STM Life Assurance PCC Plc

Solvency and Financial Condition Report ('SFCR')

(for the financial year ended 31 December 2018)

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Executive Summary

Strategy and Business 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 writes and administers 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.

Over the year, new premiums of £47.9m were written with claim payments of £36.0m. Expenses in the long-term business fund were -£10.0m. The reason for negative expenses is a large amount of unrealised gains on the assets which are included in the expense calculation within the long-term business fund.

Over the year investment income amounted to £13.1m made up of £1.6m from dividends and Interest, £12.3m of unrealised gains and £0.8m of realised losses.

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 First Line of Defence is performed by the business functions who report into Senior Management. These business functions have the day-to-day ownership and management of risks and ensure adherence to STM Life's policies and risk appetite.
- 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 Third Line of Defence is performed by STM Life's Internal Audit function. It provides independent assurance to the Board on the design and operation of the risk management and internal controls frameworks.

The Board of Directors has responsibility for the oversight of the Company's business and approves the strategy, policies and risk appetite. The Board has established three sub-committees to deal with certain functions in detail:

- Risk, Audit and Compliance Committee ('RACC') chaired by the Appointed Actuary;
- Investment Committee chaired by the Managing Director; and
- Product Governance Committee chaired by the Managing Director.

The main change to the System of Governance in 2018 was the establishment of the Product Governance Committee.

For further details see section B. System of Governance.

Risk Profile

The most material risks are as follows:

Strategic Risk - Brexit

The most significant risk facing STM Life in early 2019 is that the UK's exit from the European Union proceeds without agreement (a 'hard Brexit'). This would mean that STM Life would not be able to continue to administer current and write new insurance business (via passporting) across EU states after the date of Brexit.

Mitigation: A project is underway to apply to the Malta Financial Services Authority (MFSA) to re-domicile STM Life to Malta along with the current passporting rights to various EU countries. Alongside this re-domiciliation will be a novation of the UK and Gibraltar policies of STM Life to London & Colonial Assurance (LCA) a Gibraltar registered sister company of STM Life in the STM Group.

Life Underwriting Risk

Insurance Risk - 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, underwriting limits are approved and monitored.

Expense Risk – the risk that expenses are higher than anticipated, which would have material impact on the SCR.

Mitigation: Expenses are monitored on a monthly basis by management and reported to the Board on a quarterly basis. There is regular review of expense assumptions in the reserving process.

Lapse Risk - the risk that a policyholder lapses or surrenders their policy earlier than expected resulting in a loss to the Company.

Mitigation: for all unit-linked contracts, there is a surrender penalty in place for early lapse to recoup acquisition costs (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 will be lower than expected and hence the difference between charges and costs will be smaller than expected. This leads to higher reserves than expected.

Overall, a fall in lapse rates leads to the greatest loss in own funds when compared to an increase in lapses or a mass lapse. This occurs as a result of the increase in risk margin being greater than the fall in non-unit reserves.

Distribution Risk

To address the risks arising from the use of independent intermediaries, STM Life ensures that appropriate due diligence on intermediaries is undertaken, that guidelines and rules for the acceptance of assets are adhered to and that Business Development staff are suitably trained.

Market Risk

The two largest elements of market risk are:

Concentration risk - primarily the term deposits backing the Class I annuities,

Mitigations: Investment mandates specify maximum exposure limits to lower quality bond assets. A process is in place whereby management are informed before any transactions take place which would reduce the average credit rating of the bond portfolios.

Equity risk - collecting fewer charges than anticipated following an equity shock on those unit linked policies where charges are expressed as a percentage of policy value. A significant fall in market values of the unit-linked assets may lead to lower charges than anticipated being collected.

Mitigation: if there is a significant medium to long term reduction in asset values the Company will consider increasing charges (where permissible under the contracts and in line with the obligation to treat customers fairly) and reducing management expenses where possible.

Credit Risk

The only material credit risk that the Company faces is counterparty default risk.

The main component of this risk is due to the funds for one of the Class I annuities being held in cash awaiting investment in term deposits.

Mitigations:

- The risk appetite statement sets thresholds for counterparty exposure, which are monitored regularly through the RACC.
- Each time that a new Class 1 annuity is written the management look at the options available, credit rating 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.

Concentration risk

Concentration risk is a material risk in relation to the fixed deposits backing the Class I annuities

Mitigation: all investments in fixed deposits are agreed jointly by the CEO and Chief Actuary and are selected in line with the Investment Policy and Risk Appetite.

Operational Risk

As a small company STM Life relies on a small number of key employees, as well as a few outsourced service providers (mainly affiliated companies).

Mitigation: having contingency plans for the loss of key persons and monitoring outsourced service providers are the key mitigating controls for these operational risks.

IT Systems security and reliability is a key operational risk.

Mitigation: Business disruptions and systems failure risks are mitigated through Business Continuity and Disaster Recovery plans which are regularly tested.

Conduct Risk

Conduct risk has the potential to arise if the Company's behaviours result in poor customer outcomes. Delivering good customer outcomes is a key objective for STM Life.

Mitigations:

- The Company's products are distributed through regulated intermediaries.
- There is an effective Complaints procedure, and complaints are monitored by the Compliance function.
- In 2018 a Product Governance committee was established as documented in section B.1.

Group Risk

There is some operational dependency for STM Life due to key functions being outsourced within the Group.

Mitigation: processes and controls for selecting and monitoring the performance of the outsourced services in accordance with the Outsourcing Policy.

Capital Management

The Solvency Capital Requirement (SCR) for STM Life is calculated using the Solvency II standard formula on a quarterly basis. SCR is the amount of capital that the Company must hold to protect it from extreme risk events and to comply with EU regulation.

The Board is responsible for ensuring that the Company continuously holds sufficient eligible own funds to cover the SCR and Minimum Capital Requirement (MCR).

The Company has a target to maintain eligible capital above the SCR (as defined in the Risk Appetite Statements) in the medium term, where the medium term is defined as the time horizon of the business plan (typically three years).

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

Solvency Position	**Capital Requirement**	**Eligible Capital**	**Solvency Ratio %**
SCR	£3.2m	£6.4m	196.9%
MCR	£3.3m	£6.4m	194.0%

Significant Events

There were no significant events during 2018.

A. Business and Performance

A.1 Business

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 PLC, limited by shares and the ultimate owner is STM Group PLC. STM Life is regulated as a solo insurance entity.

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 has established a branch in the UK and is authorised to carry out services in the following countries under EEA pass-porting arrangements:

Belgium	Italy
Cyprus	Ireland
Finland	Norway
France	Spain
Germany	Sweden
Malta	United Kingdom

A.2 Underwriting Performance

The Company is authorised to write long term insurance business. Premiums received in the year relate to new contracts of insurance written in 2018. The Company does not utilise any reinsurance.

The table below shows the Company's premiums, claims and expenses split by Solvency II lines of business for the period ended 31 December 2018.

	2018 £'000			**2017 £'000**
	Class I Annuities	Unit-Linked	**Total**	**Total**
Gross Premiums	8,168	39,770	**47,938**	**132,821**
Gross Claims	(17,700)	(18,340)	**(36,040)**	**(42,063)**
Expenses (Acquisition & administration)	(101)	10,124	**10,023**	**(10,101)**

New premiums in 2018 were below those in 2017 partly due to a lower volume of Class I Annuities and partly as a result of the change to the rules for QROPs which happened in April 2017 and had a knock-on effect of writing much lower volumes of QROPs Smart Bonds.

Claims in the form of annuity payments on the Class 1 Annuities and Surrenders of unit-linked bonds were lower in 2018.

Expenses have moved from an expense of £10.1m in 2017 to a negative expense of -£10.0m in 2018. This change from large positive to large negative is mainly as a result of a large change in realised losses on the assets which are part of the expense calculation within the long-term business fund from -£17.4m in 2017 to -£0.1m in 2018.

A.3 Investment Performance

The Company has an investment policy which complies with the requirements under the 'prudent person principle'.

The Company holds two categories of asset; unit linked and non-linked. The assets held to match the unit linked liabilities are ear-marked to cover the unit linked liabilities. All non-linked assets of the Company are included within the single long-term business fund. As a result of the PCC structure of STM Life, the unit linked assets relating to each individual cell are ring fenced from all other assets. STM Life does not make any investment decisions in relation to the unit linked assets. These are made either by the Policyholder or their Investment Adviser.

The investment strategy of the non-linked assets in the long-term business fund is to balance maximising returns, whilst retaining an ability to maintain adequate solvency, an appropriate degree of matching of assets to liabilities and to provide sufficient liquidity to meet the Company's cash-flow needs.

As at 31 December 2018, the Company's long-term business fund comprised the following assets:

Type of Assets	**Amount (£'000) 2018**	**% of portfolio**	**Amount (£'000) 2017**	**% of portfolio**
Deposits with credit institutions	17,453	5.23	28,960	9.19
Cash at bank and in hand	52	0.02	60	0.02
Assets held to cover linked liabilities	316,238	94.75	286,159	90.79
Total	**333,743**	**100.00**	**315,179**	**100.00**

Over the year the long-term business fund has increased by 5.9% to £333.7m due primarily to a 10.5% increase in unit linked assets and a fall in the assets covering the Class I Annuities.

The investment return for 2018 is as follows:

	2018 £'000	**2017 £'000**
Investment Income:		
Dividends and interest income	1,609	3,036
Net gains on realisation of investments		
- Assets held to cover linked liabilities	(841)	(17,456)
	768	**(14,420)**
Net unrealised gains/(losses) on investments:		
- Assets held to cover linked liabilities	12,332	10,160
Total investment return:	**13,100**	**(4,260)**

A.4 Other material income and expense

Nothing to report.

B. System of Governance

B.1 Governance Structure

STM Life's corporate governance framework is appropriate for its size, nature, complexity and risk profile. The framework ensures that the interests of shareholders, policyholders and other stakeholders are appropriately protected.

STM Life has adopted the 'Three Lines of Defence' model to ensure appropriate segregation of roles and responsibilities across the Company. The segregation of responsibilities applies across all business functions and between committees and the Board.

The Company Board has responsibility for the oversight of the Company's business and sets its strategy and risk appetite. The Board has established sub-committees, under its overall authority, to deal with certain functions in detail. All members of the committees are considered to have appropriate skills and expertise to undertake their role within the committees.

The three committees currently in place are

- Risk, Audit and Compliance Committee ('RACC') chaired by the Chief Actuary
- Investment Committee chaired by the Managing Director and
- Product Governance Committee chaired by the Managing Director

The Board is the main decision-making body for the Company. It determines the strategic direction and has responsibility for the overall management of the Company's business affairs.

The Board sets the Company's values and standards and has overall responsibility for ensuring that obligations to policyholders and other stakeholders are understood and met.

The Board monitors and oversees the Company's operations with the purpose of maintaining competent management, sound planning, robust and prudent risk and capital management, an effective internal control environment, a culture of risk awareness and ethical behaviour, and compliance with statutory and regulatory obligations.

The Board and executive management are responsible for implementation of appropriate risk management systems and controls. The Board also sets the Company's policies and procedures.

The Board consists of such number of individuals as the Board may determine from time to time.

Risk, Audit and Compliance Committee

The Risk, Audit and Compliance Committee assists the Board in its leadership and oversight of risk across the Company including the understanding and, where appropriate, optimisation of current and future risk strategy, overall risk appetite and tolerance, risk management framework including risk policies, process and controls, 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, financial processes, financial statements and performance of its internal audit function.

The Committee consists of two Non-Executive Directors, the Chief Actuary and the Managing Director. The Compliance Function holder, STM Life Risk Manager and the STM Group Head of Internal Audit attend meetings of the Committee by invitation.

The responsibilities of the Risk, Audit 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 across the Company.
- 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 financial reporting process.
- Monitor the effectiveness of the Company's internal controls framework, risk management system and internal audit.
- Be responsible for the selection of statutory auditors and recommend the auditor to be appointed.
- Review and monitor the independence of the statutory auditors and in particular the appropriateness of the provision of non-audit services.
- Monitor the statutory audit of the annual financial statements, in particular its performance, taking into account any findings and conclusions.

Investment Committee

The Investment Committee oversees compliance with the Investment Policy and reviews its continuing appropriateness in the light of changing circumstances with consideration to the needs of both policyholders and shareholders.

The Committee consists of two Non-Executive Directors, the Chief Actuary and the Managing Director.

The primary responsibilities of the Investment Committee are to:

- Define the Investment Policy.
- Periodically review the appropriateness of the Investment Policy in light of current circumstances of the Company, in particular in respect of capital requirements and overall market conditions.
- Develop and keep under review the appropriateness of key risk indicators and tolerances, and information provided by third parties, such as financial institutions, asset managers and rating agencies.
- Oversee the application of the Investment Policy.

Product Governance Committee

The committee was established in November 2018 with a key purpose to ensure that the objectives, interests and characteristics of customers are taken into account when designing new products or making changes to existing products. It also monitors whether products are being distributed to the target customers.

Remuneration Policy

The Company's Remuneration Policy sets out the principles and practices for the development, implementation and application of the employee remuneration framework.

The policy is designed to attract, retain and motivate competent, experienced and skilled staff and is based on the following 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 will be determined fairly and objectively across the Company.
- Remuneration consists of a fixed salary, variable incentive pay, pension and other benefits.
- Variable reward for the Directors and key function holders will be linked to strategic objectives as well as considering current and future risks.

It is the Company's policy to pay a salary that is relevant to the specific role and responsibilities. Each year the level of remuneration is reviewed so that it continues to be competitive and provides proper and risk-based incentives.

The remuneration policy is structured in a way that does not encourage excessive risk-taking activities.

Non-Executive Directors
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, sub-Committee 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 determined by the Executive Directors and subject to approval of the Board.

B.2 Fit and Proper

Skills, knowledge and expertise

The Company, through its 'fit and proper' procedures, ensures that persons who effectively run the business or hold responsibility for other key functions have, individually and collectively, an appropriate depth and diversity of knowledge, skills, qualifications, and experience relevant to their respective roles and duties, in order to manage and oversee the running of the organisation in an effective, compliant, and professional manner.

The Fit and Proper requirements also apply to third-party service providers. The holders of key functions collectively possess appropriate qualifications, experience, and knowledge about at least:

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

Fitness and Propriety

To make sure that key function holders are fit and proper, they are recruited giving due regard to the following:

- Job applications.
- Interviews, case studies, role plays, knowledge and skills tests and other recruitment assessments.
- Employment history and experience e.g., CV and employment references.
- 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.

There are specific regulatory requirements relating to the obtaining and giving of employment references and the Company takes reasonable steps to obtain employment references from current and previous employers covering at least the previous six years.

All staff (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, etc.
- Criminal prosecutions, civil proceedings, etc.
- Complaints.
- Disciplinary matters.
- Business interests.

B.3 Risk Management Systems

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.

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

The business strategy has been converted into key strategic risk appetite measures. In order to establish parameters within which risk must be managed, the Company has developed a Risk Appetite statement and associated tolerances / triggers for action.

STM Life adopts a 'three lines of defence' approach to managing risk - see section B.1. There are defined roles and responsibilities for the ownership, oversight and management of risk.

Risk owners are required to assess the risk position using standardised assessment ratings (based on Probability and Impact of each risk materialising). Risks with high residual rating would require actions and timescales to be agreed.

The assessment is documented in the risk register by the Risk Function, which also provides challenge to the assessment.

Solvency capital requirement, risk assessment and key changes to the risk profile are reported to the RACC with escalation to the Board as appropriate.

The Board has the ultimate responsibility for setting the Company's risk management strategy, reviewing the Company's systems of risk management and internal control and their effectiveness and being responsible to the regulator and its policyholders for ensuring compliance with regulatory obligations including capital and solvency requirements of the ORSA.

The Risk, Audit and Compliance Committee reviews the risk appetite at least annually before it is submitted to the Board for approval. The risk tolerances are defined as risk/performance indicators and operational parameters.

Risk Management Function

The Risk Management function is headed by the Chief Actuary.

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 Actuarial, Compliance and Internal Audit functions.

The Risk Management function has a reporting line to the Risk, Audit and Compliance Committee.

B.4 Own Risk Solvency and Assessment (ORSA)

The Board uses the ORSA process and report to assess its risk-based capital requirement, based on the Company's business strategy.

The ORSA process is a key part of the Company's governance and risk management framework and risk management system. The key processes that form part of the ORSA include:

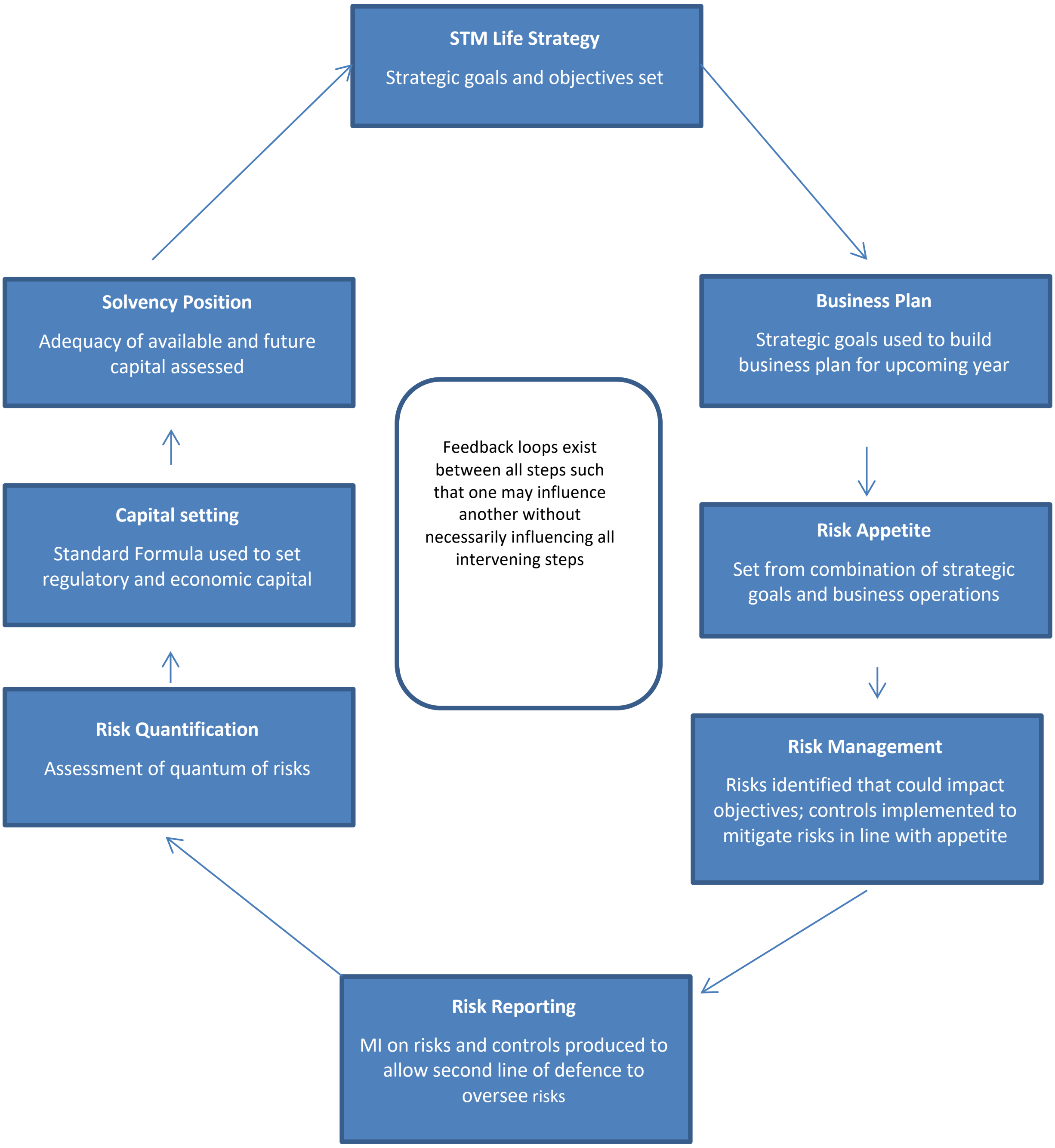
- Risk appetite/tolerance statements (and their ongoing monitoring);
- Business planning processes (and ongoing monitoring of the implementation of the plan);
- Risks and controls assessment (documented in the risk register)
- Emerging risk assessment;
- Capital assessment;
- Three-year capital projections;
- Stress and scenario testing (including reverse stress tests).

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 expense assumptions. 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 Board is ultimately responsible for ORSA framework, ORSA Policy and Process approval and ORSA report. The Board reviews, challenges and approves the ORSA Policy and Process. The Board can delegate the responsibilities to its sub-committee and key business functions for the on-going review of the ORSA in the day to day business activities and monitoring of any significant changes that impact on the ORSA.

The Risk function is responsible for the day to day ORSA Policy and Process and informs the Board regularly through the Risk, Audit and Compliance Committee for review and approval.

The ORSA process is summarised as follows:



The Company's ORSA process operates continuously through the course of the year and is accompanied with periodic formal reporting. The full ORSA report is produced at least annually for the Board with monitoring of critical metrics from the ORSA on a quarterly basis through regular risk and capital MI reporting. Additionally, the ORSA is performed at intermediate times if capital adequacy is impacted either through capital erosion from a material event or a material change in the risk profile.

B.5 Internal Control Systems

The internal control framework is designed to mitigate risks, protect the policyholders and limit the likelihood of losses or other adverse outcomes, as well as to provide a framework for the overall management and oversight of the business. Controls can take a variety of different forms, including:

- approvals and authorisations;
- policies and procedures;
- reconciliations and verifications;
- authority limits;
- management reporting; and
- peer reviews.

There are policies defining the key principles and operating procedures detailing the activities and controls individuals are expected to perform. The policies and procedures are reviewed at least once a year.

The key controls mitigating material risks are documented in the risk register. Controls which are not designed or operating effectively are escalated to the RACC, which approves actions to improve them.

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 STM's Gibraltar Head of Compliance with the compliance activities outsourced to STM Fidecs. The Compliance function is established as an independent control function and has formal status within the overall governance framework. 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 as necessary to carry out its responsibilities and is responsible for reporting to executive management any breaches or non-compliance with relevant policies, rules and regulations.

The key responsibilities of the Compliance function 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.

A compliance report is prepared quarterly for the Board.

B.6 Internal Audit

The Internal Audit function is a Key Function under Solvency II and is currently held by the Group Internal Auditor. Some Internal Audit activities are outsourced under the management and oversight of the Internal Audit function holder.

On an annual basis the Internal Audit function formulates and present an annual audit plan to the RACC for approval. The internal audit plan is risk-based and appropriate to the nature, scale and complexity of the Company. The plan is developed to make sure 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 risk areas.

Based on the audit plan, the Internal Audit function assesses the adequacy and effectiveness of the internal controls' framework. Findings from audit reviews are reported to the Risk Audit and Compliance Committee, and feed into the risk and solvency assessment processes.

B.7 Actuarial Function

The Chief Actuary has overall responsibility for the actuarial function and is the management function holder approved by the GFSC.

The function holder is a qualified actuary who is a Fellow of the Institute and Faculty of Actuaries and has complied continuously with the specific professional obligations this requires.

The Actuarial function is established as an independent function. It has appropriate access to the required resources, including internal team and external actuarial expertise for additional resource and peer reviews. The key responsibilities of the Chief Actuary are:

- Providing actuarial advice to the Company's senior management and Board.
- Regulatory reporting of technical provisions and solvency capital requirements.
- Contributing to the effective risk management system through modelling of risks and actuarial forecasts that form part of the ORSA process.
- Contributing to the stress and scenario testing and reverse stress testing.
- Ensuring the effectiveness of the Company's actuarial methodology, assumptions, systems and controls for actuarial investigations and reports.
- Providing actuarial opinion on data quality and underwriting effectiveness.

The function provides an annual report to the Board setting out the tasks undertaken by the function and its results.

B.8 Outsourcing

When considering outsourcing, the Company considers how it will fit with business strategy, the key risks the arrangement could present and the ability to continue to meet regulatory requirements.

STM Life understands that, in accordance with regulatory requirements, where it outsources any of its activities either to external third-party service providers or intra-group entities, it will continue to be responsible for the performance and output of those activities.

The Company has an Outsourcing Policy which provides guidance and sets out the process for selection and monitoring of the outsourced service providers.

The policy sets out the following:

- Due diligence, including an assessment of key risks and material factors that could impact on the potential service provider's ability to perform the business activity. The following checks are carried out: financial standing, regulatory checks, conflicts of interest, information security and business continuity.
- All outsourcing arrangements must be established with a written contractual agreement setting out the expectations and obligations of each party. The agreements must include certain terms to make sure they address risks and meet regulatory requirements.
- The contract requires internal approval as set out in the policy, and where a critical function is outsourced, this requires Board approval.
- A record of all outsourced arrangements is maintained with a process for regular monitoring and annual review.

The Company is currently utilising the following service providers to undertake critical and important functions on its behalf:

Third Party Service Provider	Function / Work performed	Jurisdiction
Oxford Actuaries & Consultants	Actuarial Software	UK
Mazars	Internal Audit services	UK

Affiliated Service Providers:	Function / Work performed	Jurisdiction
STM Fidecs	Compliance services	Gibraltar
STM Fidecs	Business Development and Marketing	Gibraltar
STM Fidecs	Company Secretarial services	Gibraltar
STM Fidecs	Human Resource management	Gibraltar
STM Fidecs	IT services	Gibraltar
STM Fidecs	Legal services	Gibraltar

The Board maintains oversight and control of all outsourced functions.

C. Risk Profile

Risk Assessment Process

The view of material risks at STM Life is a combination of the top risks from the SCR risk ranking (based on their capital impact) and the risk register (based on their residual rating). The risk profile depends on the nature of the insurance policies issued as at 31 December 2018, the assets held to match the liabilities and own funds.

The Company has 1,597 in force unit linked bonds and Class I annuities.

Given the narrow range of in force contracts the Company only has exposure to some of the core underwriting risks. These are summarised in the table below. However, there are no material concentrations.

Contract Type	Mortality	Longevity	Morbidity	Expense	Lapse
Class I annuity contracts	No	No	No	No	No
Unit-linked contracts	Minimal	No	No	Yes	Yes

Overall risk exposures

The main sources of risk for STM Life have been identified as the failure to:

- Develop and implement an effective strategy;
- Adequately manage assets and liabilities, exposures and investments;
- Adhere to licence or other regulatory conditions, and
- Appropriately manage STM Life's operations, resources and systems.

The Company uses the Solvency II Standard Formula approach to assess its exposure to risk. The main risk categories and their capital impact as at 31 December 2018 are as follows:

Solvency Capital Requirement (£000s)	**2018**	**2017**
Market Risk	1,553	2,111
Counterparty Risk	178	268
Underwriting Risk (Life)	1,649	1,355
Diversification Benefit	(638)	(740)
Basic SCR	**2,741**	**3,008**
Operational Risk	498	1,074
Reported SCR	**3,239**	**4,082**

Over 2018, market risk reduced by £0.55m, life underwriting risk increased by £0.3m and operational risk reduced by almost £0.6m.

The reduction in market risk is due partly to the lower amount of assets backing SLAs (and hence lower concentration risk) alongside a reduction in interest rate risk.

The increase in life underwriting risk is mainly as a result of the higher number of policies in force at the end of 2018 and the higher level of per policy expenses.

The reduction in operational risk is as a result of treating the Class I annuities and the unit linked business as separate ring-fenced funds with the sum of the individual operational risks leading to a lower value than at the end of 2017 which was calculated on a whole company basis.

Based on their capital impact the most significant risks faced by the Company are underwriting risk (lapse and expense) and market risk. The two largest elements of market risk are concentration risk, primarily the term deposits backing the Class I annuities, and equity risk (collecting less charges than anticipated on those unit linked policies where charges are expressed as a percentage of policy value following an equity shock).

The key risks and the Company's approach to mitigating them are detailed in sections C1 – C5.

C.1 Insurance Risk

Insurance risk includes Underwriting and Reserve 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.

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.

Reserve risk

Reserve risk arises from the inherent uncertainty surrounding the adequacy of the reserves set aside to cover insurance liabilities. At STM Life the Chief Actuary is responsible for the reserving policy and for informing the Board of the reserving requirements on a quarterly basis.

The approach to valuation of technical provisions is documented in section D.2. The key risks which are considered are as follows:

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 £200. 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.

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 will be lower than expected and hence the difference between charges and costs will be smaller than expected. This leads to a higher than expected non-unit reserve.

For STM Life, a fall in lapse rates leads to the greatest loss in own funds when compared to an increase in lapses or a mass lapse.

Expense Risk

The Company is currently in a period of rapid growth and the rate of growth in number of policies and hence charges collected from those policies is significantly steeper than the rate of growth in administration costs. Consequently, per policy expenses are reducing and some of this reduction has been taken into account when calculating technical provisions as at 31 December 2018.

Assessment and risk mitigation techniques

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

- The Company's risk appetite statement sets thresholds for underwriting risk as a proportion of the undiversified basic SCR.
- There is regular monitoring of lapse and expense assumptions.
- Controls are in place to ensure that reserving processes are adequate and that reserving data is complete and appropriate.
- There is an independent peer review of the TPs.
- The risk register covers the key risks and is reviewed quarterly with a summary reported to the RACC on a quarterly basis.

A full valuation of the technical provisions and life obligations SCR is performed each quarter and the SCR coverage is reported to the Company's Board.

Risk sensitivity for underwriting/reserving risks

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.

Distribution Risk

To address the risks arising from the use of a network of independent intermediaries for the distribution of its products, STM Life ensures that appropriate due diligence on intermediaries is undertaken, appropriate levels of introducer fees/commission are payable, its guidelines and rules for the acceptance of assets are adhered to and that STM Life's business development staff are suitably trained.

C.2 Market Risk

This represents the risk that the Company's solvency coverage is adversely affected by changes to financial market conditions which impact the fair value of assets held.

The Solvency II Regulations require that the "Prudent Person Principle" is applied to the Company's asset investment. The Company adheres to the principle by investing in a range of fixed interest and money market assets of an appropriate quality and level of diversification. There are also holdings in currency to minimise the impact of adverse market movements.

The weightings of the different asset classes and the nature of the underlying assets are regularly monitored and are reviewed quarterly by the Investment Committee to consider their appropriateness. Assets held in respect of the Solvency and Minimum Capital Requirements are also reviewed to ensure they offer an appropriate level of security and liquidity.

The assets held in relation to unit-linked policies are not subject to Market risk as all the investment risk is borne by the policyholder. For each policyholder the assets backing their policy are held in separate cells and completely ring fenced from all other policyholder and shareholder assets.

For funds backing the Class I annuities and Own Funds the Company holds a portfolio of UK and overseas assets comprising fixed interest and money market assets and is therefore subject to the Market Risk Module.

Material Market Risks

The two largest elements of market risk are:

- concentration risk, primarily the term deposits backing the Class I annuities, and
- equity risk (collecting fewer charges than anticipated on those unit linked policies where charges are expressed as a percentage of policy value following an equity shock).

Concentration Risk

Concentration risk tests the resilience of own funds against the diversification of a portfolio of assets. The largest element of concentration risk for STM Life arises from the term deposits used to back the Class I annuity liabilities. The single largest institution used for these investments is currently Lloyds Bank with 42.0% of the portfolio invested in one- and two-year term deposits.

Equity Risk

No own funds are invested in equities by STM Life. 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 initial premium.

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

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 from the intergroup loan of £400,000 as at 31 December 2018.

Assessment and risk mitigation techniques

The Company has processes in place to monitor market risks:

- The Company's risk appetite statement sets thresholds for market risk as a proportion of the undiversified basic SCR.
- A regular review of surplus assets takes place at Investment Committee meetings.
- Investment mandates specify maximum exposure limits to lower quality bond assets.
- A process is in place whereby management are informed before any transactions take place which would reduce average credit rating of the bond portfolios.
- The risk register covers key market risks and is reviewed quarterly with a summary reported to the Risk, Audit and Compliance Committee on a quarterly basis.

Risk sensitivity for Market risks

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. 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. As at 31 December 2018 the main component of this risk is due to the funds for one of the Class I annuities being held in cash in a client bank account awaiting investment in term deposits.

Assessment and risk mitigation techniques

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 through the RACC.
- Each time that a new Class 1 annuity is written, management look at the options available, credit rating of the financial institutions, how much is already invested with various financial institutions and currency of the liabilities before making a decision on which term deposits to invest in.
- There are aged debt monitoring procedures.
- The risk register covers key default risks and is reviewed quarterly with a summary reported to the Risk Audit and Compliance Committee on a quarterly basis.

C.4 Liquidity Risk

Liquidity risk arises when the Company is unable to meet its payment obligations as and when they fall due. Liquidity is not a material risk for the Company, because all policyholder liabilities are either unit linked liabilities or the Class I annuity liabilities whereby the assets are fixed term deposits which mature when annuity payments are due.

STM Life ensures that sufficient liquidity is maintained to meet both immediate and foreseeable cash flow requirements.

Expected Profit Included in Future Premiums

This requirement does not apply to STM life.

C.5 Operational Risk

Operational risk is the risk of direct or indirect loss (actual or potential) resulting from inadequate or failed internal processes, people and systems or from external events. This includes risks relating to compliance, business processes, information technology, outsourcing and financial reporting.

Assessment and risk mitigation techniques

We seek to manage operational risk through the implementation of a robust internal control framework. 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.
- A strong internal control culture.
- Staff training/awareness of the control responsibilities relating to their roles.
- Effective IT systems.
- Ensuring compliance with regulatory requirements.
- Recruiting/retaining adequately skilled staff, adequate performance assessment system.
- Procedures to minimise internal/external fraud.
- Due diligence, regular monitoring of outsourced activities.
- Ensuring accurate and timely financial and other external reporting.
- Disaster recovery and business continuity plans are put in place for all key functions/departments and take into account different types of plausible scenarios to which the Company's operations may be subject to. The plans are periodically reviewed and tested.

There are defined key risk indicators which act as early warnings of increased risk of potential losses. Effective tracking of these indicators by the Risk Management function allows the Company to identify changing risks upon their occurrence and respond to them promptly.

Risk sensitivity for operational risks

This is not currently a significant risk for the Company.

Conduct Risk

Conduct risk has the potential to arise if the Company's behaviours result in poor customer outcomes; it 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.

The Company's products are distributed through regulated intermediaries which mitigates the exposure to direct sales and distribution.

There is an effective Complaints procedure, and complaints are monitored by the Compliance function.

In 2018 a Product Governance committee was established as documented in section B.1.

C.6 Other material risks

Group Risk

There is some operational dependency for STM Life due to key functions being outsourced within the Group. The risk is mitigated by implementing controls for monitoring the performance of the outsourced services in accordance with the Outsourcing Policy.

Reputational Risk

Reputational risk can materialise as the result of inadequate management of the material risks, or contagion from external events beyond our control. The Compliance and Risk Management functions' activities, the effective internal controls framework and Board's close monitoring of the business contribute to minimising the reputational risk.

Brexit Risk

The most significant risk facing STM Life in early 2019 is that the UK's exit from the European Union proceeds without agreement (a 'hard Brexit'). This would mean that STM Life would not be able to continue to administer current and write new insurance business (via passporting) across EU states after the date of Brexit.

A project is underway to apply to the Malta Financial Services Authority (MFSA) to re-domicile STM Life to Malta along with the current pass-porting rights to various EU countries. Alongside this re-domiciliation will be a novation of the UK and Gibraltar policies of STM Life to London & Colonial Assurance (LCA) a Gibraltar registered sister company of STM Life in the STM Group.

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 50% of planned volumes.
- An immediate fall of 40% in market values of policyholder assets.

- A 10% increase in expense levels.
- A 50% increase in surrender rates and a 50% reduction in surrender rates.

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 2018:

Assets (£'000)	2018		2017	
	GFRS 102	Solvency II	GFRS 102	Solvency II
Investments – Cash	1,520	1,700	-	-
Investments - Bond and Deposits	20,353	20,353	28,960	28,961
Assets held to cover linked liabilities	316,238	316,926	286,159	285,493
Debtors	1,923	1,923	719	662
Other assets	19	-	4,302	4,884
Prepayments and accrued income	207	27	486	685
Total assets	340,260	340,928	320,626	320,685

Cash at bank in 2017 was included in other assets. 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 2018 compared with the end of 2017.

Debtors in 2018 included fees owed to STM Life of £624k which was not included in 2017, there is also an SLA Policy Debtor of £820k in relation to a PAYE payment due to HMRC which was settled in early 2019.

In 2018 Other Assets relates to Tangible assets of £18k and Deferred Income of £2k which is not included in the SII Reports. The difference between 2017 and 2018 relates to the reclassification of Company Cash and Bank and Deposits.

Accrued income per SII Legislation should be included within Cash at Bank therefore the difference between GFRS 102 and Solvency II in 2018 is the accrued interest. Further reclassification to Debtors in 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 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 II fair value hierarchy. There is no difference between the Solvency II valuation and the GFRS 102 valuation.

Property, plant & equipment held for own use

Property, plant & 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 2018.

Analysis of Technical Provisions (£000s)	**Solvency II 2018**	**Solvency II 2017**
Class 1 Annuity (BEL)	17,070	28,588
Unit Linked liabilities (BEL)	316,926	285,493
Non-unit liabilities (BEL)	(1,191)	(1,521)
Risk Margin	908	1,406
Total	**333,712**	**313,966**

Overall technical provisions have increased by £19.7m over the year with the increase mainly as a result of new unit linked policies written over the year. Less Class I annuities are in force at the end of 2018 than the previous year. The non-unit reserve is £330,000 higher at the end of 2018 whilst the risk margin is £498,000 lower. These two changes are mainly as a result of higher per policy expenses and lower surrender rates at the end of 2018 compared with 2017.

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 liabilities and risk margin is the relevant basic sterling risk free term structure of interest rates as at 31 December 2018 and provided by the European Insurance and Occupational Pensions Authority ("EIOPA").

Discount rates rose by about 0.4% during 2018 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 2018. The expenses allow for direct and outsourced servicing costs. An allowance has also been made for the fact that STM Life is growing rapidly and that the 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 increased as at 31 December 2018 reflecting a change in the methodology for apportioning expenses between acquisition and maintenance.

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 2018 compared to 2017.

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 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 liability 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 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	316,925,531	316,925,531
Non-unit Reserve for UL business	0	(1,190,959)
Policy reserves for Class I business	17,452,934	17,069,957
Default Reserve for Class I business	52,495	0
Risk Margin	0	907,736
Total reserves	**334,430,960**	**333,712,264**

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 plus a default reserve 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 key actuarial reports and figures have been subject to an independent peer review by an external actuary, Philip Whitefield.

D.3 Other Liabilities

There are no other liabilities on a Solvency II basis.

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 manging 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, Audit 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

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, wind-up and insolvency basis.

The own funds are shown in the table below:

Solvency II Balance Sheet (£M)		**2018**
Assets		340.1
Best Estimate Liabilities	332.8	
Risk Margin	0.9	
Total Liabilities		333.7
Eligible Own Funds to cover SCR and MCR		**6.4**

Solvency II Balance Sheet (£M)		**2017**
Assets		320.7
Best Estimate Liabilities	312.6	
Risk Margin	1.4	
Total Liabilities		314.0
Eligible Own Funds to cover SCR and MCR		**6.7**

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.

	2018 £M	2017 £M
Solvency Capital Requirement	3.24	4.08
Minimum Capital Requirement*	3.29	3.25

*The MCR 31 December 2018 was equal to £3.288m 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.

Solvency Capital Requirement (£000s)	**2018**	**2017**
Market Risk	1,553	2,111
Counterparty Risk	178	268
Underwriting Risk (Life)	1,649	1,355
Diversification Benefit	-638	-740
Basic SCR	**2,741**	**3,008**
Operational Risk	498	1,074
Reported SCR	**3,239**	**4,082**

The SCR has reduced by almost £0.85m over the year partly as a result in modifying the methodology for calculating Operational Risk and partly as a result of the lower number of Class I annuities (SLAs) in force at the end of 2018 compared to the end of 2017. The lower volume of SLAs reduced both the Concentration sub-module of Market Risk and the Counterparty 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 £3.288m in UK sterling using the exchange rate for year-end 2018 as advised by the GFSC.

Overall MCR calculation	**£M**
SCR	3.2
MCR cap (45% of SCR)	1.5
MCR floor (25% of SCR)	0.8
Absolute floor of the MCR	3.29
MCR	**3.29**

Solvency Position

Solvency Position	Capital Requirement	Eligible Own Funds	Solvency Ratio
SCR	£3.24m	£6.38m	196.9%
MCR	£3.29m	£6.38m	194.0%

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 2018. In the intervening periods, key risk factors are regularly monitored to identify whether they remain within tolerance levels.

APPENDICES

Appendix 1 Quantitative Reporting Templates

The following Quantitative Reporting Templates (QRTs) are required for the SFCR. 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

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

Financial period ended 31 December 2018.

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

Kevin Dann

Managing Director

For and on behalf of the Board

Date: 17th April 2018

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.