# THE EQUINE AND LIVESTOCK INSURANCE COMPANY LIMITED

Solvency and Financial Condition Report

FINANCIAL YEAR END:

30 SEPTEMBER 2016

# Contents

# 1 Executive Summary

The principal activity of The Equine and Livestock Insurance Company Limited ("ELICO") is the underwriting of general insurance policies. ELICO has permission to underwrite the following insurance classes:

- Damage to property
- Fire and natural forces
- General liability
- Legal expenses
- Liability for ships
- Miscellaneous financial loss
- Ships

These are classified as "Miscellaneous Financial Loss" and "General Liability" under the Solvency II regime.

ELICO underwrites business in the UK, Channel Islands and Isle of Man.

This is the first SFCR report solely for ELICO. The Solvency and Financial Condition Report ("SFCR") has been provided as part of ELICO's reporting requirements under the Solvency II Directive, effective from 1 January 2016. ELICO's SFCR is disclosed publicly under UK legal and regulatory requirements.

The SFCR has been completed using data and results published in the Own Risk & Solvency Assessment ("ORSA") report and year end data contained within the Prudential Regulation Authority ("PRA") return. The ORSA provides a comprehensive assessment of ELICO's risk profile and solvency position for use in decision making. It is also used for a forward looking view of potential risk scenarios that could impact ELICO's business plans over the next 3 years.

The SFCR report details all currently available information on ELICO's risk exposures and their potential capital impacts, and provides an overview of the way in which ELICO views these elements of its business. It also describes the risk management framework and processes which ELICO employs to manage risk within the Board's stated appetite and with the objective of providing protection for its policy holders.

ELICO is required to disclose this information in line with rules issued by the PRA.

# 2 Business and performance

## 2.1 Business and external environment

The Equine and Livestock Insurance Company Limited, Thorpe Underwood Hall, Ouseburn, York, YO26 9SS is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. ELICO's Financial Services Register Number is 202748. ELICO has been categorised as a category 5 firm by the PRA and a category 4 firm by the Financial Conduct Authority ("FCA"). ELICO's company registration number is 294940.

The FCA's registered address is:
Financial Conduct Authority
25 The North Colonnade
London
E14 5HS

The PRA's registered address is:
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

This SFCR has not been audited, however, ELICO's external auditors are:
Watson Buckle
York House
Cottingly Business Park
Bradford
BD16 1PF

ELICO obtains assistance in certain actuarial matters from:
Lane Clark & Peacock LLP
95 Wigmore Street
London
W1U 1DQ

ELICO is a general insurance company with three appointed representatives:

- Entertainment & Leisure Insurance Services [FRN:402234]
- Entertainment & Leisure Insurance Services Ltd [FRN: 402233]
- Entertainment and Leisure Insurance Services (Jersey) Ltd [FRN:601637]

Entertainment & Leisure Insurance Services and Entertainment & Leisure Insurance Services Ltd are related to ELICO by virtue of common management systems and structures. ELICO also has a third appointed representative: Entertainment & Leisure Insurance Services (Jersey) Ltd.

Lindsay Leggat Smith is considered to be the ultimate controlling party by virtue of the fact that he owns all of ELICO's share capital.

ELICO's financial year end is 30 September each year. There were no significant business (or other) events during the period under review that had a material impact on ELICO.

## 2.2 Underwriting performance

ELICO currently underwrites risks located in the UK and Channel Islands only. Customers are private individuals, professionals and semi-professionals residing in the United Kingdom who require low level property insurance.

ELICO writes a range of niche personal lines of business including equine (pleasure horse), pet, wedding and caravan insurance. The business is split between three core groupings: Equine; Pet; and Non-Animal (including caravan, musical equipment, wedding, golf, photographic, electrical, student possessions) covering property risk and minimal associated ancillary risk.

ELICO's objective is to strike a balance between policyholder growth, underwriting profitability, and the provision of innovative products designed with the needs of its customers central to their design. ELICO is dedicated to providing insurance products that provide comprehensive cover at an affordable price.

During the year ending 30 September 2016, gross written premiums increased 16.2% compared to the prior year and gross claims incurred increased 15.0%.

| | 2015 Total £000 | 2016 General Liability | 2016 Miscellaneous Financial Loss | 2016 Total £000 |
|---|---|---|---|---|
| **Gross Written Premium** | | | | |
| Gross Direct Business | 30,004 | 871 | 33,984 | 34,856 |
| Reinsurers Share | (102) | (7) | (283) | (290) |
| **Net Premiums Written** | **29,902** | **864** | **33,701** | **34,566** |
| | | | | |
| Gross Earned Premium | | | | |
| Gross Direct Business | 29,780 | 861 | 33,570 | 34,431 |
| Reinsurers Share | (107) | (7) | (276) | (283) |
| **Net Premiums Earned** | **29,673** | **854** | **33,294** | **34,148** |
| | | | | |
| **Claims Incurred** | 29,962 | 775 | 30,242 | 31,018 |
| **Expenses Incurred** | 2,310 | 73 | 2,861 | 2,934 |

Gross Claims Paid (non-cumulative)

| Year | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | In Current Year | Sum of Years Cumulative |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Development Year | | | | | | | | | | | | |
| Prior | | | | | | | | | | | - | - | - |
| N-9 | 8,022 | 3,965 | 319 | 95 | 2 | - | 1 | - | -2 | - | | - | 12,402 |
| N-8 | 8,806 | 5,565 | 186 | 77 | 44 | 45 | 53 | 13 | 6 | | | 6 | 14,795 |
| N-7 | 13,295 | 5,680 | 299 | 141 | 140 | 86 | 29 | 15 | | | | 15 | 19,685 |
| N-6 | 9,824 | 3,619 | 281 | 163 | 86 | 44 | 48 | | | | | 48 | 14,065 |
| N-5 | 9,555 | 4,431 | 520 | 226 | 166 | 178 | | | | | | 178 | 15,076 |
| N-4 | 9,811 | 6,321 | 454 | 324 | 158 | | | | | | | 158 | 17,068 |
| N-3 | 13,965 | 6,008 | 606 | 271 | | | | | | | | 271 | 20,850 |
| N-2 | 14,660 | 6,507 | 550 | | | | | | | | | 550 | 21,717 |
| N-1 | 16,823 | 7,275 | | | | | | | | | | 7,275 | 24,098 |
| N | 21,124 | | | | | | | | | | | 21,124 | 21,124 |
| | | | | | | | | | | | **Total** | **29,625** | **180,880** |

## 2.3 Performance from investment activities

ELICO will continue to invest its regulatory capital in low risk bank deposits and property, resulting in low investment returns for its cash balances, while deposit rates remain low, and higher returns for its property portfolio. The objective is to avoid potential adverse fluctuations in the reserves.

ELICO aligns its strategy with its capital requirements by calculating the Solvency Capital Requirement ("SCR") and Minimum Capital Requirement ("MCR") based on its business plan and revised forecast, to enable it to plan for future capital needs.

## 2.4 Performance of other activities

As well as underwriting policies, ELICO also acts as an intermediary for other products such as motor, home, life, income protection and dental products.

ELICO's net operating costs and expenses incurred for all activities were as follows:

| | 2015 £000 | 2016 £000 |
|---|---|---|
| Acquisition Costs | | |
| Commission | 261 | 302 |
| Other | 208 | 304 |
| Administrative Expenses | 688 | 944 |
| **Net Operating Expenses** | **1,157** | **1,541** |
| Claims Expenses | 1,153 | 1,393 |
| **Expenses Incurred** | **2,310** | **2,934** |

### 2.5 Any other disclosures

Aligned with ELICO's objectives, a new suite of policies under the trading name "The Insurance Emporium" were launched January 2017. These products were:

- Bicycle
- Photographic: Amateur / Semi-professional and Professional policies
- Caravan: Touring Caravan / Trailer Tent & Folding Caravan and Static Caravan policies
- Fishing Equipment
- Horse: Rider, Horse, Veteran Horse, Trailer and Trailer Hire policies
- Musical Equipment and Instrument
- Pet: Accident Only, Public Liability Only, Maximum Benefit, Lifetime and Time Limited policies
- Wedding: UK and Overseas policies
- Motor (white-labelled)
- Household (white-labelled)
- Life (white-labelled)
- Dental (white-labelled)
- Income protection (white-labelled)
- Travel (white-labelled)

ELICO compiled these products to reflect the demand from its consumers as well as following identification of gaps in the current market e.g. ELICO has a demand from consumers for a niche public liability product within its current lines of pet business.

Further products will be launched over time, including but not limited to:

- Student
- Marine: Motorised (for canal or narrowboat, motorboat or motorised sailing dinghy) and Non-motorised (canoe, kayak, rowing boat, windsurfer or non-motorised sailing dinghy)
- Golf

## 3 System of Governance

### 3.1 General governance arrangements

The Board is responsible for the overall control of the company via careful and prudent management; they are concerned with the business strategies and the day-to-day detail of insurance operations.

The role of the Board is to determine the overall strategic direction and management of ELICO and to monitor its performance. In performing its duties, the Board will meet in accordance with the best interest of ELICO's stakeholders.

ELICO operates a linear management structure that ensures good communications and efficiency of working. The management team monitors every aspect of ELICO's systems, controls and administrative structure in great detail. They are able to detect early signs of problems and market shifts and are able to resolve these problems at first hand.

The role of the Board is to determine the overall strategic direction and management of ELICO and to monitor its performance. In performing its duties, the Board will meet in accordance with the terms of reference and act in the best interests of ELICO as a whole, including its owners, employees and in appropriate cases, policyholders and creditors.

ELICO's Board as at 30 September 2016 comprised the following members:

Mr Francis Martin (Chief Executive Officer):

- CF1 Director (AR)
- SIMF1 Chief Executive Officer
- SIMF4 Chief Risk Function
- Responsible for Insurance Mediation

Mrs Karen Howells-Lee (Chief Operating Officer):

- CF1 Director (AR)
- SIMF22 Chief Underwriting Officer Function
- Claims Management Key Function Holder

Mr Christopher Hall (Chief Finance Officer):

- SIMF2 Chief Finance Function
- SIMF5 Head of Internal Audit
- SIMF20 Chief Actuary Function
- Company Secretary

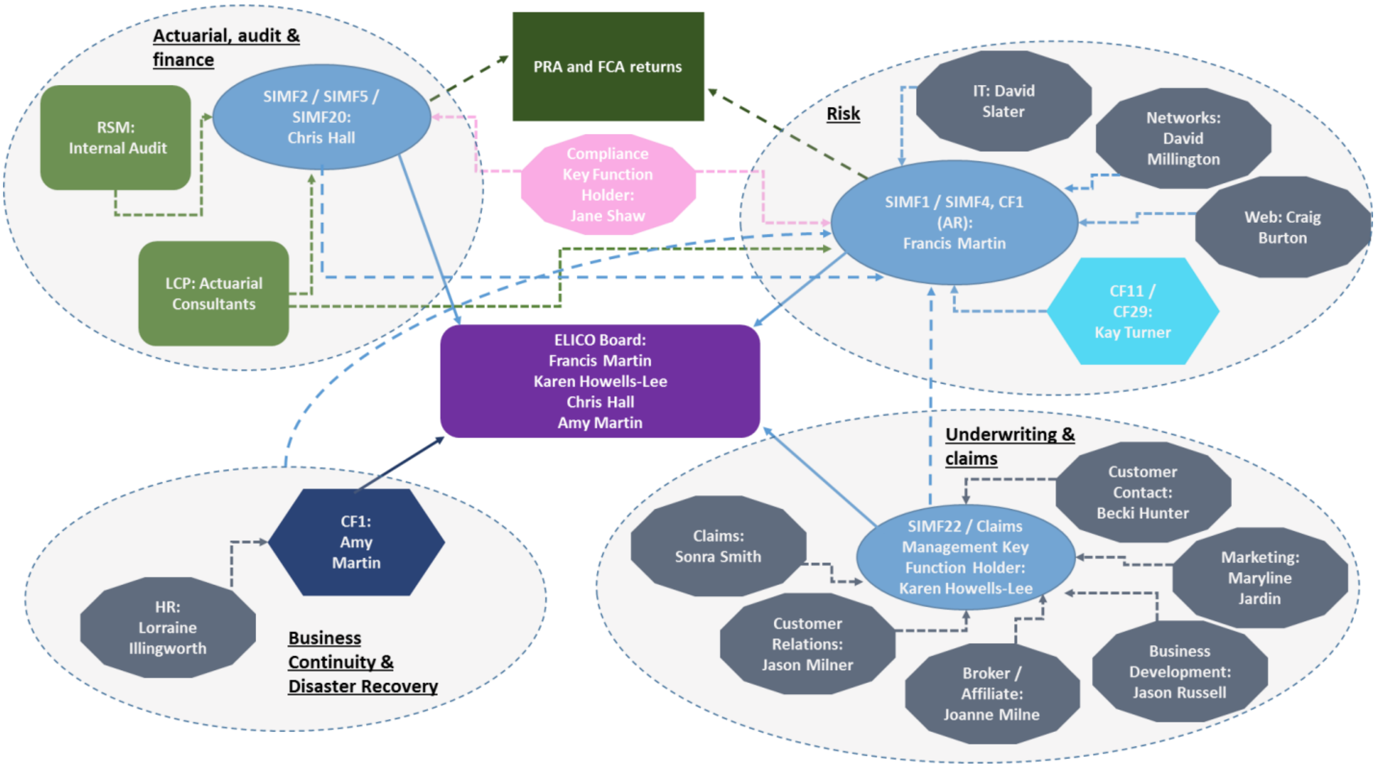
Miss Amy Martin (Disaster Recovery and Business Continuity Director):

- CF1 Director

ELICO maintains clear and appropriate apportionment of significant responsibilities through the maintenance of up to date job descriptions/role profile for all key members of staff.

ELICO's Board considers that the key functions have the necessary authority, resources and operational independence to carry out their tasks.

ELICO's reporting lines are as follows:




ELICO's Remuneration of the Board Policy seeks the ensure that the interests of the Directors are aligned with ELICO's business strategy and risk tolerance, objectives, values and ELICO's long-term interests and aims to ensure ELICO is able to attract and retain highly competent Directors. Total overall remuneration takes account of both the external market and company conditions to achieve a balanced, 'fair' outcome. The Chair or any Director will withdraw from discussions concerning their own appointment, remuneration or terms of service to avoid conflicts of interest.

### 3.2 Fit and proper requirements

ELICO has in place a Fit and Proper Persons Assessment Policy to ensure that those appointed to Senior Insurance Management Functions and Key Function Holder positions are fit and proper. The most important considerations are the person's:

- Personal characteristics (good repute, integrity etc.)
- Level of competence, knowledge and experience
- Qualifications
- Training
- Business conduct
- Compliance with conduct standards

The appointment process includes:

- Consideration of the duties and responsibilities of the post to be filled;
- A selection/appointment process that matches the selected person to the requirements of the post;

- Verification of qualifications, experience, references and membership of professional bodies; and
- Some probity checks including the completion of a fit and proper attestation form by the candidate.

Once appointed, applicants are expected to remain competent for the position(s) they hold, including ensuring continued professional development ("CPD"), displaying appropriate business conduct and demonstrating compliance with conduct standards. ELICO reviews fitness and propriety at least once annually.

Where there has been wrongdoing, ELICO may make all reasonable efforts to establish grounds for taking disciplinary action and where appropriate take the action. In any case, where such matters come to light, they may be reported immediately to the FCA and the PRA.

### 3.3 Risk management system

An effective risk management function will ensure that material risk issues receive sufficient attention from ELICO's senior management and Board. The CEO has responsibility for Risk Management and ensures regular risk reviews are conducted, documented and presented to the Board.
ELICO's objective in managing risk in this way, is to ensure that it holds sufficient capital to meet projected future insurance claims and to absorb the impact of unexpected losses, whatever their source, without compromising its governing objectives.

There is an ongoing process to identify, assess and manage risk. This process is subject to continuous improvement in order to meet regulatory requirements and improve business performance. Risks are recorded in ELICO's risk table and demonstrated in ELICO's risk report. Losses are recorded in ELICO's loss register.

ELICO's risk management process is detailed as follows:
Identify risk:

- Active risk management: review and report
- Analyse risk (including assessing frequency and severity of risk):
- Triggers
- Consequences

Control risk:

- Training
- Authority levels
- Business Continuity Plans
- Succession plans
- Risk appetite
- Systems and procedures

Improvement actions (cost/benefit analysis):

- Accept the risk is present
- Implement controls to prevent the risk

- Outsource where possible to control risk
- Reduce the risk where appropriate
- Avoid the risk where possible

Monitor and report risks:

- Identify new risks
- Review controls
- Review risks
- Review future mitigating actions

ELICO operates a “three lines of defence” approach to risk governance:

First Line of Defence – Operations: as the first line of defence, business line management are responsible for the identification and assessment of risks and controls together with the delivery of mitigating actions. They should:

- Promote a strong risk culture and sustainable risk versus return thinking;
- Promote a strong culture of adhering to limits and managing risk exposures;
- Engender ownership, responsibility and accountability for identifying risks; and
- Promote ongoing monitoring of inherent and identified risks.

Operational areas are also responsible for implementing risk tolerances. They do this by acting within agreed delegated authorities and by following the internal control processes ELICO has put in place to guide individuals in their decision making. This should ensure, for example, that insurance risk is only accepted in line with policy conditions and that claims paid are in line with policy terms.

It is also important for individuals working in operational areas to communicate back to the senior management team and Board any instances where risk appetite and strategic or business objectives have created a conflict.

Second Line of Defence – Risk and Compliance Function: As the second line of defence, the risk and compliance function challenges the completeness and accuracy of risk assessments, risk reporting and the adequacy of mitigation plans. To do this they:

- Provide overarching risk oversight for all risk types;
- Understand aggregated risk positions and support individuals across ELICO by developing and advising on risk strategies; and
- Provide objective oversight and challenge to the internal control framework operating in the first line of defence.

The Risk and Compliance Function is responsible, through oversight activities, for monitoring application of appetite in the business and for acting as a communication channel to the Board where issues around risk appetite arise.

The FCA encourages a partnership approach in areas such as product and design; the second line is actively involved from the beginning.

Third Line of Defence – Assurance: (External) Internal audit provides independent assurance to the Board on ELICO's risk management practice. They do this by:

- Assessing and reporting on the robustness and application of the Risk Framework; and
- Reviewing the appropriateness and effectiveness of internal controls.

Assurance functions are responsible for providing independent confirmation to the Board of effective implementation of risk appetite. They will also make recommendations to operational areas, support functions and the Board for improvements in the way appetite is implemented.

Assurance functions will have responsibility for ensuring that decisions made by delegated authorities are audited so as to demonstrate compliance.

Assurance functions are also responsible for documenting the annual cycle in accordance with which the various policies, reports and decisions are referred to the Board.
ELICO's risk management framework endeavours to:

- Identify likely regulatory and compliance risks
- Assess the seriousness of the identified risks taking into account likely impact and probability - risk report
- Align the risk assessment process with the business planning process
- Adhere to the risk appetite policy
- Embed risk mitigation in automated processes and workflows

Risk appetite forms a key element of the ELICO Risk Management Framework. Risk appetite means the level and nature of risks to which the Board considers it is acceptable to expose ELICO and risk appetite is implemented in practice by setting explicit limits for taking on risk of different types.

Having a clear and informed view of risk capacity is also a pre-requisite for meeting Solvency II requirements, as it is the baseline used in determining the SCR. This allows it to be contrasted with the other key measure of risk capacity used under Solvency II the MCR. This is defined in the guidance for Solvency II as the "gone measure" i.e. the funds an organisation would require to meet its liabilities in the event of a controlled winding up. It is a sub-measure of the SCR, the difference being the capital required to support ongoing business and future operations.

The volume of business taken on determines the level of gross insurance risk exposure that ELICO accepts. Where the gross exposure is more than the ELICO Board wishes to accept, reinsurance is used to reduce the potential exposure, producing a net level of insurance risk which is in line with ELICO's capital management objectives. The cover is arranged via specialist reinsurance brokers utilising Grade A or better reinsurers in the Lloyds and company market. The Board provides guidance for individuals in ELICO who have authority to make decisions which affect the level of risk exposure; so that they can act with confidence and can be sure that they are implementing the Board's intentions. Any individual proposing to take action which is outside the delegated authorities, limits and tolerances defined in this statement must seek prior approval from the Board.

All these actions and many others which are part of the everyday operation of ELICO have an impact on risk profile – the total amount of risk to which ELICO is exposed. By clearly stating its appetite, the Board makes sure that individuals acting in all of these areas know how much risk they want to take on and do not exceed that amount, without seeking prior approval.

Managing risk within appetite is best practice, and helps ELICO to meet its regulatory responsibilities. ELICO has many internal controls to manage the risks presented. These controls include:

- Economic controls (e.g. reinsurance);
- (External) Internal audit;
- Financial review (including reporting quarterly to the Board);
- Management information;
- Policies and procedures;
- Physical controls;
- Risk reviews;
- The Risk and Compliance Function, and the Board;
- Training and development of staff; and
- A whistle-blowing procedure for staff.

As ELICO acts to maintain sufficient capital to absorb losses, whatever their source, capital assessments are carried out at the aggregate level comparing total exposure to total available capital rather than looking at individual risk types in isolation.

Within this aggregated total, ELICO's appetite is to limit its exposure to a level, net of reinsurance, which creates available capital in line with its SCR calculated using the Standard Formula. This cap provides an absolute limit on the risk ELICO will accept.

ELICO assesses its capital in a way which is proportionate to the size and complexity of its exposures to different types of risk, recognising that larger more complex exposures require greater effort than those which do not have the capacity to materially affect its capital position. This creates greatest focus on insurance risk and proportionally less on others, for example operational risk, which does not have the potential to materially affect ELICO's capital strength.

### 3.4 Own risk and solvency assessment (ORSA)

ELICO will carry out an ORSA at least once annually and more frequently in the event of a material change in its risk profile.

The ORSA is a key element of ELICO's risk and capital management system and forms part of the supervisory process. The ORSA comprises the processes and procedures ELICO uses to ensure that its overall solvency needs are met at all times, and which allow it to demonstrate achievement of this objective to both the ELICO Board and the PRA. It is forward looking and considers ELICO's capital needs over each of the years for which ELICO prepares business plans. The ORSA provides management with a comprehensive assessment of ELICO's risk profile, risk appetite and solvency position to enable them to understand these risks and how they translate into capital needs, or require other mitigation.

The following are key inputs to the ORSA:

- ELICO's Risk Appetite Statement as reviewed and approved by the Board;
- ELICO's Risk Register;
- Outputs from ELICO's Standard Formula;
- ELICO's Business Plan;
- Outputs from the ELICO Capital Planning Process;
- Reports from the actuarial function, including opinions on the adequacy of technical provisions, the SCR and ELICO's underwriting and reinsurance arrangements.

### 3.5 Internal control system

ELICO's control framework consists of:

- Control functions; and
- Internal policies owned by the Board which detail:
  - Economic controls (e.g. reinsurance);
  - Financial review;
  - Management information;
  - Physical controls;
  - Risk reviews;
  - Training and development of staff; and
  - Whistleblowing.

Control functions

In addition to Senior Insurance Manager Function ("SIMF") holders, the Board has identified claims management and compliance as key functions which also require key function holders as follows:

- Claims Management Key Function Holder: Karen Howells-Lee
- Compliance Key Function Holder: Jane Shaw

These functions are responsible for providing assurance to the Board in relation to ELICO's control framework.

The main responsibility of the Claims Management Key Function is to ensure ELICO has adequate claims management procedures covering the overall cycle of claims: receipt, assessment, processing, settlement, complaint and dispute settlement, and reinsurance recoverables. The Claims Management Key Function Holder is also responsible for considering how to prudently manage ELICO's claims management strategy.

The main responsibilities of the Compliance Key Function are:

- Work with the Chief Executive Officer in the identification, assessment, monitoring and reporting of compliance risks.

- Consider possible future changes in the compliance environment and their potential effect on ELICO.
- Responsible for ELICO's compliance plan/compliance monitoring programme, which should incorporate the compliance risk and legal-changes risk for the forthcoming financial year.
- Provide advice to the Board on compliance with the laws, regulations and administrative provisions adopted pursuant to the Solvency II framework directive. This includes the training of staff.
- Provide operational areas and the risk-management function with support on compliance requirements when new products and services are to be launched or when ELICO intends to enter a new market.

In support of the control framework, departmental managers are also responsible for identifying and assessing compliance and operational risks together with delivering mitigating controls.

ELICO policies
ELICO has in place a number of policies which support its control and risk framework. These include, but are not limited to:

- Anti-bribery Policy
- Claims Management Philosophy
- Company Compliance & Risk Policy
- Complaints Policy
- Conduct Risk Policy
- Conflict of Interest Policy
- Data Security & Data Governance Policy
- Financial Crime Policy
- Financial Risk Policy
- Fit and Proper Persons Assessment Policy
- Governance Manual
- Outsourcing Policy
- Product Oversight and Governance Policy
- Risk Appetite Statement
- Risk Framework and Management Policy
- Social Media Policy
- Training & Competency Policy
- Underwriting Philosophy
- Vulnerable Persons Policy
- Whistleblowing Policy

### 3.6 Internal audit function

ELICO outsources internal audit activity to RSM Risk Assurance Services LLP, but has appointed an internal Head of Internal Audit who is responsible for managing this activity and ensuring an effective internal audit function including the implementation and tracking of internal audit actions. ELICO works with its internal auditors to ensure an annual audit plan is in place which links to ELICO's strategic objectives and key risks.

Internal audit conducts independent reviews of ELICO's procedures and challenges the controls in place. In doing so, internal audit helps ELICO to manage its risks effectively. ELICO's internal auditors use a risk-based approach to identify the strategic, operational and financial risks where ELICO needs assurance along with areas of control weakness. Recommendations made ensure corrective actions are implemented. Internal audit findings are reported to the Board.

### 3.7 Actuarial function

ELICO obtains assistance on certain actuarial matters from Lane Clark & Peacock LLP, but has appointed an internal Chief Actuary Function holder who is responsible for managing this activity and ensuring accurate calculation of technical provisions allowing for the calculation of risk and premium.

Reports from ELICO's actuarial function, including opinions on the adequacy of technical provisions, the SCR and ELICO's underwriting and reinsurance arrangements, are a key input to ELICO's ORSA.

### 3.8 Outsourcing

To conduct operations as effectively and efficiently as possible, ELICO may find it advantageous to outsource certain functions. ELICO recognises its responsibility to ensure that where outsourcing is sought from a third party, it is done in a way which is compliant with regulatory rules, that enables it to achieve good consumer outcomes and where the risk can be effectively managed.

To support its approach to outsourcing, ELICO has in place an Outsourcing Policy.

### 3.9 Adequacy of the System of Governance

ELICO continues to ensure its system of governance is adequate for it nature, scale and complexity of the risks inherent in its business.

ELICO's Board regularly reviews recommendations and outcomes from internal audit, external audit and internal compliance monitoring. Industry guidelines and best practice are also reviewed in conjunction with internal MI, root cause analysis and risk events.

## 4 Risk profile

ELICO holds capital as protection against potential losses from residual risk exposures, i.e. those remaining after all the preventative risk management processes and risk mitigations have been taken into account.

ELICO's risk management framework is used to identify, assess, manage and mitigate risk.

ELICO's predominant risk is insurance risk, arising from the provision of its range of Pet, Horse and non-animal (including Caravan) policies.

| Solvency Capital Requirement | Gross Solvency Capital Requirement £000 |
|---|---|
| Market Risk | 1,916 |
| Counterparty Default Risk | 2,011 |
| Non-Life Underwriting Risk | 24,723 |
| Diversification | (2,301) |
| Basic Solvency Capital Requirement | 26,349 |
| Operational Risk | 1,058 |
| Solvency Capital Requirement (SCR) | 27,407 |

### 4.1 Insurance risk

Insurance risk can be broken down into several elements.

- Underwriting risk refers to the risk of loss, or of adverse change in the value of insurance liabilities, due to inadequate pricing and reserving assumptions.
- Reserving risk includes the fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the undertaking at the time of underwriting. This risk can also refer to fluctuations in the timing and amount of claims settlements.
- Concentration risk means all risk exposures with a loss potential which is large enough to threaten the solvency or the financial position of undertakings.

ELICO manages its exposure to downside insurance risk by controlling pricing, underwriting and reserving assumptions and through the effective use of reinsurance.

ELICO recognises that the future is subject to uncertainty and has therefore considered key stresses and scenarios which may impact upon its plans and expectations. This testing includes the exposure to a major underwriting loss event such as a major animal epidemic which could put ELICO in breach of the Solvency II SCR. ELICO has also considered scenarios whereby claims increase faster than premium growth, thereby eroding the profit margin. Such testing includes projected profit, loss and solvency position for these events.

### 4.2 Market risk

Market risk is the risk of losses arising from fluctuations in market prices. ELICO is not exposed to significant market risk, linked only to falls in property values and/or interest rates. Market risk is managed within ELICO’s portfolio guidelines.

ELICO has invested in commercial property with long term profitable tenants where the receipt of the rent is not a major risk. ELICO undertakes stress testing for the adverse change in property values (by 10% and 20% of the SCR) and continues to monitor property values closely.

### 4.3 Credit risk

Credit risk refers to the risk of loss or of adverse change in the financial position resulting, directly or indirectly, from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which undertakings are exposed, in the form of counterparty default risk, or spread risk, or market risk concentrations. ELICO's two key credit risk exposures are reinsurer failure and counterparty failure. Credit risk within ELICO's investment portfolio is controlled through application of the investment guidelines, which cannot be changed without Board approval.

ELICO stress tests adverse changes in bank credit ratings; falls to BBB and BB have been tested.

### 4.4 Liquidity risk

Liquidity risk refers to the risk that ELICO would be unable to meet its financial obligations when they fall due. ELICO has a low appetite for liquidity risk, and it carries out cash-flow matching projections to ensure that sufficient liquid funds are available to meet liabilities as they fall due.

Liquidity risk is controlled through ELICO's bank holdings which is intended to provide sufficient liquidity for the short to medium term needs. No change to holdings is made without Board approval as agreed by the Board.

### 4.5 Operational risk

Operational risk refers to the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events. These risks include:

- Business disruption and system failures;
- Clients, products and business losses;
- Damage to physical assets;
- Employment practices and workplace safety;
- Execution, delivery and process management;
- Data loss;
- External fraud; and
- Internal fraud.

ELICO has in place a number of controls and procedures, including a risk register, to mitigate operational risk.

### 4.6 Other material risks

Strategic risk

Strategic risk is defined as the risk of the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. ELICO has an appetite for developing new products which reflect the Board's strategy for maintaining and delivering short to long term growth. In order to ensure the strategy continues to develop, and capital adequacy is maintained it will review, on a regular basis, the strategy for the firm. Strategic risk is related to reputational risk i.e. adverse publicity following poor claims outcomes or customer service. Reputational risk is managed in a number of ways including the use of MI, appropriate underwriting and proportionate third party due diligence.

Conduct risk

Conduct risk refers to the design and execution of a product and is focussed on risks to the delivery of fair consumer outcomes. Conduct risk is the "risk that a firm will result in poor outcomes for consumers". ELICO has a zero appetite for systemic unfair outcomes arising from any element of the conduct risk lifecycle which includes product design, sales or after sales processes and culture.

Environmental risk

Environmental risk pertains to industry-wide regulation / legislation. ELICO has no appetite for breaches of regulatory requirements.

### 4.7 Any other disclosures

ELICO's niche insurance business model holds inherent risk, however, ELICO's strategy is to mitigate the risks through the diversification into different niche products.

ELICO uses reverse stress testing to determine events and/or circumstances which could undermine its ability to continue in operation. These may be quantifiable events such as a catastrophic loss which reduces available assets below the level at which ELICO can continue to offer insurance. Alternatively there may be events causing severe reputational impact which make issue of further insurance products unadvisable/impossible, leading to ELICO initiating a controlled run off of its insurance business.

Overall solvency needs which will be forward looking and test possible outcomes of the ELICO Business Plan. ELICO's ORSA identifies and takes into account external factors that could have an adverse impact on overall solvency needs or the level of available own funds and includes stress tests, reverse stress tests and sensitivity and scenario analysis. Full details of stress testing are provided in ELICO's ORSA.

## 5 Valuation for solvency purposes

### 5.1 Assets

The following table details ELICO's assets as at 30 September 2016:

| Assets | Statutory Accounts £000 | Solvency II £000 | |
|---|---|---|---|
| Deferred tax assets | 0 | 20 | Net with Corporation Tax |
| Property, plant & equipment held for own use | 2,383 | 2,383 | |
| Investments (other than assets held for index-linked and unit-linked contracts) | 4,947 | 4,947 | |
| Property (other than for own use) | 4,947 | 4,947 | |

| | | | |
|---|---|---|---|
| Deferred Acquisition Cost | 26 | 0 | Not recognised under SII |
| Loans on Policies | 52 | 52 | |
| Other Loans and Mortgages | 19,395 | 20,579 | SII Includes future interest |
| Insurance Intermediaries | 2,891 | 0 | Not recognised under SII |
| Receivables (trade, not insurance) | 11 | 11 | |
| Cash and Cash Equivalents | 16,604 | 16,604 | |
| **Total Assets** | **46,309** | **44,595** | |

### 5.2 Technical provisions

Technical Provisions represent the best estimate of the future claims, including those claims already made but not yet paid, based on past experience and judgment, along with the Provision for Unearned Premium for Premiums received relating to future periods. The Solvency II basis differs from the Statutory Accounts basis and takes into account the discounted values of future premiums, claims and expense cash-flows relating to expired periods of claims risk and unexpired periods of premium provisions for all legal obligations at the valuation date.

The following table details ELICO's technical provisions as at 30 September 2016:

| Provisions | Statutory Accounts £000 | *General Liability Solvency II* | *Miscellaneous Financial Loss Solvency II* | Solvency II £000 | |
|---|---|---|---|---|---|
| Premium Provision | 1,522 | *(32)* | *(1,235)* | (1,267) | Discounted value |
| Claims provisions | 10,090 | *252* | *9,814* | 10,066 | Discounted value |
| Best Estimate | 11,612 | *220* | *8,579* | 8,799 | SII recognises discounted value on cash flow basis |
| Risk margin | n/a | *49* | *1,926* | 1,975 | |
| **Technical provisions – non-life (excluding health)** | **11,612** | ***269*** | ***10,505*** | **10,774** | |

There is a degree of uncertainty associated with the valuation of Technical Provisions as actual experience will differ from expectations, and the assumptions made may not be borne out in practice.

Gross undiscounted Best Estimate Claims Provisions

| Year | Development Year 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | Year End discounted data |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Prior | | | | | | | | | | | - | |
| N-9 | 2,800 | 347 | 149 | 16 | | | | | | | | |
| N-8 | 3,434 | 335 | 47 | 50 | | | | | | | | |
| N-7 | 3,316 | 157 | 150 | 100 | | | | | | | | |
| N-6 | 2,250 | 250 | 150 | 40 | | | | | | | | |
| N-5 | 3,500 | 350 | 160 | 60 | | | | | | | | |
| N-4 | 4,250 | 502 | 255 | 170 | | | | | | | | |
| N-3 | 4,458 | 604 | 400 | 160 | | | | | | | | 160 |
| N-2 | 5,331 | 925 | 410 | | | | | | | | | 410 |
| N-1 | 7,205 | 960 | | | | | | | | | | 959 |
| N | 8,560 | | | | | | | | | | | 8,537 |
| | | | | | | | | | | | **Total** | **10,066** |

## 5.3 Other liabilities

Other liabilities include Insurance Premium Tax and amounts due to reinsurers. The following table details ELICO's other liabilities as at 30 September 2016:

| Liabilities | Statutory Accounts £000 | Solvency II £000 | |
|---|---|---|---|
| Financial liabilities other than debts owed to credit institutions | 1,208 | 1,208 | |
| Any other liabilities, not elsewhere shown | 245 | 61 | Reinsurance not recognised under SII |
| Corporation Tax | 242 | 262 | Deferred Tax net off |

## 5.4 Any other disclosures

During the year to 30 September 2016, ELICO received approval and issued a further £19.05 million of share capital to provide additional capital strength as a result of Solvency II.

# 6 Capital management

Note: for the purpose of these calculations, the standard parameters rather than undertaking specific parameters have been used.

## 6.1 Own Funds

The unaudited Solvency II Balance Sheet position of ELICO along with the SCR and MCR as at 30 September 2016 is as follows

| Solvency II Balance Sheet at 30 September 2016 | |
|---|---|
| | **£000** |
| Total Assets | 44,595 |
| Total Technical Provisions | (10,774) |
| Non Insurance Liabilities | (1,531) |
| **Own Funds** | **32,290** |
| | |
| Solvency Capital Requirement | 27,407 |
| Capital Surplus | 4,883 |
| SCR Coverage Ratio | 118% |
| Minimum Capital Requirement | 6,852 |
| MCR Coverage Ratio | 471% |

ELICO's own funds as at 30 September 2016 were £32.3 million. These own funds comprised £23.1 million of ordinary share capital and £9.2 million of retained profit and loss and other reserves.

All of ELICO's own funds, with the exception of the Deferred Tax balance, are Tier 1 basic own funds and all are available to meet the SCR and the MCR without restriction.

| | **Total** <br> **£000** | **Tier 1 Unrestricted £000** | **Tier 3** <br> **£000** |
|---|---|---|---|
| Ordinary Share Capital | 23,050 | 23,050 | - |
| Reconciliation Reserve | 9,221 | 9,221 | - |
| Deferred Tax | 20 | - | 20 |
| **Total Basic Own Funds** | **32,290** | **32,271** | **20** |
| Total available own funds to meet the SCR | 32,290 | 32,271 | 20 |
| Total available own funds to meet the MCR | 32,271 | 32,271 | n/a |
| Total eligible own funds to meet the SCR | 32,290 | 32,271 | 20 |
| Total eligible own funds to meet the MCR | 32,271 | 32,271 | n/a |

No basic own fund item is subject to the transitional arrangements referred to in Articles 308b(9) and 308b(10) of the Solvency II Directive. There are no ancillary own fund items and no deductions are required to be made from own funds. Non-linked assets that make up ELICO's own funds are predominately invested to preserve capital values and to generate a reasonable return.

It is ELICO's intention to maintain own funds of no less than the higher of 110 per cent of ELICO's SCR. In assessing the own funds required, the Board considers its capital forecasts over a five year business planning period.

## 6.2 Minimum capital requirement and solvency capital requirement

ELICO's unaudited MCR and SCR as at September 2016 are shown below:

| **Timescale** | **30 September 2016 £000** |
|---|---|
| Minimum Capital Requirement (£000) | 6,852 |
| Solvency Capital Requirement (£000) | 27,407 |
| Available Capital (£000) | 32,290 |
| Surplus Capital (£000) | 4,947 |
| Solvency Ratio<br>(MCR basis, SCR basis) | 468%, 118% |

Minimum Capital Requirement – Linear Formula Component

| | £000 | £000 | £000 |
|---|---|---|---|
| MCRNL Result | 5,843 | | |
| | | Net (of reinsurance) best estimate TP calculated as a whole | Net (of reinsurance) written premiums in the last 12 months |
| General Liability Insurance | | 220 | 864 |
| Miscellaneous Financial Loss | | 8,579 | 33,701 |
| | | | |
| **Overall MCR Calculation** | | | |
| Linear MCR | 5,843 | | |
| SCR | 27,704 | | |
| MCR Cap | 12,333 | | |
| MCR Floor | 6,852 | | |
| Combined MCR | 6,852 | | |
| Absolute Floor of MCR | 2,657 | | |
| | | | |
| **Minimum Capital Requirement** | **6,852** | | |

ELICO calculates the capital it is required to hold against residual risk exposure on the Solvency II basis, using the Standard Formula.

ELICO calculates required capital to meet three objectives:

- To demonstrate that it has sufficient capital to provide protection to its policyholders and to meet the organisation's governing objectives;
- To provide comprehensive and detailed information and analysis for decision making; and
- To provide assurance to the ELICO Board and to the PRA that it can continue to meet the requirements of the Solvency II regime.

Results confirm that ELICO has sufficient capital to meet its requirements under the Solvency II basis. ELICO has a substantial capital surplus against the Solvency II MCR basis, this means that ELICO at 30 September 2016 is operating:

- Within the Board's stated tolerance for risk under the Solvency II regime; and
- Within the regulatory requirements under the Solvency II MCR basis.

### 6.3 Non-compliance with the Minimum Capital Requirement and with the Solvency Capital Requirement

ELICO has set its tolerance to be the 110% of the SCR and intends build a buffer as annual profits increase the available capital. There has been no non-compliance with the MCR.

### 6.4 Any other disclosures

ELICO has considered a range of stresses and scenarios, which might impact upon our capital position over the business planning horizon and believe that the occurrence of a major underwriting loss event could cause the most significant strain. If a major underwriting loss should occur, we would consider three main ways of reinstating ELICO's capital position: product re-pricing based on the increased levels of risk; adjustments to ELICO's commission arrangements for new business acquisition; and capital injections form shareholders.

Under the stressed scenarios, there are several where ELICO's ability to meet the MCR is not threatened, but where the SCR might be breached and ELICO would, therefore, need to raise additional capital. Depending upon the speed of capital erosion, we believe that three main ways of raising capital would be:

- Increases to premiums (to reflect the revised increased risks of the schemes affected);
- Changes to the commission arrangements payable for new business acquisition with a view to increasing ELICO's retained premiums; and
- Capital injection by the shareholder.