Solvency and Financial Condition Report (SFCR)

For the 14 Month Period Ended 28 February 2022

Tesco Underwriting Limited
Company Registration Number: 6967289

CONTENTS

SUMMARY

This is the sixth Solvency and Financial Condition Report (SFCR) for Tesco Underwriting Limited (TU, the Company). All amounts in the tables of this SFCR are denominated in £'000, unless stated otherwise.

A. Business and Performance

Tesco Underwriting Limited (TU) is a wholly owned subsidiary of Tesco Personal Finance plc ('Tesco Bank'). TU is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA.

On 4 May 2021, Tesco Bank acquired the remaining 50.1% ordinary share capital of TU, from its joint venture partner, Ageas (UK) Limited ('Ageas'), following regulatory approval received in March 2021. Since 4 May 2021, TU has therefore been a wholly owned subsidiary of Tesco Bank and is part of the Tesco Bank Group. Total cash consideration was £94.7m. Since the acquisition TU has been engaged in transferring the provision of its services away from Ageas and this process is largely complete, noting it is planned that the transfer of motor supply chain services will be completed in the second half of the year. In addition to the purchase of the ordinary share capital, Tesco Bank also acquired the holding of £21.2m subordinated debt from Ageas on the same date.

As a result of the change in control, the company changed its financial year end from 31 December to 28 February, to be in line with the Tesco Group. This report reflects a 14 month financial year and a financial position as at 28 February 2022.

During the period ending 28th February 2022 TU continued its underwriting of personal lines insurance business (car and home) distributed by Tesco Bank.

TU has been compliant with Solvency II requirements since the beginning of 2016 and had capital resources of 149.1% (2020:157.3%) of its Solvency Capital Requirement (SCR) on 28th February 2022.

In March 2021, a dividend payment of £20m was issued to Shareholders through retained earnings. No dividend is proposed for the 2021/22 financial year.

The IFRS profit before tax for the period ending 28th February 2022 was £20.4m. Compared to the previous financial year when TU experienced reduced claims frequency stemming from Covid 19 pandemic, the underlying performance of the motor portfolio showed both capped and large claims at expected levels. Within the home portfolio the current year result was impacted by flood and storm claims at the end of 2021 in the early part of 2022.

As noted above, at the end of February 2022 TU's capital position was:

- Solvency II Own funds - £180.6m (2020: £185.9m).
- Approved Partial Internal Model (PIM) Capital Requirement - £121.1m (2020: £118.1m).
- Solvency Ratio - 149.1%. (2020: 157.3%).

The vision for the Company is to be the "Insurer of choice for Tesco Customers" whilst the overall role for TU is to maintain a profitable position within the UK personal lines car and home market supporting the Tesco Bank personal lines insurance strategy.

TU operates in a highly competitive market place with ongoing regulatory change.

Throughout the period to 28 February 2022 TU has maintained a regular dialogue with the PRA including updates on actual and expected capital coverage as well as quarterly meetings on business progress and the sharing of Board papers.

The Covid-19 pandemic has receded in the UK with the end of most restrictions in England on 24 February, in Scotland on 21 March and in Wales on 28 March 2022. The Company continued to operate effectively in compliance with the Covid-19 pandemic restrictions during 2021 and 2022 using the protocols established during 2020, modified for the changes required as the vaccine programme rolled out and the situation in the UK eased. Following the removal of Covid 19 pandemic measures in England, the Company's Covid Triage Group was disbanded and the requirement for notification of Covid-19 cases to the Company was suspended.

During the first part of 2021 TU continued with its Crisis Management approach of continuing to have a proportion of the staff in the Claims operation in Newcastle in attendance in order to maintain claims handling tasks that could not be done remotely. All operations remained stable throughout this period.

Covid-19 updates continued to be communicated with TU staff throughout the 14 month period. The safety and wellbeing of TU staff remained the primary focus alongside ensuring that business systems and processes can continue to serve customers through this period and there was strong co-operation between the Company, Tesco Bank and Ageas during its period of ownership. Overall, the business and its partners proved resilient to the pandemic and the pandemic is not assessed to be a significant risk.

B. System of Governance

The role of the TU Board is to provide oversight of TU's business and exercise control over the business ensuring the direction and performance of the business is aligned to shareholder objectives and is managed competently and prudently in accordance with legislative and regulatory requirements. The Board delegates authority to certain Board committees in order that they may monitor and oversee specific aspects of the business without reference to the Board. The Board committees are accountable to the Board, and responsibility rests with the Board.

The TU Board has delegated authority and responsibility for key activities to designated Senior Managers in accordance with the requirements of the Senior Managers and Certification Regime ("SM&CR"). The allocation of significant responsibilities is documented and maintained within TU's Management Responsibilities Map.

TU has put in place policies and procedures that provide evidence of fitness and propriety for Directors, Senior Managers and those responsible for discharging a key function. Supporting documentation is collated prior to appointment, and in conjunction with the recruitment and appointment processes, which provides information on the individual's skills and experience.

TU operates a "Three Lines of Defence" governance model to provide management with reasonable assurance that the company is run in a proper way. TU management and staff have the primary responsibility for owning and managing risks (First Line of Defence). Oversight of the effective operation of the internal control framework is supported by the Risk Management and Compliance functions (Second Line of Defence). Internal Audit provide independent verification and challenge of the adequacy and effectiveness of the internal risk and control framework (Third Line of Defence).

The goal of TU's approach to risk management is to ensure that all significant risks are understood and effectively managed through a well-designed risk management framework. The objective of such a framework is to add value to the business as well as ensure adequate systems and controls operate.

C. Risk Profile

TU defines risk as the deviation from anticipated outcomes that may have an impact on its solvency, earnings, liquidity, customers and/or reputation and therefore its business objectives and/or future opportunities. TU's risks therefore stem from its exposure to both external and internal risk factors in conducting its business activities. TU only seeks to take on risks that:

- It has a good understanding of (i.e. is within current expertise and available information);
- Can be adequately managed at both the individual and overall portfolio level;
- Are affordable (i.e. within the TU risk appetite); and
- Have an acceptable risk-reward trade-off

The most significant risks that TU is exposed to are: Non-Life Insurance risk, Market Risk, Operational Risk and Strategic Risk – these and all risks with the TU Taxonomy are managed through a combination of polices, processes, controls and reports. Controls are designed to keep risks within appetite, with a formal risk acceptance process managed through quarterly review by the Management Risk Committee (MRC) and subsequently by the Board Risk Committee (BRC).

The monitoring of these risks as assessed by the business (First Line) is facilitated by the quarterly Control Risk Self-Assessment (CRSA) process, and articulated around the annual Strategic Planning and ORSA (Own Risk and Solvency Assessment) processes, supported by relevant modelling approaches.

D. Valuation for Solvency Purposes

The valuation of assets and liabilities for Solvency II purposes is the same as IFRS except for:

- Deferred acquisition costs, other intangibles, tangible fixed assets and prepayments are excluded from the SII balance sheet.
- Deferred tax is adjusted to reflect the tax impact of the valuation adjustments.
- Reinsurance assets (claim recoveries) are discounted for SII balance sheet purposes.
- Technical provisions (claims reserves and unearned premium reserves) are discounted for SII balance sheet valuation purposes.
- Subordinated debt within the IFRS balance sheet classified as subordinated liabilities has been reclassified from liabilities to own funds in line with SII requirements. Each of the eligibility criteria required for the subordinated debt to qualify as Tier 1 capital, as set out in Article 73 of delegated regulation (EU) 2015/35 have been met. The debt is fully subordinated in the event of a winding up, with the claims of the holder of the debt subordinated to the claims of the senior creditors (including policyholders and non-subordinated creditors). The subordinated debt is fully available to absorb losses and is free from encumbrances.

  Key valuation adjustments are shown in the table between IFRS and SII balance sheet illustrated below:

	Actual 2022	Actual 2020
Total Shareholders Equity	156,408	188,800
Subordinated Liabilities	42,333	42,333
Total Valuation differences	**(18,102)**	**(45,264)**
Removal of DACs	(11,039)	(7,817)
Derecognition of tangible and intangible assets	(12,036)	(9,763)

Derecognition of prepayments	(1,846)	(1,865)
Net best estimate of discounted liabilities	2,581	(11,744)
Tax impact on valuation differences	4,238	5,926
Forseeable dividend	-	(20,000)
Total Solvency II Own Funds (PIM)	180,639	185,869

The SII Own Funds decreased in the period ending 28th February 2022 relative to 2020. This difference is driven by a combination of business profitability offset by an increase in unrealised losses on financial assets.

E. Capital Management

TU operates a capital contingency plan which gives the business guidance on actions / considerations at different SII capital coverage levels. For example, TU successfully implemented its Capital Contingency Plan in the first quarter of 2017 following the announcement of the reduction in the Ogden discount rate to minus 0.75% on 27th February 2017. Together with 2017 profitability and the implementation of additional reinsurance this increased TU's coverage from 101% to 169% at the end of 2017.

At the period end of 28th February 2022 TU had SII own funds of £180.6m (2020: £185.9m). With the TU SCR PIM at £121.1m (2020: £118.2m) this resulted in capital coverage of 149.1% (2020: 157.3%).

As TU usually holds bonds to maturity, the volatility adjuster removes the impact of short term volatility on bond yields. Excluding the use of volatility adjuster at 28 February 2022, SII own funds would have reduced by £1.0m to £179.6m, leading to a capital coverage of 148.3%.

Directors' Statement

Approval by the Board of Directors

14 Month Period ended 28 February 2022

We certify:

(a) That the Solvency and Financial Condition Report ("SFCR") has been prepared in all material respects in accordance with the PRA Rules and Solvency II Regulations, and

(b) We are satisfied that:

(i) throughout the financial year in question, Tesco Underwriting has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable to the insurer, and

(ii) it is reasonable to believe that the insurer has continued so to comply subsequently and will continue so to comply in future.

Gary Duggan

CEO

Stephen Grainge

Finance Director

1 June 2022

Auditor’s Statement

REPORT OF THE EXTERNAL INDEPENDENT AUDITOR TO THE DIRECTORS OF TESCO UNDERWRITING LIMITED (‘THE COMPANY’) PURSUANT TO RULE 4.1 (2) OF THE EXTERNAL AUDIT CHAPTER OF THE PRA RULEBOOK APPLICABLE TO SOLVENCY II FIRMS

Report on the Audit of the relevant elements of the Solvency and Financial Condition Report (“SFCR”)

Opinion

Except as stated below, we have audited the following documents prepared by the Company as at 28 February 2022:

- the ‘Valuation for solvency purposes’ and ‘Capital Management’ sections of the SFCR of the Company as at 28 February 2022, (‘the Narrative Disclosures subject to audit’); and
- Company templates S.02.01.02, S.12.01.02, S.17.01.02, S.23.01.01, S.28.01.01. (‘the Templates subject to audit’).

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the ‘relevant elements of the SFCR’.

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

- information contained within the relevant elements of the SFCR set out about above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report;
- the ‘Executive summary’, ‘Business and performance’, ‘System of governance’ and ‘Risk profile’ elements of the SFCR;
- Company templates S.05.01.02, S.19.01.21 and S.25.02.21;
- the written acknowledgement by management of their responsibilities, including for the preparation of the SFCR (‘the Responsibility Statement’).

To the extent the information subject to audit in the relevant elements of the SFCR includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

In our opinion, the information subject to audit in the relevant elements of the SFCR of the Company as at 28 February 2022 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK), including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the SFCR in the UK, including the Financial Reporting Council’s (the ‘FRC’s’) Ethical Standards as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter – Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' sections of the SFCR, which describe the basis of accounting. The SFCR is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The SFCR is required to be published, and intended users include but are not limited to the PRA. As a result, the SFCR may not be suitable for another purpose. Our opinion is not modified in respect of these matters.

Conclusions relating to going concern

In auditing the SFCR, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the SFCR is appropriate. Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- obtaining an understanding of relevant controls around management's going concern assessment;
- assessing the company's compliance with regulation, including capital requirements;
- reviewing the Own Risk and Solvency Assessment (ORSA) to support our understanding of the risks faced by the company;
- inspecting correspondence between the company and its regulators, Financial Reporting Council ("FCA") and Prudential Regulation Authority ("PRA"), as well as reviewing relevant Board and Committee minutes to identify any potential areas of legislative or regulatory non-compliance that could impact upon going concern;
- assessing the assumptions used in the forecasts prepared by management, and their historical accuracy; and,
- assessing the financial position and prospects of the wider Tesco Group to which the company is operationally linked.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from when the SFCR is authorised for issue. Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other Information

The Directors are responsible for the Other Information. Our opinion on the relevant elements of the SFCR does not cover the Other Information and, we do not express an audit opinion or any form of assurance conclusion thereon.

Our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the relevant elements of the SFCR, or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the relevant elements of the SFCR themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors for the Solvency and Financial Condition Report

The Directors are responsible for the preparation of the SFCR in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based.

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

Auditor’s Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report

It is our responsibility to form an independent opinion as to whether the relevant elements of the SFCR are prepared, in all material respects, with financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

Our objectives are to obtain reasonable assurance about whether the relevant elements of the SFCR are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the SFCR.

A further description of our responsibilities for the audit of the financial statements is located on the FRC’s website at: https://www.frc.org.uk/auditorsresponsibilities. The same responsibilities apply to the audit of the SFCR.

Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We considered the nature of the company’s industry and its control environment, and reviewed the company’s documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities.

We obtained an understanding of the legal and regulatory frameworks that the company operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the SFCR. These included Solvency II as implemented in the UK and tax legislation; and
- do not have a direct effect on the SFCR but compliance with which may be fundamental to the company’s ability to operate or to avoid a material penalty. These included Companies Act 2006 and related Company Law, regulatory solvency requirements and environmental regulations.

We discussed among the audit engagement team including relevant internal specialists such as actuarial, tax, valuations, IT and industry specialists regarding the opportunities and incentives that may exist within the organisation for fraud and how and where fraud might occur in the financial statements.

As a result of performing the above, we identified the greatest potential for fraud in the following areas, and our specific procedures performed to address it are described below:

- Best estimate claims liabilities on large claims:

  - We engaged our actuarial specialists to review the BEL and consider the differences between the IFRS and Solvency II TPs.

  - For non-large claims, we verified that the starting point of the SII TP build was on a best estimate basis by comparing against audited IFRS reserves. For large claims, we reviewed the appropriateness of the stochastic approach by utilising an internal specialist to review methodology and assumptions applied and challenged Management on any material discrepancies between the stochastic model output and the IFRS reserves.

  - We also reviewed the model validation reporting provided by Management’s expert, EY. The audit team has tested the data used by actuaries for completeness and accuracy.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

In addition to the above, our procedures to respond to the risks identified included the following:

- reviewing SFCR disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- enquiring of management, internal audit and in-house legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- reading minutes of meetings of those charged with governance, reviewing correspondence with the PRA and FCA, reviewing internal audit reports and reviewing correspondence with HMRC.

Other Matter

The Company has authority to calculate its Solvency Capital Requirement using a partial internal model (''the Model'') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

Report on Other Legal and Regulatory Requirements.

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of Tesco Underwriting Limited's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in relation to this matter.

Use of our Report

This report is made solely to the Directors of Tesco Underwriting Limited in accordance with Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook for Solvency II firms. We acknowledge that our report will be provided to the PRA for the use of the PRA solely for the purposes set down by statute and the PRA's rules. Our audit work has been undertaken so that we might state to the insurer's Directors those matters we are required to state to them in an auditor's report on the relevant elements of the SFCR and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the PRA, for our audit work, for this report or for the opinions we have formed.

M. Bainbridge

Matt Bainbridge
Deloitte LLP
Hill House
1 Little New Street
EC4A 3TR
1 June 2022

Appendix – relevant elements of the Solvency and Financial Condition Report that are not subject to audit

Solo partial internal model

The relevant elements of the Solvency and Financial Condition Report that are not subject to audit comprise:

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions - non-life (excluding health) - risk margin
  - Row R0590: Technical provisions - health (similar to non-life) - risk margin
  - Row R0640: Technical provisions - health (similar to life) - risk margin
  - Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
  - Row R0720: Technical provisions - Index-linked and unit-linked - risk margin

- The following elements of template S.12.01.02
  - Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0110 to R0130 – Amount of transitional measure on technical provisions

- The following elements of template S.17.01.02
  - Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0290 to R0310 – Amount of transitional measure on technical provisions

- The following elements of template S.23.01.01
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

- The following elements of template S.28.01.01
  - Row R0310: SCR

- Templates S.05.01.02, S.19.01.21 and S.25.02.21
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- Elements of the Narrative Disclosures subject to audit identified as ‘unaudited’.

A

BUSINESS and PERFORMANCE (unaudited)

A.1 Business

A.1.1 General Information

The following terminology is used to denote the entities referred to within this document:

- TU – Tesco Underwriting Limited (the "Company").
- Tesco Bank – Tesco Personal Finance Plc ("Shareholder").
- Board – the Board of Directors of TU

TU is registered in England and Wales and its registered address is London Court, 39 London Road, Reigate, Surrey, United Kingdom, RH2 9AQ.

Tesco Bank is registered in Scotland and its registered address is 2 South Gyle Crescent, Edinburgh, EH12 9FQ.

TU's auditors are Deloitte LLP, 1 New Street Square, London, EC4A 3HQ.

A.1.2 Group Structure and ownership

TU is a wholly owned subsidiary of Tesco Personal Finance plc ('Tesco Bank'). TU is authorised by the PRA and regulated by the FCA and the PRA.

Contact details are:

The PRA
Bank of England
Threadneedle Street
London
EC2R 8AH

The FCA
12 Endeavour Square
London
E20 1JN

TU's Shareholder Tesco Bank is in turn owned 100% by Tesco Personal Finance Group Ltd (the latter owned by Tesco PLC).

On 4 May 2021, Tesco Bank acquired the remaining 50.1% ordinary share capital of TU, from its joint venture partner, Ageas, following regulatory approval received in March 2021. Since 4 May 2021, TU has therefore become a wholly owned subsidiary of Tesco Bank and forms part of the Tesco Bank Group. Total cash consideration was £94.7m. Since the acquisition TU has been engaged in transferring the provision of its services away from Ageas and this process is largely complete, noting it is planned that the transfer of motor supply chain services from Ageas will be completed in the second half of the year. In addition to the purchase of the ordinary share capital, Tesco Bank also acquired the holding of £21.2m subordinated debt from Ageas on the same date.

A.1.3 Description of our material lines of business and material geographical areas where we write business

The Company underwrites personal Motor and Home insurance policies for Tesco Bank customers and provides these customers with a claims management service.

The Company's policies are written within the United Kingdom and the Channel Islands.

A.1.4 Challenges facing insurers

Technology, digitisation, regulation, capital, climate change, reinsurance costs and a highly competitive market remain the largest challenges facing insurers.

New trends surrounding connected homes, autonomous and electric cars will impact the lives of our customers and, therefore, our role as insurer.

Consumer behaviours are also changing. Customers are more discerning, seeking greater control and demanding the highest levels of service. As a part of that evolution, they expect a greater degree of customisation and personalisation. To meet this need, we are investing in data analytics to enable us to support our pricing and customer experience. We will also use the insight from data to engage with our customers at an earlier stage, shifting the emphasis more towards risk prevention.

We maintain, at all times, a keen focus on treating customers fairly and ensuring we have a flexible approach to meet the needs of a diverse customer base including specific consideration of the needs of vulnerable customers which continues to be a key area of focus for the Board.

The Company has considered risks associated with Covid-19 pandemic. The Company proved resilient to the pandemic and is not assessed to be a significant risk at the time of writing.

A.2 Underwriting Performance

A.2.1 Non-life Insurance

The overall role of TU is to support the Tesco Bank personal lines insurance strategy through innovative underwriting and product initiatives, whilst driving financial returns for the shareholder by maintaining strong underwriting, risk and financial controls.

TU has defined a business strategy and vision. The core strategy for the business is to optimise the end to end value of the business and the assets and capabilities of the Tesco Bank Group.

A.2.2 Results and Capital position

The IFRS results of the business are as follows:

Total £'000	2022 *	2020	Variance
Gross Written Premium	346,594	297,731	48,863
Gross earned premiums	342,514	298,827	43,687
Reinsurers' share of premiums	(149,174)	(99,491)	(49,682)
Gross incurred claims	(220,717)	(188,403)	(32,314)
Reinsurers' share of claims	99,124	61,492	37,632
Expenses	(71,532)	(49,054)	(22,478)
Net underwriting result	216	23,371	(23,155)
Other Income	3,274	3,069	205
Investment Income	18,800	12,022	6,778
Profit before Tax and interest	22,290	38,462	(16,172)

*2022 represents the 14 months to February 2022.

An analysis of the individual lines of business (Motor and Home) can be found in QRTs S.05.01.01 (Non-Life and Life) in the Appendix. The IFRS post-tax Profit for the period ending 28th February 2022 was £16.6m (2020 £29.7m profit).

Net Assets on an IFRS basis as at 28th February 2022 were £156.4m (2020: £188.8m).

Solvency II available capital at the period end 28th February 2022 £180.6m (2020: £185.9m) which is 149.1% (2020: 157.3%) of the Partial Internal Model Solvency Capital Requirement (PIM SCR).

In March 2021, a dividend of £20m was paid through retained earnings. No dividend has been proposed for the period ending 28th February 2022.

A.3 Investment Performance

A.3.1 Information about the investment performance

Investment income increased by 56.4% during the period ending 28th February2022 mainly as a result of gains from the property fund classified as fair value through profit and loss account. The property gains were due to a post-pandemic recovery in the value of the property fund as the economy reopened.

A.3.2 Investment performance by asset class:

Investment Income £'000	2022	2020
Supranational/Agency Bonds	1,424	1,295
Corporate Bonds	12,030	10,624
Property	5,353	(76)
Bank Deposits	(7)	179
Total investment income	18,800	12,022

Period ending 28th February 2022 Investment income including realised gains and excluding investment expenses was £18.8m (2020: £12.1m).

The portfolio quality remains strong with the overall average "A+" rating.

A.3.3 Gains and losses recognised directly in equity

Assets available for sale £'000	2022	2020
Unrealised Gains	7,577	12,754
Unrealised Losses	(44,371)	(1,726)
Total	(36,794)	11,028

During the period ending 28th February 2022 TU experienced an overall unrealised loss reflecting changes in the interest rate environment and the impact of the invasion of Ukraine. As a buy and hold investor the portfolio is exposed to the movement in the yield curve as well as spread movements. It is these movements which caused the gains and losses in the period.

A.4 Performance of other activities

There are no other material activities to report upon.

A.5 Any other information

There are no other information to report upon.

B

SYSTEM OF GOVERNANCE (unaudited)

B.1 General Information on the system of governance

B.1.1 Overall governance framework

Tesco Underwriting ('TU') promotes and sustains high standards of corporate governance, and has therefore established a governance framework, based upon the high level principles as set out within the Prudential Regulation Authority (PRA) Rulebook, the Financial Conduct Authority (FCA) Handbook, the Wates Corporate Governance Principles for Large Private Companies (Wates Principles), the UK Corporate Governance Code (where relevant), aligned to shareholder governance requirements.

A Governance Framework (the 'Governance Framework') is in place which incorporates these principles and governs how they are reflected in the organisation and operations of the TU business. The Governance Framework operates through individuals fulfilling their responsibilities, and these are outlined within specific job descriptions and the TU Management Responsibilities Map (where applicable), as well as through policies, procedures and processes which record accountabilities. Compliance with these standards and requirements will ensure that TU meets not only the expectations of its shareholder but also other key stakeholders in the business such as customers, employees, business partners and regulators.

Good corporate governance means that TU maintains the flexibility to adapt its structure to altered circumstances, new legislation and other significant events. The Board will annually, or more frequently when circumstance so require, review the components of the Governance Framework and make such changes as it deems appropriate.

The Board does not delegate any decisions that are set out as Board Reserved Matters or take any decisions that are set out as Shareholder Reserved Matters. The Governance Framework defines the delegated authority based on competence and appropriate mechanisms and triggers for escalation. The Board delegates authority to certain Board committees in order that they may monitor and oversee specific aspects of the business without reference to the Board. The Board committees are accountable to the Board with responsibility resting with the Board. In summary the key responsibilities are:

The TU Board of Directors
The role of the TU Board is to provide oversight of TU's business and exercise control over the business ensuring the direction and performance of the business is aligned to shareholder objectives and is managed competently and prudently in accordance with legislative and regulatory requirements.

The Board Audit Committee
The role of the Audit Committee is to support the Board in fulfilling its responsibilities for oversight of the adequacy and effectiveness of internal controls, including internal controls over financial reporting.

The Board Risk Committee
The role of the Board Risk Committee is to support the Board in fulfilling its responsibilities for oversight of the adequacy and effectiveness of risk governance and its capital allocation and models and in particular the risk profile relative to the risk appetite determined by the Board.

The Board Remuneration Committee
The Remuneration Committee's role is to support the Board in all matters relating to the remuneration of the TU executive directors and relevant senior managers. Its primary role is to consider and make recommendations for approval by the Board on any material decision relating to the remuneration, benefits, employment terms and/or pension scheme arrangements of the TU Chief Executive Officer and his executive direct reports.

The Model Control Board

The role of the Model Control Board (MCB) is to assist the Board Risk Committee, and in turn the Board, in fulfilling its responsibilities in respect of appropriate model governance, design and operation, providing assurance to the Board via the Board Risk Committee on the appropriateness and effectiveness of the models included on the Model Register (together the "Models") taking into account independent model validation and other relevant oversight assessments.

The Investment Committee

The Investment Committee oversees the performance of TU investments, identifying, developing and recommending appropriate investment strategies to the TU Board and overseeing the implementation and adherence to the approved investment strategies by TU's investment advisers.

The Reinsurance Committee

The role of the Reinsurance Committee is to oversee the implementation of the TU reinsurance strategy, identifying reinsurance needs in the context of the overall business strategy, detailing reinsurance requirements, reviewing the appointment of placing brokers, negotiating policy terms and monitoring treaty placement.

Executive Committee

The Executive Committee's role is to support the Chief Executive Officer by providing oversight and challenge in the efficient and effective delivery of the strategic plan and overall direction of the TU business.

Senior Management

The role of Senior Managers is to manage the business function for which they are responsible in keeping with the values, strategies, policies, plans and budgets confirmed by the Board. Senior managers are required to demonstrate they are accountable and responsible in delivering effective governance, including taking responsibility and being accountable for the decisions they make, and exercising rigorous oversight of the business areas they lead. In exercising this role, Senior Management are responsible for complying with the legal and regulatory framework applicable to the business.

The Board and Chief Executive Officer, as appropriate, will delegate powers to specific individuals within the organisation. This provides a "top down" and "bottom up" reporting and accountability structure within business units and functions.

B.1.2 Material transactions during the reporting period

At 28 February 2022 TU's subordinated loan advanced by its shareholder, Tesco Bank, was in two tranches:

- £ 28,000,000 which carries an interest rate of SONIA + 3.5%, payable quarterly
- £ 14,333,333 which carries an interest rate of SONIA + 4.5%, payable quarterly

TU has related party balances with Tesco Bank who provide various outsourced services including IT, Property and HR related services and costs.

TU does not have any intra Group reinsurance arrangements.

B.1.3 Material changes in systems of governance over the reporting period

There have been no material changes in TU's systems of governance over the reporting period.

B.2 Fit and proper requirements

B.2.1 Policies and processes to ensure colleagues comply to fit and proper requirements

In accordance with the requirements of SM&CR, the responsibilities for running TU are allocated across each senior manager and set out within individual Statements of Responsibilities. This allocation includes the Prescribed Responsibilities designated by the PRA and FCA, with each Prescribed Responsibility being allocated to a SMF role holder who is the senior manager wholly accountable for it. The allocation of key responsibilities across TU, including the Prescribed Responsibilities, is shown within the Management Responsibilities Map.

The Board needs to collectively hold the qualifications, knowledge and experience necessary to run a company of TU's size and complexity.

The obligation to be fit and proper continues for as long as the individual remains a Director, a Senior Manager, a certification function or a key function holder (KFH) and failure to remain fit and proper to perform their controlled function can result in the PRA/FCA prohibiting that individual from performing that function. TU has put in place policies and procedures that provide evidence of fitness and propriety, including a recruitment and appointment process for Directors, Senior Managers, certification functions and KFHs, a regular cycle of appraisals and performance reviews, and up to date training records, in addition to an annual self-certification exercise.

Supporting documentation is collated prior to appointment, and in conjunction with the recruitment and appointment processes, which provides information on the individual's skills and experience and includes, but is not limited to:

- Detail of their personal characteristics (including being of good repute and integrity);
- Their level of competence, knowledge and experience;
- Their qualifications;
- Confirmation that they have undergone or are undergoing all training; and
- Financial soundness.

Details of TU's senior manager functions and KFHs notified to and approved by the PRA and/or the FCA under SM&CR are shown in B2.2.

B.2.2 List of people responsible for key functions as at 28 February 2022

Core Function	Role Holder	SMR/KFH	Reporting Lines
Board Chair	S Machell (INED)	SMF9	N/A
Audit Committee Chair	C Ramsay (INED)	SMF11	N/A
Board Risk Committee Chair	M Cronin (INED)	SMF10	N/A
Remuneration Committee Chair	S Machell (INED)	SMF12	N/A
CEO leadership	G Duggan (TU CEO)	SMF1	S Machell (Board Chair) (SMF9)
Finance	S Grainge (TU FD)	SMF2 SMF24	G Duggan (TU CEO) (SMF1)
Underwriting	C Anthony (CUO)	SMF23	G Duggan (TU CEO) (SMF1)
Risk Management and Compliance	S Wright (CRO)	SMF4 SMF16 KFH	G Duggan (TU CEO) (SMF1) M Cronin (INED) (SMF10)
Actuarial	L Nguyen (Chief Actuary)	SMF20 KFH	S Grainge (TU FD) (SMF2)
Internal Audit	T Deane (TU Audit Director)	SMF5 KFH	Overseen by Audit Committee Chair
Claims	D Thompson (Claims Director)	SMF18	G Duggan (TU CEO) (SMF1)
Colleague Experience	L Rennie-Smith (Tesco Bank Director of Colleague Experience)	SMF18	Overseen by the Board Chair.

B.2.3 Remuneration entitlements over the reporting period

Principles of remuneration policy

TU has established governance and procedures relating to remuneration entitlements. It has established a Remuneration Policy, oversight of which is provided by the TU Remuneration Committee of Independent Non-Executive Directors, who consider and ensure the framework and arrangements that govern the remuneration of the Executive and Senior Management are appropriate, transparent and are aligned to TU's long term business strategy, risk appetite and values, and that the remuneration structure meets statutory, regulatory and shareholder requirements.

Details of Directors' Emoluments that are applicable to TU have been included within the notes to the financial statements of the company for the 14 months ending 28th February 2022 (note 27 Directors' remuneration).

The Remuneration Policy describes the following objectives:

- To be able to attract, retain and motivate our Executives to deliver the required standard of performance;
- Reward contribution to the business as well as reflecting the objectives of the shareholders of the partnership ensuring that all risk exposures are consistent with the Company's formally agreed Risk Appetite;
- Recognise individual performance as well as seeking to reinforce personal behaviours that deliver on TU's values;
- Provide a competitive remuneration package, which is fair and reasonable compared to the market, and in the context of the wider employee population; and
- Provide remuneration entitlements which meet statutory and regulatory requirements.

The approach is to provide a combination of fixed and variable pay, consistent with UK market practices. Employees are eligible to participate in TU's Bonus Scheme which consists of two elements – business performance and individual performance. The Scheme includes an element of deferral should certain thresholds be met. All employees in the UK are eligible to join a Group Personal Pension Scheme.

Specific Features of remuneration structure

The following features of the remuneration strategy contribute to ensuring remuneration of staff supplying services to TU is aligned with TU's business strategy, risk profile, objectives, risk management practises and long-term interests:

- Fixed Pay:
    - This represents a sufficient proportion of the remuneration package, so no individual is dependent on variable pay.
    - No element of TU staff's fixed pay is dependent on sales targets and/or volumes.
    - When we decide the salaries we pay for any role, we need to balance remaining competitive enough to attract and retain talent and managing our costs effectively.
    - We undertake annual benchmarking of all roles against similar roles in the insurance industry and, for those that aren't unique to insurance, to the wider market. This benchmarking data, together with knowledge of local markets, competitors and recruitment challenges is used to agree a salary range that we believe is fair, competitive and affordable.

- Performance Targets:
    - All TU staff's personal objectives should link back to, and enable them to contribute to the delivery of TU's strategic business objectives.
    - Feedback and process against objectives is reviewed and recorded regularly, supported by regular reviews to enable effective mid-year and end-of-year reviews.
    - To achieve a particular rating, employees must meet specific criteria as described in TU's Performance Management Framework. There will be a combined rating representing Performance Against Objectives and Job Role and secondly TU Values.

- Tesco Underwriting Bonus Scheme:
    - TU's Bonus Scheme document describes the rules that will apply to all eligible colleagues.
    - The Scheme rules are discretionary and apply for performance for the 14 months ending 28th February 2022. Bonus payments are be payable with salaries in May 2022.
    - There are three measures which are included within the calculation of the bonus, each of which constitutes one third of the total on target or potential bonus payment. These are:
        - Gross written premium - the target for the value of the policies that are sold during the year;
        - Profit - achievement of our net profit target; and
        - Personal Performance as measured by a colleague's year end performance rating.
    - Bonus payment is discretionary and is subject to achievement of business and individual performance targets.
    - On target bonus payments are linked to Work Level.

- Executive Bonus Scheme:
    - TU's Executive Bonus Scheme applies to all TU individuals in an Executive level role and describes the rules that will apply to all eligible colleagues.
    - In accordance with the Remuneration Policy the scheme has a number of features, and performance is linked to the achievement of objectives in a number of areas (including Personal Performance, GWP, Profit, Customer Satisfaction, Employee Satisfaction).
    - There are deferral rules (payments made over 3 years) for bonuses over a specified threshold in order to satisfy the Solvency II Remuneration requirements.

- Share Scheme – TU does not give entitlement of shares and/or share options to any member of staff.

- Supplementary Pension or Early Retirement Schemes – there are no supplementary pension or early retirement schemes for members of the Board or other key function holders.

As part of the Company's commitment to diversity and inclusion it has completed gender pay reporting in line with statutory requirements and has signed the HM Treasury's Women in Finance Charter.

Changes following Tesco Bank acquiring the Ageas share holding

In the light of TU becoming an 100% Tesco Bank owned company in May 2021, the remuneration structure is being aligned with that used in Tesco Bank. Fixed pay is aligning from November 2021, with variable pay following for the year ending 28th February 2023. However, the principles of the Company's fixed and variable pay approach and the aim of aligning colleague benefits and Company objectives is being maintained.

B.3 Risk management system including the own risk and solvency assessment

B.3.1 Risk management overview

As a Non-Life insurance provider TU faces a number of risks that, whether internal or external, may affect its operations, its earnings, the value of its investments or the sale of certain products and services. The fundamental principle underlying the Risk Strategy of TU is to maximise shareholder value within the constraints of the Risk Appetite Framework, taking into account the protection of policyholders. To this end, the risk exposures of TU are directed towards businesses that provide attractive risk-adjusted returns.

This chapter therefore conveys how risks are managed. Firstly, TU's Risk Framework Policy will be explained through its Risk Taxonomy and through an explanation of its Risk Appetite Policy. Secondly, TU's Risk Management organisation and governance will be detailed.

In Section C (Risk Profile) TU's main risk exposures and the specific risk management frameworks applicable to them will be presented with regard to Insurance risks, Financial risks, Operational risks and Strategic risks.

The embedding of the Risk Strategy takes place in the quarterly Control Risk Self-Assessment (CRSA) process, articulated around the annual Strategic Planning and ORSA (Own Risk and Solvency Assessment) process, supported by relevant modelling approaches.

TU has chosen to adopt a Partial Internal Model (PIM), with Insurance Risk (TU's most material risk) being modelled using an Internal Model (IM), and all other risk types being modelled using the Standard Formula (SF). TU's internal model was approved in 2015 as part of the Ageas Group approval. In 2020, as a consequence of the plan for Ageas to cease to be a shareholder, TU applied for a solo PIM approval and this was approved in December 2020.

Insurance risk is the most significant source of risk (accounting for approximately 60% of capital required), and hence the specifics of TU are best modelled using an Internal Model.

TU's MCB ensures that there is an appropriate level of oversight over the TU Capital Model, considering internal validation, independent model validation and other relevant assurance assessments over a quarterly update cycle. This process reflects the Terms of Reference for the TU Model Control Board and TU Board Risk Committee.

External Model Validation has been undertaken by EY since TU received its solo model approval. The scope of the 2021 validation work was approved by the TU BRC in May 2021, and covered the following key areas:

1. Review of remediation taken against previous validation findings
2. Premium Risk deep dive
3. Validation of model changes
4. Validation of calibration update

This work concluded that with regards to the risk areas within the scope of the review the TU Partial Internal Model (PIM) remains compliant with Solvency II standards and the areas they have reviewed remain fit for the purpose of estimating the SCR.

To compliment the independent validation work conducted by EY, the TU Risk Function has undertaken additional internal validation work to provide an overall validation opinion that the TU Partial Internal Model meets all regulatory requirements.

B.3.2 Risk management framework

TU defines risk as the deviation from anticipated outcomes that may have an impact on the value of assets, capital, earnings, customer or reputation of TU, its business objectives, or future opportunities. TU risk therefore stems from its exposure to both external and internal risk factors in conducting its business activities. TU only seeks to take on risks for which:

- It has a good understanding of (i.e. is within current expertise and available information);
- Can be adequately managed at both the individual and overall portfolio level;
- Are affordable (i.e. within the TU risk appetite); and
- Have an acceptable risk-reward trade-off.

The goal of TU's approach to risk management is to ensure that all significant risks are understood and effectively managed through a well-designed risk management framework. The objective of such a framework is to add value to the business as well as ensure adequate systems and controls operate by:

- Ensuring that risks which affect the achievement of objectives are identified, assessed, monitored and managed;
- Defining risk tolerance limits and appetite and ensuring that the risk profile is kept within risk appetite;
- Supporting the decision-making process by ensuring that consistent, reliable and timely risk information, is available and understood by decision makers;
- Creating a culture of openness and risk awareness in which each Manager carries out their duty to be aware of the risks of their business, to manage them adequately, and report them transparently; and
- Ensuring that an independent assessment of risks is taking place.

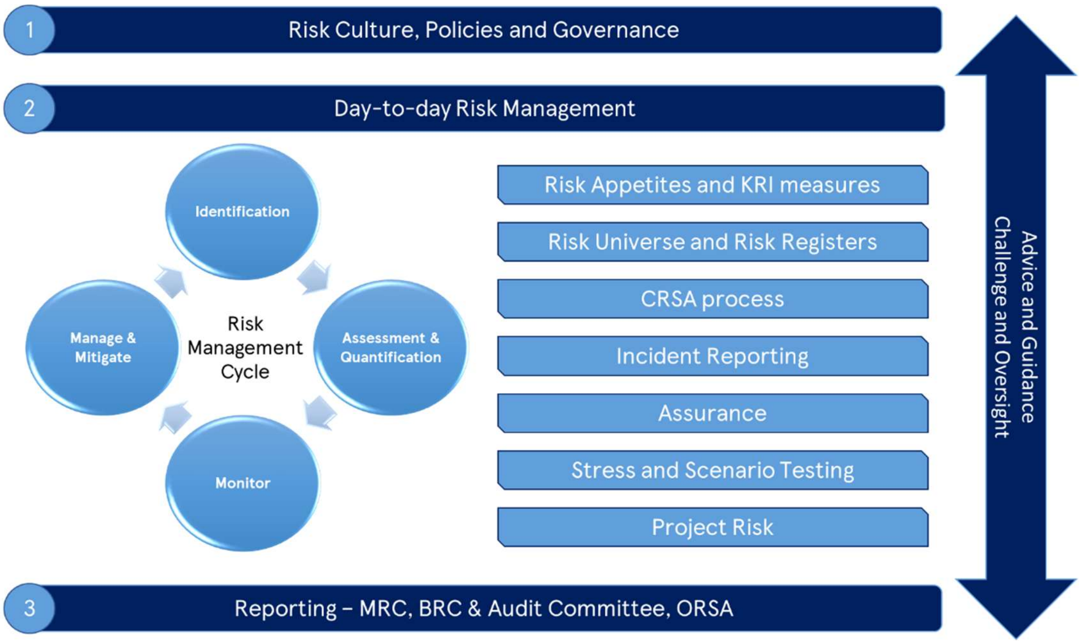
To reach this objective TU has a risk management framework in place designed to systematically and comprehensively identify risks to the company's objectives, assess their impacts and implement integrated mitigation strategies to safeguard the objectives. Risk management is a process, carried out by TU's Board of Directors, management and other personnel. It supports the entire strategy lifecycle. It is applied during the strategy setting process as well as in the everyday management of the company. It is designed to identify potential events that may impact TU, manage risks to be within its risk appetite and to provide reasonable assurance regarding the achievement of TU's objectives.

To ensure that the risk management processes are embedded within the business, TU's risk management incorporates:

- A formal structure of Committees ensuring coverage of material risks;
- Risk policies containing defined appetites and tolerance limits for all risk categories;
- Regular management information; and
- A three lines of defence risk governance model.

As part of its risk management framework, TU also has a forward looking Own Risk and Solvency Assessment (ORSA) process that takes into account its risk profile, approved risk tolerance limits and business strategy.

At TU, risk management is based on a set of guiding principles, which are captured by the risk management framework (see illustration below from the TU Risk Framework Policy for more detail). TU seeks to ensure that all significant risks are continuously identified, assessed, managed and monitored in accordance with the guidelines and standards, and intended (implicitly) to guide all business conduct within TU.



Risk Taxonomy

The TU Risk Taxonomy is a classification of the risks faced by the business. It is designed to ensure a consistent and comprehensive approach to risk identification, assessment, monitoring and response by highlighting and categorising all identified risks within the company.

Tesco Underwriting's Risk Taxonomy is linked to the overall policy framework and is divided into four broad categories: Operational Risk, Insurance Risk, Financial Risk and Strategic Risk. These categories have been aligned with Solvency II risk categories to facilitate our internal and external reporting.

Identified risks, categorised in accordance with the TU risk taxonomy are assessed and reported using a standard likelihood and impact grid which provides an overview of the overall level of concern that each risk represents (i.e. their materiality). The risks are qualitatively assessed in relation to the objectives with which they are associated.

The taxonomy should not be considered as exhaustive but as a framework within which we consider the risks Tesco Underwriting faces. It is the responsibility of business and risk management to ensure that all risks material to the business are identified.

Insurance risk is the most significant source of risk (accounting for approximately 60% of capital required), and hence the specifics of TU are best modelled using an Internal Model for this risk with the others risks appropriately covered by the Standard Formula. As indicated above the Board approves the TU ORSA Report which sets out the justification for TU's modelling approach.

Chapter C (Risk Profile) explains TU's various risk exposures in more detail.

Risk Appetite

TU's Risk Appetite is defined as the level of risk which the TU Board is prepared to accept in order to support the achievement of TU's Strategy and Objectives, which means it is able to operate effectively in both normal and stressed conditions through targeting an appropriate balance between risk and reward.

The purpose of the Risk Appetite framework is to ensure that:

- Exposure to several key risks taken by TU remains within known, acceptable and controlled targets, limits and activities;
- Risk appetite criteria are clearly defined so that actual exposures and activities can be compared to those agreed at Board level, allowing monitoring and positive confirmation that risks are controlled, and the TU Board is able and willing to accept the exposures; and
- Risk limits are linked to the actual risk taking capacity of TU in a transparent and straightforward way.

The framework has the following measures:

- **Financial**: Solvency, Earnings, Market Risk and Counterparty Default Risk; and
- **Non-Financial**: Conduct Risk, Data Protection Risk, Climate Change Risk and Operational Resilience.

For the Financial Risk Appetite measures TU sets limits on acceptable deviations from these measures, taking into account the clearly defined stress and scenario events that have been applied.

The calibration for the Non-Life Insurance risk stress events is performed using the TU Internal Model. For other risk types (i.e. Market and Counterparty Default) a modified Standard Formula model will be used to calibrate the stress events.

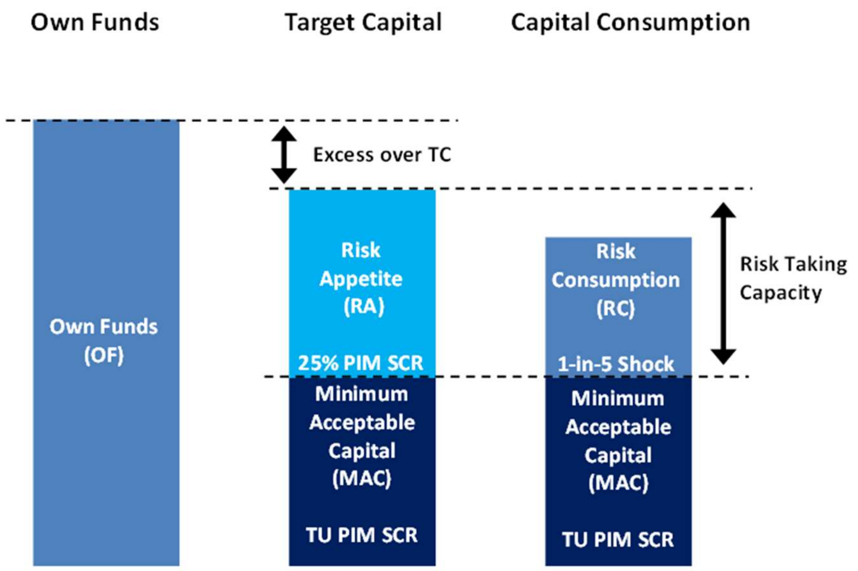
The TU stress events are calibrated to a 20% probability over 1 year ('1-in-5' year event), see the following sections for more detail. In addition, stress events calibrated to a 5% probability over 1 year (a '1-in20' year event) are used in the Tesco Bank Risk Appetite reporting.

Whilst these risks are monitored against appetite via a number of Key Risk Indicators, specific measures are called out as "Primary" based on current regulatory focus. Due to the nature of the non-financial risks, these measures are more subjective and qualitative in nature and will evolve as regulatory scrutiny changes. These will also be reviewed at least annually by the TU Board to ensure they remain relevant.

Solvency Risk Appetite Statement

Risk exposures must be limited in order to ensure that the following tests are passed at all times:

1. Own Funds (OF) remains above the Target Capital (TC) level, set at 125% PIM SCR.
2. Target Capital (TC) is greater than Capital Consumption (CC).
3. Own Funds (OF) is greater than Capital Consumption (CC) (note that this Test will pass by definition if Tests 1 and 2 are successful)



In these statements:

- RC is the level of economic capital required by TU's current risk profile, consistent with a 1-in-5 year event;
- RA is the level of capital in excess of the Minimum Acceptable Capital (MAC) which is made available to TU in order to take risks;
- CC is the total level of economic capital being consumed by TU based on its current risk profile, defined as the sum of the MAC and the RC;
- TC is the total level of capital being made available to the Group or its subsidiaries for risk taking purposes. It is defined as sum of the MAC and the RA budget; and
- MAC is the level of capital which reflects TU's internal view at which it is able to continue to write business as a going concern at planned business volumes, defined as 100% of the Partial Internal Model SCR.

When Risk Consumption exceeds Risk Appetite, it is the responsibility of management to recommend remedies to the Board for them to take actions. An example of this occurred when the Capital Contingency Plan, which envisages different levels of intervention at different levels of capital coverage, was implemented in February 2017 following the Ogden discount rate announcement.

For each of the following Risk Appetite measures TU's Board may decide to risk accept any deviation provided the rationale is noted in the minutes.

Earnings Risk Appetite Statement

Risk exposures must be limited in order to ensure that the following tests are passed at all times:

1. The deviation from the planned IFRS Profit before Tax due to a 1-in-5 year Combined risk event is limited to 100% of Profit.
2. The deviation from the planned IFRS Profit before Tax due to a 1-in-5 year Non-Life risk event (Reserve Risk or Premium Risk) is limited to 60% of Profit.

Market Risk Appetite Statement

Risk exposures should be limited in order to ensure that the following tests are passed at all times:

1. TU's Capital impact from a modelled 1-in-5 year Market Risk shock is less than 7% of the Own Funds
2. TU's Profit impact from the default of its most material Corporate Bond holding (assume 50% Loss given Default) is less than 40% of the planned IFRS Profit before tax.

The investment committee receives a quarterly updates on the investible assets and highlighting the key individual bond exposures.

Counterparty Default Risk Appetite Statement

Risk exposures should be limited in order to ensure that the following tests are passed at all times:

- TU's Capital impact from a modelled 1-in-5 year Market Risk shock is less than 3% of the Own Funds
- TU's Profit impact from the default of its most material Reinsurance Asset (assume 50% Loss given Default) is less than 75% of the planned IFRS Profit before tax.

The reinsurance committee receives a quarterly update showing the reinsurance balance sheet assets and highlighting the key individual counterparty exposures.

Non-Financial Risk Appetite Measures

These cover the main non-financial risks that are of key regulatory focus for TU:

- Conduct Risk.

- Data Protection Risk (GDPR).
- Climate Change Risk
- Operational Resilience

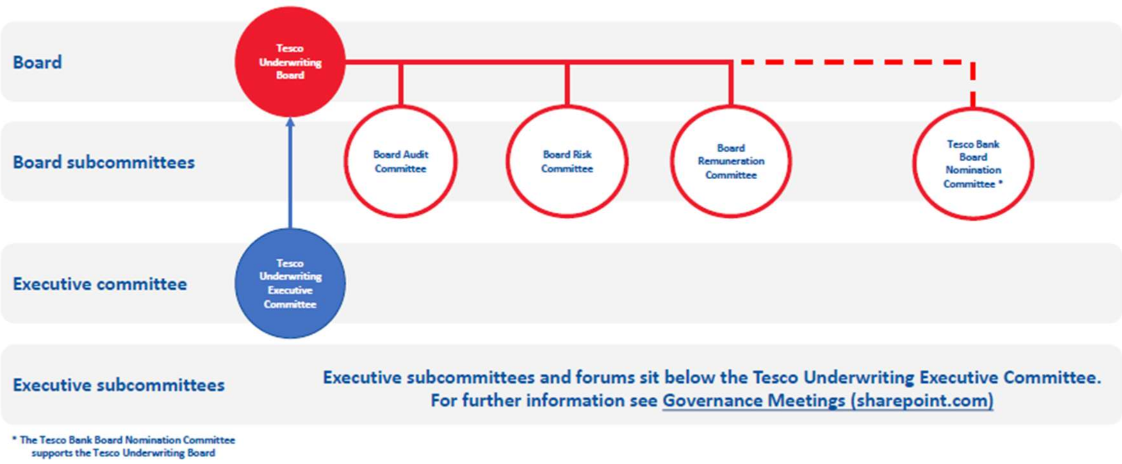
Whilst these risks are monitored against appetite via a number of Key Risk Indicators, specific measures are called out as "Primary" based on current regulatory focus.
Due to the nature of the non-financial risks, these measures are more subjective and qualitative in nature and will evolve as regulatory scrutiny changes. These will also be reviewed at least annually by the TU Board to ensure they remain relevant.
Each of the Non-Financial Risk Appetite measures will be supported by an underlying scorecard which includes quantitative and qualitative measures, which are discussed at the appropriate governance meetings.

- **Conduct Risk Appetite Statement**: Everyone in TU works towards providing our customers with a fair and positive journey.
- **Data Protection Risk Appetite**: TU has no appetite for significant regulatory breaches arising from our processing of personal data (in defining significant, TU will take account of the volume of data subjects and types of data involved).
- **Climate Change Risk:** Tesco Underwriting has no appetite for the risk to its Solvency or Earnings from the emergence of financial risks from Climate Change greater than that described in its Solvency and Earnings Risk Appetite Statements
- **Operational Resilience**: TU has a limited appetite for business interruption in excess of the agreed service category Service Level Agreements (SLAs).

B.3.3 Risk management organisation and governance

Governance Principles

Risk Management and Governance is an integral part of the business of insurance and is therefore part of the activities of TU. The overall corporate governance requirements can be found in the TU Governance Framework.
There are a number of elements which together form the Tesco Underwriting Governance Framework. These include the ownership structure, governance structure, the Board and its subcommittees (and their respective terms of reference), the Executive Committee, meeting dates, paper templates and delegated authorities.as illustrated in the following structure:



The overriding Governance principles are:

1. TU operates on the principle of delegated authority and escalation.
This applies to the organisation as well as to individual employees. It is the responsibility of the party delegating authority to set authority levels based on competence and to put in place appropriate mechanisms for monitoring and triggers for escalation.

2. Each individual at any level of the management hierarchy is fully responsible and accountable for his or her decisions
TU promotes teamwork, the active seeking of second opinions, and co-operation with specialist teams to support decision-taking processes. Nevertheless, those entrusted to take decisions cannot cede responsibility for their decisions to those that advise them and they remain accountable for their results.

3. Fit and Proper Management
All senior management within the company need to be fit and proper to take on their responsibilities. Oversight of this is maintained by Human Resources.

B.3.4 Risk management processes

In this section the risk management process is described on an aggregated level. In Chapter C the identification, assessment, management and monitoring of the individual sub risks are detailed.

Risk Monitoring and Reporting

The Control Risk Self-Assessment (CRSA) is the quarterly formal assessment and confirmation of the on-going effectiveness of TU systems and controls which ultimately feeds into the year-end financial statements.

Departmental responsibilities:

- Review and where appropriate update the departmental Risk Register;
- Ensure that each recorded risk includes relevant and up-to-date causes, consequences, impact/likelihood scores and appropriate controls and actions;
- Horizon Scan Register items need to be identified and included in the Risk Register – with a view of when and how severely these risks are likely to impact the business;
- Ensuring that all new Risk Incidents have been promptly identified, with owners, estimated monetary loss and action plans in place;
- Review existing Risk Incidents by monitoring in-force action plans;
- Any policies that are due for review in the period have been updated in line with the review schedule;
  - Adequate evidence that each policy has been fully complied with;
  - Where policy breaches have occurred, what action has been taken; and
  - A summary of the departmental view of the effectiveness of their risk management.
- Ensuring that all accepted risks (those items which are outside TU's agreed appetite) have been updated and reported appropriately;
- All data governance documents are up to date;
- All data protection controls operate effectively with appropriate action plans in place as applicable;
- All data protection impact assessments have been completed where required, and any risks identified have been adequately mitigated;

- All actual or alleged data protection breaches were reported in a timely manner; and
- Adherence to all relevant Business Unit risk policies.

Risk Team responsibilities:

- Provide the business with advice and support on the CRSA process, risk management framework and good practice in identifying, assessing, managing, monitoring and governance of risks and incidents;
- Facilitate the reporting and peer challenge to CRSA at the MRC;
- Complete themed risk reviews and dip checks to ensure key policies are understood, adhered to and effectively monitored; and

.

TU Solvency and Risk Appetite Reporting

The TU Risk Report is a quarterly report that provides information to (amongst others) TU & Tesco Bank senior management on the current situation of the following:

- Available Solvency II (in some cases local regulatory) capital / own funds trends;
- Required Capital trends;
- Solvency Ratios;
- Adherence to Risk Appetite Statements; and
- Narratives, analysis and recommendations on all of the above.

B.3.5 How we fulfil our obligation to invest all our assets in accordance with the prudent person principle

TU's investment framework clearly sets out the need to act prudently within investment guidelines. This means for investments assessing the safety of capital as well as the income to be derived. The overall investment guidelines for TU are that the investment portfolio is high quality 'A' rated corporate bonds with an overarching 'hold to maturity' strategy guide.

All assets, shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole. Assets held to cover the technical provisions shall also be invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities. Monitoring of liability durations is maintained to ensure that appropriate asset and liability matching is achieved.

Assets shall be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer, trading sector or group of undertakings.

B.3.6 How we verify the appropriateness of external credit assessments from external credit assessment institutions

If TU is investing in credit, there is always a credit analysis being carried out by a professional asset manager who has the necessary credit analysis capacity, as confirmed by a due diligence process.

TU should not rely solely or mechanistically on external credit assessments, and where necessary shall take steps to verify the appropriateness of external credit assessments as part of their risk management.

Where multiple credit ratings are available then second-best rating is used. Note that ratings used refer to the rating of the issue. Ratings provided by external asset managers may be used in case no rating is available.

B.3.7 Own Risk and Solvency Assessment (ORSA)

The main purpose of the ORSA is to ensure that TU assess all the risks inherent to its business and in view of its strategy, determine its corresponding capital needs. TU's ORSA covers all the material risks described in TU Risk Taxonomy, both the quantifiable and the non-quantifiable risks. The ORSA is directly embedded into the governance and decision making, strategy and multi-year budgeting processes as detailed in this section and is performed in compliance and consideration of the principles and rules set forth by the TU Risk Appetite Policy as well as Capital Management Policy.

TU's ORSA process involves assessing the appropriateness of the capital calculation methodology and models using an agreed methodology as detailed in the Model Governance Policy. This is applied to all risk types (other than the immaterial Lapse Risk) and provides a quantitative and qualitative approach to confirm that TU's Partial Internal Model approach is appropriate to us as the basis for TU's regulatory capital requirement and no additional capital loading is believed necessary.

The ORSA assessments and processes ensure that:

- The overall solvency needs of TU consider its specific risk profile, approved risk tolerance limits and business strategy;
- TU complies, on a continuous basis, with Minimum (MCR) & Solvency Capital Requirements (SCR) and with technical provisions requirements; and
- The significance with which the risk profile deviates from the assumptions underlying the Solvency Capital Requirement are assessed, documented and taken into consideration.

Forward looking nature of the assessment

The ORSA assessment of overall solvency needs is forward-looking and covers a medium term or long term perspective as appropriate. For TU, this means by default the Multi Year Budgeting (MYB) planning period of 3 years and longer when the risks associated to the strategy could be material over a longer horizon. This is documented in the ORSA reports.

Requirements for Stress Testing

The strategy assessed in the ORSA is subjected to a sufficient wide range of stress tests including reverse stress tests and scenario analyses in order to provide an adequate basis for the assessment of overall solvency needs. The justification of stress testing programs can be found in the ORSA Report, with an overview of the results and conclusions shown in Section C.7 – these show that TU remains solvent relative to regulatory PIM SCR under each of the stress tests performed and after the management actions taken to suspend dividends there is only 1 test for which the impact is to reduce the Solvency Ratio to below the Target Capital level at its minimum level over the projection period.

A key output of the ORSA process is the ORSA report, this is typically produced annually to summarise the key findings from the ORSA process. Based on this report, the Board will decide whether the risk profile, the approved risk appetite framework and the overall solvency needs (and the link between them) are still appropriate for TU. If this cannot be confirmed, the Board may (amongst other possibilities) decide to:

- Change the Own funds (amount or composition) as described in the Capital Management Policy;
- Change the capital allocation as described in the Capital Management Policy;
- Change the risk profile - this can be done by transferring, mitigating risks, or by modifying the strategy (e.g. terminate or reduce the risky activity) and is described in specific risk management policies as well as in the Risk Appetite Policy;
- Adjust the company's strategy; and
- Resolve other identified deficiencies.

Alignment with other reports & communication to supervisors

The information contained in ORSA reports is consistent with the information found in other reports provided to the Management Risk Committee (MRC), Executive Committee (ExCo), Board Risk Committee, Board Audit Committee (AC) and Board as well as to Supervisors.

Report and Frequency

TU performs an annual ORSA linking it to its strategic MYB exercise. This frequency takes into account TU's risk profile and the volatility of its overall solvency needs relative to its capital position. It must be justified within each ORSA report.

Non-Regular ORSA triggers are also in place to make-sure that own risk solvency assessments are performed if the situation warrants it outside the above regular ORSA process. The following non-exhaustive list of ORSA triggers are used as a reference (taking into consideration the Risk Appetite Framework in force):

- A significant change in the risk profile;
- A significant change in the composition of Own funds or in capital management / budget assumptions and forecasts;
- An acquisition (or divestment) that significantly changes business, risk or solvency profile;
- A significant change to the strategy, affecting budget assumptions in material ways;
- A significant change in the external business environment;
- A significant change in the liability portfolio;
- A significant deviation from the Risk Appetite indicators (solvency, liquidity, earnings); and
- A (significant) change in regulation.

The non-regular ORSA must explain the expected changes in the risk profile and/or financial situation, the impact on the overall solvency needs and the link to the available Own funds and SCR.

Roles and Responsibilities

The TU Board is the owner of the ORSA and responsible for reviewing and approving the assessments and scope, challenges its results and concluding on the outcome. TU's ExCo, together with the Board steer the preparation of TU's ORSA, namely how its assessments have to be performed, defining their scope, challenging their results, concluding on them and ensuring that instructions and follow-up actions are given and effectively implemented.

Operationally, they are assisted to do so by the Risk Function, the Finance & Strategy Function and the Actuarial Function.

Additional Monitoring

To verify and assess the level of ORSA follow-up and on the field embedding, TU requires the reporting of ORSA action statuses and follow-up given to previous ORSA. Once the ORSA is validated by the Board it is sent to the PRA.

It should be noted that the Solvency II ORSA monitoring of compliance with regulatory capital requirements (SCR, MCR) and Risk Appetite and Capital Management Frameworks are also performed on a quarterly basis through Risk Reporting.

B.4 Internal control function

B.4.1 Internal control system

TU creates value through the acceptance and management of risks that can be properly managed within an appropriate risk framework. Internal controls are in place across all processes in order to mitigate risks.

Internal control should strengthen the operating environment of TU, thereby increasing its capability to deal with events and detect possible process failures. Internal controls support the achievement of the company's strategy by providing one of the methods to mitigate risk. TU ensures there is a clear segregation of duties between business functions to prevent conflicts of interest.

There are also clear escalation and reporting procedures in place, supported by TU's risk governance processes. Breaches of risk appetite, limits and/or tolerances, along with the actions to address the issue, are referred to the relevant governance committee and if necessary the Management/Board Risk Committee. While risk management is the responsibility of TU's management body as a whole, the undertaking is required under Solvency II to designate at least one member of the management body to oversee the risk management system, this being the CRO.

The CRO is responsible for escalating the issue for appropriate oversight, and challenging whether action is inappropriate, insufficient or ineffective.

The system sets the standards for TU's application of an internal controls framework and defines the procedures to assess the efficiency and effectiveness of the framework, and utilises the following principles:

1. Control owners are responsible for executing controls assigned to them
Control procedures are embedded within TU's business processes. Key controls in place are assigned to an owner. Control owners understand the objective of the control, exercise the control with agreed frequency and ensure appropriateness of the control.

The responsibility of the owner is to ensure that these controls are appropriate and that they have been properly carried out and sufficiently documented.

2. Internal controls need to be adequate and effective
Control owners assess controls assigned to them, for adequacy and effectiveness against a defined testing schedule. For interdependent controls within a process, each control owner understands control linkages and dependencies to ensure end to end process control. An appropriate segregation of duties and responsibilities should is in place, both at the individual level and between functions.

3. TU ensures that incentives are managed by internal controls
TU Risk assesses incentives to identify the potential for inappropriate behaviour. Based on this identification, incentives are removed and, if not possible, reduced through the implementation of internal controls.

4. Proportionality of controls
Controlling all risk is not possible. Internal controls therefore focus on material risks to TU. The frequency of the control activity is appropriate for the nature, size and complexity of the process.

5. Internal controls are documented
Internal controls are designed, approved and documented by the control owner against all key risks in business unit risk registers. To provide assurance to management that the internal control framework in place is adequate and effective, reviews and assessments are performed and documented. Traceability of controls is essential to provide assurance to management and external stakeholders.

6. Outsourcing must be subject to at least equivalent levels of controls
TU relies on external service providers for carrying out various sets of activities. Reliance on external providers does not remove TU's responsibility towards shareholders, policyholders, personnel or other stakeholders. TU has appropriate controls in place and maintains adequate oversight to fulfil these responsibilities.

Three Lines of Defence Model

1st Line of Defence - Business Areas:	2nd Line of Defence - Risk Management and Compliance:	3rd Line of Defence - Internal Audit:
• Identifying and managing risks in their area of operations • Ongoing assessment and monitoring of risks • Implementation of effective controls to mitigate risks • Quality Assurance to ensure standards of control maintained • Complying with Policy in procedure and practice • Ensuring risk aware culture & environment, with trained & capable staff • Advising of what doesn't work	• Developing and maintaining risk appetite for Board approval • Establishing a policy framework which supports the risk appetite • Creating risk frameworks and providing tools which help line management deliver on their responsibilities • Aggregating and reporting risks at an enterprise level • Independent oversight and challenge of the enterprise risk profile • Independent oversight and challenge of the key business decisions • Provision of support and technical risk advice	• Independent review of the TU's risks and controls • Reporting to Management on key areas of risk and control weakness • Tracking of Audit issues through to closure

Operational independence bars the management body from undue influence on key functions in the exercise of their responsibilities. The management body is ultimately responsible for deciding on how to react to the results, concerns and recommendations presented by the key functions. For example, it could resolve not to act or act differently from suggestions on the findings of a key function. However, it may not exert influence to suppress or tone down key function results in order that there is no discrepancy between the findings of key functions and the management body's actions.

Each function shall be able to communicate on its own initiative with any staff member and must have the necessary authority, resources, expertise and unrestricted access to all relevant information necessary to carry out its responsibilities.

B.4.2 Key procedures in our internal control system

The sections below describe the content requirements for the control assessment:

- Control environment;
- Risk assessment;
- Control activities;
- Information and communication; and
- Monitoring.

All five control components are assessed per business function detailing the key processes, risks, controls and actions. During the assessment, the key risks, controls and actions are the most important elements considered. These components are scored according to a predefined scoring table and aggregated into the Risk Register – this is built based on every organisational unit and the processes, risks and controls.

Finally, the actions to be taken to set-up controls and/or improve existing ones are identified and followed-up on throughout the year. Time constraints are defined depending on the rating of the risk.

The internal control framework is based on the self-assessment performed by the respective control owners.

Internal Audit performs an independent assessment of the adequacy of the internal control framework as well as of the control environment within the business functions.

Control Environment

The control environment sets the tone of an organisation, influencing the control consciousness of its people. The core of any business is its people (their individual attributes including integrity, ethical values and competence) and the environment in which they operate.

Internal controls are key to prevent operational and other risks before they crystallise into losses, customer detriment or adverse reputational impact by ensuring risks are taken within defined limits.
There is a clear understanding of controls, and objectives which require good understanding of the risks. A balance will be sought between the risks faced and the cost of mitigating these risks. TU's employees will have a clear view on their responsibilities throughout the business processes. A good understanding of their role and of the importance of the controls contributes to the embedding of a risk culture. Management will ensure that the appropriate skill-set and competences are developed to support this objective (e.g. training).

All functions in TU will have appropriate training to ensure staff are familiar with their control processes. The training will ensure staff are aware of controls in place and the rationale for the controls.

Risk Assessment

All risks to which TU is exposed must be assessed. The purpose of this component is to identify the key risks faced when carrying out the business activities related to a process/function.

Control Activities

Control activities are defined by the policies and procedures that help ensure that management directives are carried out, and that necessary actions are taken to address risks in the achievement of the entity's objectives.

Control activities occur throughout the organisation, at all levels and in all functions. They include a range of activities as diverse as approvals, authorisations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Information & Communication

Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities.

Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the business. They deal not only with internally generated data, but also information about the external events, activities and conditions necessary to inform business decision-making and external reporting.

Monitoring

Internal control systems are monitored and assured. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other action personnel take in the performance of their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures.

Internal control deficiencies are reported upstream, with serious matters reported to top management and the Board.

All key (residual) risks identified during the quarterly interactions with key process owners (first lines) are captured in the Key Risk Reporting Process. The most material elements of this Key Risk Report are then considered for inclusion in the Financial Statements signed-off by the CEO and Finance Director.

B.4.3 Approach to the Compliance function

The Compliance function is an independent function within Tesco Underwriting providing reasonable assurance that the company and its employees comply with the laws, regulations, internal rules and ethical standards that are relevant to the integrity, and hence to the reputation, of TU.

Compliance Mission

The Compliance function is a key player in the establishment of a compliance culture within the company, and has the following areas of responsibility:

- Ensuring the implementation and execution of the compliance function within TU as defined by the regulatory authorities;
- Ensuring regular updating of legal and regulatory changes;
- Ensuring the translation of the regulatory framework and rules into specific policies and instructions;
- Ensuring monitoring of compliance with these policies and instructions, taking the necessary measures (training, information, sanctions) to reduce potential compliance risks;
- Ensuring adequate reporting both to internal and external stakeholders; and
- Ensuring efficient functioning of the Compliance function throughout TU.

Compliance Scope

The scope (“Compliance Universe”) is a stable feature, depending largely on the nature and location of business activities. It includes:

- Duty of care, product suitability and adequate information to customers, market practices and consumer protection (“Conduct Risk Framework”);
- Corruption and Anti-Bribery;
- Customer identification, acceptance and follow-up;
- Corporate Governance, Fit & Proper rules, Remuneration Policy and Conflicts of Interest;
- Privacy protection; and
- Fair competition.

Compliance Organisation

Compliance is a permanent, independent second-line-of-defence control function.

The suite of TU Compliance Policies describes the Compliance risks, Objectives and scope of the Compliance function (as an independent second-line-of-defence control function, and the risk-based approach), Strategy and Plans, the structure of Compliance within TU, reporting, relationship with regulators, working with other control functions. The key objectives of the Compliance function are to provide reasonable assurance that the company and its employees comply with the relevant laws, regulations, internal rules and ethical standards.

TU Compliance has responsibility for implementing the Compliance and Conduct Risk Policy and plans in accordance with the regulatory risks that impact TU.

The TU Compliance plan is produced annually, reflecting the compliance strategy and the regulatory risks of the business. The TU Compliance plan is considered by the TU Management Risk Committee and approved by the Audit Committee. A quarterly update of progress against the plan and highlights of Legal and Regulatory Updates are discussed in the TU Management Risk Committee and in the TU Audit Committee.

Compliance methodology

In practice Compliance fulfils its mission along a rule-based and risk-based approach.

Rule based approach

The rule-based approach consists of ensuring that the applicable laws, regulations, rules and standards are adequately transposed into clear and precise instructions and procedures, and that first-level-of-defence controls are in place and correctly applied together with the expectation of future changes to laws and regulations.

Risk based approach

The risk-based approach involves identifying and assessing the compliance risks and providing the assurance that every reasonable measure (including instructions, procedures, IT programs, monitoring methods, awareness and training actions, objective setting, incentives, deterrent measures and sanctions) have been taken in order to avoid or reduce the occurrence of the identified compliance risks and to minimise the damage, should one of these risks nevertheless occur. Corrective action is monitored as well.

Starting from a new or updated law or regulation, the Compliance function identifies possible consequences (the inherent risk), weighs the likelihood and impact of occurrence, checks the controls in place and determines the current level-of-concern (the residual risk). It issues specific recommendations and follows up the actions and corrective measures set up by the involved departments, until complete implementation.

In fulfilling its mission, Compliance therefore bears a responsibility for an end result in regard to the adequacy of being-in-control when talking about compliance topics. To this end, the control results of the operational services are used, supplemented by sample testing, preparation and monitoring of compliance risk indicators, interviews, etc.

B.5 Internal audit function

B.5.1 Role and Scope of Internal Audit

The Internal Audit function is responsible for providing independent, objective assurance to the TU Board and Senior Management on the adequacy of the design and operational effectiveness of internal controls and the system of risk management. The Internal Audit function has an independent reporting line to the Chair of the Board Audit Committee and is resourced by individuals with relevant experience and professional qualifications. In addition, Internal Audit resources are supplemented across a range of audits by external support to provide additional subject matter expertise when required.

Internal Audit operates within the International Professional Practices Framework (IPPF) established by the Institute of Internal Auditors (IIA) and in accordance with the guidance issued by the IIA for “Effective Internal Audit in the Financial Services Sector”.

Independent assessment is provided through the execution of an agreed plan of audits, through attendance at relevant governance committees and through stakeholder management meetings.

The role of the Internal Audit function is defined within an Internal Audit Charter, which forms part of the TU Governance Framework and is subject to annual review and approval by the TU Audit Committee.

B.5.2 The Audit Plan

Internal Audit propose an annual audit plan to the TU Board Audit Committee based on its understanding of the significant potential risks to which the organisation could be exposed. The TU Audit Director makes regular reports to the TU Audit Committee on progress against the annual plan.

B.6 Actuarial function

The Actuarial function has specific technical expertise and experience in relation to technical provisions and capital. The skills and experience of the actuarial function provide a different perspective from the underwriting or reinsurance teams' perspectives. The Actuarial function's alignment and collaboration with the other control functions – namely Internal Audit, Risk and Compliance – is elaborated in the TU Model Governance policy. Effective cooperation between these governance functions is fostered in order to avoid overlaps and omissions in roles and responsibilities.

The Actuarial function is critical to the assessment of TU's technical provisions and solvency capital requirements with oversight by the risk function. The key role of the Actuarial Function in the context of SII is to issue Actuarial Function opinions (hereafter the Opinions) and to formulate recommendations for improvement on:

- The reliability and adequacy **of technical provisions** in Solvency II by assessing methodologies, models, data quality and assumptions, and the consistent calculation of technical provision calculations;
- The appropriateness of **underwriting** practices when offering insurance products through assessment of the profitability of the portfolio, product pricing (risk/return) and acceptation rules, and benchmarking these to the applicable underwriting policy; and
- The appropriateness of the **reinsurance** arrangements by assessing the adequacy of the reinsurance policy and the alignment of the reinsurance arrangements with the applicable reinsurance policy.

Actuarial Function Report timing

The TU Actuarial Function Report is provided yearly to the TU Board.

Recommendations and their follow-up

When weaknesses are reported, recommendations to mitigate the risks need to be added. All recommendations need to receive a "level of concern" score (HML), an action owner and a realistic target date. The level of concern reflects the potential impact of the identified risk.

The Actuarial Function will assure timely follow-up of the open recommendations and report on these. The recommendations and their characteristics will be approved by relevant senior management committees.

B.7 Outsourcing

TU will only enter into an outsourced arrangement where there is an agreed sound business rationale for doing so and with a provider that is competent (i.e. has the required operational and technical capability, resources and quality standards), is financially sound and has good relevant knowledge and experience of the service it is required to supply.

Outsourcing occurs when TU appoints a third party to provide a core business activity, process, service, goods or facilities which would otherwise be undertaken by the company itself.

Any decision to outsource activities remains the responsibility of TU management, based upon the agreed strategy. Decisions and core management responsibilities concerning strategy or risk management will not be outsourced.

Oversight of outsourcing is undertaken by a specialist team with management governance through the Finance Director, Claims Director and the Business Change Committee. The Outsourcing and Third Party Supplier Policy and Outsourcing and Supply Chain Management Framework sets out the requirements for any activities which are outsourced and applies wherever Tesco Underwriting appoints a third party (either independent or intra group) for the supply of services which are integral to its main business activities.

TU has entered into service level agreements on the provision of the following services by Tesco Bank:

- Human Resources, Legal, Secretariat, Compliance
- Information technology and Information Security
- Claims Cashiers and Fulfillment
- Other supporting services

Up to the 4th of May 2021 TU also had service level agreements with Ageas for Human Resources, Legal, Secretariat, Compliance and Claims handling and management services.

The TU Outsourcing team provide assurance and oversight on all outsourced or contracted services, ensuring strong relationship management is in place and appropriate measures of supplier performance are adhered to in line with contractual obligations. These are monitored via the Executive Committee and Board Risk Committee.

TU remains responsible for all activities that are outsourced and requires that robust governance arrangements are in place in relation to the selection, management and oversight of all outsourced arrangements. A strong level of governance is applied to services outsourced to both Tesco Bank and third parties.

TU ensures that outsourcing of critical or important operational functions or activities will not:

- Unduly increase operational risk; or
- Breach applicable legal or regulatory requirements; or
- Materially impair the quality of the system of governance or the ability of its regulators to monitor TU's compliance with its obligations; or undermine continuous and satisfactory service to policyholders.

Oversight arrangements include satisfactory due diligence, robust contractual documentation, allocated business responsibility for oversight of the relationship and performance, supported by appropriate Compliance and Internal Audit monitoring. This information is brought together at the Executive Committee and reviewed in order to ensure appropriate control is being maintained. Areas monitored include key suppliers, owner of the relationship within TU, the term, notice and the contract value.

B.8 Any other information

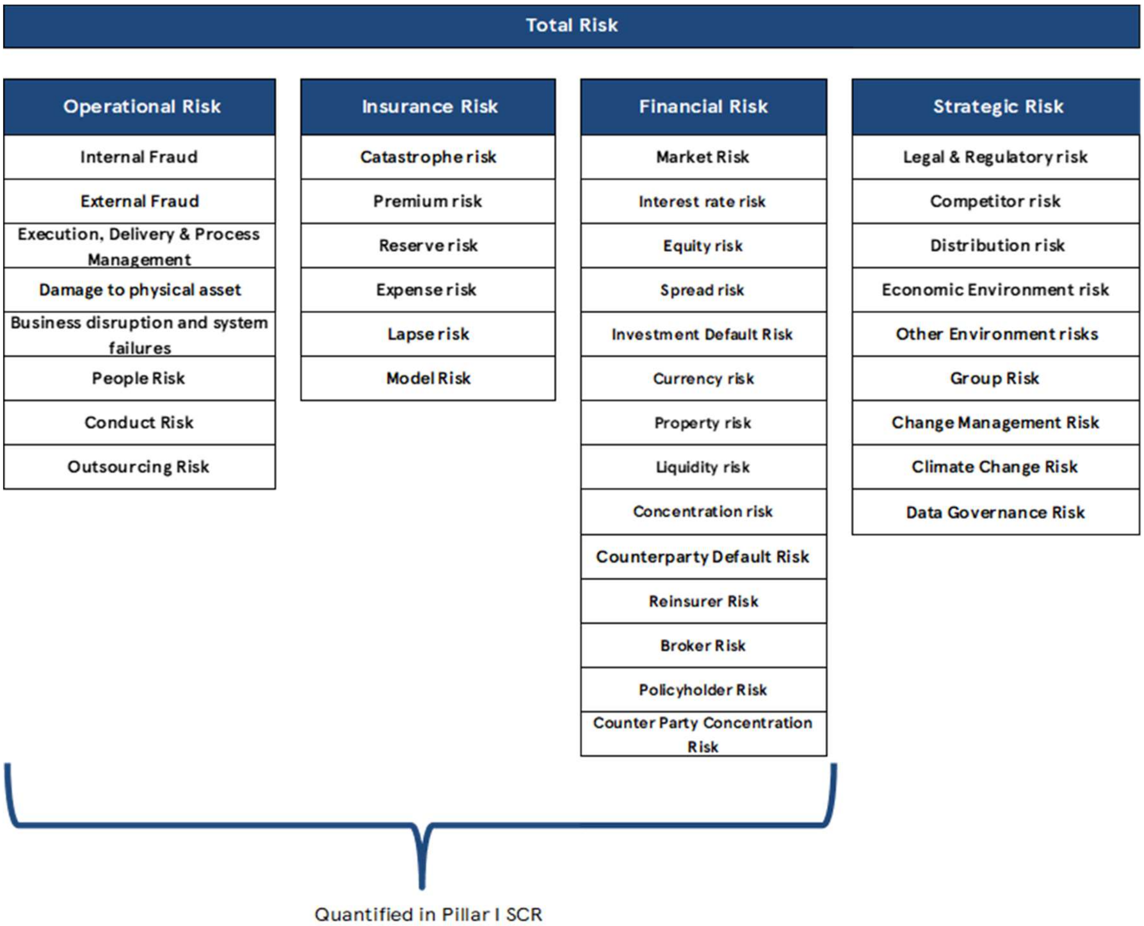
There is no other material information to disclose.

C

RISK PROFILE (unaudited)

The Company's primary activity, the acceptance of risk of loss from individuals taking out personal Motor or Home insurance policies, exposes it to a number of risks which may adversely affect the Company's ability to meet its business objectives.

TU is exposed to a wide range of risks, which are categorised in the Risk Taxonomy Policy, and which ensures that a consistent and comprehensive approach to risk identification, assessment, monitoring, and response is in place.
The diagram below shows the TU Risk Taxonomy:



TU has chosen to adopt a Partial Internal Model (PIM), with Insurance Risk (TU's most material risk) being modelled using an Internal Model (IM), and all other risk types being modelled using the Standard Formula (SF). In 2020 TU applied for a solo PIM in anticipation of Tesco Bank acquiring Ageas' stake of TU and this was approved in December 2020 with no associated terms and conditions.

Risks that are not covered under the PIM SCR are considered under Pillar 2, these are outlined in the ORSA report and briefly described below:

- To-Ultimate volatility: the PIM SCR reflects a one-year view of risk against 1 in 200 year events; this does not allow for potential adverse movement / volatility that may arise after one year (full run-off of the exposure). As part of the Internal Model Sensitivity Tests the SCR has been calculated on an 'Ultimate' time horizon basis (setting emergence factors to 100%) which demonstrates that the Target Capital level covers this - and noting there is an additional buffer from the Risk Margin within the Best Estimate Liabilities.
- Strategic Risks: TU holds no additional Pillar 2 capital adjustments for the Strategic Risks - to justify this the risks within the TU Strategic Risk register are cross-checked to ensure that there is sufficient allowance within other modelled risk types (due to overlap between the definitions) which confirmed that they appropriately covered within the Non-Life Risk and Operational Risk SCR figures.

The composition of the Solvency II capital solvency requirements is shown in Section E.2 - the following sections explain TU's various risk exposures in more detail.

£'000

	2022	2020
Market Risk	31,141	32,745
Counterparty Default Risk	10,451	8,026
Non-Life Underwriting Risk	92,770	87,441
Diversification between above mentioned risks	-23,628	-23,105
Non Diversifiable Risks	17,403	16,584
Loss-Absorption through Deferred Taxes	-7,010	-3,518
Required Capital under PIM SCR	**121,127**	**118,173**
Impact of Non-Life Internal Model on Non-Life Underwriting Risk	4,579	19,094
Impact of Non-Life Internal Model on Life Underwriting Risk	904	1,054
Impact of Non-Life Internal Model on Counterparty Default Risk	566	-98
Impact of Non-Life Internal Model on Diversification between risks	-1,251	-1,763
Capital Solvency Requirements under the SII Standard Formula	125,925	136,461

.2

Available Capital of £180.6m at the period end 28th February 2022 (2020: £185.9m) represents 149.1% (2020: 157.3%) coverage of SCR PIM.

Excluding the use of volatility adjuster at 28 February 2022, SII own funds would have been £179.6m, leading to a capital coverage of 148.3%.

The Standard Formula SCR is higher than the Internal Model SCR for Non-Life Underwriting Risk by £4.6m at 28 February 2022 (£19.1m in 2020). There are two main reasons contributing to this reduction in surplus:

i) The Standard Formula SCR is driven by the business volume which has been reducing over the year, whereas the PIM considers the specific volatility of that business which has remained comparable despite the reduction in volume.

- ii) The Non-Life catastrophe risk charge is higher in the PIM, and increased over the period to 28 February 2022 as new catastrophe exposure data was included in the PIM. The Standard Formula is relatively insensitive to changes in CAT exposure .

The following sections explain TU's various risk exposures in more detail.

C.1 Insurance risk

Risk description

The risk of loss or of adverse change in the value of insurance liabilities, due to changes to the underlying assumptions on which pricing and claims estimations have been made.

This is the predominant risk to which TU is exposed to – and is comprised of the following sub-risks:

- **Model Risk** - the risk of potential adverse consequences from decisions based on incorrect or misused model outputs and reports. Model risk can lead to financial loss, poor business and strategic decision-making, or damage to Tesco Underwriting reputation. Models by their nature are approximations of reality, and real-world events may prove those approximations inappropriate.
- **Catastrophe Risk** – the risk of loss, or of adverse change in the value of insurance liabilities, resulting from significant uncertainty of pricing and provisioning assumptions related to extreme or exceptional events and their unpredictable timing.
- **Premium Risk** – the risk that, in the coming year, claims severity or frequency differs from expectation.
- **Reserve Risk** - the risk that the cost of settling prior period claims costs differ from expectation.
- **Expense Risk** - the risk of losses arising from the value of expenses required to settle insurance liabilities, resulting from changes in the level, trend, or volatility of the expenses incurred in servicing insurance or reinsurance contracts.
- **Lapse / Persistency Risk** – the risk of losses arising from changes in the level of or volatility in the rate of policy lapses.

Risk mitigation

TU manages insurance risks through a combination of its Pricing and Underwriting policy, Reserving policy and Reinsurance policy. The Company's objective for underwriting risk is to manage the risks in line with the strategic plan and deliver the required return on capital and ensure that its plans are aligned to the strategies and business plans.

<u>Premium Risk</u>

TU recognises the risk associated with underwriting poor quality business in terms of the potential impact on profitability and solvency and indirectly on the prices we are able to offer to other risks.

The Company's strategy has been to ensure that it charges the right premium for the business underwritten and it focuses on maintaining prices in such difficult market conditions. It also monitors claims closely to identify any that may be exaggerated or fraudulent. In recent years, the insurance market in general has experienced an increase in the frequency and value of third party injury claims, and in the value of third party property damage claims, arising mainly in the private car market.

These increases have been driven by an increased propensity for the population to be litigious and the extensive activities of companies actively persuading potential victims to instigate claims. In addition, the growth in credit hire has had a significant impact and the Ogden discount rate change from 2017 has also increased costs. The Ogden rate for England and Wales was set at 2.5% until February 2017, then changed to -0.75% until August 2019. Since August 2019 the rate has been set at -0.25%. On each occasion, the change has been adverse to the market consensus view, leading to the potential for higher costs in settling large lump claims than was originally priced for and higher reinsurance costs than assumed within pricing. The Company is aware of these trends and monitors developments closely, adjusting the prices of its products accordingly, to meet its required return on capital.

<u>Reserve Risk</u>

The nature of the business makes it very difficult to predict with certainty the likely outcome of any particular claim and the ultimate cost of notified claims. Each notified claim is assessed on a separate, case by case basis with due regard to the claim circumstances and historical evidence of the size of similar claims. Case estimates are reviewed regularly and are updated as and when new information arises. The provisions are based on information currently available. However, the ultimate liabilities may vary as a result of subsequent developments. The impact of many of the items affecting the ultimate costs of the loss is difficult to estimate.

To the extent that these methods use historical claims development information they assume that the historical claims development pattern will occur again in the future. There are reasons why this may not be the case, which, insofar as they can be identified, have been allowed for by modifying the methods.
Such reasons include:

- Changes in processes that affect the development / recording of claims paid and incurred (such as changes in claim reserving procedures and/or the introduction of a new claims system);
- Economic, legal, political and social trends (resulting in, for example, a difference in expected levels of inflation) e.g. Legal, Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO) the changes in the Ogden discount rate for valuation of large bodily injury losses (February 2017 and July 2019) and the impact of Covid-19 (2020);
- Changes in mix of business; and
- Random fluctuations, including the impact of large losses.

IBNR provisions are initially estimated at a gross level and a related calculation is carried out to estimate the size of reinsurance recoveries. The Company is covered by a variety of excess of loss reinsurance programmes, as well as a quota share reinsurance and adverse development cover. The methods used by the Company take account of historic data, specific details for individual large claims and details of the reinsurance programmes, to assess the expected size of reinsurance recoveries in a range of alternative scenarios.

Recoveries through salvage and subrogation are estimated and recorded as an asset separately based on a combination of suitable benchmark assumptions and the observed development to date.

Reinsurance Risk
The timing and frequency of high severity events are, by their nature, uncertain. They represent a material risk as the occurrence of such an event would have a significant adverse impact on the Company's cash flows and profitability.
The Company reinsures a portion of the risks it underwrites in order to control its exposures to losses and protect capital resources. The Company buys primarily excess of loss (i.e. non-proportional) reinsurance treaties to reduce its net exposure to agreed levels for each line of business in accordance with the Company's risk appetite. In addition, the Company has renewed a Motor Adverse Development Cover (ADC) for 2022 and has a structured quota share (QS) covering 45% of Motor new business for 2020 to 2022 (15% of Motor new business for 2018 and 2019).

The risk is that the reinsurance contracts fail to perform as planned and do not reduce the gross cost of claims in terms of the limits purchased, either by risks not being appropriately covered or by there being gaps in the programme. The reinsurance programme is subject to considerable scenario planning, including by the Company's brokers, and is approved by the Reinsurance Committee and the Board. The failure of a reinsurer to pay a valid claim is categorised as Counterparty Default risk.

Expense Risk
This is managed through regular meetings between Finance and cost centre owners across the business, ensuring that costs are monitored against budgeted spend and any accruals held are still appropriate.

Measures used to assess risk
The management of Non-life risk at TU includes, amongst other things, risk acceptance rules, claims management guidance on claim assessment, reinsurance taking activity and management.

The key Underwriting risks faced by TU are reviewed quarterly by the Management Risk Committee and subsequently the Board Risk Committee. Premium, Reserve, Reinsurance and Expense risk are all explicitly modelled within TU's Risk Profile, and are captured by specific risks on the TU Risk Register under TU's Control Risk Self-Assessment (CRSA) process.

Risks are managed through a combination of policies, processes and reports. Key policies are as follows:

- Product Approval Policy;
- Conduct Risk Policy;
- Customer Complaints Policy;
- Document Management and Retention Policy;
- Reinsurance Policy;
- Reserving Policy;
- Pricing and Underwriting Policy
- Fraud Policy
- Risk Appetite Policy
- Disciplinary Policy and Procedure
- Underwriting Committee Terms of Reference
- Claims Management Policy
- Vulnerable Customer Policy and
- Operational Resilience Policy

Section C.6 includes further detail on the ORSA Stress & Scenario tests related to Insurance Risk, Weather event, Under-reserving, Under-pricing, Legislative change and Non-placement of Reinsurance scenarios.

Risk concentration

The Company's insurance portfolio exposes it to a potential accumulation of different risks in the event of difficult economic conditions or more challenging points in the underwriting cycle. A key aspect of the insurance risk faced by the Company is the degree of concentration of insurance risk, which may exist where a particular event or series of events could impact significantly upon the Company's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts and relate to circumstances where significant liabilities could arise.

Concentrations of risk can arise from high-severity, low frequency events, such as natural and other disasters and in situations where underwriting is biased towards a particular group, such as a particular geographical concentration. Material geographical concentrations of risk can exist in property portfolios such that natural perils of windstorm and floods may give rise to a large number of material damage and business interruption claims. The Company models its exposure to this risk to estimate its probable maximum loss and purchases reinsurance to significantly reduce its exposure to such events.

The Company identifies the total aggregate exposure that it is prepared to accept in relation to concentrations of risk. It monitors these exposures on a regular basis by reviewing reports which show the key aggregations to which the Company is exposed. The Company uses a number of modelling tools to monitor aggregation and to simulate catastrophe losses in order to measure the effectiveness of the reinsurance programmes, and to quantify the net exposure to which the Company is exposed. Additional stress and scenario tests are run using these models during the year.

Material changes over the reporting period

There have been no material changes.

C.2 Market risk

Risk description

Market risk means the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. This is the second most significant risk to which TU is exposed to – and is comprised of the following sub-risks:

- **Liquidity Risk** – is the risk that expected and unexpected cash demands of policyholders, and other contract holders cannot be met without suffering losses or without endangering the business franchise due to constraints on liquidating assets. These constraints may be structural or due to market disruption.
  The liquidity risk also covers the risk that any assumed liquidity premium, used to valuing illiquid liabilities, does not materialise.
- **Concentration Risk** - this covers exposure to concentration risk arising from all types of market risk including interest rate, equity, spread, property, and liquidity risks. Like counterparty concentration risk covered under Counter Party risk, it can arise due to high exposure to single companies or an aggregate of exposures to a number of positively correlated companies for example within one sector or region.
- **Interest Rate Risk** - this risk exists for all assets and liabilities for which the net asset value is sensitive to changes in the term structure of interest rates or interest rate volatility. This applies to both real and nominal term structures.
- **Equity Risk** – this risk arises from the level or volatility of market prices for equities or their yield. Note that the current TU investment guidelines prohibit equity investment.
- **Spread Risk (**Non-Fundamental) – this relates to the sensitivity of the value of assets, liabilities and financial instruments to changes in the level or in the volatility of credit spreads over risk-free interest rates.
- **Investment Default Risk** – this risk includes the Risk of actual default, rather than spread changes alone. This risk may be covered by the Spread risk category but is included for completeness and to ensure companies consider if and how the impact of actual defaults may differ from spread changes.
- **Currency Risk** – this risk arises from changes in the level or volatility of relevant currency exchange rates when there is a mismatch between the relevant currency of the assets and liabilities. Note that TU invests in sterling denominated assets but could be exposed to immaterial direct exchange rate risk e.g. through claims arising abroad or indirect currency exchange risk.
- **Property Risk** – this risk arises as a result of sensitivity of assets, liabilities and financial investments to the level or volatility of market prices of property or their yield.

Risk mitigation

Management of Market Risk is built around these key elements:

- Setting risk constraints (related to Risk Appetite and other risk controls).
- Carrying out strategic asset mix studies to determine the optimum investment strategy and limits taking into account the risk constraints.
- Taking action to avoid actual exposure exceeding the limits.
- Taking action in response to developments in economies and markets – i.e. adjusting the investment strategy and limits if needed.
- Investments shall be made with judgement and care. This means only for investment, considering the probable safety of capital as well as the probable income to be derived. See Section B3.5 for more detail on the prudent person principle.
- Governance - TU has a clear definition of duties in the end-to-end investment process.
- A clear segregation needs to be made between setting the strategy, executing the strategy and day-to-day operations and control.

Measures used to assess risk

Liquidity risk is explicitly modelled within TU's Risk Profile and is captured by specific risks on the TU Risk Register under TU's Control Risk Self-Assessment (CRSA) process. Risks are managed through a combination of policies, processes and reports - the key policy is the Market Risk Policy.

Section C.6 includes further detail on the ORSA Stress & Scenario tests related to Market Risk which include Economic Downturn, Interest Rate shock and Credit Spread scenarios.

Risk concentration

Diversification is an essential element to minimise concentration risk and therefore concentration limits are identified, approved and strictly obeyed. This implies not only boundaries but also early warning limits so that action can be taken in a timely fashion to avoid breaching the concentration limits. These are clearly specified in the TU Market Risk Policy and monitored in the TU Investment Committee.

Material changes over the reporting period

There have been no material changes.

C.3 Credit risk

Risk description

Credit (Counterparty default) risk reflects possible losses due to unexpected default of counterparties and debtors.
The nature of TU's business model means this is a relatively insignificant risk – and is comprised of the following sub-risks:

- **Reinsurer Risk** - This refers to the risk that a Reinsurer on one of our programmes is unable to meet its liabilities when they fall due.
- **Broker Risk** - This refers to the risk that a distributor is unable to pay premiums due.
- **Policyholder Risk** - This refers to the risk that customers default on premiums due.

Risk mitigation

In accordance with the Solvency II requirements, for counterparty default a distinction is made between two types of exposure: type 1 and type 2 exposures:

- Type 1 exposure covers exposures which are less diversifiable and where the counterparty is likely to be rated by a credit rating agency.
- Type 2 exposure represents counterparties that are likely to be unrated but that can usually be diversified.

Reinsurance contracts - With respect to reinsurance contracts, absolute exposure limits are reviewed per contract and reinsurer. Deterioration of the credit standing of a reinsurer can be the trigger for taking action, for example requiring additional guarantees or decrease in reinsurance share.

Receivables from intermediaries - Outstanding amounts due from intermediaries that are above a materiality threshold are monitored on a quarterly basis. Special escalation mechanisms are put in place in case of late payments.

Cash at banks & custody - For the main business bank accounts (with HSBC) no specific limits are in place. TU operates four Liquidity funds in which there is typically up to £25m of cash. This holding is diversified across the funds with each AAA rated fund manager spreading the risk across multiple underlying funds.

Measures used to assess risk

The key Credit risks faced by TU are reviewed quarterly by the Management Risk Committee and subsequently the Board Risk Committee. Credit risk is explicitly modelled within TU's Risk Profile and is captured by specific risks on the TU Risk Register under TU's Control Risk Self-Assessment (CRSA) process.

Risks are managed through a combination of policies, processes and reports - the key policy is the Counterparty Default Risk Policy. Counterparty default risks and limits relating to investments operation are monitored and reported monthly to the Investment Committee.
Section C.6 includes further detail on the ORSA Stress & Scenario tests related to Credit Risk which include Reinsurer default scenarios.

Risk concentration
Tesco Bank is our only significant counterparty exposure outside of reinsurance and investment and outstanding balances are reconciled on a weekly basis. Reinsurance counterparty exposure is monitored quarterly through the Reinsurance committee.

Material changes over the reporting period
There have been no material changes.

C.4 Operational risk

Risk description
Operational risk means the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events. This is the third most significant risk to which TU is exposed to – and is comprised of the following sub-risks:

- **Internal Fraud** – this is the risk of losses arising due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, which involves at least one internal party.

- **External Fraud** – this is the risk of losses arising due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party without the assistance of an internal party.

- **Execution, Delivery & Process Management** - this risk refers to losses arising from:
  - Failed transaction processing or process management, including the inability to deliver and execute according to budget and/or strategic plan due to shortage of staff or supplies.
  - Losses arising from the intended misuse of IT-applications, through e.g. misappropriation of access; and
  - Losses arising from disruption of infrastructure or system failures. Note that losses due to not having suitable IT strategy are covered under strategic risks.

- **Damage to Physical Assets** – this risk refers to losses arising from:
  - Acts of malice, spite, terrorism or the like where there is no profit intention; and
  - Losses arising from loss of, or damage to assets (physical or people) from natural disaster or other events.

- **Business Disruption and System Failures** - this risk refers to losses arising from:
  - The lack of, or inadequate business continuity plans;
  - The inappropriate or inadequate implementation of business continuity plans;
  - Losses arising from loss or damage to assets (physical or people) from natural disaster or other events

- **People Risk** – this is the risk of losses arising from :
  - Lack of people skills and or / resources;

- Inappropriate behaviour by senior management;
- Unexpected absence of key personnel; and
- Ill health, accident or injury to people.

- **Conduct Risk** – this is the risk of losses from unfair outcomes to customers arising from:
  - Failure to deal with customers fairly and treat them with respect, including handling of complaints;
  - Failing to design our products and services to meet the needs of customers;
  - Failure of products and/or services performing as expected;
  - Inadequately keeping customer data safe.

  The conduct of business risk to which Tesco Underwriting is exposed falls predominantly to our distributor Tesco Bank. However, Tesco Underwriting has a responsibility to ensure that Tesco Bank is compliant with the regulation.

- **Outsourcing Risk** – this is the risk of loss arising from the reliance on or, failure of an outsourcer to:
  - Exercise control over major processes, key operations, functions and knowledge that are critical to TU's business;
  - Failure of the outsourcer to comply with TU's Risk Policies; and
  - Failure of the outsourcer to deliver their contractual agreements.

  It also includes the risk of needing to bring back in-house the key operations and not having the capacity to do so.

Risk mitigation
The operational risk management framework aims at identifying, assessing, managing, monitoring and reporting on operational risks. These company-wide processes are:

- Loss data collection;
- Internal control assessment; and
- Key risk identification and assessment process.

Through its Risk Taxonomy TU has classified its potential sources of operational risks and aims to keep these operational risks at appropriate levels by maintaining sound and well-controlled environments in light of the characteristics of its business, the markets and the regulatory environments in which it operates. While these control measures mitigate operational risks they can never completely eliminate them.

Measures used to assess risk
The key Operational risks faced by TU are reviewed quarterly by the Management Risk Committee and subsequently the Board Risk Committee. Operational risk is explicitly modelled within TU's Risk Profile and is captured by specific risks on the TU Risk Register under TU's Control Risk Self-Assessment (CRSA) process. Risks are managed through a combination of policies, processes and reports. The key policies are the Risk Framework Policy.

The TU ORSA contains further detail on the methodology to calculate the "economic cost" of Operational Risk, in order to determine whether the standard formula-based capital charge allocation for operational risk provides an adequate reflection of the Operational Risk profile. Scenarios are chosen to cover all Operational Risk sub-risks within the TU Risk Taxonomy and each scenario is assessed against the Standard Formula SCR for Operational Risk - the results show that there are no scenarios that indicate that a higher level of capital might be required and therefore the scenarios support the use of Standard Formula for TU.

Risk concentration
Concentration of operational risk is limited within TU.

Material changes over the reporting period
There have been no material changes.

C.5 Other material risks

Strategic Risk description - Strategic risks cover external and internal factors that can impact TU's ability to meet its current business plan as well as how it positions itself to achieve ongoing growth and value creation and is comprised of the following sub-risks:

- **Legal & Regulatory Risk** - this is the risk that changes to regulations would threaten the current business model.
- **Competitor Risk** – this arises due to changes in competitor landscape or market position.
- **Distribution Risk** – this is the risk of a loss due to distribution plans deviating adversely from expectations. This type of strategic risk is particularly applicable due to the exclusive arrangement that TU has with Tesco Bank for the distribution of home and motor insurance. Distribution risk can arise due to a number of causes including lack of alignment of planning, poor stakeholder management, and misaligned strategic goals.
- **Economic Environment Risk** – this is the risk that the economic environment encounters changes and the impact this can have on general business environment, customer behaviour, etc. (e.g. the impact of an economic downturn leading to greater incidence of customer fraud at either sales or claims stage).
- **Other Environment Risks** – these risks cover a range of changes to the external environment not already covered by the categories above.
- **Group Risks** - these cover various risks associated with TU's Parent Company including change in their strategy, significant reputational damage to the Parent Company, and failure of the Parent Company.
- **Change Management Risk -** Chance Management Risk is the risk arising from change projects that fail to deliver on objectives, do not deliver on time or budget, or have an unacceptable 'knock-on' impact on business-as-usual activity.
- **Climate Change Risk** - Climate Change Risk can arise from:
  - Physical risks: the risks which arise from weather-related events, such as floods and storms.
  - Transition risks: the financial risks which could arise for Tesco Underwriting from the transition to a lower-carbon economy.
  - Liability risks: risks that could arise for Tesco Underwriting from parties who have suffered loss and damage from climate change, and then seek to recover losses from others who they believe may have been responsible.
- **Data Governance** - The risk that any data used within TU is of poor quality, leading to inappropriate outcomes. This includes data received from external parties, saved, and transformed within our own systems and utilised for decision making.

Strategic Risk Management

As part of the CRSA process, TU maintains a Strategic Risk register - which is owned by the CEO and reviewed on a quarterly basis with the CRO and Head of Strategy. This covers the risks that don't sit within any of the other departmental Risk Registers.

As mentioned in the Section C introduction the TU SCR does not explicitly cover Strategic Risks – to justify this we looked at the risks within the TU Strategic Risk register and ensured that there is sufficient allowance within other modelled risk types (due to overlap between the definitions).

C.6 Any Other Information

Stress and Scenario Testing

A well designed and executed Stress and Scenario Testing (SST) programme is part of TU's Contingency Planning. The ongoing Solvency of TU is key – but the analysis also focuses all applicable Risk Appetite measures. Where a Risk Appetite limit is breached management need to consider options available to recover and specify timescales and relevant owners for each action.

The following process was adopted in developing the Stress and Scenario Tests:

- Risk Management liaised with relevant SMEs from across the business to review the SSTs using input from internal and external sources to assess whether there were any potential gaps in coverage against TU's Key Risks.
- The draft SSTs were presented to the TU BRC in July 2021 for discussion and feedback, and the final SSTs were presented to the TU BRC in November 2021 for approval.

The following sections summarise the various tests undertaken; the tests have been selected to ensure appropriate coverage of TU's key risks underlying the business plan projections. The tables below show a description of the test, the rationale for the test, the link to TU's Key Risks/Horizon Scan Risks and an assessed return period.

Insurance Risk Stress and Scenario Tests:

#	Test Name (Return Period)	Description - Insurance Risk Stress Tests	Rationale
S1	Motor Soft Market *(1-in-5 Year)*	TU's market competitiveness worsens more than anticipated leading to a reduction in Policies in Force of c.30% over 2022/23-2024/25.	To assess the impact of lower profitability from writing lower than expected volumes.
S2	Motor Hard Market *(1-in-5 Year)*	TU's market competitiveness improves more than anticipated leading to a growth in Policies in Force of c.30% over 2022/23-2024/25.	To assess the new business capital strain from writing higher than expected volumes.
S3	Multiple Weather Events *(1-in-100 Year)*	A number of events occurring recurrently over 2022/23-2024/25 (1 in 2022/23; 2 in 2023/24; and 3 in 2024/25) as a result of increasingly aggravating climate change. Each event is below the reinsurance retention, so no recoveries are made and the 2022 events are assumed to occur after the dividend payment.	TU's Catastrophe reinsurance covers up to a 1-in-200 return period. The Non-Life Internal Model shows that multiple smaller events drive the SCR figure.
S4	PPO Severity shock *(1-in-30 Year)*	Assume all TU PPO claimants have unimpaired life expectancy and reserves increase to reflect. A knock-on impact is that this element of the premium is too low and hence the 2022/23 Loss Ratio is 3% higher than Plan. In addition, there is an increase of +5% in the ASHE index for 2022.	A key assumption in the calculation of the Claims Reserves.
S5	Adverse Large Loss experience *(1-in-30 Year)*	2021 Year-end Bodily Injury large loss reserves are insufficient (assumption of favourable case reserves run-off is incorrect and Actuarial Best Estimate increased to Incurred cost). The knock-on impact is that the BI Large loss component of the premium is too low and hence the 2022/23 Written Loss Ratio is 5% higher than Plan.	A key assumption in the calculation of the Claims Reserves.
S6	Non-Renewal of ADC and Quota Share Reinsurance *(1-in-10 Year)*	Significant reserve deterioration leads to a claim on the ADC contract, this leads to an increase in the ADC and Quota Share costs and TU make the decision not to renew the covers on 1/1/2023.	Non-renewal of the reinsurance covers (particularly the ADC) would lead to a significant increase in the SCR figure.

S7	Ogden Discount Rate change *(1-in-10 Year)*	Due to Covid-19, yields on low-risk assets are reduced and the outlook for care inflation is potentially higher – leading to external pressure for an early review of Ogden Discount Rate, which leads to it being reduced to -1.75% in July 2022.	A key driver of the cost of Bodily Injury Claims – the change would impact all open claims.

Financial Risk Stress and Scenario Tests:

#	Test Name (Return Period)	Description - Insurance Risk Stress Tests	Rationale
S8	Sudden rise in UK Interest Rates *(1-in-30 Year)*	A short-term shock to UK Interest rates, increasing to 5% in 2022/23, 4% in 2023/24, 3% in 2024/25 and 2% in 2025/26, before returning to current forward rates.	Rising yields would lead to a reduction in TU's bond portfolio valuation.
S9	Flattening of yield Curve *(1-in-30 Year)*	The impact of the surge in bond yields following the US Fed turning off one of their Quantitative Easing programs in 2013 (the 'Taper Tantrum').	Rising yields would lead to a reduction in TU's bond portfolio valuation.
S10	Widening of Credit Spreads *(1-in-100 Year)*	The impact of the spread widening following the Lehman Collapse in September 2008.	Widening spreads would lead to a reduction in TU's bond portfolio valuation.
S11	Downgrade & Default of Investments and Reinsurer default. *(1-in-50 Year)*	A significant economic downturn leads to all BBB-rated corporate bonds being downgraded by 1 whole credit grade notch, and the default of TU's largest corporate bond holding with a 50% loss. This leads to financial difficulties for a number of TU's lowest rated Motor Reinsurance counterparties (below AA rated) and TU is forced to write-off 50% of the Motor Reinsurance Recoveries due from these.	Reflecting the significant impact the Covid-19 pandemic had on the macro-economic environment. Profit impact from Reinsurance Asset write-off and Corporate bond default, and Solvency impact of increased Spread Risk following downgrades.
S12	PRA 2019 GIST Scenario 1: Deterioration in the economic environment *(1-in-100 Year)*	A parallel downward shift in risk free interest rates of 100 bps; a widening in corporate bond spreads dependent on their current credit rating (e.g. 150 bps for AAA rated assets); and a fall in other asset values (including equities down 30%, commercial property down 40% and residential property down 30%).	Consistent with results reported to the PRA as part of the 2019 General Insurance Stress Test Scenario submission – and reflecting the significant impact the Covid-19 pandemic had on the macro-economic environment.

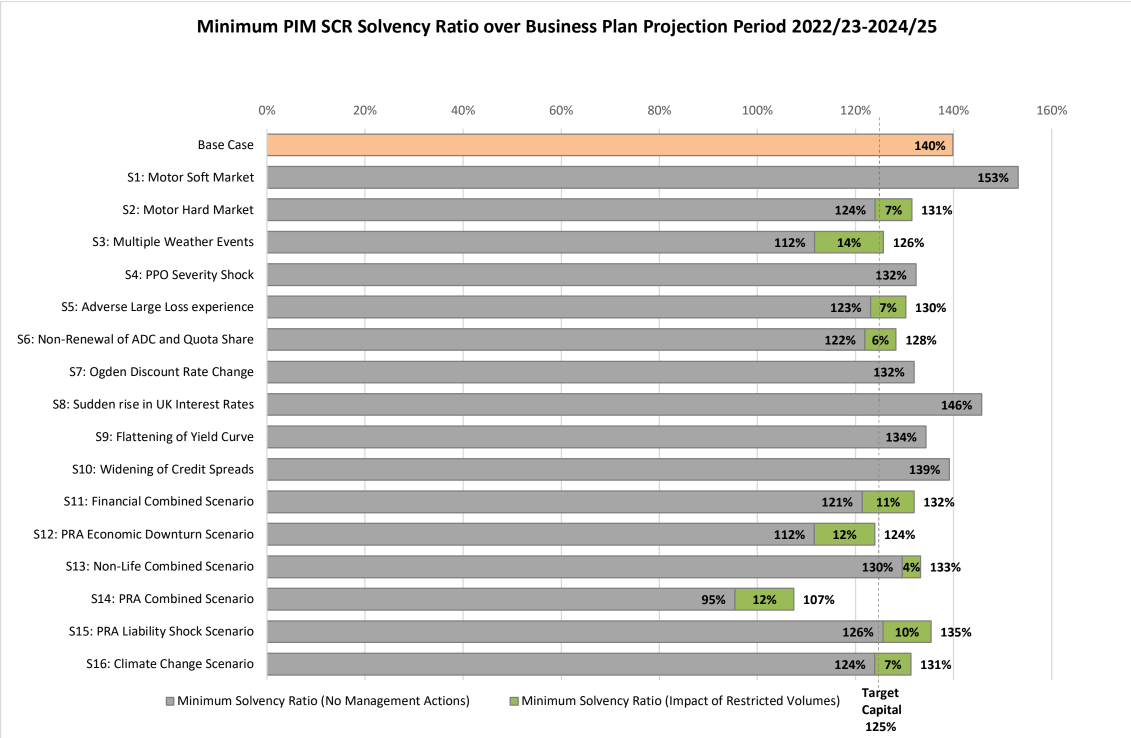
Combined Risk Stress and Scenario Tests:

#	Test Name (Return Period)	Description - Insurance Risk Stress Tests	Rationale
S13	PPO 'Frequency' increase, Reinsurer default and Reduction in UK Motor Reinsurance capacity *(1-in-100 Year)*	New legislation means that all open Large Motor claims over £1m will settle as PPOs. This in conjunction with other significant recent world-wide Natural Catastrophe events causes Swiss Re (TU's largest Reinsurance Counterparty) experience financial issues and TU is forced to write-off 50% of the Motor Reinsurance Recoveries due from Swiss Re. A number of Reinsurers stop providing cover for the UK Motor market due to fears over spiralling numbers of PPO claims – TU is only able/willing to pay for 50% of the £5m	PPO settlement propensity rate is a key assumption in the calculation of the Claims Reserves. Non-renewal of the reinsurance covers would lead to an increase in the SCR figure.

		xs. £5m XOL layer to be placed in 2023/24 and 75% in 2024/25 before returning to 100% in 2025/26.	
S14	PRA 2019 GIST Scenario 5: Natural Catastrophe shock and deterioration in the economic environment *(1-in-500 Year)*	PRA GIST Scenario 1 (S12) and a large UK windstorm and a large UK flood leading to some £22 billion of losses in aggregate to the UK insurance sector.	Consistent with results reported to the PRA as part of the 2019 General Insurance Stress Test Scenario submission.
S15	PRA 2019 GIST Scenario 6: Liability shock *(1-in-10 Year)*	A deterioration in Technical Provisions due to claims inflation (over and above consumer price inflation) being 2% p.a. higher than allowed for in the reserving basis.	Consistent with results reported to the PRA as part of the 2019 General Insurance Stress Test Scenario submission.
S16	Climate Change Scenario *(1-in-100 Year)*	A climate change scenario across physical, transition and liability risks that are material to risk profile of Tesco underwriting. (Based on 2019 PRA Stress Test - Climate Change Scenario B)	To support TU's alignment with the PRA Biennial Exploratory Scenario (BES) 2021 regulatory requirements.

The table below shows the impact of the Stress and Scenario Tests on TU's Solvency Ratio (relative to PIM SCR):

- The grey bars represent the minimum Solvency Ratio over the business plan projection period (2022/23-2024/25) assuming no additional management actions are initiated.
- The green bars show the impact on the minimum Solvency Ratio through the impact of management actions. Given that there are no forecast dividends the primary management actions taken reflects a reduction of business volumes by 30% once the Solvency Ratio reduces below 131% PIM SCR over the business plan projection period.



The Solvency impacts of the following tests are reduced by TU's Reinsurance covers:

- Home Catastrophe XOL: S3 (Multiple Weather Events), S14 (PRA Combined Scenario) and S16 (Climate Change Scenario).
- Motor XOL: S5 (Adverse Large Loss Experience), S13 (Non-Life Combined Scenario) and S15 (PRA Liability Shock Scenario).
- Adverse Development Cover (ADC): S13 (Non-Life Combined Scenario) and S15 (PRA Liability Shock Scenario).

The results before management actions (grey bars) show that TU remains solvent (relative to regulatory PIM SCR) under each of the stress tests performed, except for test S14 (PRA Combined Scenario) which results in a minimum Solvency Ratio of 95% PIM SCR.

The key management action is to reduce the volume of business written - for example under test S14 (PRA Combined Scenario) this increases the minimum Solvency Ratio by 12% (from 95% to 107%). The results after this action (green bars) show that TU meets its Target Capital level (125% PIM SCR) under each of the stress tests performed, except for tests S12 (PRA Economic Downturn Scenario) and S14 (PRA Combined Scenario) which result in a minimum Solvency Ratio of 124% and 107% PIM SCR respectively.

Reverse stress testing indicates that based on the 2021 Q3 reported position the likelihood of TU breaching its PIM SCR is approximately 1-in-50.

Financial Risk of Climate Change

TU engaged One Risk Consulting (ORC) to undertake a review of the work undertaken internally, which was benchmarked against the PRA's supervisory statement 3/19 the outcome of which was favourable in terms of the approach and work already undertaken and all action needed to ensure compliance with SS3/19 by 31st December 2021 has been completed.

TU's climate change working group including representatives from Underwriting, Claims, Finance and Risk continues to meet regularly and provides updates to the Management Risk and Board Risk Committees. Board risk training was provided with the support of (ORC). Scenario development and analysis is also being undertaken by Aon to determine an outcome for a multiple event scenario within a single calendar year (incorporating TU's planned growth and reinsurance purchases).

In the stress and scenario section of this report, TU include detail of the Climate Change related Stress & Scenario Tests S3 (Multiple Weather Events), S13 (Non-Life Combined Scenario) and RST3 (Major Catastrophe Event). The PRA's 2019 General Insurance Stress Tests (GISTs) included a Climate Change scenario, which confirmed that for TU Physical Risks are the most significant (noting that these are mitigated by the reinsurance programme) and Transition Risks are less so (due to the investment portfolio being a diversified mix of high-grade corporate bonds).

Going forward TU's climate change agenda will link in closely with the wider Tesco Bank climate change strategy and Tesco Group purpose which focuses on planet.

Risks associated with the outbreak of the Covid-19 pandemic "coronavirus"

TU continues to monitor the risk to its key services via the Covid 19 Response team that was convened at the beginning of the Pandemic, reporting periodically to the TU Executive Committee providing information on changing Government advice, the potential implications to the business and any new operational risks identified as a result. The Crisis Management Team has been stood down and risk is being managed through either BAU or new processes developed because of the Covid-19 pandemic.

Risk opinion is that TU's control environment remains robust with new processes and controls developed and implemented where necessary and monitored via the CRSA process. All risks that were identified as heightened or new in the Covid-19 environment and/or that moved outside of appetite and required temporary acceptance are now being managed as business as usual.

D

VALUATION FOR SOLVENCY PURPOSES

This chapter should be read in conjunction with the market consistent balance sheet (MCBS)

of Solvency II as reported in the Quantitative Reporting Template S. 02.01.

This section provides the value separately for each material class of assets, technical provisions and other liabilities; and a description of the bases, methods and main assumptions used for their valuation for solvency purposes. It also provides a quantitative and qualitative explanation of any material differences.

This report also confirms TU meets the required regulatory disclosure requirement related to risk management, which includes:

- TU's Risk Framework includes policies related to Pricing & Underwriting risk, Reserving risk, Market risk (covering Asset-liability management, Investment risk and Liquidity risk) – see the relevant parts of Section C for further detail including description of the risk and measures to assess and mitigate them.
- Loss-making Policies – our valuation methodology requires that loss-making policies are only offset against profit-making policies within the same homogeneous risk group, as specified in our SII Valuation manual and within the TU Liability Adequacy Policy.
- Expected Profit Included in Future Premium (EPIFP) isn't applicable for TU given the nature of its business.

D.1 Assets

The following adjustments have been made to the Statutory Accounts in arriving at the SII Balance Sheet;

- Deferred acquisition costs, other intangibles and property, plant & equipment held for own use are excluded from the SII balance sheet as there is no fair value for these items. Right of Use Assets, however, are included;
- Deferred tax is adjusted to reflect the tax impact of the valuation adjustments;
- Accrued interest on investments is reclassified to the investment value under SII as opposed to any other assets under IFRS;
- Reinsurance assets (claim recoveries) are discounted for SII balance sheet purposes; and
- Insurance & intermediary receivables are reflected as technical provisions for SII balance sheet purposes.

The Company held the following assets:

Assets at 28 February 2022 £'000

-	IFRS Accounts	SII Adjustments	SII Balance Sheet
Assets			
Deferred acquisition costs	11,039	(11,039)	-
Other intangible assets	11,120	(11,120)	-
Deferred tax assets	3,113	4,238	7,352
Property, plant & equipment held for own use	1,113	(916)	197
Investments - Bonds	576,430	8,250	584,680
Investments - Property Funds	23,100	0	23,100
Reinsurance recoverables	245,087	22,986	268,073
Insurance & intermediaries receivables	33,142	(22,128)	11,014
Reinsurance receivables	6,212	7,663	13,875
Receivables (trade, not insurance)	209	-	209
Cash and cash equivalents	64,500	-	64,500
Other assets	12,988	(10,099)	2,889
Total assets	988,053	(12,164)	975,888

Assets at 31 December 2020 £'000

	IFRS Accounts	SII Adjustments	SII Balance Sheet
Assets			
Deferred acquisition costs	7,817	(7,817)	-
Other intangible assets	9,702	(9,702)	-
Deferred tax assets	-	1,381	1,381
Property, plant & equipment held for own use	534	(61)	473
Investments - Bonds	623,915	8,582	632,497
Investments - Property Funds	18,255	248	18,503
Reinsurance recoverables	230,366	(16,766)	213,600
Insurance & intermediaries receivables	20,212	(15,993)	4,219
Reinsurance receivables	820	6,459	7,278
Receivables (trade, not insurance)	14	-	14
Cash and cash equivalents	70,961	-	70,961
Other assets	12,108	(11,420)	688
Total assets	994,704	(45,089)	949,614

D.1.1 Valuation of assets

Fair value is the amount for which an asset could be exchanged, a liability settled or a granted equity instrument exchanged between knowledgeable, willing parties in an arm's length transaction.
The table below summarises per material class of asset the basis, methods and main assumptions used for the valuation of assets. For the data, we refer to the Quantitative Reporting Template (S.02.01.02).

Deferred acquisition costs (DAC) (Revalued for SII)
Under IFRS DAC is amortised over the period in which the related premiums are earned. DAC is not recognised under SII.

Other Intangible assets (Revalued for SII)
Intangible assets consist of computer software and development. Under IFRS they are valued at net book value.
Under SII they are valued at nil unless they can be sold separately and a valuation can be derived from a quoted market price.

Property, plant and equipment (PPE) held for own use (Revalued for SII)
Under IFRS PPE is stated at cost less accumulated depreciation and impairment losses, which is approximated to be its market value. Under SII they are valued at nil apart from Right of Use Assets valued under IFRS 16 and is considered FV under SII.

Deferred tax assets
The valuation under the Market Consistent Balance Sheet (MCBS) is based on the difference between the value of the underlying assets and liabilities in the MCBS and the tax base balance sheet. The measurement principles of IAS 12 are applied in valuing deferred tax assets. The specific tax position is considered in case of a net deferred tax asset position.
A net deferred tax asset is only recognised to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. Therefore, when an entity has a history of recent losses, it is only able to recognise a deferred tax asset arising from unused tax losses or tax credits to the extent that the entity has

sufficient taxable temporary differences or there is convincing evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

Investments Bonds

Corporate bonds are valued at fair value under both IFRS and SII. There is a presentation difference between IFRS and SII; accrued interest is included in the investment value under SII but under Other Assets in the IFRS balance sheet.

Investments – Property

Investments in property (held not for own use) are measure using fair value. Monthly valuations are received from the investment management company and fluctuation in fair value are charged to the profit and loss account.

Insurance & intermediaries receivables

The balance represents premiums receivable from the intermediary and are valued at cost value under both IFRS and SII because of the short term nature of the receivables. There is a presentation difference between IFRS and SII; salvage and subrogation recoveries are included in this category under IFRS but netted off against gross technical provisions under SII.

Reinsurance Receivables

These are short-term and valued at cost under both IFRS and SII.

Cash and cash equivalents

Cash and cash equivalents have a term of less than three months. Their face value is taken to approximate fair value under both IFRS and SII.

Other assets

Any other assets include accrued income. This is a short-term asset and valued at cost under both IFRS and SII. An amount of £1,846k under IFRS relates to prepaid expenses. Due to the nature of these expenses they are valued at nil under SII.

D.2 Technical provisions

D.2.1 Technical provisions by line of business

Technical Provisions at 28 February 2022 £'000

	Motor vehicle liability insurance	Other motor insurance	Home	Total non-life obligation (per S.17.01)	Annuities stemming from non-life insurance contracts (per S.12.01)	Total technical provisions
Premium Provisions	80,984	27,054	30,088	138,125		138,125
Claims Provisions	358,330	(6,209)	30,365	382,487	90,342	472,829
Total best estimate - gross	439,314	20,845	60,453	520,612	90,342	610,954
Risk margin	14,282	697	5,492	20,471	14,260	34,730
Total gross technical provisions	453,596	21,542	65,945	541,082	104,602	645,684
Total recoverable from reinsurance	203,933	13,968	6,231	224,133	43,941	268,073
Net technical provisions	249,662	7,574	59,714	316,950	60,661	377,611

Technical Provisions at 31 December 2020 £'000

	Motor vehicle liability insurance	Other motor insurance	Home	Total non-life obligation (per S.17.01)	Annuities stemming from non-life insurance contracts (per S.12.01)	Total technical provisions
Premium Provisions	80,599	21,568	23,415	125,582	-	125,582
Claims Provisions	319,756	(4,419)	23,550	338,887	129,495	468,382
Total best estimate - gross	400,355	17,150	46,965	464,470	129,495	593,964
Risk margin	15,497	467	3,622	19,587	13,644	33,231
Total gross technical provisions	415,853	17,618	50,587	484,056	143,139	627,195
Total recoverable from reinsurance	123,990	11,807	5,502	141,299	72,302	213,601
Net technical provisions	291,863	5,810	45,084	342,757	70,837	413,594

D.2.2 General comments on valuation of technical provisions

The value of technical provisions under Solvency II is equal to the sum of the best estimate of the liabilities and the risk margin. To calculate the best estimate of the liabilities, the probability-weighted average of the expected present value of all future cash flows based on the risk-free yield curve (with volatility adjuster for PPOs) is used whereas the risk margin, which is aimed at ensuring there is sufficient capital to run-off the business, is assessed on the basis of the capital costs of the non-hedgeable risks included in the best estimate.

The time horizon used in the calculation of the best estimate is the full lifetime of the existing (re)insurance liabilities on the date of valuation. The determination of the lifetime of the (re)insurance portfolio is based on contract boundaries and realistic assumptions about when the existing liabilities will be discharged, cancelled or expired. The boundary of the contract is defined following the EIOPA's technical specifications as:

(a) Where the insurance or reinsurance undertaking has a unilateral right to terminate the contract, a unilateral right to reject the premiums payable under the contract or an unlimited ability to amend the premiums or the benefits payable under the contract at some point in the future, any obligations which relate to insurance or reinsurance cover which would have been provided by the insurance or reinsurance undertaking after that date do not belong to the existing contract;

(b) Where the undertaking's unilateral right to terminate the contract or to unilaterally reject the premiums or its unlimited ability to amend the premiums or the benefits relates only to a part of the contract, the same principle as defined above are applied to this part; and

(c) All other obligations relating to the terms and conditions of the contract belong to the contract.

Discounting cash-flows is performed for all relevant cash–in and cash–out flows, e.g. premiums, claims payments. As a simplification, cash-flows are expected to emerge at mid-year. Discounting is performed in line with the PRA policy statement 24/20: From 11pm on 31 December 2020 onward, UK insurance firms are required to use technical information published by the PRA to calculate the technical provisions required by Solvency II. Discounting is performed based on the interest curves for liabilities where the insurers are permitted to use a volatility adjustment (VA).

TU's business is managed in a more granular way than at SII Lines of Business level, so the assumptions are also set at a more granular level.

All expenses to be incurred in servicing insurance and reinsurance obligations are taken into account. They include direct operating expenses, overhead expenses as well as allocated central head-office expenses. Expenses associated with reinsurance contracts are included in the gross calculation of the best estimate.

The allowance for inflation is consistent with the economic assumptions made. Inflation rates are justifiable relative to external sources of information such as Consumer or Retail Price Indices.

The total of allocated commissions represents the actual commissions for the reporting year and cover Acquisition commission, Renewal commission, Bonus commission and claw-back of unearned commission in case of lapse.

D.2.3 Non-life technical provisions

Non-life provisions consist of:

- Claims provisions: cash flow projections relate to claim events having occurred before or at the valuation date – whether the claims arising from these events have been reported or not (i.e. all incurred but not settled claims).
- Premium provisions: the cash flows relate to claims and expenses occurring in the future related to policies in force according to contract boundaries defined below.

Granularity

The best estimate of claims provision and premium provision are calculated separately with a split between gross cash flows and reinsurance related cash flows. The minimum level of segmentation is at homogeneous risk group level with a minimum level being the Solvency II LOBs.

Cash flow projection for claims provisions

The Claims provision includes:

Inward cash-flows

- Recoverables for salvage and subrogation; and
- Recoverables from reinsurance contracts and special purpose vehicles (for calculation of net best estimate).

Outward cash-flows

- Claims payments payable to policyholders or beneficiaries;
- Expenses incurred in servicing insurance obligations; and
- Reinstatement premiums.

The Premium provision includes:

Inward cash-flows

- Premiums to be written until the term of the contract (future premiums);
- Recoverables for salvage and subrogation; and
- Recoverables from reinsurance contracts and special purpose vehicles.

Outward cash-flows

- Claims payments payable to policyholders or beneficiaries from claims occurred since the valuation date until the term of the contract;
- Commissions to be paid since the valuation date until the term of the contract;
- Reinsurance premium or reinstatement premiums;
- Expenses incurred in servicing (re)insurance obligations;
- Expenses necessary to handle claims until settlement;
- Expenses necessary to administer contracts during the valuation period;
- Acquisition expenses (other than commissions); and
- Investment expenses necessary to administer the assets representing the liabilities related to contracts during the valuation period;

Claims payments

Claims are split into five categories: attritional claims (claims with a cost under a predefined threshold), large claims (claims with a cost above a predefined threshold excluding catastrophe claims) – split into claims settled as lump sum payments and claims settled as Periodic Payment Orders (PPOs), claims arising from natural catastrophe events and claims arising from binary events (restricted to events with very low frequency-high severity (which could be one large claim or an accumulation of attritional claims)).

The main reason for isolating large (lump sum and PPO claims) and catastrophe claims from others is that, in many cases, large claims require a dedicated valuation technique. The main reason for this is that non-proportional reinsurance applies only to those claims and uncertainty is more important. PPO claims need to be separately identified for the purpose of QRT reporting, and the inputs feed into the capital model within the Similar to life category. As a consequence, isolating large and catastrophe losses from other losses warrants an appropriate calculation of best estimate values and of the uncertainty around it, both on a gross and net basis.

Methods to value attritional claims are aggregate methods where claims are grouped per accident period and where payments are grouped by accounting period to form a claims triangle. For large losses various methods are available including specific individual large loss methods. Large losses, including PPO claims are modelled using a combination of aggregate methods and individual large loss projection methods in order to compute the reinsurance recoveries on a claim by claim basis.

Tail Factor

In many loss reserve analyses, especially those involving long-tail branches (losses that do not proceed to final settlement until several years beyond the policy year), the observed historical loss development information may end before all the claims are expected to be settled and before the final costs are known. Assessments, based on the available triangle data, may lead to consider a *tail factor* that estimates the development beyond the last stage of known historical developments.

Reinsurance Recoveries

Recoverables from reinsurance contracts, including recoverables from any special purpose vehicles, are recognised and valued according to the valuation principles for non-life premium and claims provisions and are shown separately on the asset side of the balance sheet (as “recoverables from reinsurance contracts and special purpose vehicles”). The time value of money is taken into account in the calculation of reinsurance recoveries.

TU’s reinsurance programme comprises:

Motor and Home Excess of Loss programmes; a Motor Adverse Development Cover (ADC) and a 15% Motor Quota Share treaty for underwriting year 2019 and 45% Quota Share treaties for underwriting years 2020 to 2022 .

Expenses related to the internal processes for reinsurance and SPVs (such as administration or management) are allowed for in the expenses forming part of the gross best estimate.

Expenses

Expenses assumptions are based on experience over the last year or some other recent period. In this respect the past one-off expenses may be more or less adjusted. Expenses are calculated on a going concern basis and also on a run-off basis for comparison purposes.

Commissions

Future commission assumptions are only considered for the part of the premium provisions related to premiums not already written. These commission assumptions are generally expressed as a percentage of written premiums.

Acquisition Expenses

Future acquisition costs are valued regarding cash-flows related to premium provisions and considered differently depending on whether the premium has already been written or not. For the part of provision constituted by premium already written, no acquisition cost is projected since all expenses are considered as having been paid at the drawing up of the contract.

For renewals, acquisition costs are reduced with the part of the cost related to the drawing up of the contract.

Administration and Operating costs

Expenses connected with ongoing administration of in-force policies and operational businesses (including reinsurance costs) are first allocated to premium provisions.

Claims Expenses

Claim management expenses which are related to claims that have occurred before the valuation date are considered for the cash-flows related to claims provisions.

Expenses related to claims that will occur in the period covered by the in-force premiums are considered regarding cash-flows related to premium provisions.

Events Not in Data (ENIDs) – Natural Catastrophe events

The definition of “ENIDs” is restricted to those events with very low frequency-high severity (which could be one large claim or an accumulation of attritional claims) and is not otherwise considered in the best estimate as absent from historical observation, or is considered as an outlier in the valuation methods applicable to attritional or large claims. TU makes a distinction between the claims arising from natural catastrophe events classified as Natural Catastrophe claims and others, called Events Not in data (ENIDs).

Typical Natural Catastrophe events are Earthquakes, Floods, Windstorms, Tsunamis, etc.

Typical ENIDs are latent claims e.g. asbestos; legislative changes e.g. Ogden table changes, etc.

ENIDs must be explicitly considered in premium provisions and claims provisions, in a consistent way. Natural catastrophe events must be explicitly considered in premium provisions. Not all lines of business will be affected to the same extent by ENID and natural catastrophe events. Longer tailed classes of business are more affected by ENIDs. The approach and methods used to calculate the allowance for catastrophe and ENIDs are simplified methods using benchmarking and expert judgment.

Inflation

Inflation is considered when projecting future cash-flows: the cash-flows that are potentially impacted by inflation are:

- Claims costs;
- A 15% Motor Quota Share treaty for underwriting year 2019, and a 45% Motor Quota Share treaty for underwriting years 2020 to 2022;
- Expenses: the biggest part of expenses are salaries that will evolve over time; and
- Inflation that applies to claims, called “claims inflation”.

The assumptions used for valuation are consistent with other uses of Claim inflation.

Contract boundaries

In addition to the generic definition the premium provision is affected by the issues arising with respect to the contract boundary.

This document defines "unincepted business" as those contracts where a legal obligation exists but the coverage period has not started yet and also multi-year contracts.

Options and guarantees/Policyholder behaviour

This is not relevant as TU does not include options and/or guarantees in its non-life book of business.

Management action

TU does not currently consider any management action as policies currently written by TU for non-life products do not include any (discretionary) participating features.

Expert Judgment

Typical areas in non-life where expert judgment is applied are:

- Tail factors as they affect the whole claims portfolio contained in a triangle, it is usually a highly material item;

- Loss ratios affect single years, where the most uncertain parameters for the most recent years typically have the biggest impact. The loss ratio of the current year essentially determines the premium provision and is thus highly material;
- The potential impact of events not seen in historic data e.g. shutdowns associated with the Covid-19 pandemic;
- Impact continuing impact of the current inflationary environment;
- Impact of legislative changes;
- Deviations from current estimates on large claims using individual large loss projection methods; and
- Allowance for ENIDs.

D.2.4 The level of uncertainty in the amount of technical provisions

Due to the uncertainty of future events, any modelling of future cash flows (implicitly or explicitly contained in the valuation methodology) will necessarily be imperfect, leading to a certain degree of inaccuracy and imprecision in the measurement (or model error). A yearly model assessment is performed in order to review any potential modelling feature that is missing in the model and that might be significant to the determination of the Best Estimate.

Such an assessment of the model error may be carried out by expert judgement or by more sophisticated approaches, for example:

- Sensitivity analysis in the framework of the applied model: this means varying the parameters and/or the data thereby observing the range where a best estimate might be located;
- Comparison with the results of other methods: applying different methods gives insights into potential model errors. These methods would not necessarily need to be more complex;
- Descriptive statistics: in some cases the applied model allows the derivation of descriptive statistics on the estimation error contained in the estimation. Such information may assist in quantitatively describing the sources of uncertainty;
- Back-testing: comparing the results of the estimation against experience may help to identify systemic deviations which are due to deficiencies in the modelling; and
- Quantitative assessment scenario as benchmark.

D.2.5 Impact of the reduction of the volatility adjustment to zero

Within the Solvency II regulations it is permissible (with approval) to use a volatility adjustment, which increases the rate used to discount cashflows in the valuation of assets and liabilities. The principle of having a volatility adjustment is that a buy and hold investor who is not impacted by the volatility of assets caused by market fluctuations, is able to use a more appropriate discount rate, reflecting assets held. In 2019 TU submitted, and had approved, an application to use a volatility adjustment within Solvency II reporting. The impact of removing the volatility adjustment is a reduction in available capital of £1.0m (2020: £1.8m).

D.2.6 Material changes in the relevant assumptions made in the calculation of technical provisions compared to previous reporting period

Since the introduction of Covid-19 related lockdowns, it has been necessary to apply more expert judgement on the development of claims, since the assumption that historic development is a reliable guide for the future is not as valid. In particular, given changes in the mix of claims and associated severity of claims it has been necessary to apply more judgement to assess potential outcomes.

D.2.7 Material differences between the basis, methods and assumptions used for technical provisions in the Solvency II MCBS compared to IFRS

A difference in methodology exists between SII reserving and IFRS reserving. The technical reserves mentioned in Solvency II MCBS are subject to the valuation requirements in delegated acts, implementing technical standards, guidelines and information as published by the PRA. These valuation principles are not the same as those required by local accounting regulations that are still applicable to technical provisions as defined under International Financial Reporting Standards (IFRS 4). The underlying approach towards quantifying reserves under IFRS is disclosed in the 2022 annual accounts of TU.

The principal difference between the IFRS and SII valuations of reinsurance recoverables relates to discounting on a Solvency II basis.

The key differences in the valuations of technical provisions – premiums change from an Unearned Premium Reserve, being the portion of premium that is unearned on an IFRS basis, to a Solvency II basis incorporating the best estimate of claims and expenses arising and the result from unincepted but legally bound premiums.

D.2.8 Matching Adjustment

TU does not apply a matching adjustment to the technical provisions.

D.2.9 Transitional risk-free interest rate term structure

TU does not apply a transitional risk-free interest rate.

D.2.10 Transitional deduction

TU does not apply a transitional deduction to the technical provisions.

D.3 Other liabilities

Subordinated debt within the IFRS balance sheet classified as subordinated liabilities has been reclassified from liabilities to own funds in line with SII requirements. Each of the eligibility criteria required for the subordinated debt to qualify as Tier 1 restricted capital, as set out in Article 73 of delegated regulation (EU) 2015/35 have been met. The debt is fully subordinated in the event of a winding up, with the claims of the holder of the debt subordinated to the claims of the senior creditors (including policyholders and non-subordinated creditors). The subordinated debt is fully available to absorb losses and is free from encumbrances.

The Company had the following liabilities:

Liabilities at 28 February 2022 £'000

	IFRS Accounts	SII Adjustments	SII Balance Sheet
Liabilities			
Technical provisions	647,440	(1,756)	645,684
Deposits from reinsurers	114,811	7,665	122,477
Insurance & intermediaries payables	272	-	272
Reinsurance payables	557	-	557
Payables (trade, not insurance)	24,849	-	24,849
Subordinated liabilities in BOF	42,333	-	42,333
Any other liabilities	1,410	-	1,410
Total liabilities	831,672	5,910	837,582

Liabilities at 31 December 2020 £'000

	IFRS Accounts	SII Adjustments	SII Balance Sheet
Liabilities			
Technical provisions	648,209	(21,014)	627,195
Deferred Tax Liability	4,545	(4,545)	-
Deposits from reinsurers	88,673	7,279	95,952
Insurance & intermediaries payables	84	-	84
Reinsurance payables	1,738	(820)	918
Payables (trade, not insurance)	18,610	(881)	17,729
Subordinated liabilities in BOF	42,333	-	42,333
Any other liabilities	1,756	110	1,866
Total liabilities	805,948	(19,871)	786,077

D.3.1 Valuation of other liabilities

The key estimates and judgements applied are disclosed within the 2022 Annual Report. With respect to Solvency II additional estimation uncertainty is applied mainly in the valuation of technical provisions and reinsurance recoverables. Due to the uncertainty of future events, any modelling of future cash flows (implicitly or explicitly contained in the valuation methodology) will necessarily be imperfect, leading to a certain degree of inaccuracy and imprecision in the measurement (or model error).

D.4 Alternative methods for valuation

The table below summarises per material class of asset and other liabilities the material differences between the valuation for Solvency II purposes and the IFRS valuation. For the data we also refer to the Quantitative Reporting Template (S.02.01.02).

Deferred Tax Liability
Provision made on all timing differences including revaluation gains and losses on investments and is calculated at the expected tax rate.

Deposits from reinsurers
Valued at amortised cost in both IFRS and SII because of immaterial differences between amortised cost and fair value because of the short-term nature of the payables.

Insurance & intermediaries payables
Valued at amortised cost in both IFRS and SII because of immaterial differences between amortised cost and fair value because of the short-term nature of the payables.

Reinsurance payables
Valued at amortised cost in both IFRS and SII because of immaterial differences between amortised cost and fair value because of the short-term nature of the payables.

Payables (trade, not insurance)
Valued at amortised cost in both IFRS and SII because of immaterial differences between amortised cost and fair value because of the short-term nature of the payables.

Subordinated liabilities in basic own funds
The subordinated loans are advanced by shareholders. The loans are floating rate based on a margin above SONIA. The interest paid changes as the market interest rate changes leaving the market value of the loans materially unchanged. Overall, the market value of the loans will remain very close to the nominal value of the loan. Valuation is the same in both IFRS and SII.

Any other liabilities, not elsewhere shown
Valued at amortised cost in both IFRS and SII because of immaterial differences between amortised cost and fair value because of the short-term nature of the payables. cost and fair value because of the short-term nature of the payables. A lease liability is also measured at the lease commencement date at the present value of the lease payments unpaid at that date, discounted using the interest rate implicit in the lease if that rate is readily available or the Company's incremental borrowing rate.

D.5 Any other information

There is no other information to disclose.

E

CAPITAL MANAGEMENT

E.1 Own Funds

E.1.1 Available Capital

During the period to 28th February 2022, through a combination of business profitability offset by an increase in unrealised losses on financial assets, TU's own funds decreased from £185.9m to £180.6m.

In more detail basic own funds at 28th February 2022 of £180.6m (2020: £185.9m) represents SII assets of £975.9m (2020: £949.6m), less SII liabilities of £837.6m (2020: £786.1.m)

£k	**2022**	**2020**
Assets	975,888	949,615
Liabilities	(837,582)	(786,078)
Subordinated Loan	42,333	42,333
Proposed dividend		(20,000)
Own funds	180,639	185,870

E.1.2 Objectives, policies and processes for managing own funds

The multi-year planning process which is reviewed and approved in each 4th quarter of the financial year considers the implications of business performance on the capital of the company over the following 3 years.

The main goal of the capital management process is to protect policyholders, whilst optimising capital structure, composition and allocation of capital, funding profitable growth and protect viability and profitability and fund dividends to its Shareholders.

TU applies a capital management policy which sets rules and ensures discipline on:

- Capital Planning: the capital level the TU Board wants to hold, which is a function of:
    - Legal requirements, and anticipated changes;
    - Growth ambitions, and future capital commitments; and
    - Security buffers to ensure we meet obligations according to our Risk Appetite Policy.

- Capital Allocation: capital use that TU foresees, which is a function of:
    - Optimisation of risk reward; and
    - Measured performance;

- Dividend policy (and future capital raising).

Capital management policies and processes are included in the risk management system, ORSA process and internal control environment as disclosed in Section B Governance.

There have been no material changes to the objectives for managing own funds in the period.

E.1.3 Information about the structure, amount and quality of basic own funds and ancillary own funds

The position at 28th February 2022 is:

TIERING £m

in GBP mln		2022			2020	
	ACTUAL	**% Tier 1**	**% Own funds**	**ACTUAL**	**% Tier 1**	**% Own funds**
Tiering						
Tier 1 (unrestricted)	131.0	80%		142.2	80%	
Tier 1 (grandfathered hybrids)	32.7	20%		35.9	20%	
Total Tier 1 capital	**163.7**	100%	91%	**178.1**	100%	96%
Tier 2 hybrid capital	9.6		5%	6.4		3%
Tier 3	7.4		4%	1.4		1%
Total Own funds	180.6		100%	185.9		100%

At the period end of 28th February 2022;

- 91% of the Own funds are of the highest Tier 1 quality and able to fully absorb losses.
- The sum of the grandfathered (restricted) Tier 1 components amounts to 20% of total Tier 1 capital fulfilling the 20% regulatory limit.
- Tier 3 capital represents the part of Own Funds equal to the recognized Deferred Tax Assets (DTA) in the market consistent balance sheet.

Own funds at year-end 28th February 2022 do not contain ancillary Own Funds.

E.1.4 Eligible amount of own funds to cover the Solvency Capital Requirement and the Minimum Capital Requirement classified by tiers

28 February 2022 £'000

	Total	Tier 1	Tier 2	Tier 3
Total eligible own funds to meet the SCR	180,639	163,693	9,595	7,352
	Total	Tier 1	Tier 2	Tier 3
Total eligible own funds to meet the MCR	171,886	163,693	8,194	

31 December 2020 £'000

	Total	Tier 1	Tier 2	Tier 3
Total eligible own funds to meet the SCR	185,870	178,040	6,449	1,381

	Total	Tier 1	Tier 2	Tier 3
Total eligible own funds to meet the MCR	184,489	177,695	6,794	-

At the end of 28th February 2022 TU's SCR is £121.1m and MCR is £41.0m. The eligible amount of own funds to meet the SCR is £180.6m and to meet the MCR is £171.9m and is assessed as follows:

- At least 50% of the SCR, which amounts to £60.6m of TU's SCR for 2022, should be covered by Tier 1 capital. TU is well above this limit.
- In addition, Tier 1 capital is a combination of Unrestricted Tier 1 capital (ordinary share capital and retained earnings) and Restricted Tier 1 capital (subordinated loans). Restricted Tier 1 capital (TU's subordinated loan of £42.3m), is capped at 25% of Unrestricted Tier 1 capital, with any excess classed as Tier 2 capital. £32.7m of the subordinated loan is included in Tier 1 capital with £9.6m in Tier 2.
- At least 80% of the MCR, which amounts to £20.5m of TU's MCR for 2022, should be covered by Tier 1 capital. TU is well above this limit.

Deferred Tax Asset/(Liability)

IFRS

As at 28th February 2022, under IFRS TU recognised a deferred tax asset of £3.1m comprising of :-

	2022 £m
Unrealised loss on assets held as AFS through OCI	3.1
Other temporary differences	0.1
Deferred tax (liability)/asset	3.1

The deferred income tax recognised through OCI during the year relates to unrealised movements on financial investments. The movement in unrealised losses for period ending 28th February was £29.0m (2020: £8.7m)

The deferred tax asset recognised as at 28th February 2022 has been calculated based on the Corporation Tax main rate at 19% (effective 1 April 2020) for financial assets maturing before 1 April 2023 and 25% from this date.

SII

Transitioning from a Balance Sheet under IFRS, to a SII Balance Sheet, fat 28th February 2022 the Company has made reduction in net assets of £19.4m. The deferred tax asset adjustment based on this adjustment is £3.7m calculated at 19%.:-

	£m
Change in net technical provisions	5.7
All Other Movements	(25.0)
Total SII adjustments	(19.2)
Deferred Tax @ 19%	3.7
Add IFRS Deferred Tax Asset	3.1
SII Deferred Tax Asset	**6.8**

The SII deferred tax benefits of £3.7m is then added to the IFRS deferred tax asset of £3.1m to create a SII Deferred Tax Asset of £6.8m.

£6.8m of net deferred tax assets are available as basic own-fund items classified as Tier 3 in accordance with Article 76 (a) (iii) and applying the eligibility limits set out in Article 82 of Commission Delegated Regulation (EU) 2015/35.

E.1.5 Quantitative and qualitative explanation of any material differences between equity as shown in the undertaking’s financial statements and the available own funds as calculated for solvency purposes

Differences between equity in the IFRS financial statements and the excess of assets over liabilities as calculated for Solvency II purposes (Own Funds) are explained in detail in Section D and mainly stem from the following sources:

- Reclassification of subordinated liabilities;
- Valuation differences due to assets and liabilities not recorded at fair value under IFRS;
- Liabilities arising from insurance and investment contracts also need to be recognised at market-consistent values; and
- De-recognition of other intangibles under Solvency II.

The reconciliation from IFRS equity to Solvency II Own Funds is as follows :

RECONCILIATION IFRS EQUITY TO OWN FUNDS
in £'000

	Actual 2022	Actual 2020
	156,408	188,800
Subordinated Liabilities	42,333	42,333
Total Valuation differences	**(18,102)**	**(45,264)**
Removal of DACs	(11,039)	(7,817)
Derecognition of tangible and intangible assets	(12,036)	(9,763)
Derecognition of prepayments	(1,846)	(1,865)
Net best estimate of discounted liabilities	2,581	(11,744)
Tax impact on valuation differences	4,238	5,926
Forseeable dividend	-	(20,000)
Total Solvency II Own Funds (PIM)	180,639	185,869

During the period ending 28th February 2022, through a combination of business profitability offset by an increase in unrealised losses on financial assets TU's own funds decreased from £185.9m to £180.6m.

No items have been deducted from own funds, and there are no restrictions in relation to the availability and transferability of own funds.

See section D for further detail on the adjustments made between IFRS and Solvency II.

E.2 Solvency Capital Requirement and Minimum Capital requirement

E.2.1 Quantitative information on our SCR split by risk modules where standard formula is used and by risk category where an internal model is applied (unaudited)

The composition of the Solvency II capital solvency requirements can be summarised as follows:

	2022	**2020**
Market Risk	31,141	32,745
Counterparty Default Risk	10,451	8,026
Non-Life Underwriting Risk	92,770	87,441
Diversification between above mentioned risks	(23,628)	(23,105)
Non Diversifiable Risks	17,403	16,584
Loss-Absorption through Deferred Taxes	(7,010)	(3,518)
Required Capital under PIM SCR	**121,127**	**118,173**
Impact of Non-Life Internal Model on Non-Life Underwriting Risk	4,579	19,094
Impact of Non-Life Internal Model on Life Underwriting Risk	904	1,054
Impact of Non-Life Internal Model on Counterparty Default Risk	566	-98
Impact of Non-Life Internal Model on Diversification between risks	(1,251)	(1,763)
Capital Solvency Requirements under the SII Standard Formula	125,925	136,461

Available Capital of £180.6m at 28th February 2022 (2020: £185.9m) represents 149.1% (2020: 157.3%) coverage of SCR PIM.

Within the PIM SCR, TU accounts for £7m in respect of the loss absorbing capacity of deferred taxes (2020: £3.5m). This figure is calculated taking into account a prudent view of the expected profit (pre-tax) over the next 12 months, multiplied by the average tax rate over the coming 12 months.

TU's PIM covers the entirety of TU's business in respect of Non-Life underwriting risk. The main sub-components of the model are Premium Risk and Reserve Risk. Within Premium Risk and Reserve Risk there are separate components for TU's lines of business and different claim types. For the purpose of the SCR, it is calibrated to assess the risk at the 99.5th percentile over a one-year time horizon. Market risk, counterparty default risk and operational risk are calculated using the Solvency II Standard Formula. Within the standard formula no simplifications are used and no Undertaking Specific Parameters (USPs) are used.

Outside of the setting of the SCR, TU's PIM is used for capital allocation, which feeds into pricing, for reinsurance purchases and reinsurance optimization, as a tool to support the ORSA and to support investment modelling with a view to matching assets and liabilities and assessing the risk/return trade-off.

The PIM uses a variety of methods and assumptions in generating an overall probability distribution forecast. The model is composed of a number of components, which are appropriate for modelling variability by line of business for premium and reserve risk. For example, within reserve risk, historic reserve variability, combined with bespoke large loss modelling and TU's reinsurance arrangements are used together. Within premium risk, allowance is made for variability of attritional claims using TU's own data with overlays to include natural catastrophes, man-made catastrophes and variability of individual large losses where the frequency and severity are modelled. A matrix structure is used to aggregate the components using correlations determined by experts in the business, with reference to the standard formula.

The SCR has increased by £3m over the year primarily as a result of growth in the catastrophe exposure in non-life underwriting risk.

The Standard Formula SCR is higher than the Internal Model SCR for Non-Life Underwriting Risk by £4.6m at 28 February 2022 (£19.1m in 2020). There are two main reasons contributing to this reduction in surplus:

- i) The Standard Formula SCR is driven by the business volume which has been reducing over the year, whereas the PIM considers the specific volatility of that business which has remained comparable despite the reduction in volume.
- ii) The Non-Life catastrophe risk charge is higher in the PIM, and increased over the period to 28 February 2022 as new catastrophe exposure data was included in the PIM. The Standard Formula is relatively insensitive to changes in CAT exposure.

The Minimum Capital Requirement (MCR) at 28 February 2022 is £41.0m (2020: £42.6m). The MCR has been calculated using the outputs from the SCR PIM, premiums and technical provisions.

E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement (unaudited)

This is not applicable for TU.

E.4 Differences between the standard formula and any internal model used (unaudited)

On the 23rd December 2015, Tesco Underwriting was granted authorisation to use its partial internal model (PIM) to calculate its Solvency Capital Requirement as part of the Ageas Group, with some terms and conditions which were subsequently fully satisfied. In December 2020 TU received authorisation to use a solo PIM, without terms and conditions, in the context of it being fully owned by Tesco Bank. The scope of this partial internal model is the Underwriting component of the Standard Formula.

The Standard Formula has been calibrated to be appropriate for an average Solvency II insurer. Given TU's relative size and straightforward approaches to investment, counterparty and other risk types, the Standard Formula is reasonably well aligned to TU.

TU uses the PIM to calculate its SCR and uses the Standard formula SCR calculation to monitor portfolio and model changes, including model drift.

The key drivers of the differences between the Standard Formula SCR and Internal Model SCR are as follows:

- Different calculation basis on underwriting risks: The Standard formula uses a deterministic shock based approach to assess a 99.5% loss, whereas the partial internal model generates a distribution using stochastic simulations. From this distribution, the 99.5% loss is assessed.
- Dependency Structure – Correlation and diversification: The Standard Formula has been developed for an average Solvency II insurer and uses a relatively simple approach for combining different risk types. The line of business risks at the 99.5% level are combined and aggregated using EIOPA specified correlation matrices under Annex IV of the delegated regulation (EU) 2015/35. The PIM, by comparison takes a more granular approach to losses before combining them. For example, large losses and attritional losses are dealt with separately and reinsurance is assessed in each simulation to generate distributions both gross and net of reinsurance.

Reserve risk:
Split into Motor Liability (attritional and large), Motor Other and Household. A bespoke model is used for large Motor liability claims taking into account the modelling of PPO propensity, longevity and inflation, interacting with TU's reinsurance

programmes. Outside of these reserves, TU's historic variability is used to calibrate loss distributions for each line of business. The distributions are then combined using correlation matrices to produce a reserve risk distribution.
Settled PPO claims are dealt with under Life Underwriting Risk within the Standard Formula.

Premium Risk:
Split into Motor liability (attritional and large), Motor Other and Household. Loss ratios and historic variability are used to calibrate loss distributions outside of ML large. For ML large, TU's own data, combined with market data and expert judgement are used to calibrate the frequency and severity of large losses. The above distributions are then combined using correlation matrices to produce a premium risk distribution.

Catastrophe Risk (Natural and Man-Made):
TU's exposure is fed into an external catastrophe model. This is used to generate a number of natural catastrophe losses in different locations and with different impacts. Man-made losses are generated from a study into historic man-made CAT losses. Reinsurance is calculated in line with the relevant programmes for each of the losses generated from the above simulations. The results from CAT risk are combined using a correlation matrix.

Each of Reserve Risk, Premium Risk and Catastrophe Risk are combined using a correlation matrix to arrive at an overall distribution for Insurance risk within the PIM.

The parameterisation of the model is driven largely by TU's own experience on shorter tailed classes of business. The policy and claims data used within the model parameterization is of good quality and is fit for purpose. For the submissions done during the reporting period under consideration, it was ensured that the data feeding into the PIM and SCR calculation has been reviewed in detail by Finance before each of quarterly and annual submissions.

The PIM is governed by TU's Model Control Board (MCB) and validated by an external independent validation team. The MCB assesses the appropriateness of models and methodologies and ensures compliance with the Solvency II regulations and any terms and conditions imposed by TU's regulators (PRA). The PRA approved solo PIM will continue to be governed by TU's MCB and be validated by external validators from the change in control to 100% Tesco Bank.

The adverse development cover reinsurance contains a benefit of £9.0 as at 28 February 2022.The Quota Share cover has a £8.9m benefit.

TU uses the Standard Formula for market risk, counterparty default risk and operational risk, having determined that this is appropriate for the business. The combination of the risks and non-life underwriting risk is done using the same correlation matrix as the Standard Formula in for the period ending 28 February 2022.

E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement (unaudited)

There is no non-compliance with either the Minimum Capital Requirement or the Solvency Capital Requirement.

E.5.1 Capital contingency plan

TU operates a Capital Contingency Plan which gives the business guidance on actions / considerations at different SII capital coverage levels. For example, TU successfully implemented its Capital Contingency Plan in the first quarter of 2017 following the announcement of the reduction in the Ogden discount rate from 2.5% to minus 0.75% on 27th February 2017. Together with 2017 profitability and the implementation of additional reinsurance this increased TU's coverage from 101% to 169% at the end of 2017.

E.5.2 Other information regarding capital management (unaudited)

For the period ending 28th February 2022 TU had SII own funds of £180.6m. With the TU SCR PIM at £121.1m this resulted in capital coverage of 149.1%.

E.6 Any other information

There is no other additional information.

Appendix
ANNUAL QUANTITATIVE REPORTING TEMPLATES (QRTS)

S.02.01.02
Balance sheet

	Solvency II value
Assets	C0010
Goodwill	
Deferred acquisition costs	
Intangible assets	
Deferred tax assets	7,352
Pension benefit surplus	
Property, plant & equipment held for own use	197
Investments (other than assets held for index-linked and unit-linked contracts)	607,780
Property (other than for own use)	0
Holdings in related undertakings, including participations	0
Equities	0
Equities - listed	
Equities - unlisted	
Bonds	584,680
Government Bonds	57,280
Corporate Bonds	525,745
Structured notes	0
Collateralised securities	1,655
Collective Investments Undertakings	0
Derivatives	
Deposits other than cash equivalents	0
Other investments	23,100
Assets held for index-linked and unit-linked contracts	
Loans and mortgages	0
Loans on policies	0
Loans and mortgages to individuals	
Other loans and mortgages	
Reinsurance recoverables from:	268,073
Non-life and health similar to non-life	224,133
Non-life excluding health	224,133
Health similar to non-life	0
Life and health similar to life, excluding index-linked and unit-linked	43,941
Health similar to life	0
Life excluding health and index-linked and unit-linked	43,941
Life index-linked and unit-linked	0
Deposits to cedants	0
Insurance and intermediaries receivables	11,014
Reinsurance receivables	13,926
Receivables (trade, not insurance)	0
Own shares (held directly)	0
Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
Cash and cash equivalents	64,500
Any other assets, not elsewhere shown	3,097
Total assets	975,939

S.02.01.02
Balance sheet

	Solvency II value
	C0010
Liabilities	
Technical provisions - non-life	541,082
Technical provisions - non-life (excluding health)	541,082
TP calculated as a whole	0
Best Estimate	520,612
Risk margin	20,471
Technical provisions - health (similar to non-life)	0
TP calculated as a whole	0
Best Estimate	0
Risk margin	0
Technical provisions - life (excluding index-linked and unit-linked)	104,602
Technical provisions - health (similar to life)	0
TP calculated as a whole	0
Best Estimate	0
Risk margin	0
Technical provisions - life (excluding health and index-linked and unit-linked)	104,602
TP calculated as a whole	0
Best Estimate	90,342
Risk margin	14,260
Technical provisions - index-linked and unit-linked	0
TP calculated as a whole	0
Best Estimate	0
Risk margin	0
Other technical provisions	
Contingent liabilities	
Provisions other than technical provisions	
Pension benefit obligations	
Deposits from reinsurers	122,477
Deferred tax liabilities	
Derivatives	
Debts owed to credit institutions	
Financial liabilities other than debts owed to credit institutions	
Insurance & intermediaries payables	272
Reinsurance payables	557
Payables (trade, not insurance)	24,900
Subordinated liabilities	42,333
Subordinated liabilities not in BOF	
Subordinated liabilities in BOF	42,333
Any other liabilities, not elsewhere shown	1,410
Total liabilities	837,633
Excess of assets over liabilities	138,306

S.05.01.02

Premiums, claims and expenses by line of business

Non-life

	Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)			Total
	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	
	C0040	C0050	C0070	C0200
Premiums written				
Gross - Direct Business	225,265.19	52,839.98	68,488.42	346,593.59
Gross - Proportional reinsurance accepted				0.00
Gross - Non-proportional reinsurance accepted				0.00
Reinsurers' share	143,819.65	0.00	7,093.51	150,913.16
Net	81,445.54	52,839.98	61,394.91	195,680.43
Premiums earned				
Gross - Direct Business	227,034.77	53,255.07	62,224.09	342,513.92
Gross - Proportional reinsurance accepted				0.00
Gross - Non-proportional reinsurance accepted				0.00
Reinsurers' share	142,204.85	0.00	6,968.65	149,173.50
Net	84,829.91	53,255.07	55,255.44	193,340.42
Claims incurred				
Gross - Direct Business	121,304.74	62,829.18	39,904.14	224,038.06
Gross - Proportional reinsurance accepted				0.00
Gross - Non-proportional reinsurance accepted				0.00
Reinsurers' share	98,494.71	0.00	1,113.60	99,608.31
Net	22,810.02	62,829.18	38,790.54	124,429.74
Changes in other technical provisions				
Gross - Direct Business				0.00
Gross - Proportional reinsurance accepted				0.00
Gross - Non-proportional reinsurance accepted				0.00
Reinsurers' share				0.00
Net	0.00	0.00	0.00	0.00
Expenses incurred	43,076.65	10,104.40	18,350.82	71,531.87
Other expenses				
Total expenses				71,531.87

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

Life

	Line of Business for: life insurance obligations	
	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Total
	C0260	C0300
Premiums written		
Gross		0.00
Reinsurers' share		0.00
Net	0.00	0.00
Premiums earned		
Gross		0.00
Reinsurers' share		0.00
Net	0.00	0.00
Claims incurred		
Gross	(3,321.47)	(3,321.47)
Reinsurers' share	(484.10)	(484.10)
Net	(2,837.37)	(2,837.37)
Changes in other technical provisions		
Gross		0.00
Reinsurers' share		0.00
Net	0.00	0.00
Expenses incurred	0.00	0.00
Other expenses		
Total expenses		0.00

S.12.01.02
Life and Health SLT Technical Provisions

	Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Total (Life other than health insurance, incl Unit-linked)
	C0090	C0150
Technical provisions calculated as a whole		0
Technical provisions calculated as a sum of BE and RM		
Best estimate		
Gross Best Estimate	90,342	90,342
Total recoverables from reinsurance/SPV and Finite Re before the adjustment for expected losses due to counterparty default	43,941	43,941
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	43,941	43,941
Best estimate minus recoverables from reinsurance/SPV and Finite Re	46,401	46,401
Risk margin	14,260	14,260
Amount of the transitional on Technical Provisions		
Technical Provisions calculated as a whole		0
Best estimate		0
Risk margin		0
Technical provisions - total	104,602	104,602
Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total	60,661	60,661

S.17.01.02
Non-Life Technical Provisions

	Direct business and accepted proportional reinsurance			Total Non-Life obligation
	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	
	C0050	C0060	C0080	C0180
Technical provisions calculated as a whole	0	0	0	0
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole				0
Technical provisions calculated as a sum of BE and RM				
Best estimate				
Premium provisions				
Gross - Total	80,984	27,054	30,088	138,125
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	32,230	17,721	4,184	54,134
Net Best Estimate of Premium Provisions	48,754	9,333	25,904	83,991
Claims provisions				
Gross - Total	358,330	(6,209)	30,365	382,487
Total recoverable from reinsurance/SPV and Finite Re before the adjustment for expected losses due to counterparty default	171,704	(3,753)	2,048	169,998
Net Best Estimate of Claims Provisions	186,626	(2,456)	28,318	212,488
Total best estimate - gross	439,314	20,845	60,453	520,612
Total best estimate - net	235,380	6,877	54,222	296,479
Risk margin	14,282	697	5,492	20,471
Amount of the transitional on Technical Provisions				
TP as a whole				0
Best estimate				0
Risk margin				0
Technical provisions - total	453,596	21,542	65,945	541,082
Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total	203,933	13,968	6,231	224,133
Technical provisions minus recoverables from reinsurance/SPV and Finite Re- total	249,662	7,574	59,714	316,950

S.19.01.21
Non-Life insurance claims

Total Non-life business

Accident year / underwriting year | Accident year

Gross Claims Paid (non-cumulative)
(absolute amount)

	C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0170	C0180
Year					**Development year**							**In Current**	**Sum of years**
	0	1	2	3	4	5	6	7	8	9	10 & +	**year**	**(cumulative)**
Prior											794,295	6,505	794,295
-9	175,965	84,670	29,605	21,028	18,115	8,047	836	1,200	298	0		298	339,764
-8	170,382	65,345	28,613	26,132	15,150	8,930	1,972	710	0			710	317,234
-7	158,082	65,206	21,877	19,341	20,648	7,577	8,643	0				8,643	301,373
-6	151,071	54,990	32,248	19,264	18,963	10,147	0					10,147	286,683
-5	134,629	51,805	20,439	24,782	9,046	0						9,046	240,700
-4	133,013	54,742	19,415	16,280	0							16,280	223,451
-3	122,445	44,257	19,085	0								19,085	185,787
-2	83,969	38,000	0									38,000	121,968
-1	113,477	0										113,477	113,477
0	8,721											8,721	8,721
											Total	230,911	2,933,453

Gross Undiscounted Best Estimate Claims Provisions
(absolute amount)

	C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0300	C0360
												Year end
Year					**Development year**							**(discounted**
	0	1	2	3	4	5	6	7	8	9	10 & +	**data)**
Prior											1,135,677	14,358
-9	202,571	122,200	73,504	36,110	19,738	5,524	5,346	2,800	1,545	0		1,478
-8	172,504	101,389	63,124	54,399	39,131	8,903	9,293	2,083	0			1,939
-7	154,694	75,677	93,645	47,050	20,278	12,438	7,756	0				7,084
-6	155,233	158,162	79,108	57,957	38,178	18,168	0					16,575
-5	162,779	103,067	61,917	26,040	10,927	0						9,276
-4	162,385	100,941	54,118	44,035	0							40,158
-3	148,302	111,780	81,198	0								76,029
-2	133,043	84,587	0									77,248
-1	112,964	0										105,262
0	34,063											33,078
											Total	382,487

S.23.01.01
Own Funds

Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
	C0010	C0020	C0030	C0040	C0050
Ordinary share capital (gross of own shares)	129,668	129,668		0	
Share premium account related to ordinary share capital	0	0		0	
Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
Subordinated mutual member accounts	0		0	0	0
Surplus funds	0	0			
Preference shares	0		0	0	0
Share premium account related to preference shares	0		0	0	0
Reconciliation reserve	1,286	1,286			
Subordinated liabilities	42,333		42,333	0	0
An amount equal to the value of net deferred tax assets	7,352				7,352
Other own fund items approved by the supervisory authority as basic own funds not specified above	0	0	0	0	0
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds					
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	0				
Deductions					
Deductions for participations in financial and credit institutions	0				
Total basic own funds after deductions	180,639	130,954	42,333	0	7,352
Ancillary own funds					
Unpaid and uncalled ordinary share capital callable on demand	0				
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0				
Unpaid and uncalled preference shares callable on demand	0				
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
Other ancillary own funds	0				
Total ancillary own funds	0			0	0
Available and eligible own funds					
Total available own funds to meet the SCR	180,639	130,954	42,333	0	7,352
Total available own funds to meet the MCR	173,287	130,954	42,333	0	
Total eligible own funds to meet the SCR	180,639	130,954	32,739	9,595	7,352
Total eligible own funds to meet the MCR	171,886	130,954	32,739	8,194	
SCR	121,127				
MCR	40,968				
Ratio of Eligible own funds to SCR	149.13%				
Ratio of Eligible own funds to MCR	419.56%				

Reconciliation reserve	C0060
Excess of assets over liabilities	138,306
Own shares (held directly and indirectly)	0
Foreseeable dividends, distributions and charges	
Other basic own fund items	137,019
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0
Reconciliation reserve	1,286
Expected profits	
Expected profits included in future premiums (EPIFP) - Life business	
Expected profits included in future premiums (EPIFP) - Non- life business	
Total Expected profits included in future premiums (EPIFP)	0.00

S.25.02.21

Solvency Capital Requirement - for undertakings using the standard formula and partial internal model

Unique number of component	Component description	Calculation of the Solvency Capital Requirement	Amount modelled	USP	Simplifications
C0010	C0020	C0030	C0070	C0090	C0120
50101I	Premium risk (Attritional)	25,262.05		9	
50102I	Premium risk (Large Losses)	11,604.51		9	
50201I	Reserve risk	46,957.52		9	
50301I	Non-life catastrophe risk (CAT NAT)	65,190.49		9	
50302I	Non-life catastrophe risk (CAT Man Made)	5,238.09		9	
50401I	Non-life lapse risk	1,229.88		9	
59901I	Diversification within non-life underwriting risk	(62,712.39)		9	
10200I	Interest rate risk up	7,178.36		9	
10400I	Equity risk	0.00		9	
10600I	Property risk	5,878.18		9	
10700I	Spread risk	26,931.66		9	
10800I	Concentration risk	278.64		9	
10900I	Currency risk	0.00		9	
19900I	Diversification within market risk	(9,125.51)		9	
20100I	Type 1 counterparty credit risk	5,953.87		9	
20200I	Type 2 counterparty credit risk	5,215.52		9	
20300I	Diversification within counterparty credit risk	(718.12)		9	
70100I	Operational risk	17,402.59		9	
80300I	Loss absorbing capacity of deferred taxes	(7,010.29)		9	

Calculation of Solvency Capital Requirement	C0100
Total undiversified components	144,755.06
Diversification	(23,628.37)
Adjustment due to RFF/MAP nSCR aggregation	
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	
Solvency capital requirement excluding capital add-on	121,126.69
Capital add-ons already set	
Solvency capital requirement	121,126.69
Other information on SCR	
Amount/estimate of the overall loss-absorbing capacity of technical provisions	
Amount/estimate of the overall loss-absorbing capacity of deferred taxes	(7,010.29)
Capital requirement for duration-based equity risk sub-module	
Total amount of Notional Solvency Capital Requirements for remaining part	
Total amount of Notional Solvency Capital Requirement for ring fenced funds	
Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	
Diversification effects due to RFF nSCR aggregation for article 304	

Approach to tax rate	C0109
Approach based on average tax rate	Yes

Calculation of loss absorbing capacity of deferred taxes

	LAC DT
	C0130
Amount/estimate of LAC DT	(7,010.29)
Amount/estimate of LAC DT justified by reversion of deferred tax liabilities	
Amount/estimate of LAC DT justified by reference to probable future taxable economic profit	(7,010.29)
Amount/estimate of AC DT justified by carry back, current year	
Amount/estimate of LAC DT justified by carry back, future years	
Amount/estimate of Maximum LAC DT	

S.28.01.01

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

Linear formula component for non-life insurance and reinsurance obligations	C0010
MCR_{NL} Result	39,994

	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
	C0020	C0030
Medical expense insurance and proportional reinsurance	0	
Income protection insurance and proportional reinsurance	0	
Workers' compensation insurance and proportional reinsurance	0	
Motor vehicle liability insurance and proportional reinsurance	235,380	80,629
Other motor insurance and proportional reinsurance	6,877	35,608
Marine, aviation and transport insurance and proportional reinsurance	0	
Fire and other damage to property insurance and proportional reinsurance	54,222	54,989
General liability insurance and proportional reinsurance	0	
Credit and suretyship insurance and proportional reinsurance	0	
Legal expenses insurance and proportional reinsurance	0	
Assistance and proportional reinsurance	0	
Miscellaneous financial loss insurance and proportional reinsurance	0	
Non-proportional health reinsurance	0	
Non-proportional casualty reinsurance	0	
Non-proportional marine, aviation and transport reinsurance	0	
Non-proportional property reinsurance	0	

Linear formula component for life insurance and reinsurance obligations	C0040
MCR_L Result	974

	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
	C0050	C0060
Obligations with profit participation - guaranteed benefits		
Obligations with profit participation - future discretionary benefits		
Index-linked and unit-linked insurance obligations		
Other life (re)insurance and health (re)insurance obligations	46,401	
Total capital at risk for all life (re)insurance obligations		

Overall MCR calculation	C0070
Linear MCR	40,968
SCR	121,127
MCR cap	54,507
MCR floor	30,282
Combined MCR	40,968
Absolute floor of the MCR	3,126
Minimum Capital Requirement	40,968