UNAUDITED SOLVENCY AND FINANCIAL CONDITION REPORT

PINNACLE INSURANCE PLC

Company Registration Number: 1007798
Financial Conduct Authority Firm reference number: 110866

At 31 December 2021

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SUMMARY

The information in this report relates to Pinnacle Insurance plc ("the Company"). The Company is a subsidiary of Cardif Pinnacle Insurance Holdings plc (the "UK Parent"), a member of the BNP Paribas Cardif group, which is part of the global banking group BNP Paribas SA ("the Group"), a European leader in banking and financial services, with a Standard and Poor's long-term rating of A+ (Stable outlook). The Group operates in 65 countries and employs 190,000 people.

The Company was formed in 1971 as a provider of personal lines insurance, principally within the UK. The Company underwrites Pet, Creditor, Warranty and GAP.

In September 2021, the Board agreed to fully reinsure all non-pet business to Darnell DAC (a wholly owned subsidiary of the BNP Paribas Group authorised by the Central Bank of Ireland) effective from 31 December 2021.

In October 2021, BNP Paribas Cardif announced the formation of joint business venture (JV) with JAB Holdings to build a top three position in Pet healthcare and insurance services covering UK, EMEA and Latam. JAB Holdings will set up a holding company which will purchase 100% of the share capital of the Company and its fellow subsidiary Cardif Pinnacle Insurance Management Services Ltd (CPIMS). The ownership structure of the JV will be: JAB Holdings 70% and BNP Paribas Cardif 30%. This transaction is subject to regulatory approval of the change of control, and is anticipated to complete in Q2 2022.

The report covers the Solvency & Finance Condition Report (SFCR) of the Company as a Solo entity and provides information on its Solvency i.e. the Company's ability to pay liabilities.

The information in this report is from the Company's most recent financial year, which is the year ended 31 December 2021.

The Company is authorised by the Prudential Regulation Authority (PRA), and jointly regulated by the Financial Conduct Authority (FCA) and the PRA.

The following is a high-level description of the contents of each section in this document.

A. Business and performance
This section describes the Company's performance and significant events during the year, legal structure, how the Company is regulated and who the Company auditors are.

B. System of governance
This section outlines the Company's system of governance and risk management, and how the Company is managed and controlled. It also describes the Company's Human resources policy and practices, and its adherence to the 'Fit and Proper Requirements'.

C. Risk profile
This section describes the Company's risk profile, including risk exposures, concentrations, mitigation and sensitivity.

D. Valuation for solvency purposes

This section describe the bases and methods used for the valuation of the Company's assets, technical provisions and other liabilities with an explanation of any major differences in the bases and methods used for the SII valuations, compared to the International Financial Reporting Standards (IFRS) basis used for the 2021 Annual Report and Accounts.

E. Capital management

This section describes the Company's approach to capital management, and includes information on the amount and quality of the Company's own funds.

The Company's capital position as at 31 December 2021 is as follows:

	2021	2020
	£'000	£'000
Eligible own funds	136,724	135,494
Solvency capital requirement (SCR)	73,032	68,734
Capital Surplus	63,692	66,760
Ratio of Eligible own funds to the SCR	187%	197%

The Company has a strong capital position with solvency capital surplus of £63.7m (2020: £66.8m) in excess of its solvency capital requirement. The Company's eligible own funds increased by £1.2m due to a decrease in the Solvency II valuation differences offset by the IFRS loss and movement in deferred tax.

The SCR increased from £68.7m to £73.0m between 2020 and 2021. This increase is mainly driven by the non-life underwriting risk component of SCR resulting from an increase in Pet policies.

The Company's capital management policy is to maintain sufficient own funds to cover a minimum 120% of the Solvency Capital Requirement (SCR). The Company calculates its SCR using the Standard Formula under Solvency II requirements.

Impact of the UK's departure from the EU (Brexit)

There continues to be uncertainty with Financial Services provision between the United Kingdom and the European Union (EU), particularly with regard to reform of the Solvency II regime and equivalence with the EU. As these might affect the Company developments are being monitored carefully.

Impact of Covid-19 in the UK

The effect of the Covid 19 pandemic, specifically the invocation of the remote working model, has had a significant impact on a number of processes, which were assessed and remediated where appropriate. Throughout the pandemic, the Company has maintained the level of service its customers require and has continued to meet its regulatory obligations.

As the Company planned, during 2021, for a post lock-down environment, staff welfare remained the primary consideration. A phased and flexible return to the office was implemented, with the focus on returning to the office with purpose and without compromising employee safety. Managers have continued to seek feedback from employees to ensure wellbeing remains a focus.

The Crisis Management Team (CMT) has continued to operate and to provide a focus for monitoring and responding to any future UK Government proposals.

Climate change

Financial risks from climate change do not currently represent a material risk to the company. The Executive Management and subject matter experts use the Risk Register review process to review climate related risks and have concluded that no material physical or liability financial risks from climate change could arise from the current business model and operations. Business continuity is assessed as a low risk with no material impact from climate and weather related events (through disruption to the work environment or disruption to supply chains).

In view of the existing business model, financial risks from climate change are only likely to arise as transition risks i.e. asset devaluation as a consequence of climate change factors. Transition financial risks from climate change are assessed as being more likely to arise from a reduction in asset values due to the impact from climate change. The company monitors exposure to climate change factors through the application of Group and BNP Paribas Cardif policies relating to SRI (Social Responsible Investments) and ESG (Environmental, Social & Governance) are reviewed by the Investment Committee (a sub-committee of the Board).

Basis of preparation

In line with the Company's previous SFCRs, this document is a Solo SFCR for the Company. There are two key bases for measuring and reporting solvency, which can be used under the SII regime during the UK transition period:

- the 'Standard Formula' and
- an 'Internal Model'.

The figures disclosed in the Company's SII reporting, including this document, are prepared using the Standard Formula. The Board considers that the Standard Formula delivers an SCR that is prudent and appropriate for the Company having regard to the size and the complexity of the business.

The report makes reference to the Company's Annual Report and Accounts which can be accessed from the Company's website at http://www.cardifpinnacle.com/about/reports. Information in the Annual Report and Accounts is prepared in accordance with International Financial Reporting Standards (IFRSs); whereas information in this report is governed by Solvency II rules. Important differences include valuation methodologies for assets, technical provisions and other liabilities. Therefore the numbers, including financial, in this report will not always correspond to in the Annual Report and Accounts.

A M Wigg
Chief Executive Officer
6th April 2022

DIRECTORS' REPORT

Directors

The Directors who held office throughout the year (unless stated otherwise) were:

G Binet (resigned 9 February 2022)
M Haderer (resigned 17 November 2021)
N D Rochez *
R A Hines * (Chairman) +
A M Wigg
M J Lorimer
S L P F Chevalet
S M Luton +
H E Rennie +

* Independent Non-Executive Director
+ Subject to regulatory approval

Statements of Directors' Responsibilities

The Directors are responsible for preparing the Solvency Financial Condition Report, including the attached public quantitative reporting templates, in all material respects in accordance with PRA Rules and the Solvency II Regulations.

The Solvency II Directive, the Delegated Acts, related Implementation Rules, Technical Standards and Guidelines as transposed into the PRA rulebook, as well as PRA rules provide the regulatory framework in which the Company operates. The Solvency II rules and regulations include, but are not limited to, the recognition and measurement of its assets and liabilities including Technical Provisions and Risk Margin, the calculation of its capital requirement and the reporting and disclosures of the Solvency II results.

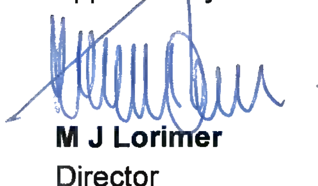
Compliance with the Solvency II framework

The Company has complied in all material respects with the requirement of the PRA Rules and Solvency II regulations as applicable throughout the financial year 2021. The Company reasonably believes that it will comply with PRA rules and Solvency II regulations subsequently and will continue to comply for the foreseeable future.

Audit

The Company is exempt from external audit requirement of the SFCR for the year ended 31 December 2021 based on qualifying score of being less 100. The calculations are based on the guidelines published in the PRA consultation paper CP8/18.

Approved by the Board on 6th April 2022 and signed on its behalf by:



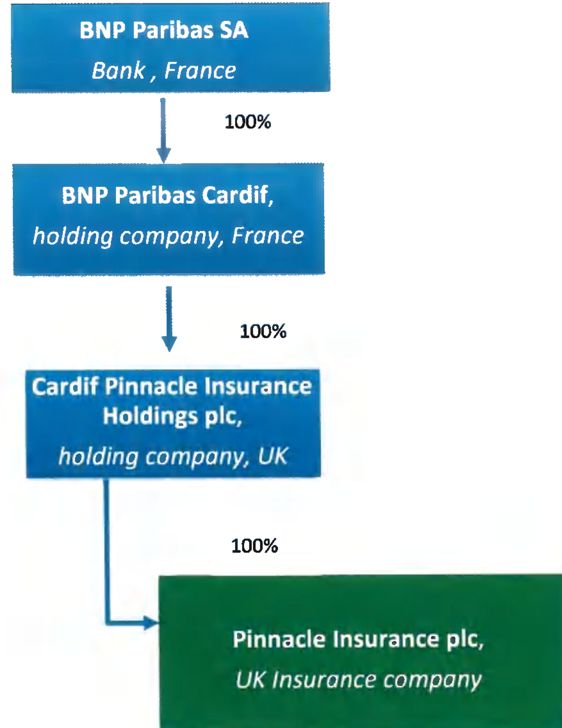
M J Lorimer
Director

A. BUSINESS AND PERFORMANCE

A.1 Business

Pinnacle Insurance plc ("the Company") is a limited company incorporated in 1971 in the United Kingdom. The registered address of the Company is Pinnacle House, A1 Barnet Way, Borehamwood, Hertfordshire, WD6 2XX.

Simplified legal group structure



The Directors regard BNP Paribas SA (incorporated in France), as being the Company's ultimate parent undertaking and the controlling party, and Cardif Pinnacle Insurance Holdings plc (incorporated in the United Kingdom) as being the immediate parent undertaking.

BNP Paribas Cardif, a holding company, is the head of the insurance group for Solvency II purposes and therefore, results of the Company are also consolidated in the insurance group SFCR.

Supervision and External Audit

Pinnacle Insurance plc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

www.bankofengland.co.uk/pra
www.fca.org.uk

The Company's statutory annual financial statements are audited by Deloitte LLP who can be contacted as follows: Deloitte LLP, 2 New Street Square, London, EC4A 3BZ.

A.2 Underwriting performance

The Company reported a pre-tax loss of £6.9m (2020: loss of £9.6m), the result has been reduced by the reinsurance of non pet which resulted in a reduction in the Technical Result of £0.9m along with a further reduction of £3.9m due to the write off of DAC on the non pet business, excluding the impact of the non pet reinsurance the loss was £2.1m.

Company's key performance indicators	2021	2020
	£'000	£'000
Gross Written Premiums	107,350	86,830
Net Earned Premiums	67,633	57,637
Technical Result	18,627	10,567
Investment Return	56	2,940
Administration Expenses	(25,569)	(23,095)
(Loss) / Profit Before Tax	(6,886)	(9,589)
Technical Ratio	74%	95%
Claims Ratio	44%	74%
Commission Ratio	29%	21%

Gross Written Premiums (GWP): represents the total premiums written in a given year before deductions of reinsurance and ceding commission and is analysed as:

GWP by line of business	2021	2020	Change
	£'000	£'000	Increase/ (decrease)
Pet	83,263	64,167	19,096
Creditor	14,162	15,527	(1,365)
Motor Warranty and GAP	8,808	6,713	2,095
Household and Motor (MGA)	(4)	(6)	2
	106,229	**86,401**	**19,828**
Inward reinsurance	719	-	719
	106,948	**86,401**	**20,547**
Long-term business	403	429	(26)
Gross written premiums	**107,350**	**86,830**	**20,520**

GWP increased in the year by £20.5m (24%) due to the growth of the Pet business offset by the continued and expected decrease in Creditor:

- Pet GWP increased by 30% to £83.3m (2020 £64.2m) mainly due to growth in business from partnership arrangements;
- Creditor business decreased by 9% to £14.2m (2020: £15.5m). The sale of new Creditor products has ceased and all intermediary business is in run-off. This portfolio was reinsured 100% to Darnell DAC from December 31st 2021;

- Motor warranty and GAP increased by 31% to £8.8m (2020: £6.7m). The growth was driven by a new GAP partnership with a leading car manufacturer which ceased at the end of 2021. This portfolio was reinsured 100% to Darnell DAC from December 31st 2021;
- Household and Motor MGA business ran off during 2016. This business is now closed and there are no more policies on risk. This portfolio was reinsured 100% to Darnell DAC from 31 December 2021;
- Inward Reinsurance business resulted from the Company's reinsurance of a debt waiver benefit provided by a third party insurer for contracts written for a six month period in 2020;
- Long-term business which includes business underwritten for mortgage loan protection, leasing creditor and standard of living guarantee income products. This business is in run-off with GWP at £0.4m in 2021 (2020: £0.4m). This portfolio was reinsured 100% to Darnell DAC from December 31st 2021.

The Company's business entirely relates to one geographical market (United Kingdom).

Net Earned Premiums (NEP): represents the portion of the policy's premium that applies to the expired portion of the policy. The reinsurance treaty for the non-pet business reduced NEP by £26.5m excluding this NEP increased by £36.5m due to the growth of Pet £37.7m, partly offset by a decrease on Creditor and Motor Warranty.

Technical Result: represents the balance of earned income less incurred claims, commission and profit share payments, net of associated reinsurance balances. The technical result has been impacted by a loss on the reinsurance treaty with Darnell DAC of £4.8m of which £3.9m is the write off of Deferred Acquisition costs on the non-pet business. Excluding the impact of the reinsurance with Darnell DAC the Technical Result was £23.4m.

Technical Ratio: reflects the profitability of the general business before direct and indirect costs and is calculated as the sum of commission and net incurred claims expressed relative to NEP. The technical ratio decreased to 74% (2020: 95%). Excluding the impact of the reinsurance to Darnell DAC the Technical Ratio was 80%, the reduction in 2021 being due to the impact if unemployment claims reserved at the end 2020.

Claims Ratio: Calculated as net claims incurred expressed as a percentage of NEP. The claims ratio in 2021 decreased to 44% (2020: 74%) due to reinsurance out of non-pet business claims reserves to Darnell DAC. Excluding the impact of the reinsurance to Darnell DAC the Claims Ratio was 50%

Commission Ratio: Commission incurred expressed as a percentage of NEP. The Commission ratio in 2021 was 29% (2020: 21%). As a result of the reinsurance of the non-pet portfolio at the end of 2021, all Deferred Acquisition Costs for non-pet were written off, excluding this the commission ratio was 24%.

A.3 Investment performance

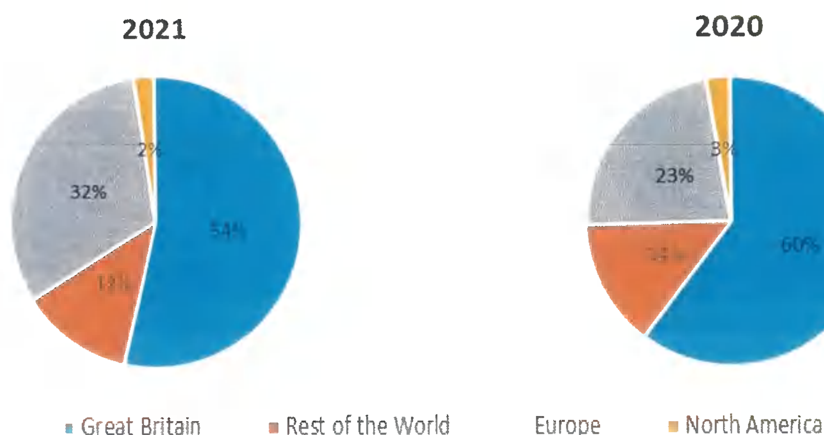
Investment income represents income arising from the Company's investment portfolio including the impact of marked to market revaluations and realised losses on investments.

The investment portfolio comprises bonds, cash and term deposits of high credit quality. The total portfolio was valued at £137.7m at 31 December 2021 (2020: £179.6m) of which 37% (2020: 29%) was held in bonds, 52% (2020: 51%) in term-deposits with credit institutions and 11% (2020: 19%) in cash and cash equivalents.

Total net investment return for the year is £0.1m (2020: £2.9m) which comprises interest earned on financial investments of £2.2m (2020: £2.9m), realised loss on bonds of £1.2m (2020: gain £0.1m) and unrealised loss of £1.0m (2020: £0.1m).

	2021		2020	
By assets class	Investments	Return on investments	Investments	Return on investments
	£'000	£'000	£'000	£'000
Bonds	51,232	(850)	52,782	1,507
Deposits	71,810	904	92,263	1,430
Cash at bank	14,697	3	34,545	3
Total	**137,739**	**57**	**179,590**	**2,940**

The chart below provides geographical split of the investments as follows:



A.4 Performance of other activities

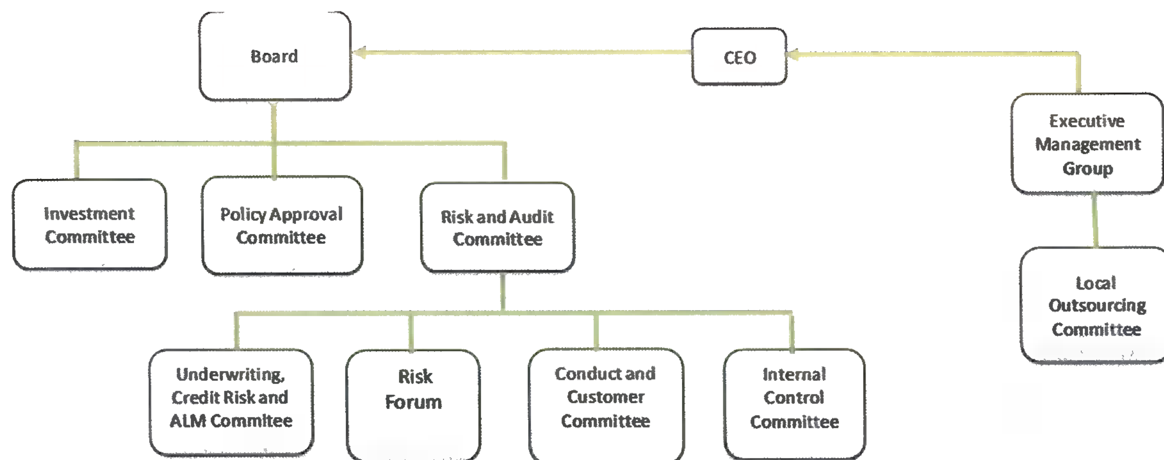
Administration expenses represent those operating expenses incurred by the Company, which are not classified as either acquisition or claims handling costs. Administration expenses increased by £2.5m to £25.6m (2020: £23.1m), £0.5m of the increase is due to the net impact of provision and accrual releases in 2020. Aside from this, expenses increased by £2.0m, this increase was due to a number of factors including international initiatives, the transfer of staff from fellow subsidiary BNP Paribas Cardif Limited to the Company's service company Cardif Pinnacle Insurance Management Services PLC and higher volumes.

A. SYSTEM OF GOVERNANCE

B.1 General Information on the system of governance

The Company's Board comprises Directors and Non-Executive Directors who are responsible to the shareholder and other stakeholders for ensuring that the Company is appropriately managed and achieves its objectives. The Board met six times in 2021 to determine the Company's strategic direction, review operating and financial performance, and to ensure that the Company is adequately resourced and effectively controlled.

The Company's governance regime is summarised as follows:



The following Board members were the holders of significant management functions during the year (unless stated otherwise):

Name	Function	Description of a controlled function
Andrew Wigg	SMF1	Chief Executive Officer
	SMF 20	Chief Actuary
Marie Haderer **	SMF 23	Chief Underwriting Officer
Matthew Lorimer	SMF 16	Compliance Oversight
	SMF 17	Money Laundering Reporting Officer (MRLO)
Sophie Luton	SMF 2	Chief Finance Officer
Gerard Binet ***	SMF 9	Chair of Governing Body
	SMF 10	Chair of the Risk Committee
Richard Hines *	SMF 11	Chair of the Audit Committee
Nik Rochez * +	SMF 12	Chair of the Human Resources Committee
Stanislas Chevalet	SMF 7	Group Entity Senior Manager

* Independent non-Executive Director
** Held SMF functions until 22.07.2021 resigned from Board 17.11.2021
***Resigned from the Board 22.02.2022, application for R Hines for SMF 9 submitted on same date
+ SMF 12 Withdrawn 15.12.2021

Risk and Audit Committee (RAC)

The RAC is chaired by an independent Non-Executive Director. Its main responsibilities are to:

- assist the Board in meeting its oversight responsibilities in ensuring an effective system of internal control, reporting process, audit process, compliance and accurate external financial reporting;
- provide a channel of communication to the Board for the internal and external auditors;
- receive reports and review the output from the Group's Risk Management Function internal control framework and risk management, systems and procedures including the four key functions under Solvency II and systems and controls relating to financial reporting;
- have oversight of the work of the Internal Controls Committee (ICC), Conduct and Customer Committee (CCC), Underwriting and Credit & ALM Risks Committee (UCAR) and Risk Forum and to receive minutes and verbal updates in respect of the above mentioned Committees.
- receive reports from the Compliance Function including the follow-up of any outstanding recommendations, the impact of new and possibly evolving regulations and review any reports on compliance issues including all material reports to Regulators;
- review and approve the annual plan of the Risk Management Function and the annual Compliance Monitoring Plan, oversee its realisation and results and report to the Board on the sufficiency and quality of resource within the Risk Management and Compliance Departments;
- review and approve such of the Group's Policies as shall be delegated to the Committee by the Board to ensure that operations, policies and procedures comply with relevant law and regulations, industry codes and requirements of the BNP Paribas Group as appropriate;
- advise the Board on risk related matters including policy, strategy and implementation for each area of risk namely: Operational; Strategic, Conduct, Market Integrity, Financial, Investment, Liquidity, Credit and Insurance;
- review the firm's most significant risks on the Risk Register, monitor management's response to any major risk issues, and escalate to the Board as considered appropriate;
- review annually on behalf of the Board the proposed risk appetites and tolerances having regard to any group wide risk appetites that BNP Paribas Cardif (BNPPC) wishes PIC to consider or apply;
- receive reports on the work of the Risk Forum; and

Policy Approval Committee

The Committee is chaired by a Director and reports to the Board. It reviews and approves all policies that require Board approval only. The Committee's main responsibilities are to:

- ensure all policies are reviewed and approved annually and have sufficient discussion and debate;
- ensure the policies align with and are reflective of any policies covering the same subject matter issued by BNP Paribas or BNP Paribas Cardif;
- ensure all approved policies are communicated to and adopted by the relevant business areas.

Investment Committee

The Committee is chaired by the Chief Executive Officer and reports to the Board. It meets on a quarterly basis and its main responsibilities are to:

- ensure asset exposures do not exceed the limits set in the investment policy;
- maximise investment return within the risk framework of the investment policy and regulatory requirements; and
- agree investment returns to be used for future investments, new products types, constraints of asset duration, constraints on credit rating, counterparties and removal of counterparties' restrictions.

Conduct and Customer Committee (CCC)

The Committee is chaired by a Director and reports to the RAC. It reviews and provides direction on the Company's Conduct Risk strategy, including overseeing all product governance controls and reviews, and provides direction on the development of products. The Committee's main responsibilities are to identify, assess and report on key Conduct Risks faced by the Company, specifically to:

- promote and encourage a corporate culture that ensures the recognition of Conduct Risk and the fair treatment of customers;
- continue to encourage the development, analysis and use of further Conduct Risk Indicators (CRI) or other management information and to ensure the CRI measures are constantly challenged;
- ensure that staff appropriately record Conduct Risk issues including the findings and resulting outcome using an agreed process or system such as (but not limited to) Incident Reporting Treating Customers Fairly (TCF) and Root Cause Analysis ("RCA") database;
- demonstrate a positive attitude and company-wide commitment to fair treatment of customers;
- review issues brought to the CCC and make recommendations that are in the best interests of the customer and ensure those recommendations are acted upon as required; and
- monitor and maintain an understanding of developments in the market, regulatory and legal environments that may impact on the Conduct Risk framework, and to research and highlight industry best practice.

Risk Forum

The Chief Executive Officer chairs this committee. It meets at least four times per year and reports to the RAC. The Risk Forum's focus on prudential regulations includes overseeing Solvency II quarterly, annual returns and Own Risk and Solvency Assessment (ORSA) runs. The Risk Forum also reviews the ORSA triggering events and monitors performance against risk appetite tolerances.

Internal Control Committee (ICC)

The ICC is chaired by a Director and reports to the RAC. Its main responsibilities are to:

- oversee the risk management culture in the Company;

- identify, assess and report on key non-financial risks faced by the Company including those relating to outsourced activities (in accordance with the Group Guidance "Control of Risks Associated with Outsourced Processes");
- review the effectiveness of the internal control and compliance arrangements;
- update the Company's Risk Register on a regular basis;
- establish effective systems of internal control and reporting for key risks, appropriate to the size, nature and complexity of the Company;
- establish effective systems of compliance appropriate to the size, nature and complexity of the Company;
- monitor the performance of all suppliers of outsourced activities (operational performance, quality indicators and technical monitoring including KPIs & SLAs); and
- monitor the performance of security and business continuity by review of security incidents, test and exercises, critical IT risks and recommendations in progress.

Underwriting, Credit Risk and Asset Liability Management Committee (UCAR)

This Committee is chaired by the Head of Actuarial – Closing and Risk and reports to the RAC. It meets quarterly and the Committee's main responsibilities are to:

- provide effective risk monitoring and risk follow up for all the key underwriting, credit and ALM risks, including stress test and sensitivity analysis when relevant, and guarantee the escalation process (alert system) to the Risk & Audit Committee (RAC);
- review the underwriting, credit risks, ALM risks, and the related risk mitigation techniques set out in the risk map, once per year;
- review the new products that could materially change the Company's risk profile, prior to product launch and provide an opinion as part of the approval process;
- review the adequacy of the reinsurance programme as part of the risk mitigation techniques;
- review the underwriting and credit risk monitoring procedures and the Underwriting policy at least once per year, and propose any changes to the RAC;
- report any appropriate ALM risk to the Investment Committee.

Local Outsourcing Committee (LOCC)

This Committee is chaired by a Director. It reports into the Executive Management Group which reports to the Board.

The Committee's main responsibilities are to:

- review the risk position of the outsourcing;
- ensure that any proposed outsourcing delivers benefits that outweigh risks;
- review potentially severe incidents on outsourced running activities;
- review all inputs relating to the supervision of outsourced activity;
- oversee the invocation of exit plans;
- ensure relevant controls are in place.

B.2 "Fit and proper" requirements

The Company applies the "Fit and Proper Requirement" criteria laid down by the FCA and PRA in the appointment of controlled function holders including those individuals encompassed in the Senior Managers & Certification Regime (SM&CR).

The Company assesses individuals' fitness and propriety by giving consideration to their:

- financial soundness;
- honesty, integrity and reputation;
- competence and capability.

The Company employs the following procedures to assess "fit and proper":

- compliance with the applicable PRA Conducts Standards and FCA Conduct Rules;
- compliance with internal policies and procedures;
- disclosure and barring service (DBS) checks;
- annual performance reviews and assessments;
- self-attestation annually; and
- references completed by a candidate's previous employer.

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

The Board has overall responsibility for the establishment and oversight of the risk management framework. The Risk and Audit Committee (RAC) oversees how management monitors compliance with risk management policies and procedures and reviews the adequacy of the risk management framework.

The RAC is assisted in its oversight role by Internal Audit, which undertakes both regular and ad-hoc reviews the results of which are reported to the RAC.

Risk management policies and procedures are established to identify and analyse the risks faced by the Company, to set appropriate risk appetites and limits, and to identify, measure, record, manage and report on existing and emerging risks, so that they can be managed within Board-approved risk appetites.

Risk management policies and systems are reviewed at least annually to ensure that they remain effective and appropriate for the management of the Company's risks.

The Company, through its training and management standards and procedures, aims to maintain a disciplined and constructive control environment in which all employees understand their roles and responsibilities.

Own Risk and Solvency Assessment (ORSA)

In line with Solvency II, the Company is required to assess its solvency at least every 12 months, by conducting an Own Risk & Solvency Assessment (ORSA). Risk profile changes are monitored by the Risk Forum through review of risk appetite limits.

The Risk Forum also reviews the occurrence (and ongoing relevance) of ORSA triggering events and reports to the RAC on any material changes. If a triggering event occurs, the Risk Forum will inform

the Board who will consider whether a requirement to re-run the ORSA has arisen.

The ORSA is conducted in accordance with the Board's ORSA policy. The Board and RAC provide guidance to the process, e.g. by setting the stress and scenario tests to be used in the ORSA, requiring amendments to the ORSA content, etc. The Board receives updates from the Risk Forum through the RAC (setting out work completed, key tasks and deliverables, etc.) and together with the RAC reviews, approves the draft ORSA content and drafting. The Board challenges as it deems fit and will approve the final version for publication.

B.4 Internal control framework

The Board has the overall responsibility for maintaining the systems of internal control of the Company and for monitoring their effectiveness, while the implementation of internal control systems is the responsibility of the executive management. The Company's systems of internal control are designed to manage the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurance against material financial misstatement or loss. The systems are designed to:

- safeguard assets;
- maintain proper accounting records;
- provide reliable financial information;
- identify and manage business risks;
- maintain compliance with appropriate legislation and regulation; and
- identify and adopt best practice.

The Company has an established governance framework, the key features of which include:

- a Corporate Governance manual including matters reserved for the Board and Terms of Reference for each of the Board's Committees;
- a clear organisational structure, with documented delegation of authority from the Board to executive management;
- a policy and procedures framework, which sets out risk management and control standards for the Company's operations; and
- defined procedures for the approval of major transactions.

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. The Company's risk management and control framework is designed to support the identification, assessment, monitoring, management and control of risks that are significant to the achievement of its business objectives. The Company has a set of formal policies that govern the management and control of both financial and non-financial risks.

The Board regularly reviews the effectiveness of the Company's systems of internal control. Where weaknesses were identified as part of the control review, mitigating actions have been taken or plans put in place. These are monitored by the appropriate Committee on behalf of the Board.

B.5 Internal Audit function

The Company has outsourced its Internal Audit function to BNP Paribas Group which has a centralised independent internal audit function, which provides assurance to the Risk and Audit Committee and to the Board as to the effectiveness of Company's internal systems and controls, making recommendations and monitoring progress against those recommendations as appropriate.

Findings may contain recommendations, which will include agreed actions for closure that are deemed to have been completed only once Internal Audit is satisfied with them.

The RAC agrees the audit schedule set out by Internal Audit. Where required, the schedule is adjusted in consultation with the RAC to address new or emerging risks. This might be the case if the RAC or Board wants a particular area of the Company's operations to be reviewed, perhaps in response to external drivers such as new regulations.

B.6 Actuarial function

The Company has an in-house Actuarial team which carries out a day-to-day actuarial role, including claims reserving. The formal role of the actuarial function under Article 48 of the Solvency II Directive as transposed into the PRA rulebook is to report formally to the Board on technical provisions, reinsurance and underwriting policy.

B.7 Compliance

The Company has an in-house Compliance function that reports on a hierarchical basis to the BNP Paribas Cardif Compliance function and on a functional basis to a Director to identify relevant legislative, regulatory and Group requirements. The Compliance function is responsible for ensuring the Company implements the necessary arrangements, systems and controls so as to facilitate adherence to these obligations.

The RAC agrees the annual Compliance monitoring schedule and all findings from the periodic reviews are reported to the RAC. The findings may contain recommendations which are monitored and closed by the Compliance function.

B.8 Outsourcing

This section of the report details the outsourcing arrangements for the Company's critical or important outsourced activities.

The outsourcing role is carried-out by one full-time employee. However, Subject Matter Experts are drawn from across all functions.

Before an activity is outsourced, the Company conducts a comprehensive pre-outsourcing assessment of the potential outsource provider in line with BNP Paribas Cardif Group procedures and the Board approved Policy. This is performed by staff from the key areas of the business. Each assessment is specific to both the activities being outsourced and the potential outsource provider.

The results of the pre-outsourcing assessment are reviewed by senior management to assess the balance between risk and reward in respect of the potential outsourcing as well as determining the likely effectiveness of the control of those activities, once outsourced.

Once an activity has been outsourced, the Company applies post-outsourcing controls and governance in order to ensure that the outsource provider remains suitable and that all risks associated with that outsourcing are managed effectively.

A number of critical activities are outsourced across a number of schemes, including, fulfilment, policy administration, premium collection, claim handling and internal audit.

B.9 Any other information

There is no other information to disclose.

C. RISK PROFILE

The Company's activities expose the business to a number of key risks, which have the potential to affect the Company's ability to achieve its business objectives. The Board is responsible for ensuring that an appropriate structure for managing these risks is maintained. The key risks and risk mitigation framework are highlighted below:

C.1 Underwriting risk

The non-life underwriting risk is the main component of the Company's risk profile, representing 89% of the solvency capital requirement at the end of 2021 (2020: 89%).

Non-life underwriting risks mainly relate to the premium and reserve risk accounting for 49% after diversification (2020: 53%) and the catastrophe risk representing 46% (2020: 42%), the remaining 5% arising from lapse risk (2020: 5%).

The premium and reserve risk arises from the premium exposure and the development of outstanding unsettled claims at year end.

The Gross of Reinsurance non-life exposure relates to:

- primarily the Miscellaneous line of business with 79% of the non-life exposure (2020: 70%) comprising unemployment risk and Pet health insurance;
- the Motor liability, General liability and Fire lines of business with 8% of exposure (2020: 19%) comprising motor insurance cover and household for claims outstanding mainly; and
- the other Motor line of business with 10.4% of exposure (2020: 9%) corresponding to Motor warranty products.

Catastrophe risk arises from infrequent shock events that give rise to large numbers of claims or large individual claims and mostly relates to the Pet insurance, and unemployment risk cover (on Gross basis only).

Lapse risk quantifies the impact of policyholders terminating their contracts earlier than expected. This risk remains relatively small for the Company due to the short-term nature of the products it currently underwrites (most of which being monthly or annual policies), which limits the period over which adverse changes in customer behaviours can apply.

The Company's exposure to underwriting risk on Pet health insurance cover has increased with business growth expected in 2022 triggering a substantial increase in catastrophe risk.

On the creditor book, the Company's underwriting risk profile relates mainly to the risk inherent to unemployment and temporary disability. The exposure is reducing in line with the business volumes but the Company continues to be exposed to the economic impacts of Brexit and Covid-19 on unemployment.

The Company's Motor and household exposure to risks ceased at the end of 2016. However, the Company continues to be exposed to the development of some historic claims (reserving risk) and notably for large bodily injury Motor claims.

The Company's annuity and assurance book is in run-off leading to a continuously decreasing exposure to longevity risk.

For the other lines of business, the exposure to catastrophe risk for life or health related risks is limited.

As of 31/12/2021, following the introduction of quota share reinsurance treaty with Darnell DAC, our Net of Reinsurance non-life exposure is zero on all non-Pet business, meaning that Miscellaneous line of business covers almost 100% of the net non-life exposure (with <0.1% exposure on general liability relating to pet third party liability).

The Company adopts the following to mitigate these risks:

- Underwriting policy, risk tolerance and pricing and reserving procedures;
- Reinsurance (proportional and non-proportional) notably on annuity and assurance life book and large motor claims;
- Re-pricing when deemed necessary;
- Risk monitoring dashboards and risk monitoring committee; and
- External review of reserves.

C.2 Market risk

Market risk is the risk that the Company is adversely affected by movements in the value of its financial assets arising from market movements.

The Company is mainly exposed to interest rate risk, concentration risk and spread risk. Concentration risk arises with exposures on the same counterparty over a certain threshold and spread risk arises from the change in credit spread over the risk-free interest rate term structure.

The Company is exposed to interest rate risk. This risk exists for all investment assets, best estimate liability and best estimate ceded reinsurance liability which are sensitive to changes in term structure of interest rate.

The Company has a low risk appetite for market risk, which has been translated into a policy allowing the Company to invest predominantly in short-term bonds or cash to match the short-tail nature of most of its claims. The risk is managed by the Investment Committee.

C.3 Credit / Counterparty risk

The Company's exposure to credit risk arises from its direct insurance trading activities, the exposure to the reinsurance it purchases and those of its investment activities. The risk is the risk of default arising from any of these exposures.

The primary source of credit risk for the Company is:

- Investments portfolio including deposits, cash and cash equivalents;
- Amounts due from reinsurer; and
- Amounts due from insurance intermediaries.

Investment activities

The Company, through the Board and the Investment Committee, seeks to limit, as far as is practical, exposure to credit risk from its investment activities. The investment credit risk managed through established guidelines and procedures. The Company's investment policy prescribes the investments limits and credit quality of the investments, which are monitored and reviewed by the Investment Committee on quarterly basis.

The Company maintains a low risk, high quality investment portfolio with exposure concentrated in bonds, bank deposits and cash. The table below provides IFRS investment portfolio by credit quality:

Investment portfolio by credit quality	2021		2020	
	£'000	%	£'000	%
AAA	15,053	11%	10,952	6%
AA-	39,164	28%	38,012	21%
A+	27,484	20%	51,326	29%
A	38,737	28%	37,371	21%
A-	17,300	13%	28,572	16%
BBB+	-	0%	13,358	7%
	137,739	**100%**	**179,590**	**100%**

Concentration of credit risk exists where the Company has significant exposure to an individual counterparty or a group of counterparties. As at 31 December 2021, the Company has £15.3m investment with a single issuer with a credit rating of "A+" with a duration of 2 months. The single party exposure is within the Company's prescribed investment policy limit.

Reinsurance risk

The Company manages the risk through the use of preferred reinsurers. No reinsurance counterparty has a rating lower than BBB+.

The highest exposure to single reinsurance counterparty is £27.0m (2020: £23.7m) rated A-.

The best estimate ceded reinsurance liability under IFRS basis as at 31 December 2021 is £71.7m, of this £26.7m is due to the reinsurance of non-pet with Darnell DAC, (2020: £44.6m) and £63.1m (2020: £42.2m) under Solvency II basis. The difference is due to valuation approaches under two basis (see section D (e)).

Insurance debtors and other receivables

The Company regularly reviews receivables, the collectability of these receivables and adequacy of associated impairment. Outstanding premiums receivables balances are monitored by the business operations team on a monthly basis, as a minimum. Concentration risk is also monitored for large partners/brokers.

The carrying value of the insurance and other receivables at 31 December 2021 is £62.9m (2020: £48.4m) net of bad debts provisions of £nil (2020: £nil). The value of these receivables under Solvency II basis is £25.1m (2020: £20.3m). See section D for detail on the valuation differences.

The Company mitigates its credit risk and risk concentration as follows:

- individual counter-party risk assessment using Standard & Poor's rating assigned to each counterparty;
- credit and concentration risk limits relating to cash, short term deposits and bond investments are defined in the Investment policy. The Company has a very low risk appetite for any default by counterparties with whom deposits are placed and will not place funds with counterparties whose S&P credit rating is lower than BBB- or lower rated investments;
- selection of reinsurance counterparties from a pre-approval list or for new approvals according to actuarial governance framework;
- monies held in trust accounts (or in segregated accounts); and
- contractual audit rights and rights to terminate contracts due to the failure of counterparties to perform agreed duties including the right to set-off.

C.4 Liquidity risk

Liquidity risk is the risk that sufficient financial resources are not available in cash to enable the Company to meet obligations as they fall due. The Company mitigates liquidity risk in the following ways:

- The Company maintains a strong liquidity position by holding its assets predominantly in investment grade fixed income securities, call accounts and readily tradable corporate bonds; and
- The Company prepares forecasts to predict the required level of liquidity levels both for short-term and medium-term and adjusts the assets accordingly.

The tables below analyses the liquid resources available to meet Company's liabilities as they fall due:

As at 31 December	2021	1 Year	2-3 Years	4-5 Years	Over 5Years	2020
Highly liquid resources	£'000	£'000	£'000	£'000	£'000	£'000
Financial investments	123,041	53,422	40,250	20,358	9,011	145,045
Cash & cash equivalents	14,697	14,697	-	-	-	34,545
	137,738	**68,119**	**40,250**	**20,358**	**9,011**	**179,590**
Expected liabilities						
Gross insurance liabilities	70,517	25,181	7,484	2,342	35,510	81,027
Other payables	14,833	14,833	-	-	-	12,925
	85,350	**40,014**	**7,484**	**2,342**	**35,510**	**93,952**
Surplus funds	**52,388**	**28,105**	**32,766**	**18,016**	**(26,499)**	**85,638**

The table above shows the Company has surplus funds of £52.4m (2020: £85.6m) when gross liabilities are taken into account with a projected deficit over 5 years of £26.5m. The deficit is a timing difference

between financial investments maturity profiles against expected liabilities during the 5 year period, furthermore the company reinsured all non pet liabilities with effect from year end 2021 therefore on a net basis the Company's liabilities are £27m overall.

With regard to liquidity risk, the Expected Profit Included in the Future Premium ("EPIFP") means the expected present value of future cash-flow which results from the inclusion in technical provisions of premium relating to existing insurance contracts that are expected to be received in the future. The increase in EPIFP from last year is mainly a reflection of the economies of scale that are materialising from the Company's initial upfront investment made on the Pet business line.

As at 31 December	Unaudited 2021	Unaudited 2020
	£'000	£'000
EPIFP	4,098	1,344

C.5 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, human or system errors, or from external events.

Operational risks are usually more difficult to quantify ex ante therefore their materiality is assessed using a severity / impact scoring approach. This allows risks to be ranked in order of their potential impact and enables risk management to focus on those risks warranting the greatest attention.

The Company is exposed to the following material operational risks:

- Impact of Covid-19 on operational processes: The effect of the pandemic, specifically the invocation of the remote working model has had a significant impact on a number of processes as we adapted to a remote working model. Throughout the periods of lockdown, a comprehensive re-assessment of the key processes, resources and suppliers has been carried out to identify the best way to provide continuity of service to customers.

- Cyber Risk: The increasing reliance on IT systems and internet based customer facing platforms means that businesses are more susceptible to data security (Cyber Risk) issues. A comprehensive Information Security Framework has been adopted by the company, including clear policies, procedures and governance for managing Cyber Risk. This framework is subject to regular review and maintenance to ensure it remains an effective control against known and emerging Cyber Risk.

- IT Failure: The increasing reliance on IT systems and internet based facing platforms to service customers means businesses are more susceptible to IT Failure risks. To mitigate this risk, the company has implemented an IT Governance Framework that provides policies and procedures for managing the risk of all applications, hardware and software within the IT estate.

- Insufficient Resource: The risk of not having sufficient or experienced staff within the company may lead to a failure of the key processes. This is mitigated through the application of a capacity management and planning process, a comprehensive succession planning process, a companywide training and development programme and a Human Resources control framework.

The Company manages operational risk through a framework of robust systems and controls which includes:

- Internal committees reviewing and reporting material operational risks;
- Incident reporting system: This is used by staff for reporting any operational incidents which are reviewed by the Business Risk and Controls Department placing appropriate preventive and corrective actions in place;
- Risk and Control Self Assessment (RCSA): A Company wide operational risk assessment is undertaken annually to identify key process based operational risks. This assessment is supported by incident management, procedure assessments and control evaluations. The results are discussed by the Company executive management group;
- Corporate level risk register: the risk owners report on their most material risks and their evolution; and
- Risk reports are sent to the RAC, which in turn reports to the Board: Reports are regularly submitted on operational, compliance and legal risks.

Regulatory Risk: The Company is required to comply with the requirements of the Prudential Regulation Authority and Financial Conduct Authority. Regulatory risk is the risk of loss owing to a breach of regulatory requirements or failure to respond to regulatory change. The Regulatory Risk is managed by the Risk and Compliance teams to ensure legislative and regulatory changes are identified understood and observed.

C.6 Risk sensitivities

The Company has identified the following stress scenarios and assessed the impact of these scenarios on its solvency position:

Scenario 1: Default of the Company's largest reinsurance exposure at 31 December 2021 amongst all such exposures with a credit rating of A[i1] or lower and not subject to any collateral contract, which the Company considered would materialise in an instant loss equal to the amount of the reinsurance exposure after expected liquidation recoveries (40% recovery according the Solvency II standard parameters for such credit rating), leading to an increase in the Company's net liabilities and its reserve risk SCR capital requirement as a result, together with a (relatively smaller) second-order reduction in Counterparty default risk SCR.

The stress scenario would trigger a £1.3m increase in the Company's net BEL (directly reducing own funds) combined with a net £0.1m increase in SCR.

[1] Standard & Poor's or equivalent credit rating

Scenario 2: New variants of feline leukaemia virus (Cats) and canine distemper virus (Dogs) emerge for which current vaccines are not effective. The diseases spread in particular regions in the UK (e.g. London) affecting 5% of pets in those regions. The viruses contaminate 1% of the total cats and dogs insured by the Company in the UK, at an average cost per treatment of £350 per pet.

The stressed scenario would trigger an increase in BEL of £0.7m partly mitigated by profit share (directly reducing own funds) and no SCR movement.

Considering both scenarios, the Company's solvency ratio remains above 180%.

D. VALUATION FOR SOLVENCY PURPOSES

D.1 Assets

The following table summarises the assets held by the Company as at 31 December 2021 with analysis of the differences between Solvency II and IFRS valuation rules:

Total Assets	Notes	2021 IFRS	Adjustment for Solvency purpose	Unaudited 2021 Solvency II	Unaudited 2020 Solvency II
		£'000	£'000	£'000	£'000
Financial investments	D.1 (a)	123,041	10,161	133,202	171,044
Reinsurance assets	D.1 (b)	71,733	(8,672)	63,061	42,236
Insurance and other receivables	D.1 (c)	62,984	(37,779)	25,205	18,952
Cash and cash equivalents	D.1 (d)	14,697	(9,900)	4,797	9,045
Deferred acquisition Costs	D.1 (e)	5,446	(5.446)	-	-
Deferred tax asset		-	1,121	1,121	3,105
Total Assets		**277,901**	**(50,515)**	**227,386**	**244,382**

Solvency II Directive and Delegated Regulation (EU) 2015/35 as transposed into the PRA rulebook generally provides for undertakings to recognise and value assets and liabilities other than technical provisions in accordance with the International Financial Reporting Standards ("IFRS") adopted by the European Commission in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, except where this is not consistent with Article 75 of the Solvency II Directive.

The valuation principles applied between each material asset class are explained below:

D.1 (a) Financial investments: The Company's financial investments comprise bonds and term-deposits which are analysed below:

Financial investments	2021 IFRS	Reclassification for Solvency purpose	Unaudited 2021 Solvency II	Unaudited 2020 Solvency II
	£'000	£'000	£'000	£'000
Corporate bonds	21,658	209	21,867	41,207
Government bonds	29,574	52	29,627	12,076
Investments funds	-	9,900	9,900	25,500
Deposits with credit institutions	71,809	-	71,809	92,262
Total	**123,041**	**10,161**	**133,202**	**171,045**

Adjustment for Solvency II purposes represents reclassification of:

- Highly liquid deposit of £9.9m (2020: £25.5m) into Solvency II balance category of "Investment Fund" which is held within cash and cash equivalents under IFRS basis; and
- Accrued interest of £0.3m (2020: £0.5m) is recognised in the valuation of 'investments' on the Solvency II balance sheet, but held within 'other assets' on the IFRS balance sheet. The amount is split between Corporate, Government bonds and Deposits with credit institutions as appropriately required.

Under the IFRS basis, financial assets, which also include financial investments, are classified into the following specified categories:

- financial assets at fair value through profit or loss (FVTPL);
- held to maturity investments;
- available-for-sale financial assets; and
- loans and receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. The Company designates its corporate bonds and government bonds at fair value through profit or loss which is valued using quoted market prices at the period end date provided by recognised pricing sources.

Deposits with credit institutions are classified as loans and receivables which carry fixed payments that are not quoted in the active market. These are measured at amortised cost under IFRS.

The Solvency II valuation rules for financial investments are consistent and in line with those applied in the IFRS financial statements.

D.1 (b) Reinsurance assets: These were valued at £71.3m under IFRS and £63.1m under Solvency II resulting in a (£8.7m) Solvency II valuation difference (2020: £2.4m).

The table below provides the difference between the IFRS and Solvency II carrying values:

Reinsurance assets	2021 IFRS	Valuation differences (IFRS vs. SII)	Unaudited 2021 Solvency II	Unaudited 2020 Solvency II
	£'000	£'000	£'000	£'000
Non-life excluding health	30,966	(6,238)	24,729	16,640
Health similar to non-life	3,789	159	3,948	-
Life excluding health	36,978	(2,593)	34,385	25,596
Total Assets	**71,733**	**(8,672)**	**63,061**	**42,236**

The valuation difference of (£8.7m) between IFRS basis to Solvency II basis arises from:

- the de-recognition of premium asset receivables arising from annual policies payable monthly, ceded to reinsurance which are annualised in the IFRS balance sheet, £2.0m;
- the de-recognition of the commission element booked within the IFRS unearned premium reserve ceded to reinsurance, but not booked as ceded IFRS deferred acquisition costs for non-Pet reinsured business, £6.7m; and the recognition of the margin included in the Company's IFRS claims provisions £7.9m and premium provisions £0.8m ceded to reinsurance;

Mainly, offset by the following factors:

- the provision for extra expenses, primarily overheads, within Solvency II provisions ceded to reinsurance (£4.0m);
- the reclassification of loss-absorbing element of profit share payables into technical provisions under Solvency II ceded to reinsurance (£3.6m),
- an allowance for events not in data (or ENID) representing potential adverse developments in the Company's large bodily injury outstanding motor claims ceded to reinsurance (£1.3m); and
- different discount rates used to convert future cash-flows in today's monetary value (£0.3m); and
- other factors with less material contributions (-£0.5m combined).

The recoverable from reinsurance contracts are £63.1m (2020: £42.2m). The significant increase in recoverable is driven by the introduction of a new quota share reinsurance treaty on Darnell DAC heavily impacting non-Pet business.

The valuation difference resulted in a decrease in the carrying value of the reinsurance assets and is reflected in the reconciliation reserves (see section E.1).

D.1 (c) Insurance and other receivables: value as at the year-end is £62.9m (2020: £48.5m) under IFRS and £25.1m (2020: £19.0m) under Solvency II. The total valuation difference is £37.8m made up of:

- Insurance receivables of £33.9m (2020: £29.0m);
- Receivables (trade, not insurance) of £3.6m (2020: nil); and
- Accrued interest of £0.3m (2020: £0.5m).

- In accordance with Solvency II guidelines, premium cash flows falling due after the valuation date are recognised within technical provisions, and premiums due at the valuation date are recognised as an asset. Hence, the valuation difference of £33.9m is allowed for in the Solvency II BEL calculations as future inflows within the premium provisions. The valuation difference of £3.6m relates to the reclassification of loss-absorbing element of reinsurance profit share receivable under Solvency II.

The impact of the adjustments are reflected in the reconciliation reserves to offset against the valuation difference between IFRS and Solvency II technical provisions. (See note E.1).

Accrued interest of £0.3m held as part of other receivables under IFRS is reclassified within corporate bonds, government bonds and deposits with credit institutions for Solvency II purposes.

Other elements within other receivables including amounts due from group undertakings and prepayments are considered a close approximation to the fair value due their short-term nature.

D.1 (d) Cash and cash equivalents: Cash and cash equivalents comprise cash in hand and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of a change in value.

Under IFRS, cash and cash equivalents are £14.7m (2020: £34.5m) which have reduced to £4.8m (2020: £9.0m) due to a reclassification of a highly liquid deposit of £9.9m (2020: £25.5m) into Solvency II balance category of “Investment Fund".

The Solvency II valuation rules for cash and cash equivalents are consistent and in line with those applied in the IFRS financial statements.

D.1 (e) Deferred acquisition costs (DAC): Under IFRS, the acquisition costs should be deferred commensurate with the unearned premiums provisions. The deferred acquisition costs (DAC) are separately presented as an asset in the IFRS balance sheet. However, under Solvency II, the DAC of £5.4m (2020: £8.1m) is valued as nil as it is included in the premiums provisions valuation (part of Solvency II best estimates) and therefore not included as an asset.

D.2 Technical provisions

Technical provisions are valued in accordance with Article 77 of the Solvency II Directive as transposed into the PRA rulebook which states that the value of technical provisions shall be equal to the sum of a Best Estimate Liabilities (BEL) and the risk margin. The technical provisions as at 31 December 2021 were:

Balance Sheet Extracts –Technical provisions As at 31 December	Unaudited 2021	Unaudited 2020
	£'000	£'000
Technical provisions – non-life (excluding health)		
Best Estimate	35,872	55,357
Risk margin	4,472	10,421
Technical provisions - health (similar to non-life)		
Best Estimate	3,9487	3,456
Risk margin	16	157
Technical provisions – life		
Best Estimate	34,385	27,778
Risk margin	447	350
TECHNICAL PROVISIONS INC. BEST ESTIMATE OF LIABILITIES – SOLVENCY II	**79,138**	**97,518**
TECHNICAL PROVISIONS IFRS	**121,259**	**120,255**

IFRS technical provisions: comprises unearned premium reserves, claims outstanding and long-term business provisions, increased from £120.3m to £121.3m in 2021 due to:

- Unearned premium reserve: increased by £11.5m from £39.3m in 2020 to £50.7m in 2021 mainly due to a significant increase in Pet, £7.0m and Motor warranty and GAP insurance, £4.6m offset by a reduction in Creditor of £0.2m.

- *Claims outstanding:* decreased by (£5.2m) from £49.5m in 2020 to £44.3m in 2021 largely due to:

  - Release of Covid-19 unemployment related claims and decrease in the safety margin on Creditor business of £9.7m;
  - Motor warranty and GAP insurance reserve, release £0.2m;
  - Reduction in Claims handling expenses of £0.7m, offset by;

  - Pet reserve increase of £4.7m, in line with business growth;
  - Motor reserve increase of £0.3m; and
  - Household reserve increase of £0.4m.

- <u>Long-term Business Provision:</u> The long-term business provision consists mainly of annuities in payment which are c. 97% reinsured. The gross of reinsurance provision has decreased by (£5.3m) to £26.2m (2020: £31.5m) over 2021 with reducing exposure and reducing life expectancy.

Solvency II technical provisions against IFRS: decreased by £42.2m (2020: increased by £22.2m) from £121.3m to £79.1m under Solvency II, which is explained by the combination of the main following factors:

- the de-recognition of premium asset receivables arising from annual policies payable monthly, which are annualised in the IFRS balance sheet and of deferred acquisition costs not permitted under Solvency II (£33.9m and £0.1m respectively excluding up-front commissions that have already been paid, totalling £34.0m combined);
- the de-recognition of the commission element booked within the IFRS unearned premium reserve but not booked as IFRS deferred acquisition costs for non-Pet reinsured business, £6.7m;
- the recognition of the margin included in the Company's IFRS claims provisions £9.2m and premium provisions £0.8m;
- an allowance for expected profits in future premiums within Solvency II provisions £4.1m; and

Mainly, offset by the following factors:

- the provision for extra expenses, primarily overheads, within Solvency II provisions (£4.3m);
- the reclassification of the £3.6m loss-absorbing element of profit share payables into technical provisions under Solvency II, net of the absorbency of £1.0m earlier technical losses available to offset projected technical profits (£2.6m),
- an allowance for (events not in data or ENID) representing potential adverse developments in the Company's large bodily injury outstanding motor claims (£1.3m);
- different discount rates used to convert future cash-flows in today's monetary value (£0.3m);
- the addition of the Solvency II risk margin reflecting the cost of capital (£4.9m); and
- other factors with less material contributions (-£0.4m combined).

Solvency II technical provision against prior year: comprise best estimates claims provisions, premium provisions and the risk margin net of reinsurance. The technical provisions before reinsurance decreased by £18.4m from £97.5m to £79.1m in 2021 are explained by:

- <u>Best estimate claims provisions:</u> decreased by £10.9m from £48.5m to £37.6m, mostly driven by the growth in Pet £2.7m, decrease outstanding claims reserves on the Creditor book primarily due to the favourable experience in unemployment claims by £7.6m, and the run-off of the motor book (£6.5m across life and non-life risks).

- <u>Best estimate premium provisions (for unexpired risks):</u> decreased by £1.5m from £38.1m to £36.6m, mainly explained by anticipated increase in exposure on Motor warranty £3.4m, reduction in Creditor exposure of £1.0m, upward movement of the risk-free yield curve implying

a decrease on the Company's annuity products of £2.3m and improved performance on Pet business resulting in reduction of £1.5m.

- Risk margin: The risk margin calculated is £4.9m (2020: £10.9m) and represents 6.2% (2020: 11.2%) of the overall gross technical reserves. The decrease captures mainly the reduction of the risk net of reinsurance following Darnell DAC quota share introduction and the increase in discount yields.

The BEL is the sum of the claims provision BEL (valuation of IFRS claims reserves run-off under Solvency II standards) and the premium provision BEL (arising from future events).

The gross technical provisions by Solvency II lines of business are set out in the table below:

By line of business	Unaudited 2021			Unaudited 2020		
	Best estimate	Risk margin	Total	Best estimate	Risk margin	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Medical expense	-	-	-	(1)	1	-
Income protection	3,948	16	3,963	3,456	156	3,613
Motor vehicle liability	12,343	198	12,541	27,408	7,332	34,740
Other motor	6,960	10	6,970	3,472	90	3,562
Fire & other damage to property	1,412	-	1,412	1,052	23	1,076
General liability	638	2	640	286	3	288
Miscellaneous financial loss	14,518	4,282	18,780	23,140	2,972	26,112
Non-life	**39,819**	**4,487**	**44,306**	**58,813**	**10,578**	**69,391**
Annuities stemming from non-life	8,721	368	9,090	-	-	-
Other life	25,664	78	25,742	27,778	350	28,127
Life	**34,385**	**446**	**34,832**	**27,778**	**350**	**28,127**
TOTAL TECHNICAL PROVISIONS	**74,204**	**4,934**	**79,138**	**86,591**	**10,927**	**97,518**

In the above table:

- The gross BEL for miscellaneous financial loss line of business is £14.5m (2020: £23.1m), comprises Pet and PPI unemployment risks, together representing 37% (2020: 39%) of the Company's overall non-life BEL;
- The gross BEL for motor liability is £12.3m (2020: £27.4m) representing 31% (2020: 47%) of the non-life BEL. As the activity on motor ceased in 2015, this only includes outstanding claims;
- The line of business "Fire and other damage to property" mostly relates to household insurance for a gross BEL of £1.4m (2020: £1.1m); and

- The life long term fund BEL is £34.4m (2020: £27.8m) representing 46% of the total BEL (2020: 32%). Large outstanding bodily injury claims that have settled in 2021 as a periodical payment

orders (PPO) have been transferred from the motor vehicle liability line to the annuities stemming from non-life line, for a total gross BEL of £8.7m.

D.2 (a) Description of method used for technical provision assessment

Assessment of the Best Estimate Liabilities

The liability cash flow projections are assessed using deterministic based and best estimate assumptions.

For annuities and assurances products, the projections are made for each individual policy in line with the financial statement methodology. For the other lines of business (Non-life and Health), the projections are made by homogeneous risk groups. The cash flows taken into account for the purpose of the projections are:

- future premiums arising from existing contracts at the projection start date;
- claims payable (arising from outstanding claim reserve, unearned premium reserve and future premium on existing contracts);
- commissions and profit share payable to intermediaries;
- overheads (including claims management cost and administration costs); and
- recoverable from reinsurance.

Assessment of the reinsurance recoverable

The best estimates are calculated gross of reinsurance and without deduction of amounts recoverable from reinsurance contracts.

The amounts recoverable are calculated separately, following the same principles as presented for the best estimate and consistently with the contract liability term of the underlying policies covered and the reinsurance contract term. The result is then adjusted to take account of expected losses due to default of the counterparty. This adjustment is based on the probability of default of the reinsurance counterparty based on its rating.

The above adjustment is applicable only on Pet business. Pinnacle is protected on any credit risk on this reinsurance via a collateral agreement whereby Darnell DAC place an amount equivalent to the initial reinsurance premium (SII BEL + Risk Margin) into a custodian account. So reinsurance credit risk adjustment is set to zero for all non-Pet business.

Assessment of Risk Margin

The risk margin is assessed as the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirement (SCR) necessary to support the insurance obligations over their lifetime. It is calculated as 6% of the present value of the projected SCR at the end of each year. The SCR is assessed based on year end using drivers for each component based on the run off risk profile of the portfolio.

D.2 (b) Uncertainty associated with the amount of technical provisions

There is uncertainty arising from the projection method (deterministic approach).

For non-Life projections, there is uncertainty related to the grouping of insurance and reinsurance obligations on a limited number of homogeneous risk group for liabilities arising from future premiums. However this risk is limited due to the short projection horizon of future premium.

D.2 (c) Material differences with financial statements valuation

For the purpose of the valuation of the BEL claims, the approach between Solvency II and the statutory accounts are aligned. The statutory accounts best estimate claims outstanding reserves are used as the basis for future payment projections. The differences are limited to the use of an annual payment pattern combined with the application of a risk-free discount rate and the introduction of Events Not In Data (ENID).

Compared to the financial statements, the future cash flows arising from premium exposure at the end of the financial year (unearned premium reserve and expected future premium generated by the monthly premium product cover up to their contractual liabilities terms) are taken into account.

With the exception of annuities and assurance products, the future claims payments are estimated using a loss ratio approach applied to the premium exposure.

D.2 (d) Details on key assumptions

The key assumptions used in the projection are the following:

- future loss ratios;
- discount rate;
- best estimate mortality table; and
- overheads projected.

Overheads

The overheads are projected using two main components: administration costs and claims management expenses.

The overheads projections are based on the detailed analysis of 2021 costs structure taking into account expected future inflation.

Loss ratio

The loss ratio used for the purpose of BEL premium assessment is calibrated using a tailor made study for most material homogeneous risk group and based on past months experience for others.

D.3 Other liabilities

The table below provides total liabilities analysis including other liabilities as at 31 December 2021 of £11.5m (2020: £11.4m).

Liabilities as at 31 December	Notes	Unaudited 2021 Solvency II	Unaudited 2020 Solvency II
		£'000	£'000
Technical provisions incl. best estimate of liabilities (BEL)	D.2	**79,138**	**97,518**
Insurance & intermediaries payables		6,725	6,179
Insurance payable-reinsurance operations		210	141
Amounts owed to group undertakings		703	1,303
Other taxation and social security		3,443	3,450
Accruals and deferred income		443	296
Other liabilities	D.3(a)	**11,524**	**11,369**
Excess of assets over liabilities (basic own funds)	E.1	**136,724**	**135,494**
Total Liabilities		**227,386**	**244,382**

D.3 (a) Differences between Solvency II valuation and IFRS valuation by material class of other liabilities

Insurance & intermediaries payables: represents profit share and claims payable, which are due to be settled after the reporting period.

There is a valuation difference between IFRS carrying value of insurance and intermediaries payable and Solvency II basis. The valuation difference relates to profit share payable of £3.6m (2020: £1.6m).

Under Solvency II Level 1 Directive, Article 77(2) as transposed into the PRA rulebook, the cash flow projections to estimate the technical provisions should take into account all cash in and out flows required to settle the insurance and reinsurance obligations. Therefore, the profit share payable for contracts within the contract boundaries is included within BEL calculations resulting in reclassification of the amount to the reconciliation reserve (see note E.1).

As a result of the valuation difference, the amount relating to insurance and intermediaries payables under IFRS decreased from £10.3m to £6.7m under Solvency II basis. The IFRS amount includes PS10/12 PPI and ARS provision of £0.3m (2020: £1.1m).

Amounts owed to group undertakings: represent short-term intercompany liability which is valued at amortised cost. The carrying value of £0.7m (2020: £1.3m) which is subject to 30 days credit terms deemed to be fair value as at the year end. Therefore there is no difference between the IFRS and Solvency II carrying values.

Other taxation and social security: represents Insurance Premium Tax (IPT) payable to HM Revenue & Customs (HMRC). The IPT is a financial liability valued as loans and receivables under IFRS which is deemed to be an approximate to fair value due to the short-term settlement time after the reporting date.

The following amounts included within other liabilities above in the table are under IFRS principles:

- Insurance payable-reinsurance operations;
- Amounts owed to credit institutions; and
- Accruals and deferred income.

The carrying value of these liabilities is deemed to be a close approximation to fair value as they are all due within one year. Therefore, no adjustment is required under Solvency II.

D.4 Alternative methods for valuation (article 263)

The Company does not use any alternative methods for valuation.

D.5 Any other information

The Company does not apply the:

- Matching adjustment referred to in Article 77b of Directive 2009/138/EC*;
- Volatility adjustment referred to in Article 77d of Directive 2009/138/EC*;
- Transitional risk-free interest rate-term structure referred to Article 308c of Directive 2009/138/EC*; and
- Transitional deduction referred to in Article 308d of Directive 2009/138/EC*.

* As transposed into the PRA rulebook

E. CAPITAL MANAGEMENT

E.1 Own funds

Under the Solvency II regime, the Company is required to hold sufficient own funds to cover its Minimum Capital Requirement (MCR) and Solvency Capital Requirement (SCR).

The Company's capital management policy is to maintain its own funds in excess of SCR with a target minimum coverage of 120%. The following table provides Company's own funds position as at 31 December 2021:

Own Funds	Unaudited 2021	Unaudited 2020
	£'000	£'000
Ordinary share capital	126,557	126,557
Share premiums	23,323	23,323
Reconciliation reserve	(14,276)	(17,490)
Deferred tax asset	1,120	3,105
Total available own funds to meet SCR	**136,724**	**135,494**

None of the Company's own funds are subject to transitional arrangements and the Company has no ancillary own funds as at 31 December 2021. The Company classifies its own funds as Tier 1, Tier 2 or Tier 3 depending on the characteristics of the capital. Tier 1 capital is the best form of capital for the purposes of absorbing losses. All of the Company's own funds items fall under Tier 1-unrestricted category except the net deferred tax asset classified as Tier 3 capital.

The Company's available own funds increased by £1.2m mainly due to a reduction in IFRS retained earnings (£6.2m) and net deferred tax movement (£2.0m), which was offset by Solvency II valuation differences £9.4m.

Reconciliation reserve (£'000)	Notes	Unaudited 2021	Unaudited 2020
IFRS Retained earnings		(8,379)	(2,140)
Solvency II valuation differences			
-reinsurance share of technical provisions	D.1(b)	(8,672)	(2,401)
-gross technical provisions liability	D.2	42,121	22,736
-premium receivables	D.1(d)	(33,900)	(29,047)
-profit share payable	D.3(a)	-	1,687
-de-recognition of deferred acquisition costs	D.1(e)	(5,446)	(8,094)
-deferred tax asset		-	(233)
		(5,897)	**(15,351)**
Reconciliation reserve		**(14,276)**	**(17,490)**

E.2 Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR)

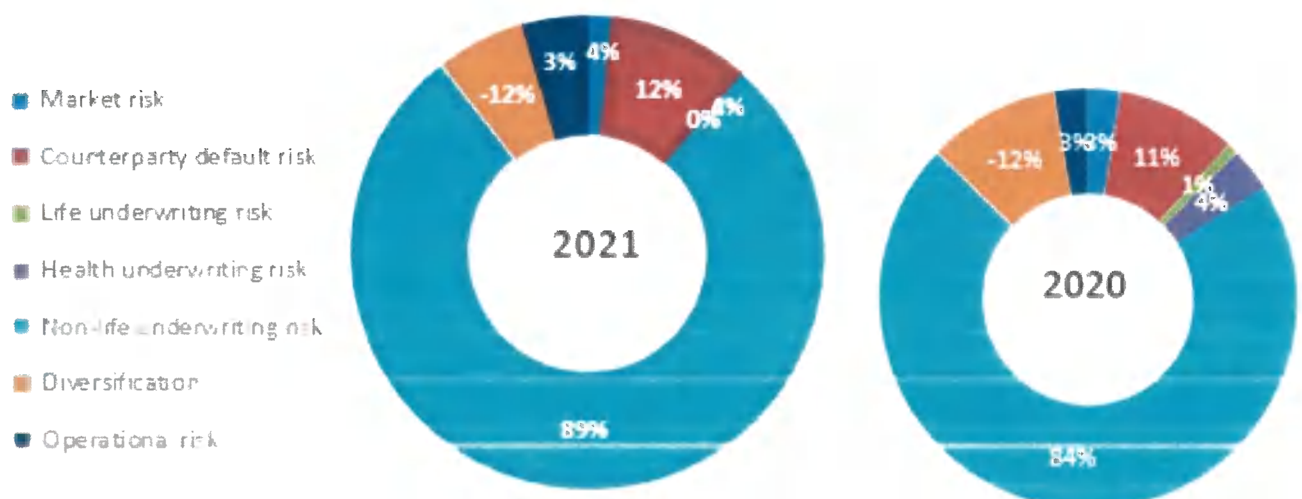
The Company's SCR as at 31 December 2021 is £73.0m (2020: £68.7m). The Company's MCR as at 31 December 2021 is £18.3m (2020: £17.1m). The SCR of the Company is the aggregation of the market, counterparty and underwriting risks, less a credit for diversification and an additional charge to represent the operational risks faced by the Company.

The table below provides the breakdown of the SCR by risk:

Solvency Capital requirement (SCR) by risk	Unaudited 2021	Unaudited 2020
	£'000	£'000
Market risk (diversified)	1,744	2,455
Counterparty default risk	7,757	8,056
Life underwriting risk	-	455
Health underwriting risk	-	2,775
Non-life underwriting risk	64,682	61,395
Diversification	(4,815)	(8,460)
Basic Solvency Capital Requirement	**69,368**	**66,676**
Operational risk	3,664	2,058
Solvency Capital Requirement	**73,032**	**68,734**

Non-life underwriting risk remained the main component of the SCR.

The Company has not used undertaking specific parameters to calculate the SCR pursuant to Article 104(7) of the Solvency II Directive as transposed into the PRA rulebook. The SCR remains subject to formal supervisory assessment and includes no adjustments or capital add-on.



Market Risk: a component of the SCR is driven by the risks inherent within the Company's assets and liabilities portfolio and the details of the changes over the reporting period are as follows:

Solvency Capital Requirement	Unaudited 2021	Unaudited 2020
	£'000	£'000
Interest rate risk	1,455	476
Spread risk	745	1,669
Currency risk	4	35
Concentration risk	628	1,476
	2,822	**3,657**
Less: Diversification effect	(1,078)	(1,202)
Market risk	**1,744**	**2,455**

The Market risk SCR net of diversification changed to £1.7m. The Market Risk arises from:

Spread risk: results from the sensitivity of the value of assets, liabilities and financial instruments to changes in the level or in the volatility of credit spreads over the risk-free interest rate structure. The spread risk applies to the Company's holdings in corporate bonds and money market funds. The spread risk decreased to £0.7m (2020: £1.6m). This was due to a decrease in corporate bonds holdings from £41.2m in 2020 to £21.9m in 2021 impacted by Darnell DAC reinsurance payment for non-pet business.

Concentration risk: arises from large investments in individual counterparties and single name exposure. It applies to investment holdings in excess of a specified threshold, and is based on exposure, rating and total assets held. The Company's concentration risk decreased to £0.6m in 2021 from £1.5m in 2020 due to bonds holding exposure reducing to £61.3m in 2021 from £76.7m in 2020 coupled with an improvement in credit rating mix.

Currency risk: arises from changes in the level or volatility of currency exchange rates.

Interest rate risk: driven by changes in assets and liabilities of the Company due to changes in term structure of interest rates. The Company's interest rate risk increased to £1.5m (2020: £0.5m) impacted by upward movement in risk-free yield curves.

The Company does not hold any investments in equities or properties, hence no SCR required.

Diversification effect: between the sub-modules of Market SCR reduced to £1.1m (2020: £1.2m) due to reduction in the overall investment portfolio.

Counterparty default risk: module of £7.8m (2020: £8.1m) arises from risk of default on reinsurance recoverable and cash at bank and deposits. The table below provide breakdown by each asset class.

	Unaudited 2021	Unaudited 2020
	£'000	£'000
Type 1 - rated		
Reinsurance recoverable	648	519
Cash at bank and deposits	3,877	5,004
Type 2 - unrated		
Receivables from intermediaries	3,763	3,037
Diversification	(531)	(505)
Counterparty default risk	**7,757**	**8,056**

The Counterparty default SCR was £7.8m (2020: £8.1m) the main changes were as follows:

- Receivables from intermediaries increased to £3.8m (2020:£3.0m) due to the growth in pet policies;
- Capital charge on cash at bank and deposits decreased to £3.9m (2020: £5.0m) due to a reduction in cash holdings impacted by the Darnell DAC reinsurance payment for non-pet business;
- Reinsurance recoverable increased to £0.6m (£2020: £0.5m)
- The Diversification effect remained stable at £0.5m (2020: £0.5m)

Life underwriting risk: represents the risk of adverse change in the value of long-term BEL due mainly from mortality rates and longevity risk. The life underwriting risk SCR is £nil (2020: £0.4m).

Health underwriting risk (Non similar to Life techniques): provides composition of Health underwriting risk. The health underwriting risk SCR is £nil (2020 £2.8m)

	Unaudited 2021	Unaudited 2020
	£'000	£'000
Health Non-SLT	-	2,755
Health Catastrophe	-	75
Diversification	-	(55)
Health underwriting risk	-	**2,775**

Non- life underwriting risk: SCR risk module comprises:

	Unaudited 2021	Unaudited 2020
	£'000	£'000
Non-life premium & reserve	42,095	42,729
Non-life Lapse	4,888	4,498
Non-life Catastrophe	39,463	34,457
Diversification	(21,764)	(20,288)
Non-life underwriting risk	**64,682**	**61,395**

The non-life underwriting risk SCR arises from:

- premium and reserve risks of £42.1m (2020: £42.7m) mostly driven by premium exposure to miscellaneous financial loss (Pets);
- catastrophe exposure of £39.5m (2020: £34.5m) mostly driven by future premium exposure on miscellaneous financial loss, reflecting planned growth of the Company's Pet product line; and
- lapse risk of £4.9m (2020: £4.5m) on future premium arising from existing contracts up to their contractual term.

Operational risk: of £3.7m (2020: £2.1m) is driven by life and non-life - gross earned premium.

Solvency Capital requirement	Unaudited 2021	Unaudited* 2020
	£'000	£'000
Premium Component		
-Gross Earned Premium Non-Life x3%	3,648	2,024
-Gross Earned Premium Life x 4%	16	35
Provision Component		
-Gross Non-Life BEL x 3%	-	-
-Gross Life BEL x 0.45%	-	-
Operational risk	**3,664**	**2,058**

The Company has calculated the MCR based on rules set out in the Delegated Regulation. The MCR calculation is mainly based on the net value of technical provisions and the volume of premiums written in the last year. The result of the calculation is then subject to a floor and a cap, of 25% and 45% of the SCR respectively. As at 31 December 2021, the MCR is of £18.3m and within the SCR corridor at 25% of SCR.

Minimum Capital Requirement	Unaudited 2021	Unaudited 2020
	£'000	£'000
Linear minimum capital requirement	12,110	15,875
Solvency capital requirement - SCR	73,032	68,734
Minimum capital requirement cap	32,864	30,930
Minimum capital requirement floor	18,258	17,183
Combined minimum capital requirement	18,258	17,183
Absolute floor of the minimum capital requirement	6,262	6,577
Minimum Capital Requirement - MCR	**18,258**	**17,183**

Capital position

The Company has Solvency II capital surplus of £63.7m and Solvency ratio of 187%. The Company's capital position as at 31 December 2021 is detailed below:

Solvency Ratio	Unaudited 2021	Unaudited 2020
	£'000	£'000
Available own funds to meet the solvency capital requirement	136,724	135,494
Available own funds to meet the minimum capital requirement	135,604	132,389
Solvency capital requirement (SCR)	73,032	68,734
Minimum capital requirement (MCR)	18,258	17,183
Ratio of Eligible own funds to the solvency capital requirement	187%	197%
Ratio of Eligible own funds to the minimum capital requirement	743%	770%

E.3 Any Other Information

The Company does not use an internal model to calculate the Solvency Capital Requirement.

There was no breach of the Solvency Capital Requirement (and hence the Minimum Capital Requirement) over the reporting period.

ANNEX - QUANTITATIVE REPORTING TEMPLATES

The following templates form part of the published SFCR report.

Templates	
S.02.01.02	Balance Sheet
S.05.01.02	Premiums, claims and expenses by line of business -life
S.05.01.02	Premiums, claims and expenses by line of business – non-life
S.12.01.02	Life and Health SLT Technical Provisions
S.17.01.02	Non-Life Technical Provisions
S.19.01.21	Non-life insurance claims
S.23.01.01	Own funds
S.25.01.21	Solvency Capital Requirement - for undertakings on Standard Formula
S.28.02.01	Minimum Capital Requirement - Both life and non-life insurance activity

These templates are un-audited.