropriateness and effectiveness of internal control. It is a dedicated audit team who are specialised in fund management, led by the Aviva Investors Audit Director who reports to the Chief Audit Officer of Aviva plc (Group CAO) and the Chair of the AIHL Audit Committee.

Internal Audit provides reports to the Audit Committee of the AIHL Board and to management on the effectiveness of Aviva Investors' system of internal controls, and the adequacy of this system to manage business risk and to safeguard the company's assets and resources. Their work provides coverage of key Investment activities performed by AIGSL on behalf of AIPL and any specific concerns relating to AIPL would be reported to the Board on an exception basis, with the Aviva Investors Audit Director in attendance.

In pursuit of this purpose, Internal Audit undertakes, objectively and independently from management, to assess and report on the effectiveness of the design and operation of the framework of controls; on the effectiveness of management actions to address any deficiencies within the framework of controls; and to investigate and report on cases of suspected financial crime.

Internal Audit is responsible for performing these functions efficiently and effectively but it is not responsible for setting AIPL's risk appetite or for the effectiveness of the framework of controls.

### B.5.1 Independence and objectivity of the internal audit function

Internal Audit must be independent from management at all times in order to be effective in performing its activities. The arrangements to protect the independence of Internal Audit are set out below.

#### Appointments and reporting lines

- The Group Chief Audit Officer (Group CAO) has a dual reporting line into the chair of the Group Audit Committee and to the Group Chief Financial Officer (Group CFO). The Group CAO has direct and unlimited access to the Group Board Chair, the chairperson of the Group Audit Committee (GAC), the chairperson of the Group Risk Committee (GRC), the chairperson of the Group Governance Committee (GGC) and the chairs of the local audit committees.
- The Aviva Investors Audit Director reports directly to the Group CAO.
- In addition, the AI Audit Director has a dotted reporting line to the Chair of the AIHL Audit Committee.
- The AIHL Audit Committee has a duty to recommend the appointment or dismissal of the AI Audit Director to the AIHL Board and to participate, jointly with the Group CAO or designee, in the determination of the objectives of the AI Audit Director and the evaluation of his levels of achievement, including consultation with AI's CEO.

## Staff

- Internal Audit staff shall have no direct responsibility or authority over any operational activities reviewed and should not relieve others of such responsibilities.
- Internal Audit will maintain a formal policy of rotating staff to ensure that independence is maintained.
- Internal auditors will not perform or manage reviews in the business area for which they were previously responsible for a period of at least one year after the end of their role within the business. This excludes similar business areas in other legal entities or operating units. Internal auditors on rotation from a business unit will not perform or manage reviews in the business area for which they were previously responsible.
- Internal Audit will provide to the Group and business unit audit committees an annual confirmation of its independence, supported by an independence declaration form signed by all members of Internal Audit staff.

### B.5.2 Authority and resources of the internal audit function

- Internal Audit is authorised to review all areas of the Aviva Group and has full, free, and unrestricted access to all activities, records, property and personnel necessary to complete their work.
- The scope of Internal Audit's activities extends to all legal entities, joint-ventures (JVs) and other business partnerships, outsourcing and reinsurance arrangements, other than where the audit capabilities of the JV counterparty are deemed to be sufficient by the Group CAO, in which case the JV's internal audit services may be provided by the JV partner.
- The Group CAO shall propose a budget which ensures that Internal Audit has sufficient skills and resources to discharge its responsibilities.

### B.6 Actuarial function

The Aviva Group Actuarial Function is accountable for Group-wide actuarial methodology, reporting to the relevant governing body on the adequacy of reserves and capital requirements, and on the adequacy of underwriting and reinsurance arrangements. The Actuarial Function has been implemented in line with Solvency II requirements, and where any interpretation has been made, this has been documented in the Actuarial Charter.

The AIPL Actuarial Function is outsourced to Aviva UK Life business (UK Life) and overseen by the Aviva UK Life Chief Risk Actuary and supported by actuaries working in the Chief Finance Actuary function of UK Life.

The Actuarial Function has authority to review all areas of the business and has full, free and unrestricted access to all activities, records, property and personnel necessary to complete its work. The Group Chief Risk Actuary leads Aviva's global Actuarial function, supported by the local Chief Risk Actuary within UK Life.

UK Life's Actuarial Function has a functional report to the Group Actuarial Function ensuring that the function is effective. As such, UK Life's Actuarial Function is required to confirm to the Group Actuarial Function the appropriate use of methodologies and underlying models, assumptions made in the calculation of provisions and other statutory requirements.

All persons employed by the Actuarial function in a defined 'actuarial' role are subject to Aviva Group's Fit and Proper minimum requirements, to ensure they have the requisite skills and knowledge to complete the responsibilities outlined in these sections.

### B.7 Outsourcing

The Aviva Group Procurement and Outsourcing Standard sets out the relevant responsibilities, objectives, process and monitoring arrangements to be applied in cases of outsourcing, all of which shall be consistent with the overall business strategy. The standard applies equally to any externally or internally (intra-group) outsourced activity. The objective of this standard is to ensure that minimum control objectives and controls for supplier-related activities are

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followed by all Aviva businesses, supplier risk is managed effectively, customers are being treated fairly and continue to receive good outcomes, as well as to mitigate potential financial, operational, contractual and brand damage caused by inadequate management.

The standard is benchmarked against UK regulatory expectations, FCA, PRA, Solvency II framework and Group Solvency II requirements, and where appropriate, regulatory guidance will be applied as a requirement.

The standard applies to all staff involved in supplier-related activities and provides direction to staff on their roles and responsibilities in effectively managing supplier activity. It provides clarity to businesses on the definition of outsourcing, including where activity is delegated to an intermediary, and whether a function or activity outsourced is critical or important. All staff have a responsibility to comply with this standard if they are involved with supplier related activity.

Aviva Group's Board Risk Committee approves the control objectives and controls in the standard, which cover the following areas:

- Supply governance – business oversight of operational performance for sourcing and supply management activities;
- Sourcing – how a service provider of suitable quality is selected;
- Supplier contracting and approvals – financial, commercial and legal approval of contracts; and
- Supplier management and business continuity – risk based approach to management of supply contracts.

## Outsourced functions and activities

AIPL outsources a wide range of operational functions and activities, including policy administration, fund and investment management, claims handling, customer contact centres and IT services. The Procurement & Outsourcing Standard requires a global Supplier Landscape document to be produced bi-annually to capture details of all critical or important outsourced operational functions and activities.

Material outsourced functions include the following:

- Primary outsourcing to AIGSL who provide asset management services:
  - AIGSL subsequently outsource to JP Morgan (custodian and fund accounting)
  - AIGSL subsequently outsource to Royal Bank of Canada (RBC) (transfer agent)
- Outsourcing of actuarial function to UK Life, who provide the Best Estimate Liabilities (BEL) and Risk Margin (RM) for AIPL's unit-linked and annuities business and assist with methodologies to calculate SCR and review the outputs.
- Outsourcing of annuities business policy administration to UKA.

The jurisdiction of each of the above outsource providers is the UK with the exception of the Transfer Agent which operates out of Luxembourg.

## Material intra-group outsourcing arrangements

Material intra-group outsourcing arrangements include IT services, finance and capital management, fund and investment management, compliance, risk, actuarial and audit services for the year ended 31 December 2016.

## B.8 Any other material information

No other information on Aviva's system of governance is considered material requiring disclosure in this section.

# Section C

## Risk Profile

### In this Chapter

- C.1 Underwriting risk
- C.2 Market risk
- C.3 Credit risk
- C.4 Operational risk
- C.5 Liquidity risk
- C.6 Other material risks
- C.7 Any other information

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## SECTION C: RISK PROFILE

### Overview of the Company's risk profile

An overview of the Company's process for identifying, assessing, managing and monitoring the risks it is exposed to is set out below (see also section B.1.1 'Overview of AIPL's system of governance'). Further details, including key changes to the Company's risk profile in the reporting period and any exposure to off-balance sheet items, are further explained in sections C.1 to C.6.

The Company performs stress and scenario testing and sensitivity analysis for decision-making and planning purposes, and to understand the impact of changes on the Company's Risk Profile, Own Funds, Risk Margin and SCR. Refer to section C.7 for details on the methodology employed in sensitivity analysis, stress and scenario analysis, and the results obtained.

#### Risk identification

Risk identification is carried out on a regular basis, embedded in the business planning process and any major business initiatives, drawing on a combination of internal and external data, covering both normal conditions and stressed environments. Primary sources for identifying risks include risk events analysis, external and internal trends analysis, regulatory developments, stress and scenario testing and management information as well as other risk governance processes and input from the Board and subject matter experts within Aviva Investors and the Aviva Group.

#### Exposure measurement and monitoring

The primary basis used by AIPL to measure and assess its risks is the Solvency II SCR on the Solvency II Standard Formula basis as it appropriately reflects AIPL's risk profile and balance sheet exposures. The SCR is risk sensitive and proportionate and reflects a level of Solvency II Own Funds at risk in a 1-in-200 year loss event over a 1-year time horizon. Refer to section E.2 of this report for details of the methodology and assumptions used in the calculation of AIPL's Solvency II SCR.

The risk types measured in AIPL's Solvency II SCR Standard Formula are:

- Underwriting risk (refer to section C.1 of this report for further details);
- Market risk (refer to section C.2 of this report for further details);
- Counterparty default risk i.e. credit risk (refer to section C.3 of this report for further details); and
- Operational risk (refer to section C.4 of this report for further details).

The SCR disclosed below is net of loss-absorbing capacity of technical provisions and deferred taxes. Further information on the SCR is reported in the public disclosure Quantitative Reporting Template (QRT) S.25.01.21 'Solvency Capital Requirement – for undertakings on Standard Formula' that is included in section F.2 'Public disclosure templates' and in the rest of this section (including commentary on changes in risk profile measured by Solvency II SCR).

SCR by risk module at 31 December 2016	£m
Life underwriting risks (i.e. lapse risk and expense risk) (see C.1)	4.7
Market risk (see C.2)	2.0
Credit risk (counterparty default risk) (see C.3)	0.6
Operational risk (see C.4)	1.9
Loss absorbing capacity of deferred taxes	(0.3)
Total undiversified components	8.9
Diversification	(1.5)
Solvency capital requirement	7.4



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## Risk management and mitigation

Risks arising in AIPL are mitigated through application of the AIPL RMF, including governance, policies and standards, appetites and limit frameworks. Refer to section B of this report for details on AIPL's overall system of governance.

In addition to AIPL's risk framework, a range of risk mitigation techniques are employed across the different types of risks that it faces. These techniques are explained in detail by risk type in sections C.1 to C.6.

### Monitoring the effectiveness of risk mitigation techniques

Annually the AI CRO undertakes an assessment, presented to the Board, of the effectiveness of AIPL's risk management and the robustness of its control environment. Other inputs include key risk and control indicators and the results of the risk policy and business standard attestation process. See sections C.1 to C.6 for further details by risk type.

Concentration risk is also monitored and managed by AIPL. Any significant concentrations of risk identified at the level of the individual risk are presented in sections C.1 to C.6 of this report.

### Prudent Person Principle

AIPL ensures that its assets are invested in accordance with the prudent person principle as set out in Article 132 (Directive 2009/138/EC) through the collective application of its risk policies and business standards. These ensure that AIPL invests in assets whose risks it can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs.

AIPL adopts the provisions of the Aviva Group Investment Management business standard which contain mandatory requirements to ensure that AIPL develops its own set of key risk indicators and takes into account the risks associated with its investments without relying only on the risk being adequately captured by the capital requirements.

The Board has established an Investment Committee, to which it has delegated, amongst other matters, reviewing fund performance and fund risk. The Investment Committee requires investment reports and presentations from its asset manager, AIGSL, which allows it to regularly review and monitor the security, quality, liquidity and profitability of the portfolio as a whole.

The Aviva Investors Investment Risk team provides additional review and challenge of investment risk, both within asset classes and at a total fund level, and provides risk analysis and recommendations to the fund managers, as well as to the Investment Committee. Its objective is to ensure that each portfolio's risk profile is consistent with the funds' objectives and the stated investment process. Investment breaches are reported, together with remedial action plans, to the Investment Committee and the OCC.

### Exposure to special purpose vehicles

At 31 December 2016, AIPL has no special purpose vehicles as defined in the Solvency II Directive (2009/138/EC).

## C.1 Underwriting risk

Underwriting risk is the risk of loss on underwriting activity caused by an adverse change in the value of liabilities arising from inappropriate insurance pricing, inadequate claims reserving assumptions as well as unforeseen fluctuations in the timing, frequency and severity of insured events relative to the expectations at the time of

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underwriting. The risk excludes operational risk arising from internal processes in the writing of insurance business or settling of claims.

## C.1.1 Risk exposure

Life insurance risk at AIPL arises through its exposure to longevity risk (annuitants living longer than we expect) and exposure to worse than anticipated operating experience on factors such as persistency levels (customers lapsing or surrendering their policies) and expense risk (the amount it costs us to administer policies).

The annuity book of business is closed to new business and is fully reinsured. Therefore AIPL is no longer exposed to longevity risk.

AIPL is exposed to persistency (lapse) and expense risk in the unit-linked pensions business.

## C.1.2 Measurement and monitoring

AIPL follows the Solvency II Standard Formula SCR methodology, including its standard stresses, to measure its exposure to persistency risk. A high-level analysis of actual experience against expected experience is conducted to support ongoing monitoring of the appropriateness of lapse risk assumptions.

AIPL conducts reverse stress tests for assumptions based on standard stresses that are identified as sufficiently critical to the profitability and risk profile of the business to render it unviable.

At 31 December 2016, life insurance SCR amounted to £4.7 million post diversification. See S.25.01.21 'Solvency Capital Requirement - for undertakings on Standard Formula' in section F.2 'Public disclosure templates' for underwriting risk SCR.

## C.1.3 Changes to risk profile in the reporting period

Given the issue of the EIOPA guidance in 2016, AIPL revised its approach to the use of contract boundaries for estimating the Solvency II technical provisions (both best estimate liabilities and risk margin) effectively removing the short contract boundary assumption previously applied. This increases the sensitivity of the BEL to lapses. As a result, the Solvency II SCR for persistency (lapse) risk increased from £0.2 million to £4.2 million before diversification at 31 December 2016. Similarly, expense risk increased from £0.0 million to £0.9 million before diversification at 31 December 2016. Diversification effects of £0.4 million reduce total life underwriting risk to £4.7 million.

## C.1.4 Risk management and mitigation

AIPL manages underwriting risk as follows:

- Longevity risk is mitigated by use of reinsurance.
- Persistency risk is managed through frequent monitoring of company experience, and benchmarked against local market information. Generally, persistency risk arises from lapses on customer policies earlier than has been assumed. Where possible, the financial impact of lapses is reduced through appropriate product design. Businesses also implement specific initiatives to improve the retention of policies which may otherwise lapse.
- Expense risk is primarily managed by the Company through the regular assessment of the Company's profitability and frequent monitoring of expense levels.

## C.1.5 Risk concentration

There are no material concentrations of underwriting risk for AIPL.

## C.2 Market risk

Market risk is the risk of adverse financial impact resulting, directly or indirectly, from fluctuations in interest rates, foreign currency exchange rates, equity and property prices. Market risk arises in the business due to fluctuations in both the value of liabilities and the value of investments held, which has an impact on the asset management charges earned by the Company.

### C.2.1 Risk exposure

The principal market risk type that AIPL is exposed to is property price risk on holdings of investment properties in the unit-linked pensions business. The nature of the Company's unit-linked insurance product results in the value of the Company's insurance contract liability being directly linked to the value of the related investment assets and therefore the Company's exposure relates solely to the management fees earned on the assets.

### C.2.2 Measurement and monitoring

The Investment Committee monitors fund performance and fund risk and requires investment reports and presentations from its asset manager which allows it to regularly review and monitor the security, quality, liquidity and profitability of the portfolio as a whole.

The Aviva Investors Investment Risk team provides additional review and challenge of investment risk, both within asset classes and at a total fund level, and provides risk analysis and recommendations to the fund managers, as well as to the Investment Committee. Its objective is to ensure that each portfolio's risk profile is consistent with the funds' objectives and the stated investment process. Investment breaches are reported, together with remedial action plans, to the Investment Committee and the OCC.

Sensitivity analysis and stress and scenario testing is conducted to monitor the Company's exposure to fluctuations in the values of assets. The impact of a fall in policyholder assets is limited to the impact on revenue, which is accrued based on those values and which is partially offset by amounts payable by the company for investment sub-advisory services provided by other entities within the Aviva Investors group.

At 31 December 2016, market risk SCR amounted to £2.0 million post diversification. See S.25.01.21 'Solvency Capital Requirement - for undertakings on Standard Formula' in section F.2 'Public disclosure templates' for market risk SCR.

### C.2.3 Changes to risk profile in the reporting period

The Solvency II SCR for market risk increased from £0.1 million to £2.7 million before diversification at 31 December 2016 as a result of the revision of contract boundaries, as described in C.1.3, for calculating the Solvency II technical provisions. Diversification between market risk components amounted to £0.7 million reducing total market risk to £2.0 million.

### C.2.4 Risk management and mitigation

The Board monitors the surplus of Own Funds over the Company's Solvency II SCR.

As the Company's exposure to fluctuations in the values of the assets relate to the impact on fee income, sensitivity analysis and stress and scenario testing is conducted for decision-making and planning purposes.

## C.2.5 Risk concentration

Due to the size and nature of the property fund, relative to other AIPL funds, the Company has a concentrated exposure to property price risk in so far as it impacts the management fees earned on the assets.

## C.3 Credit risk

Credit risk is the risk of financial loss as a result of the default or otherwise failure of third parties to meet their obligations to the Company.

### C.3.1 Risk Exposure

Given that the Company's annuity business is 100% reinsured to UKA, the shareholder bears the risk of default by the reinsurer. As the reinsurer for the Company's annuity business is part of the Aviva Group, the exposure to the risk for AIPL is considered low.

The nature of AIPL's unit-linked insurance product results in the credit risk on the investment assets held to cover the linked liabilities being borne by the policyholders.

Remaining credit risk relates to cash and cash equivalents held on deposit at credit institutions. Credit risk on cash and cash equivalents is considered low due to the financial strength (as assessed by credit rating agencies) of the credit institutions.

### C.3.2 Measurement and monitoring

Credit risk is measured using the Solvency II Standard Formula approach which considers the Company's exposure to counterparties, the loss given default and their probabilities of default.

Each counterparty is allocated to one of two categories, Type 1 or Type 2, depending on the nature of the counterparty. Generally, type 1 counterparties are rated entities, whereas type 2 counterparties are likely to be unrated. The major constituents of these two classes are:

#### Type 1

- Reinsurance arrangements
- Cash at bank
- Deposits with ceding institutions (up to 15 independent counterparties)

#### Type 2

- Receivables from intermediaries
- Policyholder debtors
- Deposits with ceding institutions (if the number of independent counterparties exceed 15)

The capital requirements for both types of counterparty are calculated separately and combined in a final calculation that assumes a low diversification effect between the two categories. At 31 December 2016, credit risk SCR amounted to £0.6 million. See S.25.01.21 'Solvency Capital Requirement - for undertakings on Standard Formula' in section F.2 'Public disclosure templates' for credit risk SCR.

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## Credit quality indicators – External credit ratings

Financial assets are graded according to current external credit ratings issued. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. Financial assets which fall outside this range are classified as sub-investment grade. The following table provides information regarding the aggregated credit risk exposure of AIPL for financial assets with external credit ratings. 'Not rated' assets capture assets not rated by external ratings agencies.

As at 31 December 2016	AAA	AA	A	BBB	Less than BBB	Not rated	Carrying value £m
Cash deposits	42%	4%	8%				11.8
Reinsurance assets						46%*	10.1
Total							21.9

\*The reinsurance counterparty, UKA, is not rated. UKA has a solvency ratio of 170%.

The overall credit quality of AIPL's financial investments remains strong at 31 December 2016.

### C.3.3 Changes to risk profile

There were no changes in the risk profile in 2016.

### C.3.4 Risk management and mitigation

#### Banking exposures

The credit risk associated with cash and cash equivalents is managed through adherence to internal credit policy and limits frameworks and placement of funds with counterparties with high credit ratings assigned by international credit agencies. Credit exposures are identified, evaluated and managed in accordance with best practice and AIPL's risk appetite.

#### Reinsurance asset

The risk associated with the default of UKA is monitored with reference to the credit rating applied to the counterparty. As UKA is unrated, the solvency ratio of 170% is used to quantify the probability of default for the asset as outlined in Article 199 (3) of the Delegated Regulation (EU) 2015/35. The default risk is monitored but no mitigation techniques are adopted and therefore the risk is otherwise accepted.

#### Trade, other receivables and other assets

AIPL's exposure to credit risk from trade and other receivables is mainly influenced by the default risk of its client base. Aviva Investors has credit control procedures in place to ensure prompt settlement of fees due and, ultimately, has recourse to the clients' funds. Historic losses in respect of unpaid invoices have been immaterial.

### C.3.5 Risk concentration

AIPL adheres to the Aviva Group credit limit framework, which limits investments in individual issuers, geographies, sectors, and asset classes to ensure the Aviva Group, individual business units and legal entities are not individually exposed to significant concentrations of credit risk. Credit concentrations are monitored as part of the regular credit monitoring process and are reported to the Aviva Investors Capital Committee.

AIPL's only reinsurance counterparty is UKA. At 31 December 2016, the present value of the reinsurance asset recoverable, including debtor balances, from UKA on a Solvency II basis was £10.0 million.

## C.4 Operational risk

### C.4.1 Risk exposure

Operational risk is the risk of direct or indirect loss arising from inadequate or failed internal processes, people and systems, or external events, including changes in the regulatory environment. AIPL has a low appetite for operational risk and aims to reduce this risk as far as is commercially sensible.

Operational risk arises mainly through the investment process, distribution channels, product development, information technology and operations, including the transfer agency activities, of which the majority of these processes have been outsourced to AIGSL.

Operational risks facing the Company are assessed regularly, according to the likelihood of them materialising and the potential impact on the business should they materialise. Where appropriate, actions are put in place to address risks outside of tolerance or where control deficiencies have been identified.

### Conduct risk

An important element of operational risk is conduct risk. This is the risk that positive customer outcomes are not achieved, and arises throughout the whole product lifecycle from the development of products, the sales and investment processes to handling client redemptions.

### Reputational risk

This is the risk that litigation, employee misconduct, operational failures, the outcome of regulatory investigations, media speculation and negative publicity, disclosure of confidential client information, inadequate services, whether or not founded, could impact AIPL's brand or reputation. AIPL's brand or reputation could also be affected if products or services do not perform as expected (whether or not the expectations are well founded) or customers' expectations for the product change. Management seek to reduce this risk to as low a level as commercially sensible.

### C.4.2 Measurement and monitoring

Operational risks for AIPL are identified and assessed through risk identification workshops held by the OCC and reviewed and challenged by the Board. At least annually, the Board reviews and updates the risk appetite statements and sets its tolerances for operational risk. The OCC is responsible for providing oversight of key business initiatives, monitoring and overseeing services provided by its outsourced providers, monitoring adherence to the Company's operational risk tolerances, and ensuring adherence to regulatory responsibilities. Risk events impacting the Company are reviewed by the OCC, which is authorised to agree mitigation and action plans with its outsource providers to remedy certain identified errors and breaches. The OCC is required to escalate any significant matters to the Board. The key operational risks are reported quarterly to the Board.

At 31 December 2016, operational risk SCR amounted to £1.9 million. See S.25.01.21 'Solvency Capital Requirement - for undertakings on Standard Formula' in section F.2 'Public disclosure templates' for operational risk SCR.

### C.4.3 Changes to risk exposure in the period

There have been no material changes to AIPL's operational risk profile in the period.

## C.4.4 Risk management and mitigation

The majority of the operating activities of AIPL have been outsourced to AIGSL which is the nominated investment manager for the AIPL funds. Therefore, AIPL has concentrated operational risk exposure to AIGSL. As part of the ORSA, the Board has considered the Company's exposure to outsourcing risk (operational risk) and has set aside additional capital for this exposure. This is considered by the Board to be a prudent approach.

## C.4.5 Concentration risk

There are no material concentrations of operational risk for AIPL.

## C.5 Liquidity risk

Liquidity risk is the risk that liabilities cannot be met in a timely and cost-effective manner as they fall due. Liquidity issues may arise from uncertainty in the value and timing of liabilities as well as uncertainty in the ability to realise assets into cash to meet its obligations.

### C.5.1 Risk exposure

AIPL is exposed to liquidity risk from a shareholder (principal) and a policyholder (fund liquidity) perspective.

#### Shareholder liquidity risk

The key risks facing AIPL from a shareholder liquidity perspective are as follows:

- Medium to long term reduction of the AIPL business model through client redemptions (persistence risk) or poor performance causing ongoing losses and negative cash generation;
- Late receipt of fee income although this is considered low due to the diverse client base and direct deduction of asset management charges on pooled assets in the fund;
- Exceptional fines or other operational risk event crystallisation;
- Mismatches in revenue collection compared to operating outflows and dividend payments; and
- High levels of bad debt write-offs.

#### Policyholder liquidity risk (fund liquidity risk)

Policyholder liquidity risk arises from the following factors:

- Nature of the assets held in the funds;
- Redemption terms provided to policyholders;
- Concentration of investors in the funds;
- Policyholder or investor sentiment; and
- Market conditions

### C.5.2 Measurement and assessment of liquidity risk exposure

#### Shareholder liquidity risk

AIPL aims to ensure a high degree of confidence that it can meet its obligations as they fall due. To support this, AIPL complies with the Aviva Group Liquidity Business Standard and Aviva Group Liquidity Policy that requires management to consider a range of approaches to determine the appropriate minimum liquidity appetite.

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Monthly rolling 12 month cash flow forecasts are prepared by the Aviva Investors Finance function and are monitored at the Board and at the Aviva Investors Capital Committee.

## Policyholder liquidity risk

AIPL manages the exposure to liquidity risks through setting appropriate liquidity parameters within which the funds are to be managed. Fund liquidity risk is monitored at the Investment Committee, with the Investment Risk team (second line of defence) providing independent reporting and challenge on fund liquidity risk. Any breaches of risk appetite are escalated to the Board.

### C.5.3 Changes to risk profile in the reporting period

#### Policyholder liquidity risk

Policyholder liquidity risk increased following the outcome of the UK Referendum on the continued membership of the EU. The uncertainty for the UK economy created by the referendum resulted in increased redemption requests in the property fund. As allowed by the Policy Document, redemption requests from the property fund were deferred while planned sales of property were undertaken to raise the necessary liquidity, and in accordance with the wider property fund strategy.

### C.5.4 Risk management and mitigation

#### Shareholder liquidity risk

At its quarterly meetings the Board receives a shareholder liquidity status report and a 12-month liquidity forecast. The liquidity status and forecast is measured against the Board's approved liquidity risk appetite.

#### Policyholder liquidity risk

The AIPL Policy Document allows AIPL to defer any transaction involving the cancellation of units in any AIPL fund, other than investments in direct property, for a period of up to three months if the encashment is more than 5% of the respective fund's asset value or up to twelve months in the case of investments in direct property (or any investment that have holdings in funds that invest in direct property) if it is in the interest of existing policyholders or if there is insufficient liquidity in the respective fund. The deferral period operates individually for each redemption instruction. This however does not apply in the case of payments required to provide retirement benefits.

### C.5.5 Concentration risk

#### Shareholder liquidity risk

There are no material concentrations of shareholder liquidity risk for AIPL.

#### Policyholder liquidity risk

The property fund is the largest fund run by AIPL and therefore represents a source of concentration risk for the Company in the case of material level of redemptions as experienced in 2016. The majority of policyholders invested in the property fund are advised by pension fund consultants, who could recommend to their clients to leave the property fund, who could act on behalf of their clients and redeem from the property fund. These actions could lead to material redemptions in excess of available liquidity in the property fund. At 31 December 2016, approximately 43% of the investments in the property fund are managed by consultants and 30% by real estate multi-managers.



## C.5.6 Expected profit in future premium

The amount of expected profit in future premium included within the valuation of the Company's Technical Provisions at 31 December 2016 is £0.0 million. See QRT S.23.01.01 (section F.2 'Public disclosure templates').

## C.6 Other material risks

The Company has no material information to disclose regarding other material risks.

## C.7 Any other information

### C.7.1 Stress and scenario testing and sensitivity analysis

The Company performs stress and scenario testing and sensitivity analysis for decision-making and planning purposes, and to understand the impact of changes on the Company's Risk Profile, Own Funds, Risk Margin and SCR. Furthermore AIPL seeks to identify and quantify appropriate management actions that the business could take to mitigate the impact of stressed events which may arise. As part of this process it considers the likelihood of success of these management actions and any barriers to their successful implementation.

#### Stress and scenario testing

The stress scenarios conducted in 2016 represent an appropriate range of adverse circumstances relevant to AIPL and its risk profile and include sudden and severe events. Management agreed that, if required, the main action that would be taken in the short term under the stress scenarios would be a reduction of dividends to AIHL, its parent company, or a request for a capital injection. A review of AIPL's cost structure would be conducted in the longer term, due to the fact that all costs are tied to contracts.

#### Sensitivity analysis

AIPL conducts sensitivity analysis to understand the impact of material risks and events on AIPL's key financial drivers and the magnitude of the change required to put AIPL's capital at risk. The following risk exposures were subjected to sensitivity analysis:

- Operational/liquidity risk: depletion of own funds or exhaustion of cash and cash equivalents that cannot be mitigated by the primary or secondary management actions.
- Business/reputational risk: redemption levels (persistence risk) that result in the underlying funds no longer being viable.
- Fund liquidity risk: redemption levels (persistence risk) that may result in redemption queues not cleared during the deferral period.
- Group risk: Depletion of own funds or exhaustion of cash and cash equivalents due to increased expenses (expense risk)

Management concluded that AIPL is sufficiently resourced to mitigate the material risks to which it is exposed.

# Section D

## Valuation for Solvency Purposes

### In this Chapter

D.1 Assets

D.2 Technical Provisions

D.3 Other Liabilities

D.4 Alternative methods of valuation

D.5 Any other material information

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## SECTION D: VALUATION FOR SOLVENCY PURPOSES

The Valuation for Solvency Purposes section of the report provides a description of the bases, methods and main assumptions used in the valuation of assets, technical provisions and other liabilities for each material asset/liability class. It also provides an explanation of the material differences between the IFRS and Solvency II bases of valuation.

Assets and liabilities under Solvency II are valued in accordance with AIPL's accounting policies established under IFRS as adopted by the European Union (EU), except for those that are described in sections D.1 'Assets', D.2 'Technical Provisions' and D.3 'Other Liabilities'. A summary of AIPL's accounting policies under IFRS can be found in the Accounting policies section of the 2016 Annual report and financial statements.

The table below sets out a summarised balance sheet at 31 December 2016. The Company's Solvency II balance sheet is detailed in the balance sheet QRT, S.02.01.02 see section F.2 'Public disclosure templates'. The IFRS balance sheet has been reclassified, from the presentation used under IFRS in the financial statements, to the categories used in the balance sheet QRT.

### Balance Sheet – IFRS and Solvency II

As at 31 December 2016	Corresponding IFRS financial statement note	IFRS balance sheet £m	Reclassified IFRS balance sheet £m	Solvency II balance sheet £m	Difference between reclassified IFRS and SII balance sheet £m	SFCR note
<b>Assets</b>						
Investment property	8	971.0	-	-	-	D.1.1
Financial investments	9	525.0	-	-	-	D.1.2
Collective Investment Undertakings (investment funds)		-	9.2	9.2	-	D.1.5
Assets held for index-linked and unit-linked funds		-	1,616.5	1,616.5	-	D.1.3
Reinsurance recoverables	14	8.7	8.7	10.0	1.2	D.1.4
Trade receivables	10	29.2	0.5	0.5	-	D.1.7
Cash and cash equivalents	18	104.0	2.6	2.6	-	D.1.6
<b>Total assets</b>		<b>1,637.9</b>	<b>1,637.6</b>	<b>1,638.8</b>	<b>1.2</b>	
<b>Liabilities</b>						
Technical provisions	13	(1,571.1)	(1,605.3)	(1,604.9)	0.4	D.2
Insurance liabilities	14	(8.7)	-	-	-	D.2
Finance lease liabilities	15	(17.4)	-	-	-	D.3.3
Deferred tax liabilities	7	(0.1)	(0.1)	(0.3)	(0.3)	D.3.1
Payables (trade, not insurance)	16	(29.4)	(18.5)	(18.5)	-	D.3.4
Other liabilities		-	(2.5)	(2.5)	-	D.3.5
<b>Total liabilities</b>		<b>(1,626.7)</b>	<b>(1,626.4)</b>	<b>(1,626.3)</b>	<b>0.1</b>	
<b>Excess of assets over liabilities</b>		<b>11.2</b>	<b>11.2</b>	<b>12.5</b>	<b>1.3</b>	

### IFRS Balance Sheet reclassified into Solvency II Balance Sheet categories

The main bases, methods and assumptions in respect of the valuation of assets and liabilities under Solvency II are broadly consistent with those of IFRS, disclosed through the Company's Annual report and financial statements. The key classification differences relate to assets backing unit-linked and index-linked contracts, cash and cash equivalents and investment funds. The nature of the reclassification differences are set out in sections D.1 'Assets', D.2 'Technical Provisions' and D.3 'Other Liabilities'.

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## Valuation differences

As noted earlier, a number of valuation differences exist in respect of the assets and liabilities reporting in the Company's balance sheet under Solvency II compared to IFRS at 31 December 2016. The net impact of these differences is an overall increase in net assets of £1.3 million. This primarily reflects the differences in assumptions and reserving methodology used under Solvency II compared to IFRS. The nature of the differences are set out in sections D.1 'Assets', D.2 'Technical Provisions' and D.3 'Other Liabilities'.

### D.1 Assets

Assets have been valued according to the requirements of the Solvency II Directive and related guidance. The basis of the Solvency II valuation principle is the amount for which the assets could be exchanged between knowledgeable willing parties in an arm's length transaction. This section details the Solvency II valuation basis of each material class of asset and any material difference between that and the IFRS valuation.

#### D.1.1 Investment property

Investment property is valued in accordance with IFRS whereby it is recognised at its fair value at the balance sheet date. The fair values are assessed by qualified external valuation specialists or by qualified staff and reflect rental income and other assumptions that market participants would use when pricing the investment property under current market conditions. All investment property relates to the unit-linked business and so is reclassified in the Solvency II balance sheet (section D.1.3 'Assets held for index-linked and unit-linked contracts').

Further information on investment property valued using an alternative method to either a quoted market price or a quoted market price for a similar asset is included in section D.4 'Alternative methods of valuation'.

#### D.1.2 Financial Investments

Financial investments are valued in accordance with IFRS whereby they are recognised at fair value at the balance sheet date. Fair value is obtained from quoted market prices or, if these are not available, by using relevant valuation techniques. All financial investments are attributable to the unit-linked business (section D.1.3 'Assets held for index-linked and unit-linked contracts').

There are no financial investments valued using an alternative method to either a quoted market price or a quoted market price for a similar asset.

#### D.1.3 Assets held for index-linked and unit-linked contracts

Assets held for index linked and unit-linked contracts represent all assets that are attributable to policyholders upon redemption of their investment contracts. Assets held to cover index-linked and unit-linked funds are measured at fair value for both Solvency II and IFRS purposes. These assets are not recognised separately in the IFRS balance sheet and are therefore reclassified to this category for Solvency II reporting purposes. As such, the assets held for index linked and unit-linked contracts comprises in whole or part the IFRS balances of investment property, financial investments, cash and cash equivalents, receivables and payables that have been reclassified from their separate captions in the IFRS financial statements.

There is no difference between the valuation basis for Solvency II and the IFRS balance sheets.

#### D.1.4 Reinsurance recoverables

Reinsurance recoverables are calculated as a probability-weighted average of discounted future cash flows relating to reinsurance contracts, adjusted for the expected losses due to counterparty default.

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The reinsurance recoverables at 31 December 2016 were £8.7 million on an IFRS basis compared to £10.0 million on a Solvency II basis.

The difference in value of the reinsurance recoverable under Solvency II and IFRS is due to the different rate used to discount future cash flows and allowance for counterparty default risk in the Solvency II valuation which is not allowed for under IFRS. The risk-free interest rate (RFR) is used as the discount rate on a Solvency II basis, while under IFRS the discount rate is higher because it includes a liquidity premium. All internal reinsurance is valued in the same way as external reinsurance would be. All reinsurance is with other entities within the UK operations of Aviva.

See section D.2.2 'Technical provisions methodology and assumptions' and D.2.4 'Level of uncertainty in value' for further information regarding methodology/assumptions and the level of uncertainty in valuing reinsurance recoverables.

## D.1.5 Collective Investment Undertakings (investment funds)

Collective Investment Undertakings (CIUs) consist of investments in internally managed liquidity funds. Under IFRS, the assets are recognised as cash and cash equivalents (D.1.6 'Cash and cash equivalents'). AIPL's total investment in CIUs at 31 December 2016 is £9.2 million. These investments are measured at fair value in the Solvency II valuation which is equal to the IFRS carrying value.

## D.1.6 Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, deposits held at call with banks and other short term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand only with an insignificant change in their fair values. Under Solvency II shareholder investments in CIUs are reclassified from cash and cash equivalents to Collective Investment Undertakings (investment funds) (see section D.1.5), while cash and cash equivalents attributable to the policyholders of the unit-linked business are reclassified to Assets held for index-linked and unit-linked contracts (see section D.1.3). The residual balance held in the cash and cash equivalents line under Solvency II is valued in accordance with IFRS principles.

## D.1.7 Receivables (insurance, reinsurance and intermediaries)

Under Solvency II, receivables are held at fair value, being the amount for which they could be exchanged between knowledgeable parties in an arm's length transaction. Where receivables are expected to be recovered within one year, as is the case for AIPL, the Solvency II fair value is equal to the IFRS carrying value. Receivables attributable to the policyholders of the unit-linked business are reclassified to Assets held for index-linked and unit-linked contracts (see section D.1.3).

## D.2 Technical Provisions

This section describes the Solvency II valuation of technical provisions, the level of uncertainty associated with the valuation and an explanation of material differences between the Solvency II and IFRS valuation.

Technical provisions are detailed in the QRT S.12.01.02 'Life Technical Provisions', section F.2 'Public disclosure templates'.

## D.2.1 Definition of Technical Provisions

The value of technical provisions under Solvency II is equal to the sum of a best estimate liability and a risk margin. The best estimate liability is defined as the probability-weighted average of the present value of future cash flows on a market consistent basis, using the relevant risk-free interest rate term structure after making allowance for credit risk.

The risk margin is the present value of the cost of capital held each year in respect of non-hedgeable risks and represents the amount, in addition to the best estimate liability, that a third party would expect to receive in order to take over the insurance obligations of an existing entity.

The following general principles apply to technical provisions valuation:

- The calculation of technical provisions is performed on a going concern basis. This means a proportion of expected future costs (such as general overheads) will be covered by future new business.
- The definition of a "best estimate" assumption is one that represents the expected outcome from the range of possible outcomes for future experience of that assumption and is reasonable and realistic with no deliberate margins for prudence included.

AIPL has not applied to the competent authority for any transitional measures on technical provisions.

## D.2.2 Technical provisions methodology and assumptions

### (i) Cash flow modelling

A deterministic valuation approach producing point estimates, based on best estimate assumptions and all relevant future cash flows required to settle the life insurance liabilities, is used. The best estimate liability is calculated separately for cash flows in different currencies. AIPL's cash flows are all modelled in sterling. Cash flows are modelled gross and net of reinsurance recoverables.

The cash flow projections used in the calculation of the best estimate liability for life insurance business are made separately for each policy for annuity business, but grouped together for unit-linked business since contracts are essentially homogeneous.

The calculation of technical provisions is performed on a going concern basis. This means current fully loaded unit costs are assumed to continue, which implicitly assumes that future business will replace that running off.

### (ii) Minimum technical provision per policy

Technical provisions for insurance contracts are allowed to be negative where future cash in-flows are expected to exceed future cash out-flows.

The technical provisions of an insurance or reinsurance contract may be lower than the surrender value available to the policyholder of the underlying contract. This means that if the sum of the best estimate liability and the risk margin of a contract is lower than the surrender value of that contract, then the value of insurance liabilities is not increased to the surrender value of the contract.

### (iii) Contract Boundaries

Solvency II technical provisions are required to allow for any boundaries of the insurance contract. A boundary exists where the insurance undertaking has a unilateral right to: terminate the contract; reject premiums payable under the

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contract; or amend the premiums or benefits payable under the contract at a future date in such a way that the premiums fully reflect the risks.

As per EIOPA guidance (see "Answers to questions on Guidelines on contract boundaries" on <https://eiopa.europa.eu/Pages/Guidelines/Q-and-A-on-Regulation-Answers-Guidelines.aspx>), Solvency II technical provisions for unit linked business are required to take into consideration all expected profits over the expected lifetime of the contracts based on those premiums paid to date. At 31 December 2016, the Solvency II technical provisions were calculated projecting cash flows over the expected lifetime of the policyholder contracts rather than applying a short contract boundary. Only premiums paid to date were included in the projection; any future premiums would fall outside the contract boundary.

## (iv) Cash flows in scope

For life insurance obligations, all cash flows required to settle the insurance liabilities over their lifetime are taken into account. The table below summarises the main cash flows that are modelled:

Gross cash in-flows	Gross cash out-flows
Annual management (and other) charges in Unit Linked Business	Benefits including: <ul style="list-style-type: none"><li>- Surrender benefits</li><li>- Annuity payments</li></ul>
	Expenses including: <ul style="list-style-type: none"><li>- Investment management expenses</li><li>- Administrative expenses</li></ul>
Reinsurance cash in-flows	Reinsurance cash out-flows
Reinsurance recoveries in respect of gross annuity benefit payments	None

No future premiums are taken into account. There are no regular premium contracts in force.

## (v) Annuity payments

The annuity business is valued by discounting future benefit payments with an allowance for mortality, including future improvements in mortality. The liability is zero net of reinsurance. The mortality allowances are expressed as a percentage of PCMA2000 and PCFA2000 tables projected to 2015. Future improvements are based on CMI\_2015 with a long-term improvement rate of 1.75% pa for males and 1.5% pa for females.

## (vi) Economic and non-economic assumptions

Economic assumptions are reviewed quarterly while non-economic assumptions are reviewed at least on an annual basis to ensure that these remain appropriate, relevant and realistic. The choice of assumptions is validated through experience analyses and, where available and appropriate, benchmarked against external sources.

The basic risk-free rate curves used to value the technical provisions reflect the curves published by EIOPA.

The risk-free rates at key durations used to value the technical provisions at full year 2016 are stated in the table below. The figures shown below allow for a Credit Risk Adjustment of 17 bps.

Risk-free rates	1 year	5 years	10 years	15 years	20 years
	0.38%	0.69%	1.08%	1.26%	1.32%

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There is no Matching Adjustment or Volatility Adjustment applied.

Expense inflation

Expenses which are not directly related to unit-linked assets are assumed to increase in line with RPI +0.5% p.a. The annual rate of increase used at end-2016 was 3.92%.

Tax rates

The tax assumptions used at 31 December 2016 are shown in the table below.

Parameter	31 December 2016
Corporation tax (current year)	20%
Corporation tax (future profits)	18%

## (vii) Reinsurance counterparty default allowances

Reinsurance counterparty default risk is allowed for in calculating the best estimate liability. Reinsurance counterparty default in the best estimate liability depends on:

- The probability of default based on the credit rating of the counterparty and the year of projection; and
- The recovery rate which is a constant over time, but varies by reinsurer.

## (viii) Expenses

For the reinsured annuity business, the gross reserves are calculated assuming the same level of expenses as the reinsurer and the net reserve for expenses is zero.

For unit-linked business, the future profits following the valuation date allow for all expected expenses, including:

- Investment management fees in line with the management agreement between AIPL and Aviva Investors Global Services Limited (AIGSL);
- Fund administration and other administration services payable to AIGSL for costs equivalent to those levied by JPMorgan Chase Bank related to fund accounting and also other corporate overhead fees in line with the outsourcing arrangement;
- Registrar and transfer agent fees payable to AIGSL to cover maintenance and system access in line with the outsourcing arrangement and also costs equivalent to those levied by Royal Bank of Canada (RBC) to cover shareholder servicing, transaction processing and any other transfer agent fees; and
- Distribution fees payable to AIGSL for business development services.

## (ix) Persistency assumptions

Recent persistency experience is reviewed annually in order to set assumptions for the number of unit-linked policies remaining in force. The lapse rate assumptions are 10% p.a. for segregated schemes, and 12% p.a. for other business.

## (x) Events not in data ("ENID")

The term ENID refers to any events not deemed to be captured by the data, which need to be allowed for within the best estimate calculation to allow for the uncertainty in the future cash flows. ENIDs are considered both at line of business level, and at portfolio level with allocations to lines of business, depending on the scenario being considered.



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AIPL considers ENID through adjusting the best estimate assumptions to ensure the likely impact of the event is included. Expert judgement is applied to determine the expected impact on future experience.

For unit-linked business, the assumed lapse rates take into account expert judgement on expected future experience. For the reassured annuity business, annuitant mortality assumptions follow the reinsurer's basis which implicitly allows for ENID.

## (xi) Tax

Reserves are established (or credit is taken) for tax on unrealised gains (or losses) for unit-linked business as part of the technical provisions.

## (xii) Consistency of assumptions

The calculation of the best estimate liability requires a number of projection assumptions to be used. These assumptions are consistently reflected in both the valuation of technical provisions and the calculation of the SCR where necessary.

### D.2.3 Material differences between the SII and IFRS valuation bases

In contrast to Solvency II, the IFRS provisions are a single calculation of liabilities, with appropriate margins for risk included within the assumptions and/or methodology. There is also a different approach to discounting.

The following table summarises the Company's gross technical provisions split by Solvency II line of business. The Solvency II technical provisions in 'Other life insurance' are shown gross of reinsurance (see F.2 'Public disclosure templates', S.02.01.02 'Balance sheet').

#	Insurance liability As at 31 December 2016	IFRS technical provisions £m	Best Estimate Liability (BEL) £m	Risk Margin (RM) £m	Solvency II technical provisions £m	Difference £m
31	Index-linked and unit-linked	1,596.6	1592.4	1.9	1,594.4	(2.2)
32	Other life insurance	8.7	10.1	0.4	10.5	1.8
	Total	1,605.3	1602.5	2.4	1,604.9	(0.4)

Key areas of difference between the methods used to calculate Solvency II technical provisions and the methods used to calculate IFRS technical provisions are:

### (i) Treatment of unit-linked business

Under IFRS, the technical provisions for unit-linked business are based on current unit value (plus an allowance for non-unit cash flows if this would increase the technical provisions, though this is not the case at 31 December 2016). Under Solvency II, the technical provisions are lower than the unit value reflecting the profits expected to emerge in respect of future management charges expected to be earned from existing business. This results in a decrease in Solvency II best estimate liability relative to IFRS technical provisions.

## (ii) Discount Rates

Solvency II best estimate liabilities are valued using an EIOPA prescribed basic risk-free rate curve with an allowance for credit risk. No matching adjustment or volatility adjustment is used. For annuities, the IFRS discount rate is higher than the Solvency II risk-free rates because it includes a liquidity premium; this results in lower IFRS best estimate liability for annuities business. Discount rates have no impact on unit-linked IFRS best estimate because IFRS non-unit provisions are zero due to the treatment described above.

As noted earlier in this report, AIPL has not applied to the competent authority for any transitional measures on risk-free interest rates.

## (iii) Risk Margin

In addition to the best estimate liability, Solvency II technical provisions include a risk margin for all material life lines of business. This, combined with the different discount rate applied, results in Solvency II technical provisions being higher than IFRS technical provisions for the annuities business. For the unit-linked business, the risk margin offsets the reduction in best estimate liability versus the IFRS technical provisions but does not result in the Solvency II technical provisions exceeding IFRS technical provisions due to the recognition of profits on future business (see section D.2.2 (i) 'Treatment of unit-linked business').

## (iv) IFRS margins

For annuities, best estimate mortality assumptions are aligned between IFRS and Solvency II. Under IFRS, explicit margins are added to the mortality assumptions, and these increase the IFRS technical provisions relative to the Solvency II best estimate liability. However, this is more than offset by the difference in discount rates used for annuity business.

IFRS margins have no impact on unit-linked IFRS technical provisions because IFRS non-unit provisions are zero due to the treatment described above.

## D.2.4 Level of uncertainty in value

The best estimate liability corresponds to the probability-weighted average of future cash flows, taking account of the time value of money using the relevant risk-free interest rate term structure. They reflect estimates of how markets and the business might behave in the future given policyholder data, cash flow models and a set of assumptions.

All estimates are based on management's knowledge of current facts and circumstances; assumptions based on that knowledge; and their predictions of future events and actions. Actual results may differ from those estimates, possibly significantly. The list below sets out the estimates and assumptions that are considered particularly susceptible to valuation uncertainty:

- Fluctuation in the amount and/or timing of claims events, e.g. when estimating the length of time for which an annuity will be paid. This requires a projection of annuitant mortality rates in excess of 20 years into the future which cannot be done with certainty;
- Changes in the value of an index/market values used to determine claims amounts, e.g. estimating future market values of the unit-linked assets; and
- Uncertainty in policyholder behaviour, e.g. for estimating lapse rates for unit-linked policies.

The best estimate liability assumptions are governed by a rigorous process, underpinned by actuarial judgement and peer review.

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Following the requirements of the Aviva Group Data Governance and Model Governance standards helps to ensure that the cash flow models used to calculate technical provisions, and the data which is used within that calculation, are fit for purpose and are managed under appropriate change control processes.

## Regulatory compliance

The Company's insurance business is subject to local regulation in the UK. It is dual regulated directly authorised by both the PRA (for prudential regulation) and the FCA (for conduct regulation). Between them, the PRA and the FCA have broad powers including the authority to grant, vary the terms of, or cancel a regulated firm's authorisation; to investigate marketing and sales practices; and to require the maintenance of adequate financial resources. The Company has compliance resources to respond to regulatory enquiries in a constructive way, and take corrective action when warranted. However, all regulated financial services companies face the risk that their regulator could find that they have failed to comply with applicable regulations or have not undertaken corrective action as required. The impact of any such finding could have a negative impact on the Company's reported results.

### D.2.5 Risk margin methodology

The risk margin is calculated using a Cost of Capital (CoC) approach allowing for diversification between lines of business, and is on a net-of-reinsurance basis.

The calculation of the risk margin is defined as the present value of the cost of capital applied to the Solvency Capital Requirement in respect of non-hedgeable risks in each future year.

The cost of capital rate is the cost in excess of the risk-free rate, to the third party taking over the liabilities, of raising and holding capital to support the non-hedgeable risks over the lifetime of the business. The same cost of capital rate is used for all insurance companies and is prescribed by EIOPA at 6% per annum.

As the SCR in the risk margin calculation takes into account non-hedgeable risks only, the rate used to discount the projected non-hedgeable SCR is the basic risk-free rate (including credit risk adjustment).

The SCR in the risk margin calculation takes the following risks into account:

- Life underwriting risk, including lapse risk
- Counterparty default risk with respect to reinsurance contracts
- Operational risk

All market risks in respect of investment assets are considered hedgeable.

No allowance for the loss absorbency of deferred taxes is included in the risk margin.

In order to project the non-hedgeable Solvency Capital Requirement which underpins the risk margin, some projection simplifications are necessary to ensure that the risk margin calculation remains proportionate to the nature, scale and complexity of the business.

This means that for expense risk, the projected SCR run-off has been calculated directly and no approximation is made, but for other risks, so-called risk carriers are used, where a suitable statistic is chosen which can be readily projected and used as a proxy for the projected size of the risk relative to its size at the balance sheet date. For example, the best estimate liability excluding the unit value ("non-unit BEL") is used as a carrier for both lapse risk and operational risk. For counterparty default risk, the gross annuity best estimate liability is used as a carrier.

The risk margin allows for diversification between risks using the Standard Formula defined aggregation approach.

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## D.2.6 Simplified methods

There are no material simplifications used by management.

## D.3 Other Liabilities

This section details how "other liabilities" are valued under Solvency II rules and how this differs to the statutory accounts valuations. There have been no changes made to the recognition and valuation bases during the reporting period.

Under Solvency II, other liabilities expected to be paid within one year are considered to be the same as IFRS value.

### D.3.1 Deferred tax liabilities

Deferred tax for Solvency II valuation purposes is determined on a non-discounted basis in accordance with IAS 12 principles on 'temporary differences' between the economic value of assets or liabilities on the Solvency II balance sheet and their tax base.

Deferred tax balances in the Solvency II balance sheet differ from those already recognised in the IFRS balance sheet as a result of differences between the IFRS and Solvency II balance sheet valuation basis and consequential impact on recognition of deferred tax liabilities.

Under IFRS, at 31 December 2016, the IFRS value of deferred tax liabilities is £0.1 million. The Solvency II value is £0.3 million. The difference is due to the deferred tax liability associated with the risk margin and the present value of future profits on unit linked contracts within the best estimate liabilities.

### D.3.2 Lease arrangements

At 31 December 2016, AIPL has finance lease commitments totalling £17.4 million. The average lease term is 86 years (2015: 85 years). All other leases are operating leases held off balance sheet. There is no difference between the IFRS and Solvency II valuation of finance leases.

### D.3.3 Payables (trade, not insurance)

Under Solvency II, payables are measured at fair value, adjusted to eliminate movement in fair value due to changes in the own credit standing of the entity. Under IFRS, payables are initially recognised at cost, being fair value. Subsequent to initial measurement they are measured at amortised cost. There is no difference in the valuation of trade payables between the restated IFRS balance sheet and the Solvency II balance sheet.

### D.3.4 Other liabilities

Other liabilities expected to be paid within one year are carried at cost under Solvency II, which approximates to fair value. This is consistent with the valuation approach for IFRS.

## D.4 Alternative methods of valuation

At 31 December 2016, approximately 65% of AIPL's unit-linked assets are held in investment property for which quoted market data or observable market data is not available. In addition, approximately 8% of AIPL's unit-linked assets in debt securities are valued based on inputs other than quoted prices in active markets that are observable for the asset, either directly or indirectly. The remainder of AIPL's assets and liabilities are measured at fair value based

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on quoted market information or observable market data. Where the quoted market information or observable market data is not available, an alternative method for valuation is used.

Although the Solvency II valuation hierarchy differs from IFRS, the methodology for valuing assets and liabilities measured at fair value remains consistent. The assets valued using quoted prices for identical or similar assets from inactive markets (within the fair value hierarchy of IFRS) fall under alternative methods for valuation under Solvency II.

## (i) Justification for use of alternative valuation method approach

In accordance with the Aviva Group Assets Valuation Business Standard, alternative methods for valuation are applied in respect of the valuation of assets and liabilities only where a readily observable, external market valuation is not available, or where the relevant market is deemed to be inactive.

## (ii) Assumptions underlying the valuation approach and key drivers of valuation uncertainty

Alternative methods for valuation include the use of estimates and assumptions that are not market observable but based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible. Valuation uncertainty arises from variation in the expected range of the key inputs feeding into models, judgemental features of model inputs and assumptions used and reliance on third-party adherence to accepted valuation standards.

The main assumptions underlying the valuation approach and key drivers of valuation uncertainty for investment property are described below:

### Investment Property

Directly held investment property is valued in the UK at least annually by external chartered surveyors in accordance with guidance issued by The Royal Institution of Chartered Surveyors (RICS), and using estimates during the intervening period. Investment properties are valued on an income approach that is based on current rental income plus anticipated uplifts at the next rent review, lease expiry, or break option taking into consideration lease incentives and assuming no further growth in the estimated rental value of the property. The uplift and discount rates are derived from rates implied by recent market transactions on similar properties.

The extent of uncertainty systemic within the valuation of investment properties has been assessed based on ranges of expected rental yields provided by several independent surveyors by property type.

The property fund also holds properties in a development programme which are valued using a residual valuation method. Under this methodology, the valuer assesses the completed development value using income and yield assumptions. Deductions are then made for estimated costs to complete, including finance and developer's profit, to arrive at the valuation. As the development approaches completion, the valuer may consider the income capitalisation approach to be more appropriate.

## (iii) Adequacy of valuation compared to experience

AIPL is required to operate independent price verification (IPV) controls, including an assessment of adequacy of valuation methods applied, across all assets.

For illiquid assets such as AIPL's investment property, which are marked to model, the IPV process includes a review of the valuation methodology and periodic assessment of both observable and judgemental model inputs.

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For investment property AIPL relies on implementation of accepted valuation standards by parties that are independent to the Group.

## D.5 Any other material information

The Company has no other material information to disclose.

# Section E

## Capital Management

### In this Chapter

- E.1 Own Funds
- E.2 Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR)
- E.3 Use of duration-based equity risk sub-module in the calculation of the SCR
- E.4 Difference between the standard formula and any internal model used
- E.5 Non-compliance with the MCR and non-compliance with the SCR
- E.6 Any other material information

## SECTION E: CAPITAL MANAGEMENT

The Capital Management section of the report describes the objectives, policies and procedures employed by AIPL for managing its own funds. The section also covers information on structure and quality of own funds and calculation of SCR.

### E.1 Own Funds

#### E.1.1 Management of Own Funds

The primary objective of capital management is to maintain an efficient capital structure, in a manner consistent with the Company's risk profile and the regulatory and market requirements of the business. In managing Own Funds, the Company seeks to:

- Match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- Maintain sufficient, but not excessive, financial strength in accordance with risk appetite to support new business growth and satisfy the requirements of its policyholders and its regulators;
- Retain financial flexibility by maintaining strong liquidity; and
- Allocate capital efficiently to support growth and repatriate excess capital where appropriate.

In order to achieve these objectives, Own Funds are monitored via projections over a three year planning horizon. The Company also uses a number of sensitivity tests to understand the volatility of earnings (being the primary determinant of Own Funds for the Company) and to manage its capital more efficiently. Sensitivities to economic and operating experience are regularly produced on the Company's key financial performance metrics to inform decision making and planning processes, and as part of the framework for identifying and quantifying the risks to which the Company is exposed.

A Capital Management Standard, applicable Aviva Group-wide, sets out minimum standards and guidelines over responsibility for capital management, including consideration for capital management discussions and requirements for management information, capital monitoring, reporting, forecasting, planning and overall governance.

There have been no material changes to the objectives, policies or processes with respect to the management of Own Funds during the year.

#### E.1.2 Own Funds by tier

The table below sets out AIPL's Own Funds by tier at 31 December 2016.

As at 31 December 2016	Total £m	Tier 1 Unrestricted £m
Ordinary share capital	8.0	8.0
Reconciliation reserve	4.5	4.5
<b>Total Basic Own Funds</b>	<b>12.5</b>	<b>12.5</b>
<b>Total Eligible Own Funds to meet the SCR &amp; MCR</b>	<b>12.5</b>	<b>12.5</b>

All of the Company's Own Funds is unrestricted Tier 1 capital. This consists of ordinary share capital and the reconciliation reserve, which reconciles the total excess of assets over liabilities less share capital. Dividend payments are not declared. As such all of the Company's share capital can be classified as Tier 1.



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At 31 December 2016, total basic Own Funds equal the total eligible Own Funds to meet the SCR, with no tiering limit restrictions. Further information on Own Funds by tier is presented in QRT S.23.01.01 'Own Funds' within section F.2 'Public disclosure templates'.

## E.1.3 Reconciliation reserve

The table below sets out the constituents of the reconciliation reserve:

	Total £m
As at 31 December 2016	
Solvency II excess of assets over liabilities	12.5
Share capital	(8.0)
Reconciliation reserve	4.5

The reconciliation reserve equals the total excess of Solvency II assets over liabilities reduced by the share capital.

## E.1.4 Differences between IFRS net assets and the excess of assets over liabilities as calculated for solvency purposes

The table below lists the material differences between equity as shown in the financial statements of the Company and the excess of assets over liabilities as calculated under Solvency II:

	Total £m
As at 31 December 2016	
Total equity on an IFRS basis	11.2
Liability valuation differences	4.1
Reinsurance recoverable valuation differences	(0.1)
Inclusion of risk margin	(2.4)
Net deferred tax <sup>1</sup>	(0.3)
Solvency II Net Assets	12.5
Difference between IFRS and SII Net Assets	1.3

<sup>1</sup>Net deferred tax includes the tax effect of all other reconciling items in the table above which are shown gross of tax.

Overall, the increase in net assets of £1.3 million under Solvency II compared to IFRS results from solvency valuation differences. The key component of this movement is the recognition of future expected profits within unit linked Solvency II best estimate liabilities (£4.1 million) which is partially offset by the associated Solvency II risk margin (£2.4 million). Other differences include the default risk associated with reinsurance recoverables and the deferred tax liability arising on valuation differences which are shown gross of tax.

Valuation of assets and liabilities is explained further in sections D.1 'Assets', D.2 'Technical Provisions', D.3 'Other liabilities' and D.4 'Alternative methods of valuation'.

## E.2 Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR)

### E.2.1 SCR Calculation Method

AIPL calculates the SCR using the Standard Formula which is a regulatory prescribed method with standard model parameters. Given the company has a non-complex business model offering no guarantees on performance or charges, the Board considers that this appropriately reflects AIPL's risk profile. Appropriate allowance is made for agreed management actions within the calculation of the SCR.

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## E.2.2 Solvency Capital Requirement (SCR)

AIPL's SCR at 31 December 2016 is £7.4 million. The SCR has increased in 2016, primarily as a result of the removal of the short contract boundary assumption leading to a longer projection period for future expected profits (see section E.1.4).

The table below shows the SCR split by risk module and the diversification benefit between risks.

SCR by risk module at 31 December 2016	£m
Life underwriting risks (i.e. lapse risk and expense risk)	4.7
Market risk	2.0
Credit risk (counterparty default risk)	0.6
Operational risk	1.9
Loss absorbing capacity of deferred taxes	(0.3)
Total undiversified components	8.9
Diversification	(1.5)
Solvency capital requirement	7.4

### Diversification Benefits

AIPL performs an analysis of the diversification benefit to provide assurance that the level of diversification applied is reasonable given the company's structure, mixture of risks and underlying risk calibrations. AIPL's overall diversification benefit is £1.5 million which is calculated on an undiversified SCR of £8.9 million, which is a ratio of 17%.

## E.2.3 Minimum Capital Requirement (MCR)

The MCR for each European Economic Area (EEA) insurance undertaking is calculated using a linear formula that applies prescribed factors to Technical Provisions, written premiums, capital at risk, deferred tax and administrative expenses (all net of reinsurance). In accordance with the guidelines the MCR is subject to a floor, equal to of 25% of the SCR, and a cap, equal to 45% of the SCR. The MCR is also subject to an absolute floor of €3.7 million. The MCR for the Company at 31 December 2016 is £3.3 million. The MCR is disclosed in QRT S.28.01.01 'Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity' (see section F.2 'Public disclosure templates').

## E.2.4 Standard Formula Simplifications

Where the SCR is calculated using the SF approach, the Solvency II regulations specify simplified calculations that may be used across all of the SF risk modules except operational risk. Management has not used any of these simplified calculations to calculate the SCR at 31 December 2016.

## E.2.5 Standard Formula Undertaking Specific Parameters (USPs)

Where the SCR is calculated using the SF approach, Solvency II regulations specify certain USPs that may be used in place of the standard parameters, subject to regulatory approval. These are available for life and health revision risks, and non-life (including some health) premium and reserve risks. Management has not used any USPs to calculate the SCR at 31 December 2016.

## E.2.6 Transitional measures, disclosure of capital add-ons and USPs (unaudited)

Local regulators have the power to impose capital add-ons to the SCR or to require the use of certain USPs in the SF, where there are significant deficiencies in a firm's internal model or partial internal model, or where a SF firm's risk profile deviates significantly from the assumptions underlying the SF. AIPL has not had to apply any capital add-ons to calculate the SCR at 31 December 2016. In addition, regulators have the option to specify that any capital add-ons

or the SCR impact of any required USPs do not need to be disclosed separately to the total SCR, during a transitional period. The PRA has chosen to exercise this option with a two-year transitional period.

## E.2.7 Material changes over the reporting period

The removal of the short contract boundary for unit-linked business was a material change in the year. This led to a longer projection period for future expected profits.

Management has complied with the MCR and SCR at all times during 2016. In anticipation of the change in contract boundaries, the business issued £2 million of ordinary share capital in December 2016, thereby ensuring that surplus capital, £5.1 million, and solvency ratio, 170%, remained within the risk appetite.

Previously, the absolute floor of the MCR exceeded SCR. However, the increase in SCR resulted in the combined MCR increasing to the cap, 45% of SCR, or £3.3 million. At 31 December 2016 the MCR cap is approximately equal to the absolute floor of €3.7 million, or £3.3 million, when converting the latter at the 31 October 2016 foreign exchange rate prescribed by the regulator.

## E.3 Use of the duration-based equity risk sub-module in the calculation of the SCR

Insurance firms that have particular types of retirement provision business managed on a ring-fenced basis, for which the SCR is calculated using the standard formula, are entitled to calculate the equity risk capital requirement using a specified duration-based approach. Management does not use the duration-based equity risk sub-module in the calculation of the SCR.

## E.4 Difference between the standard formula and any internal model used

Management only uses the Standard Formula and has not used an Internal Model at any point during 2016.

## E.5 Non-compliance with the MCR and non-compliance with the SCR

Management has complied with the MCR and SCR at all times during 2016.

## E.6 Any other material information

Management has no other material information to disclose regarding the capital management of its insurance undertaking.

# Section F

## Other Information

### In this Chapter

- F.1 Glossary of abbreviations used in the report
- F.2 Public disclosure templates
- F.3 Directors Statement
- F.4 Audit Opinion

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## F.1 Glossary of abbreviations used in the report

AIGSL	Aviva Investors Global Services Limited
AIHL	Aviva Investors Holdings Limited
AIPL	Aviva Investors Pensions Limited
Aviva Group	Aviva Plc Group
AUM	Assets under management
BEL	Best Estimate Liabilities
BMG	Business Management Group
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIU	Collective Investment Undertakings
CoC	Cost of Capital
CRO	Chief Risk Officer
EEA	European Economic Area
ENID	Events not in data
EU	European Union
FCA	Financial Conduct Authority
GAC	Group Audit Committee
GGC	Group Governance Committee
GRC	Group Risk Committee
Group CAO	Group Chief Audit Officer
IFRS	International Financial Reporting Standards
IPV	Independent price verification
JV	Joint Ventures
MCR	Minimum Capital Requirement
nhSCR	Non-hedgeable Solvency Capital Requirement
OCC	Operations & Controls Committee
ORSA	Own Risk and Solvency Assessment
PRA	Prudential Regulation Authority
QRT	Quantitative Reporting Template
RBC	Royal Bank of Canada
RFR	Risk-free interest rate
RM	Risk Margin
RMF	Risk Management Framework
SCR	Solvency Capital Requirement

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SF	Standard Formula
SFCR	Solvency and Financial Condition Report
USP	Undertaking Specific Parameter
UK	United Kingdom
UK Life	Aviva UK Life business

## F.2 Public disclosure templates

List of reported templates:

S.02.01.02 - Balance sheet

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

S.05.02.01 - Premiums, claims and expenses by country

S.12.01.02 – Life and Health SLT Technical Provisions

S.23.01.01 - Own Funds

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

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

The templates are included at the end of this report.

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## F.3 Directors statement

The Board is satisfied that to the best of its knowledge and belief:

(a) throughout the financial year to 31 December 2016, the firm has complied in all material respects with the requirements of the PRA rules and Solvency II Regulations as applicable to the firm; and

(b) it is reasonable to believe that in respect of the period from 31 December 2016 to the date of the publication of the SFCR, the firm has continued so to comply and that it will continue so to comply for the remainder of the financial year to 31 December 2017.

David Clayton  
Director

Tom Howard  
Director

19 May 2017



## F.4 Audit opinion

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

Report on the Audit of the relevant elements of the Solvency and Financial Condition Report

Opinion

We have audited the following documents prepared by the Company as at 31 December 2016:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2016, ('the Narrative Disclosures subject to audit'); and
- Company templates S.02.01.02, S.12.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 ('the Templates subject to audit').

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the 'relevant elements of the Solvency and Financial Condition Report'.

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

- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S.05.01.02 and S.05.02.01;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report ('the Responsibility Statement').

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Company as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

Basis for opinion

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

Emphasis of Matter - Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in

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accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

## Responsibilities of Directors for the Solvency and Financial Condition Report

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations.

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

## Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report

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

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

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

## Report on Other Legal and Regulatory Requirements

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

# SOLVENCY AND FINANCIAL CONDITION REPORT (SFCR)

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*PricewaterhouseCoopers LLP*

*Chartered Accountants*

7 More London Riverside,

London,

SE1 2RT

19 May 2017

- The maintenance and integrity of the Aviva Investors Pensions Limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Solvency and Financial Condition Report since it was initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of Solvency and Financial Condition Reports may differ from legislation in other jurisdictions.

**S.02.01.02****Balance sheet****Assets**

Intangible assets
Deferred tax assets
Pension benefit surplus
Property, plant & equipment held for own use
Investments (other than assets held for index-linked and unit-linked contracts)
Property (other than for own use)
Holdings in related undertakings, including participations
Equities
Equities - listed
Equities - unlisted
Bonds
Government Bonds
Corporate Bonds
Structured notes
Collateralised securities
Collective Investments Undertakings
Derivatives
Deposits other than cash equivalents
Other investments
Assets held for index-linked and unit-linked contracts
Loans and mortgages
Loans on policies
Loans and mortgages to individuals
Other loans and mortgages
Reinsurance recoverables from:
Non-life and health similar to non-life
Non-life excluding health
Health similar to non-life
Life and health similar to life, excluding health and index-linked and unit-linked
Health similar to life
Life excluding health and index-linked and unit-linked
Life index-linked and unit-linked
Deposits to cedants
Insurance and intermediaries receivables
Reinsurance receivables
Receivables (trade, not insurance)
Own shares (held directly)
Amounts due in respect of own fund items or initial fund called up but not yet paid in
Cash and cash equivalents
Any other assets, not elsewhere shown
<b>Total assets</b>

		Solvency II value
		C0010
<b>R0030</b>		
<b>R0040</b>		
<b>R0050</b>		
<b>R0060</b>		
<b>R0070</b>		9,200
<b>R0080</b>		
<b>R0090</b>		
<b>R0100</b>		
<b>R0110</b>		
<b>R0120</b>		
<b>R0130</b>		
<b>R0140</b>		
<b>R0150</b>		
<b>R0160</b>		
<b>R0170</b>		
<b>R0180</b>		9,200
<b>R0190</b>		
<b>R0200</b>		
<b>R0210</b>		
<b>R0220</b>		1,616,482
<b>R0230</b>		
<b>R0240</b>		
<b>R0250</b>		
<b>R0260</b>		
<b>R0270</b>		9,953
<b>R0280</b>		
<b>R0290</b>		
<b>R0300</b>		
<b>R0310</b>		9,953
<b>R0320</b>		
<b>R0330</b>		9,953
<b>R0340</b>		
<b>R0350</b>		
<b>R0360</b>		
<b>R0370</b>		
<b>R0380</b>		538
<b>R0390</b>		
<b>R0400</b>		
<b>R0410</b>		2,640
<b>R0420</b>		4
<b>R0500</b>		1,638,817

**S.02.01.02****Balance sheet****Liabilities**

Technical provisions – non-life

Technical provisions – non-life (excluding health)

TP calculated as a whole

Best Estimate

Risk margin

Technical provisions - health (similar to non-life)

TP calculated as a whole

Best Estimate

Risk margin

Technical provisions - life (excluding index-linked and unit-linked)

Technical provisions - health (similar to life)

TP calculated as a whole

Best Estimate

Risk margin

Technical provisions – life (excluding health and index-linked and unit-linked)

TP calculated as a whole

Best Estimate

Risk margin

Technical provisions – index-linked and unit-linked

TP calculated as a whole

Best Estimate

Risk margin

Contingent liabilities

Provisions other than technical provisions

Pension benefit obligations

Deposits from reinsurers

Deferred tax liabilities

Derivatives

Debts owed to credit institutions

Financial liabilities other than debts owed to credit institutions

Insurance &amp; intermediaries payables

Reinsurance payables

Payables (trade, not insurance)

Subordinated liabilities

Subordinated liabilities not in BOF

Subordinated liabilities in BOF

Any other liabilities, not elsewhere shown

**Total liabilities****Excess of assets over liabilities**

	Solvency II value
	C0010
<b>R0510</b>	
<b>R0520</b>	
<b>R0530</b>	
<b>R0540</b>	
<b>R0550</b>	
<b>R0560</b>	
<b>R0570</b>	
<b>R0580</b>	
<b>R0590</b>	
<b>R0600</b>	10,504
<b>R0610</b>	
<b>R0620</b>	
<b>R0630</b>	
<b>R0640</b>	
<b>R0650</b>	10,504
<b>R0660</b>	
<b>R0670</b>	10,075
<b>R0680</b>	429
<b>R0690</b>	1,594,374
<b>R0700</b>	
<b>R0710</b>	1,592,435
<b>R0720</b>	1,939
<b>R0740</b>	
<b>R0750</b>	
<b>R0760</b>	
<b>R0770</b>	
<b>R0780</b>	326
<b>R0790</b>	
<b>R0800</b>	
<b>R0810</b>	
<b>R0820</b>	
<b>R0830</b>	
<b>R0840</b>	18,549
<b>R0850</b>	
<b>R0860</b>	
<b>R0870</b>	
<b>R0880</b>	2,549
<b>R0900</b>	1,626,302
<b>R1000</b>	12,515.66





S.12.01.02  
Life and Health SLT Technical Provisions

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

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

**Best Estimate**  
**Gross Best Estimate**  
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default  
Best estimate minus recoverables from reinsurance/SPV and Finite Re - total

**Risk Margin**  
**Amount of the transitional on Technical Provisions**  
Technical Provisions calculated as a whole  
Best estimate  
Risk margin

**Technical provisions - total**

	Insurance with profit participation	Index-linked and unit-linked insurance		Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, incl. Unit-Linked)	
		Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees				
	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0150
<b>R0010</b>										
<b>R0020</b>										
<b>R0030</b>			1,592,435			10,075				1,602,510
<b>R0080</b>						9,953				9,953
<b>R0090</b>			1,592,435			122				1,592,557
<b>R0100</b>		1,939			429					2,368
<b>R0110</b>										
<b>R0120</b>										
<b>R0130</b>										
<b>R0200</b>		1,594,374			10,504					1,604,878



**S.23.01.01**

**Own funds**

**Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation (EU) 2015/35**

- Ordinary share capital (gross of own shares)
- Share premium account related to ordinary share capital
- Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings
- Subordinated mutual member accounts
- Surplus funds
- Preference shares
- Share premium account related to preference shares
- Reconciliation reserve
- Subordinated liabilities
- An amount equal to the value of net deferred tax assets
- Other own fund items approved by the supervisory authority as basic own funds not specified above

**Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds**

Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds

**Deductions**

Deductions for participations in financial and credit institutions

**Total basic own funds after deductions**

**Ancillary own funds**

- Unpaid and uncalled ordinary share capital callable on demand
- Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand
- Unpaid and uncalled preference shares callable on demand
- A legally binding commitment to subscribe and pay for subordinated liabilities on demand
- Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC
- Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC
- Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC
- Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC
- Other ancillary own funds

**Total ancillary own funds**

	Total	Tier 1 - unrestricted	Tier 1 - restricted	Tier 2	Tier 3
	C0010	C0020	C0030	C0040	C0050
<b>R0010</b>	8,000	8,000			
<b>R0030</b>					
<b>R0040</b>					
<b>R0050</b>					
<b>R0070</b>					
<b>R0090</b>					
<b>R0110</b>					
<b>R0130</b>	4,515	4,515			
<b>R0140</b>					
<b>R0160</b>					
<b>R0180</b>					
<b>R0220</b>					
<b>R0230</b>					
<b>R0290</b>	12,515	12,515			
<b>R0300</b>					
<b>R0310</b>					
<b>R0320</b>					
<b>R0330</b>					
<b>R0340</b>					
<b>R0350</b>					
<b>R0360</b>					
<b>R0370</b>					
<b>R0390</b>					
<b>R0400</b>					

**S.23.01.01**

**Own funds**

**Available and eligible own funds**

Total available own funds to meet the SCR

Total available own funds to meet the MCR

Total eligible own funds to meet the SCR

Total eligible own funds to meet the MCR

**SCR**

**MCR**

**Ratio of Eligible own funds to SCR**

**Ratio of Eligible own funds to MCR**

**Reconciliation reserve**

Excess of assets over liabilities

Own shares (held directly and indirectly)

Foreseeable dividends, distributions and charges

Other basic own fund items

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

**Reconciliation reserve**

**Expected profits**

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

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

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

	<b>Total</b>	<b>Tier 1 - unrestricted</b>	<b>Tier 1 - restricted</b>	<b>Tier 2</b>	<b>Tier 3</b>
<b>R0500</b>	12,515	12,515			
<b>R0510</b>	12,515	12,515			
<b>R0540</b>	12,515	12,515			
<b>R0550</b>	12,515	12,515			
<b>R0580</b>	7,363				
<b>R0600</b>	3,332				
<b>R0620</b>	1,6999				
<b>R0640</b>	3.7775				

	<b>C0060</b>
<b>R0700</b>	12,515
<b>R0710</b>	
<b>R0720</b>	
<b>R0730</b>	8,000
<b>R0740</b>	
<b>R0760</b>	4,515
<b>R0770</b>	
<b>R0780</b>	
<b>R0790</b>	

**S.25.01.21**

**Solvency Capital Requirement - for undertakings on Standard Formula**

Market risk  
 Counterparty default risk  
 Life underwriting risk  
 Health underwriting risk  
 Non-life underwriting risk  
 Diversification  
 Intangible asset risk  
**Basic Solvency Capital Requirement**

**Calculation of Solvency Capital Requirement**

Operational risk  
 Loss-absorbing capacity of technical provisions  
 Loss-absorbing capacity of deferred taxes  
 Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC

**Solvency capital requirement excluding capital add-on**

Capital add-on already set

**Solvency capital requirement**

**Other information on SCR**

Capital requirement for duration-based equity risk sub-module  
 Total amount of Notional Solvency Capital Requirement for remaining part  
 Total amount of Notional Solvency Capital Requirements for ring fenced funds  
 Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios  
 Diversification effects due to RFF nSCR aggregation for article 304

	Gross solvency capital requirement	USP	Simplifications
	C0110	C0090	C0100
<b>R0010</b>	2,006		
<b>R0020</b>	591		
<b>R0030</b>	4,720		
<b>R0040</b>			
<b>R0050</b>			
<b>R0060</b>	- 1,540		
<b>R0070</b>			
<b>R0100</b>	5,777		

	C0100
<b>R0130</b>	1,859
<b>R0140</b>	
<b>R0150</b>	- 273
<b>R0160</b>	
<b>R0200</b>	7,363
<b>R0210</b>	
<b>R0220</b>	7,363
<b>R0400</b>	
<b>R0410</b>	
<b>R0420</b>	
<b>R0430</b>	
<b>R0440</b>	

**S.28.01.01**

**Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity**

**Linear formula component for life insurance and reinsurance obligation:**

	<b>C0040</b>
MCR <sub>L</sub> Result	<b>R0200</b> 11,150

	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
	<b>C0050</b>	<b>C0060</b>
Obligations with profit participation - guaranteed benefits	<b>R0210</b>	
Obligations with profit participation - future discretionary benefits	<b>R0220</b>	
Index-linked and unit-linked insurance obligations	<b>R0230</b> 1,592,435	
Other life (re)insurance and health (re)insurance obligations	<b>R0240</b> 122	
Total capital at risk for all life (re)insurance obligations	<b>R0250</b>	

**Overall MCR calculation**

	<b>C0070</b>
Linear MCR	<b>R0300</b> 11,150
SCR	<b>R0310</b> 7,363
MCR cap	<b>R0320</b> 3,313
MCR floor	<b>R0330</b> 1,841
Combined MCR	<b>R0340</b> 3,313
Absolute floor of the MCR	<b>R0350</b> 3,332
	<b>C0070</b>
<b>Minimum Capital Requirement</b>	<b>R0400</b> 3,332