STM Life Assurance PCC PLC

Solvency and Financial Condition Report ('SFCR')

for the financial year ended 31 December 2019

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Executive Summary

Business and Performance

STM Life Assurance PCC PLC (STM Life) was established in Gibraltar in 2008 and is part of STM Group PLC, a leading cross-border financial services group, listed in London on the LSE AIM market.

STM Life is an insurance company conducting long-term life business and is regulated and licensed by the Gibraltar Financial Services Commission. The Company is structured as a Protected Cell Company subject to the provisions of Gibraltar's Protected Cell Companies Act 2001. This means that STM Life may 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.

STM Life's aim is to provide products and services that enable its policyholders to maintain and grow their assets. This service is delivered in a timely, personal and friendly manner using technology as appropriate.

The Company is licensed to write and administer contracts of insurance as follows:

- Life & Annuity contracts (Class I)
- Unit-linked contracts (Class III)
- Capital Redemption contracts (Class VI)

STM Life utilises independent financial intermediaries within the EU and Rest of the World countries, where permitted by regulation, for the introduction of its business. The Company does not offer financial, tax or investment advice.

During 2019 new premiums of £55.2m were written (compared to £47.9m in 2018) with claim payments of £36.4m (compared to £36.0m in 2018).

In previous years, movements in the technical provision other than premiums received and claims made were reported as acquisition and administration expenses. This led to an expense of £30.5m in 2018 of which £29.0m consisted of realised and unrealised losses on investments. Acquisition and administration expenses relate to the actual expenses incurred by the Company to acquire and subsequently administer the policies and therefore in 2019 expenses were £1.7m.

Return on investments for 2019 was £8.1m compared to £768k in 2018. Unrealised gains in 2019 were £12.4m compared to an unrealised loss in 2018 of £28.2 m.

During 2019, 277 UK and Gibraltar policies of STM Life were novated to London & Colonial Assurance (LCA).

System of Governance

STM Life'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 STM Life is calculated using the Solvency II Standard Formula.

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

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

STM Life has maintained own funds in excess of the Minimum Capital Requirement (MCR) and SCR throughout the reporting period. The solvency position as at 31 December 2019 was as follows:

Solvency Position	Capital Requirement	Eligible Own Funds	Solvency Ratio %
SCR	£5.8m	£8.4m	144.3%
MCR	£3.2m	£8.4m	263.1%

The solvency ratio of 144.3% is lower than the ratio as at 31 December 2018 of 196.9%, partly as a result of novating 277 policies to London & Colonial Assurance (LCA) during 2019 as part of STM Group's Brexit strategy and partly following a change to the calculation of expense risk in the actuarial model.

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

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

Risk Profile

Material risks based on their capital requirements

The material risks based on their SCR contribution are Life Underwriting Risk, Market and Operational Risk:

Life Underwriting Risk

Most of the business of STM Life does not carry any significant insurance risk as there is little additional death benefit over and above the unit fund at time of death for most products. Where a product does carry a higher level of death benefit, underwriting limits are approved and monitored. The largest elements of Life Underwriting Risk are Lapse risk and Expense risk.

Market Risk

Investment risks are largely transferred to policyholders through the use of unit-linked products. Most of the retained Market risk relates to:

- Concentration risk, which arises from the term deposits backing the Class I annuities.
- Equity Type 1 risk, which 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 lower charges than anticipated being collected.

Operational Risk

For STM Life's unit-linked business, the main elements of the calculation of Operational Risk are the expenses of running the business with operational risk calculated as 25% of these expenses using the standard formula. For the Class I annuities the operational risk is calculated using a formula taking into account premium income and technical provisions.

Operational risks also represent a significant proportion of the top risks in the risk register. As a relatively small company STM Life relies on a number of key employees, as well as a number of service providers (predominantly affiliated companies, but also an external provider of asset management services). IT Systems adequacy and MI reporting are also key operational risks. The controls mitigating Operational risks are summarised in **section C.5** below.

Credit Risk

There are credit and concentration limits for the investment of shareholders' funds. This risk is not material for the Company.

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

Most of the top risks in the risk register are categorised as Strategic. STM Life does not explicitly allocate capital for this type of risk, however the stress and reverse stress testing considers the impact of certain extreme events relating to Strategic risks that could cause significant strain on the Company.

The most material strategic risk is that the Company's 2020 business plan would not be achieved as a result of the COVID-19 pandemic impact. The risks associated with the UK leaving the European Union are also material for STM Life. Further details on these risks and their mitigations are provided in **Section C.6.1.**

Group Risk

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

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 STM Life is well placed to withstand the stresses.

A. Business and Performance

A.1 Business and Performance

A.1.1 The Company

STM Life is a Protected Cell Insurance Company registered in 2008. The Company number is 100244.

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).

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

STM Life is a private company limited by shares. The Company's immediate parent company is STM Fidecs Limited and the ultimate owner is STM Group PLC.

STM Life is regulated as a solo insurance entity. The Company has a branch established in the United Kingdom.

As at 31 December 2019 STM Life had 1,503 policyholders.

A.1.2 Products

The Company writes and administers contracts of insurance as follows:

- Life and Annuity contracts (Class I)
- Unit-linked life assurance contracts (Class III)
- Capital Redemption contracts (Class VI)

STM Life is authorised to carry out services in the following countries under EEA passporting arrangements: United Kingdom, Belgium, Italy, Cyprus, Ireland, Finland, Norway, France, Spain, Germany, Sweden and Malta.

A.1.3 Significant Business Events

In 2019 the majority of the UK and Gibraltar unit-linked policies (277 policies) were novated from STM Life to London and Colonial Assurance PCC Plc (LCA). LCA is owned by STM Life's parent company STM Group and the decision to novate the policies was part of the Group's Brexit contingency planning. The administration of the novated policies continues to be performed by STM Life's team on an outsourced basis.

From mid-2019 all new UK and Gibraltar unit-linked business was written by LCA instead of STM Life.

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

A.2 Underwriting Performance

The table below shows the premiums received, claims and expenses by line of business:

	2019 £'000			2018 £'000
	Class I Annuities	**Unit-Linked**	**Total**	**Total**
Gross Premiums	10,527	44,770	55,297	47,938
Gross Claims	(8,215)	(28,214)	(36,429)	(36,040)
Premiums relating to Novated Policies	-	(79,606)	(79,606)	-
Expenses (Acquisition & Administration)	(465)	(1,959)	(2,424)	(30,494)

New premiums in 2019 were higher than in 2018 due to an increase in the volume of Class I Annuities and unit-linked policy sales.

Claims represent annuity payments on the Class 1 Annuities and surrenders of unit-linked bonds. The 2019 numbers were comparable to 2018.

In previous years, technical expenses (such as unrealised gains and losses) were reported as 'Expenses (Acquisition and Administration)', however these expenses form part of the Policy and any movement solely affects the technical provision and not the Company's profitability. In 2019, the Company's operating expenses were split between the Class I Annuities and Unit-Linked Annuities. The assumption used to split the costs is based on the total premium received during the year.

277 of STM Life's unit-linked UK and Gibraltar policies were novated to LCA during 2019. This included a transfer of the assets held in the cells of STM Life belonging to the policies.

STM Life continues administering the novated policies.

A.3 Investment Performance

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

	2019 £'000	**2018** £'000
Investment return attributable to unit-linked policyholders	20,446	(27,425)
Investment returns on assets held to meet insurance liabilities	139	289
Investment return	**20,585**	**(27,136)**

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

In £'000	Income received	Realised and Unrealised Gains	Total
Loans & Receivables	24	-	24
Cash & Other Investments	59	56	115
Total	**83**	**56**	**139**

A.4 Other Material Income and Expense

A.4.1 Overview of Revenue

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

Revenue	**2019** £'000	**2018** £'000
Net fee income from authorised activities	2,429	2,180
Income from investments	115	263
Income from Group undertakings	24	24
Total Revenue	**2,568**	**2,467**

Further information relating to the Company's performance can be found in the Income Statement of STM Life Assurance PCC PLC's 2019 Financial Statements.

A.4.2 Overview of Expenses

The table below provides an analysis of the Company's other operating and administrative expenses on a GAAP basis as presented within the 2019 Financial Statements (note 7 'Other Charges').

	2019 £'000	**2018** £'000
Regulatory costs	103	129
Salaries	462	424
Social insurance	28	26
Other employment costs	12	23
Directors fees	151	185
Legal and professional costs*	1,184	922
Audit fees	45	16
Establishment costs	81	108
Other costs	358	598
Total Expenses	**2,424**	**2,431**

* The following expenses are included here: legal costs, professional fees (i.e. Risk Manager, tax consultancy), PI&DO insurance, actuarial fees, tax adviser fees, and dealing charges.

B. System of Governance

B.1 Governance Structure

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

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

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

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

B.1.1 Three Lines of Defence

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

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

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

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

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

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

B.1.2 Responsibilities of Board and Committees

The key responsibilities of the Board of Directors are:

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

The Board meets at least four times per year.

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

The key responsibilities of the committees are summarised below.

Risk and Compliance Committee

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

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

The responsibilities of the Risk and Compliance Committee are to:

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

- Identify and assess the potential impact of emerging risks.
- Monitor the risk events (losses and near misses).

Audit Committee

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

The key responsibilities of the Audit Committee 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, 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 the 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 STM Life's strategic objectives, commercial and technical standards and that any associated risk is evaluated under STM Life's risk appetite framework.

The responsibilities of the Product Governance Committee are:

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

B.1.3 Key Functions

As required by the Solvency II regulations STM Life 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.
- Currently there are no budgeted bonus (variable compensation) arrangements in place in STM Life. However, the Company outsources its Sales and Business Development activities to a Group function. Roles in that function do have variable compensation arrangements in place across the Group.

Annual Bonus Scheme for the MD of STM Life

The bonus 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 and the achievement of personal objectives.

Pension Scheme

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

Non-Executive Directors' Fees

Remuneration for Non-Executive Directors comprises a basic fee.

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

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

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

Remuneration Committee

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

Remuneration at the subsidiary level is overseen by local management.

Remuneration Policy

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

B.2 Fit and Proper

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

Fitness and Propriety Assessment

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

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

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

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

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

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

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

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

- Financial difficulties, arrangements with creditors, bankruptcy.

- Criminal prosecutions, civil proceedings.
- Complaints.
- Disciplinary matters.
- Business interests.

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

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

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

B.3.1 Risk Management System

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

STM Life adopts a 'Three Lines of Defence' approach to managing risk, as 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 Statements.
- Identify and assess the impact of emerging risks.
- Provide regular risk reporting to the Board.
- Undertake second line monitoring to assess whether the first line of defence is operating effectively.
- Coordinate the Own Risk and Solvency Assessment processes and prepare the ORSA report.
- Facilitate the stress, scenario and reverse stress testing.
- Investigate any reported near-misses or loss events.
- Provide advice and training to business functions and the Board on risk and control-related matters.
- Coordinate assurance activities with the Compliance and Internal Audit functions.

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

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

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

B.3.3 ORSA

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

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

ORSA Processes

The key processes that form part of the ORSA are:

- 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, and reverse stress tests;
- Three-year capital projections and solvency assessment.

The Company has determined that the Solvency II standard formula would be used to calculate the required solvency capital and to assess overall solvency needs.

A three-year base-case projection of the Solvency II Balance Sheet and solvency capital requirement (SCR) position is produced 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

STM Life'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 could decide that an ORSA update is required out of the annual cycle and would recommend to the Board a timetable for the completion of the report. The circumstances that could 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.

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

The controls mitigating material risks are documented in the risk register. The design and operation of controls 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 Compliance Function reports to the Risk and Compliance Committee and the Board on a quarterly basis.

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 – to make sure staff 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.

B.5 Internal Audit

B.5.1 Internal Audit Policy

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

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

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

B.5.2 Internal Audit Plan

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

The Company outsources some of its key functions as follows:

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

The Company has established an Outsourcing Policy which defines:

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

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

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

C. Risk Profile

Risk categories based on their capital impact are as follows:

	2019 £'000	**%**	**2018** £'000	**%**
Life Underwriting Risk	4,517,753	73.8%	1,648,712	48.8%
Market Risk	1,577,075	25.7%	1,552,932	45.9%
Counterparty Risk	30,401	0.5%	178,252	5.3%
Undiversified SCR	**6,125,229**	**100%**	**3,379,896**	**100%**
Diversification	(718,900)		(638,459)	
Basic SCR	**5,406,329**		**2,741,437**	
Operational Risk	404,842		497,962	
Reported SCR	**5,811,171**		**3,239,399**	

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

C.1 Insurance Risk

Life 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

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

C.1.1 Risk Assessment

All figures in £s.

	2019		2018	
Risk Category	**Unit-linked**	**Class I Annuities**	**Unit-linked**	**Class I Annuities**
Expense Risk	2,476,780	482	1,345,279	645
Lapse Risk	2,707,359	0	473,309	0
Mortality Risk	167,812	0	62,061	0
Diversification within risk module	(834,679)	0	(232,582)	0
Life Risk SCR	**4,517,272**	**482**	**1,648,067**	**645**

Most of the business of STM Life does not carry any insurance risk as there is little additional death benefit over and above the unit fund at time of death for most products.

Where a product does carry a higher level of death benefit then the Chief Actuary is responsible for setting the underwriting limits and for monitoring underwriting practice against these limits.

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

The key risks which are considered are as follows:

Expense Risk

The per-policy expense in 2019 reduced compared to 2018 following a detailed expense analysis. All expenses were analysed in relation to new business activity and maintenance activity and the overheads were split in similar proportions.

The effect of this change on the SCR has been to reduce the Expense risk and increase the Lapse risk. The effect of lower per-policy expenses is to make in-force business more profitable in future years. This in turn means that the mass lapse test yields a much larger capital requirement to cover Lapse risk.

A change in the calculation of expense risk in the actuarial model has led to an increase in Expense Risk. If this change had been made at the end of 2018 then Expense Risk as at the end of 2018 would have been approximately £1m higher and the Life Risk SCR would have been approximately £900K higher and hence a much lower difference between 2018 and 2019 than shown in the table above.

Lapse Risk

This is the risk that a policyholder lapses or surrenders their policy earlier than expected resulting in a loss to the Company. For all unit-linked contracts, there is a surrender penalty in place for early lapse to recoup acquisition costs and hence the Company is protected against the risk of not recouping these costs. The main Lapse risk that the Company is exposed to 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 annual lapse rate has fallen in recent years and the lapse assumption has been reduced as at 31 December 2019. This in turn leads to the mass lapse shock having higher prominence. The combined effect of lower per-policy expenses and lower annual lapse rates has led to a significantly higher Lapse risk at the end of 2019.

Mortality Risk

Where insurance contracts pay out a lump sum on death, the Company is exposed to the risk either that there are more deaths than expected or that policyholders die, on average, sooner than expected.

Mortality risk is not a significant risk for the Company for the following reasons:

- The majority of unit-linked contracts pay a death benefit of 101% of the value of the units with a maximum of the value of the units plus £2,000. Consequently, the sum at risk for STM Life is very small and the mortality risk is set at zero on grounds of proportionality.
- Annuity contracts are not subject to mortality risk as higher death rates reduce the value of the main benefits.

Longevity Risk

Where insurance contracts pay out benefits which are dependent on survival or which lead to higher claims costs with increased longevity, the Company is exposed to the risk either that there are fewer deaths than expected or that policyholders die, on average, later than expected.

The key exposures to Longevity risk are non-profit annuities in payment. The Class I annuity that STM Life currently sells is a short-term annuity with a term of 2 years and 1 month. The annuity payments are effectively guaranteed and therefore there is no Longevity risk.

C.1.2 Risk Mitigation

The Company has processes in place to monitor 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.
- Early Lapse risk 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

All figures in £s

	2019		2018	
Risk Category	**Unit-linked**	**Class I annuities**	**Unit-linked**	**Class I annuities**
Concentration Risk	531,562	496,214	179,536	510,569
Equity Risk	536,058		821,678	
Interest Rate Risk	514,438	42,446	29,720	54,975
Currency Risk	204,614		185,482	
Spread Risk	167,956		155,165	
Diversification within risk module	(875,579)	(40,634)	(332,170)	(52,024)
Market Risk SCR	**1,079,049**	**498,026**	**1,039,411**	**513,520**

For unit-linked business interest, Concentration and Equity risks are all of similar weight in the Market risk sub-module. There was a small increase in the total Market risk capital requirement for unit-linked business in 2019 compared to 2018. Concentration risk and Interest risk both increased whilst Equity Type 1 risk fell as a result of the novated policies to LCA.

Interest rate risk rose as a result of the fall in discount rates and the fact that in 2019 the "interest up" shock has become the dominant test.

The rise in Concentration risk is mainly due to an error in the 31 December 2018 calculation which was corrected during 2019.

For the Class I annuity business Concentration risk is the main element of Market risk.

Concentration Risk

Concentration risk tests the resilience of own funds against the diversification of a portfolio of assets.

The main element of Concentration risk for STM Life arises from investing shareholder assets in just two term deposits, the loan to STM Group and the term deposits used for the Class I annuity assets.

Equity Type 1 Risk

There is a risk that following a sustained fall in asset values the Company's charges would be lower than budgeted, because charges are expressed as a percentage of the policy value for some unit-lined policies. This would lead to a higher capital requirement. The capital requirement in relation to this risk fell during 2019 as a result of the novation of 277 unit-linked policies to LCA.

No shareholder funds are invested in equities by the Company.

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 of the two tests. As at 31 December 2019 the 'interest rate up' shock gives the higher result.

Currency Risk

There is an element of currency risk which arises from the fact that some policies are expressed in currencies other than GBP. The main two other currencies in the current portfolio are Euros and US Dollars.

Spread Risk

There is a small amount of spread risk arising mainly from an intergroup loan.

C.2.2 Risk Mitigation

Investments of shareholders' funds are undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The Company has processes in place to mitigate Market risks relating to shareholders' funds:

- The Company ensures that the 'Prudent Person Principle' is applied when investing the shareholders' assets (following the counterparty credit limits and concentration limits). The Company makes sure that new investments do not reduce the average credit rating of the bond portfolios.
- Equity risk mitigation - charges are being expressed as a percentage of initial premium rather than fund value (for the business currently being written and the business written over the past few years).
- The Company's risk appetite statement sets thresholds for Market risk as a proportion of the undiversified basic SCR.

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

- For unit-linked funds we would only accept and hold assets which comply with the Statement of Investment Principles.
- All management of clients' funds is based on instructions from the policyholders and their investment advisors.
- There are regular asset reconciliations with custodians.
- There are regular communications with policyholders, IFAs and pension trustees.

C.2.3 Risk Sensitivity

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

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

C.3 Credit Risk

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

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

C.3.1 Risk Assessment

	2019 £'000	**2018** £'000
Counterparty Default Risk	30,401	178,252

The only component of this risk in 2019 was the shareholder fund held in cash at bank, which is then apportioned to the Class I annuity ring-fenced fund.

At the end of 2018 there were also £5m of client funds held in a client bank account, which accounted for the higher Counterparty risk capital requirement.

C.3.2 Risk Mitigation

The key mitigating controls for credit risk are:

- 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.
- When a new Class 1 annuity is written Management would look at the options available, credit ratings of the financial institutions, how much is already invested with various financial institutions and the currency of the liabilities before making a decision on which term deposits to invest in.
- There are procedures for aged debt monitoring.

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 all policyholder liabilities are either unit-linked liabilities or Class I annuity liabilities whereby the assets are fixed term deposits which mature when annuity payments are due. We do not hold dedicated capital for Liquidity Risk.

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,
- cashflow projections and monitoring,
- approved authority limits for bank payments and investments.

C.4.3 Expected Profit Included in Future Premiums

This requirement does not apply to STM life.

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

For the unit-linked business of STM Life the main element of Operational risk are the expenses of running the business (Operational risk is calculated as 25% of these expenses using the standard formula). For the Class I annuities Operational risk is calculated using a formula taking into account premium income and technical provisions.

C.5.2 Risk Mitigation

Operational risk is managed through:

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

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

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

C.5.3 Risk Sensitivity

Operational risk accounts for 10.6% of the total SCR for STM Life with the main sensitivity being to the expenses of managing the business.

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 STM Life 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.

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

The key Strategic risks for the Company are as follows:

Brexit

The most significant strategic risk facing STM Life is the UK's exit from the European Union ('Brexit'). Uncertainties remain around the arrangements after the end of the transitional period in 2020.

During 2019 the following changes were made as part of the Brexit contingency planning:

- Novation of the majority of the UK and Gibraltar unit-linked policies from STM Life to its sister company London & Colonial Assurance PCC PLC.
- From mid-2019 all new UK and Gibraltar unit-linked business was written in LCA instead of STM Life.

The Board is monitoring Brexit developments and will change the business strategy and plans if necessary.

Merger of STM Life and LCA

At the end of 2019 the Board decided to evaluate the potential of a merger of STM Life with its sister company LCA , by way of a transfer of business from one entity to the other. LCA is a company registered in Gibraltar (authorised to write Class I, Class III and Class VI business) and shares the same office and Management as STM Life.

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

COVID-19 Pandemic

On 11 March 2020 the World Health Organisation announced that the COVID-19 outbreak is a pandemic.

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

- There could be some impact on operations if a high proportion of staff members are unable to come to the office. The mitigation is that all employees have the tools to work from home, and at the time of writing this report most staff members are already working from home.
- There is a potential risk that internet services may have outages as a result of many people working from home or using streaming services at the same time.
- We do not expect any disruption as a result of outsourced service providers' failure as they are all part of STM Group, which has its own business continuity plans.
- Our key external supplier is Gibraltar Asset Management (GAM) and they confirmed that they have effective business continuity plans for all of their staff to work from home.
- The impact on the Company's revenue is difficult to assess at this time, however it is expected that the sales may be lower than budgeted for 2020.
- There is likely to be some financial impact for the Company as a result of the fall in policyholder asset values although this is limited as the fees for most STM Life policies are based on initial premiums rather than the value of policyholder assets. The Q1 Solvency II valuation results show that Own Funds decreased by £143K and the SCR increased by £167K during the first quarter of 2020. The main reason for these changes was the fall in EIOPA discount rates at the end of Q1. The Solvency ratio over the SCR fell to 137.9% which is just below the minimum set by the Board and at the time of writing the Board and Executive management of STM Life are exploring solutions to restore the solvency ratio above 140%.
- Since the end of Q1, asset values have been rising again but discount rates have reduced further and are likely to remain low for the foreseeable future.
- Impact on IFAs - like all other businesses the distributors of our products will be impacted by the pandemic. It is not clear when the IFAs will be able to return to business as usual.
- Customer service impact – there may be some minor delays in responding to policyholders' queries due to the increased workload that the Operations team is experiencing.

- From an Insurance Risk point of view there is not expected to be any impact on our business as we hold minimal mortality risk.

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

C.6.2 Group Risk

Outsourcing to Group

STM Life benefits from operational support through the services provided by Group functions as discussed in **Section B.7**. The Outsourcing risk is mitigated by monitoring the performance of the outsourced services in accordance with the Outsourcing Policy.

The risk of failure of a Group company providing services to STM Life 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

STM Life 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 STM Life'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 STM Life.

Group Loan

STM Life has provided a loan to the ultimate parent company. The loan is repayable on demand and interest is charged at 6% per annum.

C.6.3 Reputational Risk

Reputational risk arises from the negative perception on the part of customers, Independent Financial Advisors, shareholders, investors or regulators which can adversely affect STM Life'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
- Board's and Committee's 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 Company's risk appetite.

STM Life's products are distributed through regulated intermediaries, which mitigate 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 signing off product documentation and marketing materials.
- Products' key features are communicated to the policyholders.

- The Product Governance committee is approving 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 STM Life's ability to meet the capital requirements under stressed conditions.

The risks considered in the scenario testing are:

- New business at 75% of planned volumes.
- No new business from the IFA that provides most of our sales.
- An immediate fall of 25% in market values of policyholder assets.
- A 25% increase in expense levels.
- A 50% increase in surrender rates and a 50% reduction in surrender rates.
- Combinations of the above.

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

In addition, a reverse stress test of a "hard" Brexit was performed, and the outcome was used in the Brexit contingency planning process.

D. Valuation for Solvency Purposes

D.1 Assets

Summary of asset valuation

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

Assets (in £'000)	**2019**		**2018**	
	GFRS 102	**Solvency II**	**GFRS 102**	**Solvency II**
Investments – Cash	1,013	1,013	1,520	863
Investments - Bond and Deposits	13,638	13,637	20,353	20,353
Assets held to cover linked liabilities	246,090	246,132	275,713	275,713
Debtors	1,234	1,232	1,923	1,923
Other assets	8	-	19	-
Prepayments and accrued income	149	27	207	27
Total assets	**262,132**	**262,041**	**299,735**	**298,879**

Total assets on a GFRS102 and Solvency II basis reported for the year-ended 31 December 2018 above are different to those reported in the 2018 SFCR due to the fact that the 2018 SFCR was submitted before the 2018 Audited Financial Statements were completed. The 2018 GFRS102 total now agrees to the signed 2018 Financial Statements.

The main reason for the fall in bonds and deposits over the year is the lower number of SLAs in force at the end of 2019 compared with the end of 2018.

Fair value measurement

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

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

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

Deposits other than cash equivalents

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

Assets held for index-linked and unit-linked contracts

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

Insurance and Intermediaries receivables

The valuation of these assets follows the Solvency II fair value hierarchy. There is no difference between the Solvency II valuation and the GFRS 102 valuation.

Property, plant and equipment held for own use

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

There is no difference between the Solvency II valuation and the GFRS 102 valuation of these assets.

Cash and cash equivalents

This consists of highly liquid cash holdings held and valued at their actual balances. There is a small difference between the Solvency II valuation and the GFRS 102 valuation of these assets.

Receivables (trade, not insurance)

The valuation of these assets follows the Solvency II fair value hierarchy. There is no difference between the Solvency II valuation and the GFRS 102 valuation.

Any other assets, not elsewhere shown

The valuation of these assets follows the Solvency II fair value hierarchy. There is a small difference between the Solvency II valuation and the GFRS 102 valuation.

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 2019.

Analysis of Technical Provisions:	**Solvency II 2019** £000	**Solvency II 2018** £000
Class 1 Annuity (BEL)	10,278	17,070
Unit Linked liabilities (BEL)	246,132	275,713
Non-unit liabilities (BEL)	(6,806)	(1,191)
Risk Margin	3,514	908
Total	**253,118**	**292,500**

Overall technical provisions have reduced by £39.4m over the year with the reduction being as a result of:

- The novation of 277 policies to LCA.
- Fewer Class I annuities were in force at the end of 2019 compared to the previous year.
- The non-unit reserve is £5.6m lower (i.e. a larger negative) at the end of 2019 as a result of a reduction in the per policy expense assumption to £575 per policy in 2019.
- The risk margin is £2.6m higher mainly as a result of:
    - lower surrender rates at the end of 2019 compared to 2018 meaning a greater influence of the mass lapse test and
    - lower discount rates at the end of 2019 compared to the end of 2018.
    - A correction to the calculation of expense risk in the actuarial model.

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

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

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

Main Assumptions

Discount Rates

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

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

Expenses

Best estimate per-policy expenses have been derived from the latest analysis of actual recurring maintenance expenses and actual volumes and mix of business as at 31 December 2019. The expenses allow for direct and outsourced servicing costs. An allowance has also been made for the fact that the in-force portfolio of STM Life is expected to continue to grow and that per-policy expense will reduce over the coming years.

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

The per-policy expense assumption reduced as at 31 December 2019 reflecting a change in the methodology for apportioning expenses between acquisition and maintenance. The 2019 expense analysis involved a detailed review of expenses and a new approach to the split between new business and maintenance resulting in a per-policy expense at the end of 2019 in line with that at the end of 2017.

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 updated to reflect relevant actual experience over recent years and were reduced in 2019 compared to 2018.

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 controls.

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 cashflows for each monthly time period within a policy's contract boundary. The cash flows are discounted using the EIOPA risk free yield curve and thus allow appropriately for the time value of money.

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

Risk Margin

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

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

Uncertainty in the Technical Provisions

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

GAAP Reserves versus Solvency II Technical Provisions

All figures in £s

	GAAP Reserves	Solvency II TPs
Unit Reserve for UL business	246,131,739	246,131,739
Non-unit Reserve for UL business	0	(6,806,822)
Policy reserves for Class I business	10,433,401	10,278,374
Risk Margin	0	3,514,967
Total reserves	**256,565,140**	**253,118,259**

Unit-linked liabilities are the same for GAAP reserves and Solvency II TPs. For the GAAP reserves non-unit reserves cannot be negative and so are set to zero for the portfolio as a whole whereas Solvency II Best Estimate Liabilities can be negative and hence there is a negative non-unit reserve. This is countered by a Risk Margin.

For Class I annuities the GAAP reserve is taken as the value of the assets whereas for the Solvency II valuation the Best Estimate Liability is a discounted cash flow. There is also an element of Risk Margin for the Class I annuities.

Independent Peer Review

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

D.3 Other Liabilities

Other liabilities include Insurance & Intermediary Payables and Other Creditors (mainly payments for outsourced services and accruals).

E. Capital Management

E.1 Own funds

Objective, policies and processes for managing own funds

STM Life 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 through an ongoing 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

Own funds are classed as Tier I 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.

The own funds are shown in the table below:

Solvency II Balance Sheet (£m)		**2019**
Assets		262.0
Best Estimate Liabilities	249.6	
Risk Margin	3.5	
Other Liabilities	0.5	
Total Liabilities		253.6
Eligible Own Funds to cover SCR and MCR		**8.4**

Solvency II Balance Sheet (£M)		**2018**
Assets		298.9
Best Estimate Liabilities	291.6	
Risk Margin	0.9	
Total Liabilities		292.5
Eligible Own Funds to cover SCR and MCR		**6.4**

No dividends were paid by STM Life in 2019.

E.2 Solvency and Capital Requirement and Minimum Capital Requirement

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

	2019 £m	**2018** £m
Solvency Capital Requirement	5.81	3.24
Minimum Capital Requirement*	3.19	3.29

*The MCR 31 December 2019 was equal to £3.187m being the absolute minimum capital requirement.

STM Life 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.

	2019 £'000	2018 £'000
Market Risk	1,577	1,553
Counterparty Risk	30	178
Underwriting Risk (Life)	4,518	1,649
Diversification Benefit	(719)	(638)
Basic SCR	**5,406**	**2,741**
Operational Risk	405	498
SCR	**5,811**	**3,239**

The SCR has increased by almost £2.6m over the year partly as a result of the lower surrender rates in 2019 which leads to a greater capital requirement due to the mass lapse shock and lower discount rates in 2019 compared to 2018, and partly due to the correction in the expense risk calculation. **Section C. Risk Profile** provides additional information on the key risk drivers for each type of risk**.**

Minimum Capital Requirement

The components of the MCR calculation are shown below. The absolute floor of the MCR is prescribed by EIOPA as €3.7M for an insurer with long term liabilities. This equates to £3.187m in UK sterling using the exchange rate for year-end 2019 as advised by the GFSC.

Overall MCR calculation	**£m**
SCR	5.8
MCR cap (45% of SCR)	2.6
MCR floor (25% of SCR)	1.5
Absolute floor of the MCR	3.19
MCR	3.19

The Solvency Position is as follows:

	Capital Requirement	Eligible Own Funds	Solvency Ratio
SCR	£5.81m	£8.38m	144.3%
MCR	£3.19m	£8.38m	263.2%

E.3 Use of Standard Equity Risk Sub-module

Not Applicable for STM Life.

E.4 Differences between Standard Formula and internal model

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

E.5 Compliance with MCR and SCR

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

Appendix 1 Quantitative Reporting Templates

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

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

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Disclaimer

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

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

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

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

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

Financial period ended 31 December 2019.

We certify that:

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

Approval by the Board of the SFCR and reporting templates

David Easton

Managing Director

For and on behalf of the Board

Date: 29th May 2020