London & Colonial Assurance PCC PLC

Solvency and Financial Condition Report ('SFCR')

Contents

Executive Summary

Introduction

This report is the Solvency and Financial Condition Report (SFCR) of London & Colonial Assurance PCC PLC ('LCA' or 'the Company') for the reporting period ended 31 December 2020, pursuant to the Gibraltar Financial Services (Insurance Companies) Regulations 2020.

Business and Performance

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

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

During 2020 the new premiums received were £10.6m compared to £4.9m in 2019.

Claim payments were £41.0m in 2020 compared to £32.3m in 2019, and expenses were £1.1m in 2020 compared to £1.1m in 2019.

Returns on unit-linked investments for 2020 was (£0.1m) compared to £3.6m in 2019. The difference relates to a change in the way the Company reports movements within the policyholders' investment portfolios from 1 January 2020. Unrealised gains in 2020 were £12.7m, while in 2019 they were £23.6m.

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

System of Governance

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

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

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

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

Capital Management

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

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

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

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

The solvency position as at 31 December 2020 is as follows:

	Capital Requirement	Eligible Capital	Solvency Ratio
SCR	£ 6.7m	£ 11.3m	169.5%
MCR	£ 3.3m	£ 11.3m	338.1%

The solvency ratio is lower than the ratio as at 31 December 2019 (190.3%) mainly as a result of a fall in Eligible Own Funds of £1.2m and a small increase in SCR of £0.1m. The largest element of the fall in Own Funds was an increase in the expense inflation assumption from 0% to 2% per annum.

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

The Gibraltar Financial Services Commission (GFSC) requires that the Quantitative Reporting Templates (QRTs) are disclosed alongside the SFCR and the QRTs as at 31 December 2020 are published on the Company's website.

Risk Profile

Material risks based on their capital requirements

Insurance Risk

LCA's business does not carry any longevity risk as annuity payments are not guaranteed if the policyholder's fund runs out. LCA carries only negligible mortality risk on the portfolio bonds novated from its sister company STM Life Assurance PCC Plc ('STM Life').

The Life Underwriting Risk SCR reduced in 2020 mainly as a result of the following changes:

- Expense Risk - there is a risk that expenses are higher than anticipated, which would impact the SCR.

  The modelled "per-policy" expense was reduced in 2020 from £675 to £650 per policy as a result of the move to using a service company to administer the business of LCA as well as its sister company, STM Life. The use of a service company leads to a reduction in expense risk as future increases in per policy expenses are limited to increases due to economic inflation.

- Lapse Risk - the major element of the Lapse Risk SCR is the result of the mass lapse shock. The change in the expense inflation assumption from 0% to 2% led to an increase in the Non-unit reserves (i.e. a smaller negative value) which in turn led to a lower Mass Lapse capital requirement.

Market Risk

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

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

Overall, Market Risk rose by £1.0m in 2020 compared to 2019, primarily as a result of a bridging loan to STM Group of £1.8m made in November 2020.

Operational Risk

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

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

Material risks which are not in scope of the SCR

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

Strategic Risk

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

Further details are provided in **Section C.6.1 Strategic Risk.**

Group Risk

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

Stress and Scenario Testing

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

A. Business and Performance

A.1 Business and Performance

A.1.1 The Company

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

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

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

The Company's registered office and operating address is:

Montagu Pavilion

8-10 Queensway

Gibraltar

GX11 1AA

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

PO Box 940

Suite 3, Ground Floor Atlantic Suites

Europort Avenue

Gibraltar

Tel:+350 20040283

Fax:+350 20040282

E-Mail: information@fsc.gi

The Company's external auditor is:

Deloitte Limited

Merchant House

22/24 John Mackintosh Square

Gibraltar

GX11 1AA

A.1.2 Products

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

LCA is authorised to carry out services in the United Kingdom. LCA was also authorised to carry out services under EEA passporting arrangements, however from January 2021 (when the BREXIT transition period ended) Gibraltar-based insures are not able to sell their products in the EU.

A.1.3 Significant Business Events

- The UK's exit from the EU (BREXIT) did not have any impact on our business performance because LCA operates solely in the UK. The only change following BREXIT is that the Company is now required to comply with Gibraltar Financial Services (Insurance Companies) Regulations 2020 instead of EU's Solvency II regulations.
- In December 2020 the Board resolved to establish a Service Company for the provision of administration services to LCA and its sister company STM Life. LCA and STM Life have their own discrete resources, however pooling these resources in a common service company is expected to result in economies of scale. Staff and operations will be moved to the Service Company in 2021.

A.2 Underwriting Performance

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

	2020 £'000	**2019** £'000
New Gross Premiums	10,620	4,931
Premiums (assets) relating to Novated Policies *	9,075	79,606
Gross Claims (including annuity payments)	(41,035)	(32,363)
Expenses (Acquisition & Administration)	(1,062)	(1,088)

** In January 2020, 18 STM Life' Gibraltar and UK unit-linked policies were novated to LCA.*

Claims in the form of annuity payments, transfers out and the transfer of deceased proceeds to the estates were 27% greater than in 2019.

Expenses in 2020 were lower than in 2019. A breakdown of the expenses is provided in **Section A.4.2**.

A.3 Investment Performance

The investment return for 2020 compared to 2019 was as follows:

	2020 £'000	**2019** £'000
Investment return attributable to unit-linked policyholders	12,623	27,044
Investment returns on assets held to meet insurance liabilities	161	225
Investment Return	**12,784**	**27,269**

The investment income and investment performance in 2020 on assets held to meet the non-linked insurance liabilities of the Company are as follows:

	2020 £'000	**2019** £'000
Loans & Receivables	58	42
Cash & Other Investments	103	179
Total	**161**	**221**

A.4 Other Material Income and Expense

A.4.1 Overview of Revenue

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

Revenue	**2020** £'000	**2019** £'000
Net fee income from authorised activities	1,942	1,977
Income from investments	103	183
Income from Group undertakings	58	42
Total Revenue	**2,103**	**2,204**

Further information relating to the Company's performance can be found in the Income Statement of LCA's 2020 Financial Statements.

A.4.2 Overview of Expenses

The table below provides an analysis of the Company's other operating and administrative expenses on a GAAP basis as presented within the 2020 Financial Statements.

	2020 £'000	**2019** £'000
Staff Costs	273	182
Premise Costs	34	31
Other General Expenses	11	16
IT & Communications	31	11
Inter-Company Recharges	218	553
Audit	43	37
Actuarial	147	73
Other Professional Fees	199	82
License Fees	53	55
Bank Charges	2	10
Depreciation	4	4
Non-Executive Directors Fees	47	34
Total Expenses	**1,062**	**1,088**

B. System of Governance

B.1 Governance Structure

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

LCA's Board is comprised of three independent non-executive directors and two executive directors. The directors collectively have the appropriate balance of skills, knowledge and experience in the financial services industry. In setting its governance arrangements, the Board either reserves decision making powers to itself, or delegates these powers to a Board approved sub-committee or the Managing Director.

The responsibilities of the Board and Committees are summarised in **Section B.1.2** below. The responsibilities of the key functions are documented in the respective sections below.

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

- The Managing Director resigned in June 2020 a new Managing Director joined in July 2020.
- The Operations Director (who was also a member of the Board) resigned in November 2020.

B.1.1 Three Lines of Defence

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

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

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

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

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

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

B.1.2 Responsibilities of Board and Committees

The key responsibilities of the Board of Directors are:

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

The Board meets at least four times per year.

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

The key responsibilities of the committees are summarised below.

Risk and Compliance Committee

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

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

The responsibilities of the Risk and Compliance Committee are to:

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

taken to manage the risk profile.

- Monitor the effectiveness of internal controls. Approve actions to improve the controls and reduce the risks. Ensure that controls mitigating significant risks are regularly audited.
- Identify and assess the potential impact of emerging risks.
- Monitor the risk events (losses and near misses).

Audit Committee

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

The Audit Committee's key responsibilities are to:

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

Product Governance Committee

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

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

B.1.3 Key Functions

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

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

B.1.4 Remuneration Policy

The Company applies the following remuneration principles:

- Reward and remuneration will be clear and up to date with the market so that individuals are motivated and the Company is able to attract and retain key talent.
- Remuneration packages will be competitive and will recognise the relative remuneration in comparable markets.
- Remuneration is structured in a way that does not encourage excessive risk-taking activities.
- Remuneration consists of a fixed salary, pension and other benefits.
- With the exception of the Managing Director who is eligible to participate in the broader STM Group Senior Manager Performance Bonus Scheme, currently there are no budgeted bonus (variable compensation) arrangements in place for colleagues in LCA.

Annual Bonus Scheme for the MD of LCA

The Managing Director is eligible to participate in the broader STM Group Senior Manager Annual Performance Bonus Scheme. This scheme is predicated on the STM Group meeting its financial targets PBT (Profit Before Tax) with any bonus pot thereafter being generated from the surplus in excess of the PBT target. Bonuses are a function of the achievement of both Group financial targets, stretch subsidiary (Gibraltar businesses) financial targets, and the achievement of personal objectives.

Pension Scheme

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

Non-Executive Directors’ Fees

Remuneration for Non-Executive Directors comprises a basic fee.

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

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

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

Remuneration Committee

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

Remuneration at the subsidiary level is overseen by local management.

B.2 Fit and Proper

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

Fitness and Propriety Assessment

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

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

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

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

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

- Interviews, case studies, role plays, knowledge and skills tests and other recruitment assessments.
- Employment history and experience e.g. CV.
- Employment and character references.
- Identity verification, financial sanctions checks, and work permit checks.
- Financial services register and Companies House checks.
- Qualifications checks e.g., certificates, membership of professional bodies.
- Background financial checks e.g., credit checks.
- Background criminal checks e.g., disclosure and barring service.
- Background reputational and disciplinary/enforcement checks.
- Regulatory authorisation application form declarations.
- The candidate's openness and co-operation in providing such information when requested.

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

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

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

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

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

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

B.3.1 Risk Management System

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

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

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

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

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

Risk Appetite

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

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

Risk Identification, Assessment and Mitigation

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

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

Risk Management Reporting

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

B.3.2 Risk Management Function

The key responsibilities of the function include:

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

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

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

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

B.3.3 ORSA

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

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

The key processes that form part of the ORSA include:

- Risk appetite/tolerance statements (and their ongoing monitoring);
- Business planning processes (and ongoing monitoring of the implementation of the plan);

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

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

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

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

ORSA Report

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

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

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

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

Use of ORSA Results

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

- The ORSA results are an integral input to business planning and strategic decision making.
- When developing new products, changing or discontinuing existing products the Board would consider the impact on the capital and risk position of the Company.
- The results from the ORSA capital projection are used for capital planning to ensure the continued solvency is maintained.
- New risks associated with the business plan can be identified during the ORSA, in which case the risk appetite statement may have to be updated and new procedures and controls for managing

the risks will have to be implemented.

- Highlighting risk appetite breaches would require the Board to agree risk-reduction actions, or to decide that the risk appetite tolerance is not appropriate any longer and requires update.

B.4 Internal Control Systems

B.4.1 Internal Control Framework

The internal control framework is designed to:

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

The control framework includes the following elements:

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

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

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

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

B.4.2 Compliance Function

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

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

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

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

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

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

B.5 Internal Audit

B.5.1 Internal Audit Policy

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

LCA's Internal Audit function is outsourced to STM Group Internal Audit.

The implementation of recommendations is monitored by the Group Internal Audit function and reported to the Audit Committee on a quarterly basis.

B.5.2 Internal Audit Plan

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

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

B.6 Actuarial Function

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

The key responsibilities of the Chief Actuary are to:

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

- Provide actuarial opinion on data quality and underwriting effectiveness.

B.7 Outsourcing

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

Affiliated Service Providers:	Function / Work performed	Juris-diction
STM Group PLC	IT Services	UK
STM Group PLC	Human Resource Management	UK
STM Group PLC	Internal Audit Services	UK
STM Group PLC	Product Development and Marketing	UK
STM Fidecs Central Services	Compliance Services	Gibraltar
STM Fidecs Central Services	Company Secretarial Services	Gibraltar
STM Fidecs Central Services	Finance Function	Gibraltar
STM Fidecs Central Services	Legal Services	Gibraltar
STM Life	Policy Administration (for novated policies only)	Gibraltar

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

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

C. Risk Profile

Risk categories based on their capital impact are as follows:

	2020 £'000	2019 £'000
Life Underwriting Risk	3,900	4,939
Market Risk	3,787	2,754
Counterparty Risk	738	266
Diversification	(2,061)	(1,645)
Basic SCR	**6,364**	**6,315**
Operational Risk	325	272
SCR	**6,689**	**6,587**

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

The most significant changes between 2019 and 2020 affecting the figures are as follows:

- The "per-policy" expense reduced slightly from £675 to £650, however the assumption of expense inflation increased from 0% to 2% as a result of lower new business expectations.
- Overall Life Underwriting Risk reduced mainly as a result of a fall in mass lapse risk.
- Market Risk has increased by £1.0m from 2019 to 2020. The main driver of the increase is an increase in the loans to STM Group following a bridging loan of £1.8m made in November 2020.

C.1 Insurance Risk

Underwriting Risk

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

Reserving Risk

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

C.1.1 Risk Assessment

Risk Category	2020 £'000	2019 £'000
Expense Risk	1,436	1,721
Lapse Risk	2,959	3,825
Mortality Risk	163	209
Diversification within risk module	(658)	(816)
Life Risk SCR	**3,900**	**4,939**

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

The key risks are as follows:

Expense Risk

In 2020, the "per-policy" expense was reduced slightly from £675 to £650 as a result of an agreement with the service company which is currently being established. The central expense inflation assumption was increased from 0% to 2%. The move to the service company reduces future expense risk for LCA as per policy expenses are fixed subject to annual increases in economic inflation.

Overall, Expense Risk has reduced in 2020 in comparison to 2019 by £0.3m.

Lapse Risk

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

The increase in the expense inflation assumption from 0% to 2% per annum has contributed to a fall in Lapse Risk. The effect of higher expense inflation is to make in-force business less profitable in future years. This in turn means that the mass lapse shock yields a smaller capital requirement to cover Lapse Risk.

Overall, it is the mass lapse shock which provides the majority of the Lapse Risk SCR which has reduced by £0.8m from 2019 to 2020.

Mortality Risk

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

Longevity Risk

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

C.1.2 Risk Mitigation

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

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

The Company does not have any reinsurance in place.

C.1.3 Risk Sensitivity

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

C.2 Market Risk

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

C.2.1 Risk Assessment

Risk Category	**2020** £'000	**2019** £'000
Concentration Risk	2,400	794
Equity Type 1 Risk	2,503	2,488
Interest Rate Risk	43	241
Spread Risk	538	180
Diversification within risk module	(1,697)	(949)
Market Risk SCR	**3,787**	**2,754**

There was an increase in Market Risk capital requirements in 2020 compared to 2019 mainly as a result of the increases in Concentration Risk and Spread Risk.

The elements of Market Risk are:

Equity Type 1 Risk

No shareholder funds are invested in equities by LCA.

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

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

Equity Type 1 Risk remained fairly stable in 2020 compared to 2019.

Interest Rate Risk

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

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

Currency Risk

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

Concentration Risk

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

During 2020, loans to STM Group increased by £2.3m with a £0.5m loan in July and a further bridging loan of £1.8m made in November 2020.

The additional loans led to an increase in concentration risk of £1.6m in 2020 compared to 2019.

Spread Risk

Spread Risk arises mainly from the intercompany loans and increased by £350K in 2020 as a result of the additional loans.

C.2.2 Risk Mitigation

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

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

- The Company ensures that the 'Prudent Person Principle' is applied when investing the shareholders' assets (following the counterparty credit limits and concentration limits).
- The Company's risk appetite statement sets thresholds for Market Risk as a proportion of the undiversified basic SCR.
- If there is a significant reduction in asset values, the Company will consider reducing management expenses and increasing charges where possible. Within the LCA policies terms and conditions, there is a provision for fees to be changed subject to giving policyholders at least 30 days' notice. The Board will review whether making such increases in charges treats our customers fairly and if so, a cost of living increase will be applied to the charges. A cost of living increase can be applied to the novated STM Life policies as well, in accordance with their terms and conditions.

C.2.3 Risk Sensitivity

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

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

C.3 Credit Risk

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

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

C.3.1 Risk Assessment

	2020 £'000	**2019** £'000
Counterparty Risk	738	266

The funds held in bank accounts are the main element of this risk. The credit rating of the bank holding cash were reviewed at 31 December 2020 leading to an increase of £0.4m in counterparty risk.

C.3.2 Risk Mitigation

The key mitigating control for Credit Risk is:

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

C.3.3 Risk Sensitivity

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

C.4 Liquidity Risk

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

C.4.1 Risk Assessment

Liquidity Risk

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

£4.5m of policyholder assets are held in property funds, which represents an insignificant proportion (1.39%) of the total assets and does not require additional capital to be held.

C.4.2 Risk Mitigations

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

The following controls mitigate Liquidity Risk:

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

C.4.3 Expected Profit Included in Future Premiums

This requirement does not apply to LCA.

C.5 Operational Risk

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

C.5.1 Risk Assessment

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

C.5.2 Risk Mitigation

Operational Risk is managed through:

- Effective corporate governance, including segregation of duties, avoidance of conflicts of interest, clear lines of management responsibility, management information (MI) reporting.

- A strong internal control culture.
- Staff training/awareness of the control responsibilities relating to their roles.
- Appropriate and secure IT systems.
- Ensuring compliance with regulatory requirements.
- Recruiting/retaining adequately skilled staff, adequate performance assessment system.
- Procedures to minimise internal/external fraud.
- Ensuring accurate and timely financial and other external reporting.

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

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

C.5.3 Risk Sensitivity

Operational Risk is not a key risk driver for the SCR.

C.6 Other Material Risks

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

C.6.1 Strategic Risk

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

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

The emergence of the Coronavirus represented a new risk in 2020. When a global pandemic was declared in March 2020 the Company put in place contingency plans to minimise business disruption. The primary focus was the continued safety of staff and ensuring that we continue to provide a high quality service for our customers. The pandemic has so far had only limited impact on the Company's financial performance and risk profile.

A strategic project to merge LCA with its sister company STM Life has been initiated through initially forming a Service Company that will support both of the Life companies. A project to have one team working together was initiated in December 2020. This involved a restructuring and alignment of operations and administration areas supported by key functions.

C.6.2 Group Risk

Outsourcing to Group

LCA benefits from operational support through the services provided by Group functions as discussed in **Section B.7**. The Outsourcing Risk is mitigated by monitoring the performance of the outsourced services.

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

Group-wide Professional Indemnity (PI) insurance policy

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

Group Loans

LCA has provided a loan to its parent company and two further loans to the ultimate parent company.

C.6.3 Reputational Risk

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

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

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

The risk is mitigated by:

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

C.6.4 Conduct Risk

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

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

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

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

- Training is provided to employees.

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

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

C.7 Stress and Scenario Testing

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

The risks considered in the scenario testing in the 2020 ORSA were:

- No new business.
- Assets Values reduced permanently by 25%.
- Double Operational Risk.
- Compensation payments as a result of distressed assets.
- A combination scenario.

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

D. Valuation for Solvency Purposes

D.1 Assets

Summary of asset valuation

The table below sets out the valuation of the Company's assets on a GFRS102 and Solvency basis as at 31 December 2020:

Assets (£'000)	2020		2019	
	GFRS 102	Solvency	GFRS 102	Solvency
Investments – Cash	1,837	2,838	1,755	1,385
Investments - Bond and Deposits	1,000	-	2,807	2,807
Assets held to cover linked liabilities	333,650	323,120	342,266	333,926
Debtors	3,584	3,585	1,184	1,051
Other assets	2	10,201	6	8,472
Prepayments and accrued income	14	14	32	32
Total assets	**340,087**	**339,758**	**348,050**	**347,673**

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

Fair value measurement

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

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

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

Deposits other than cash equivalents

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

Assets held for index-linked and unit-linked contracts

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

Insurance and intermediaries' receivables

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

Property, plant & equipment held for own use

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

Cash and cash equivalents

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

Receivables (trade, not insurance)

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

Any other assets, not elsewhere shown

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

D.2 Technical Provisions

Analysis of Technical Provisions

The table below shows the technical provisions split by line of business and between the best estimate liability and risk margin as at 31 December 2020.

Analysis of Technical Provisions (£000s)	**Solvency 2020**	**Solvency 2019**
Unit Linked liabilities (BEL)	323,120	333,926
Non-unit liabilities (BEL)	(8,384)	(9,589)
Risk Margin	2,591	1,967
Total	**317,327**	**326,304**

Overall technical provisions have reduced by £9.0m over the year mainly as a result of the lower value of unit linked assets and liabilities.

The non-unit reserve is higher (i.e. a smaller negative) by £1.2m whilst the risk margin is £0.6m higher. These two changes are mainly as a result of the higher inflation assumption on future expenses.

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

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

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

Main Assumptions

<u>Discount Rates</u>

The valuation interest rates used to discount the best estimate liability and risk margin are the relevant basic sterling risk free term structure of interest rates as at 31 December 2020 and provided by the Prudential Regulation Authority ("PRA").

Discount rates fell by about 0.7% during 2020 reflecting the change in the term structure of risk-free interest rates in the year.

Expenses

Best estimate “per-policy” expenses are as agreed with the service company which is currently being established.

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

The “per-policy” expense assumption reduced as at 31 December 2020 as covered in more detail in **Section C.1.1** above whilst the expense inflation assumption increased.

Lapses

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

Lapse rates were reviewed to reflect relevant actual experience over recent years and the result was no change in the lapse assumptions for the old LCA policies. The surrender rates for the novated policies from STM life reduced compared to year end 2019 following a detailed lapse analysis.

Mortality Assumptions

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

Methodology

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

Best Estimate of Liabilities

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

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

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

Risk Margin

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

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

Uncertainty in the Technical Provisions

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

GAAP reserves versus Solvency Technical Provisions

All figures in £s

	GAAP Reserves	Solvency TPs
Unit Reserve for UL business	323,120,353	323,120,353
Non-unit Reserve for UL business	-	(8,384,412)
Risk Margin	-	2,590,786
Total reserves	**323,120,353**	**317,326,726**

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

Independent Peer Review

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

D.3 Other Liabilities

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

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

E. Capital Management

E.1 Own funds

Objective, policies and processes for managing own funds

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

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

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

Own Funds classified by tiers

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

Eligible Own Funds are shown in the table below:

Solvency Balance Sheet (£m)	2020	2019
Total Assets	**339.7**	**347.7**
Best Estimate Liabilities	314.7	324.3
Risk Margin	2.6	2.0
Other liabilities	10.8	8.5
Total Liabilities	**328.1**	**334.8**
Ineligible preference share capital	0.3	0.4
Eligible Own Funds to cover SCR and MCR	**11.3**	**12.5**

E.2 Solvency and Capital Requirement and Minimum Capital Requirement

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

	2020 £m	2019 £m
Solvency Capital Requirement	6.67	6.59
Minimum Capital Requirement*	3.35	3.19

* The MCR 31 at December 2020 was equal to £3,345,910 being the absolute minimum capital requirement.

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

Solvency Capital Requirement Split by Risk Module

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

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

Solvency Capital Requirement	**2020** £'000	**2019** £'000
Market Risk	3,787	2,753
Counterparty Risk	738	266
Underwriting Risk (Life)	3,900	4,939
Diversification Benefit	(2,076)	(1,645)
Basic SCR	**6,349**	**6,315**
Operational Risk	325	272
SCR	**6,674**	**6,587**

The SCR has increased by £0.1m over the year. **Section C. Risk Profile** provides additional information on the key risk drivers for each type of risk.

Minimum Capital Requirement

The components of the MCR calculation are shown in the table below. The absolute floor of the MCR is prescribed by GFSC as €3.7M for an insurer with long term liabilities. This equates to £3.346m in UK sterling using the exchange rate for 31 December 2020 as advised by the GFSC.

Overall MCR calculation	**£m**
SCR	6.7
MCR cap (45% of SCR)	3.0
MCR floor (25% of SCR)	1.7
Absolute floor of the MCR	3.3
MCR	**3.3**

Solvency Position

	Capital Requirement	Eligible Capital	Solvency Ratio %
SCR	£ 6.7m	£ 11.3m	169.5%
MCR	£ 3.3m	£ 11.3m	338.1%

The solvency ratio of 169.5% is lower than the ratio as at 31 December 2019 (which was 190.3%), mainly as a result of the change in expense inflation assumption.

E.3 Use of Standard Equity Risk Sub-module

Not Applicable for LCA.

E.4 Differences between Standard Formula and internal model

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

E.5 Compliance with MCR and SCR

The Company has performed a full valuation at the end of each quarter during 2020. In the intervening periods, key risk factors are regularly monitored to identify whether they remain within tolerance levels.

Appendix 1 Quantitative Reporting Templates

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

QRT Ref	QRT Template name
S.02.01.01	Balance Sheet
S.05.01.01	Premiums, claims and expenses
S.05.02.01	Premiums, claims and expenses by country
S.12.01.01	Life and Health SLT Technical Provisions
S.23.01.01	Own Funds
S.25.01.01	Solvency Capital Requirement – for undertakings on Standard Formula
S.28.01.01	Minimum Capital Requirement – Only Life or only non-life insurance or reinsurance activity

Disclaimer

The financial information in the SFCR is based on the draft financial statements for 2020, because the regulatory deadline for the SFCR is earlier than the deadline for the audited financial statements. If there are any material changes to the financial statements after the SFCR is published a new version of the report will be prepared and published.

Some of the statements in this report may refer to LCA's future expectations based on the information available to LCA's Board of Directors and their current views and assumptions at the time of writing the SFCR.

LCA cannot make any representation or warranty as to the accuracy and/or completeness of such forward looking statements, which by their nature involve unknown risks and uncertainties, nor is any representation or warranty made that they will be reviewed, amended or brought up to date.

There are many factors and conditions (including but not limited to economic, financial or political conditions, market performance, external catastrophic events), that may cause actual results to be significantly different from those that may be anticipated in these forward looking statements.

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

The SFCR and the QRTs referred to in Appendix 1 have not been subject to external audit as this is not required by the GFSC.

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

Financial period ended 31 December 2020.

We certify that:

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

Approval by the Board of the SFCR and reporting templates:

Grant Armstrong

Managing Director

For and on behalf of the Board

Date: 7 April 2021