



**GPI**

A Kinnell Group Company

**SOLVENCY  
& FINANCIAL  
CONDITION  
GROUP  
REPORT  
2019**

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## Summary

The Kinnell Group of companies comprises of six entities, each performing different but complementary roles related primarily to the provision and administration of insurance backed guarantees. The regulatory Group for Solvency II (SII) purposes comprises of Kinnell Holdings Limited (hereafter referred as KHL) and Guarantee Protection Insurance Ltd (hereafter referred to as GPI). This report has been produced in relation to the regulatory Group for SII purposes and comprises of KHL and GPI (hereafter referred to as KH SII Group).

GPI is wholly owned by KHL and is the only active insurer within the Kinnell Group. In addition to GPI, two more Kinnell Group companies undertake regulated financial activities: Warranty Services Limited (WSL) and Kinnell Corporate Limited (KCL), and both are authorised and regulated by the FCA. The Kinnell Group has applied direction<sup>1</sup> from the PRA by way of waiver to exclude all other subsidiaries from Group Supervision, apart from GPI.

The purpose of this report - titled the Group Solvency & Financial Condition Report (SFCR) - is to satisfy the public disclosure requirements under the SII Directive.

The elements of required disclosure relate to business performance, governance, risk profile, solvency, and capital management.

During the reporting period there have been several key new and continuing developments in the following areas:

- **System of governance changes**

During the reporting period there were a number of changes to the Governance Structure of GPI, including the appointment of a new Independent Non-Executive, Graham Singleton, who became a member of the Risk Committee and has also taken up the position of Chair of the Audit Committee (SMF 11). A number of other changes to the governance structure were made, with all changes being communicated with the Prudential Regulation Authority, and set out in more detail in Section B.

- **Potential Acquisition**

The shareholder entered into a Sale and Purchase agreement on 22 October 2019 which requires certain conditions precedent to be met prior to a legal acquisition occurring including regulatory approvals. At the balance sheet date the conditions precedent had not yet been met. The Sale and Purchase agreement includes a longstop date, five months from the date of signing the Sale and Purchase agreement, terminating the agreement unless an extension is agreed by both parties.

The conditions precedent had not been met by the longstop date and have not been met as at the signing of the financial statements. It is understood by the Directors that the vendor has subsequently agreed to extend the longstop date to 31<sup>st</sup> December 2020, with an irrevocable option for the proposed acquirers to extend the longstop date to 31<sup>st</sup> March 2021, in order to provide the potential acquirer with additional time to satisfy the conditions precedent (inter alia; by submitting a completed change in control form and having this approved by the regulators).

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<sup>1</sup> Direction given by PRA 15<sup>th</sup> December 2015 under section 138A of the Financial Services and Markets Act 2000

- **Purchase of material reinsurance contract**

Consistent with the prior financial year, a Loss Portfolio Transfer an Adverse Development Cover insurance contract was commuted and rewritten in the year for a cost of £1.2m. The contract covers all business written in the period 1<sup>st</sup> January 2003 to 31<sup>st</sup> December 2019 and offers protection to the claims costs occurring from these policies. This resultant risk transfer also provides a material beneficial reduction in capital requirement in relation to these policies.

The Prudential Regulation Authority issued a statement on 23 March 2020 confirming that COVID-19 should be treated as a “major development” as per Article 54 (1) of the Solvency II Directive. The valuations reported within this report are based on information up to 31 December 2019. Therefore, based on the KH SII Group’s interpretation of Article 77 (2) of the Solvency II Directive, the valuations and technical provisions do not reflect the impact of COVID-19. The outbreak of COVID-19 has resulted in a pandemic causing extensive disruption across the globe. As at 31 December 2019, a very limited number of cases had been reported to the World Health Organisation. Since then the spread of the virus has been significant and the number of reported cases and deaths has increased substantially. Whilst there remains significant uncertainty as to the impact of COVID-19 on the Kinnell Group, significant progress has been made to mitigate the risks including an efficient migration of all staff to home working.

Financial and operational risks have been modelled in order to assess the solvency position under relevant stresses. The KH SII Group expects to continue to meet its solvency and capital requirements as required by current laws and regulations. The impact of COVID-19 is continuing to evolve and therefore it is not practicable to quantify with certainty the potential financial impact on the KH SII Group at the time of writing. Further information relating to the COVID-19 pandemic is included within sections A, B, C, D and E of the report.

Beyond the developments listed above there have been no material changes to the KH SII Group’s business and performance, system of governance, risk profile, valuation for solvency purposes and capital management, and an executive summary of the document is detailed below:

### **Key Elements and drivers of the business**

GPI is wholly owned by KHL and is the only insurer within the Kinnell Group.

GPI is a specialist underwriter which retains experience and expertise in the provision of long-term Insurance Backed Guarantees (IBGs) for construction and related work, with a historic niche in timber treatment, damp proofing, roofing, and double glazing.

The Kinnell Group’s risk appetite is aligned to provide focus around driving consolidation and concentration on the core business activities as described above.

The Kinnell Group continues to embed appropriate and proportionate strategic values and culture to support corporate governance and prudent risk management.

## Underwriting Performance

<i>Material Class of Business</i>	<b>100% Miscellaneous Financial Loss</b>	
	<i>100% UK &amp; Ireland</i> 2019 (£m)	<i>100% UK &amp; Ireland</i> 2018 (£m)
<i>Gross Written Premium</i>	3.34	3.36
<i>Technical Provisions</i>	19.67	19.78
<i>Movement in UPR</i>	0.43	0.30
<i>Claims Paid and Incurred</i>	2.45	1.76
<i>Operating Expenses</i>	1.29	1.42
<i>Expenses as a % of Premium</i>	39%	42%

<b>Investment Performance</b> <i>2019 (£m)</i>	Net Investment Income	Net Investment Expense	Net Realised Gains and Losses	Changes in fair value	Net Investment Result
<b>Managed Funds</b>					
<i>Government Bonds</i>	255,974	-	(96,007)	18,783	178,750
<i>Corporate Bonds</i>	212,344	-	(48,022)	181,625	345,947
<b>Loans and Receivables</b>	17,804	-	-	-	17,804
<b>Investment in Subsidiary</b>	750,000	-	-	-	750,000
<b>Cash and Cash Equivalents</b>	19,666	(2,872)	-	-	16,794
<b>Investment Property</b>	-	-	-	-	-
<b>Other Investment Income</b>	14,336	-	-	-	14,336
	1,270,124	(2,872)	(144,029)	200,408	1,323,631

<b>Investment Performance</b> <i>2018 (£m)</i>	Net Investment Income	Net Investment Expense	Net Realised Gains and Losses	Changes in fair value	Net Investment Result
<b>Managed Funds</b>					
<i>Government Bonds</i>	277,352	-	(28,897)	(201,855)	46,600
<i>Corporate Bonds</i>	189,954	-	(20,470)	(218,635)	(49,151)
<b>Loans and Receivables</b>	19,721	-	-	-	19,721
<b>Investment in Subsidiary</b>	350,000	-	-	-	350,000
<b>Cash and Cash Equivalents</b>	7,338	(3,187)	-	-	4,151
<b>Investment Property</b>	-	-	-	5,000	5,000
<b>Other Investment Income</b>	28,090	-	-	-	28,090
	872,455	(3,187)	(49,367)	(415,490)	404,411

## Key Elements of the Governance System

KH SII Group is subject to the Senior Managers & Certification Regime (SMCR) which is a regulatory framework that came into force on 12th December 2018. The regime reflects the regulators' intention to align regulation of insurance with the banking supervision rules, with its primary purpose to strengthen accountability and governance, and ensure that Senior Insurance Managers conduct themselves with honesty, integrity, and skill.

GPI is part of the Kinnell Group of six companies, and due to the size, scale, and complementary nature of the businesses the Kinnell Group has adopted a holistic, integrated approach to the implementation of its governance, risk, and compliance frameworks. To achieve this the Kinnell Group has established a unitary operating board structure - the Group Management Board (GMB).

The GMB has delegated authority from each of the individual entity boards within the Kinnell Group, except in relation to 'matters reserved for the Board'. The current governance structure ensures that Directors approved under the Senior Managers & Certification Regime with relevant control functions effectively have authority over the whole of the Kinnell Group.

The GMB is made up of 8 Members:

- Non-Executive Chairman - Jeremy Brettell
- Non-Executive Director - Paul Wakefield
- Non- Executive Director- Graham Singleton
- Non-Executive Director - Jon Vanstone (WSL)
- Chief Executive Officer - Andrew Page
- Interim Chief Financial Officer - Carol Ritchie
- General Manager (Interim) - Fiona Ross (Maternity Leave from May 2020)
- Operations Director - Jay Frew

The corporate governance structure has been designed to include at least two Independent Non-Executive Directors as members of the GMB, and this is to ensure effective, independent oversight and challenge, and to prevent any one individual director having unfettered powers of decision.

The GMB is supported by a number of sub-committees at both board and executive management level, namely:

- The Nomination and Remuneration Committees (Subcommittee)
- The Risk Committee (Subcommittee)
- The Audit Committee (Subcommittee)
- The Executive Committee (Executive management committee)
- The Asset and Liability Committee (Executive management committee)
- The Reserving Committee (Executive management committee)

This corporate governance framework has been established to ensure that all entities within the Kinnell Group comply with their relevant regulatory obligations; the GMB has adequate oversight of business activities; and that the Kinnell Group has defined, transparent and consistent lines of responsibility, and effective processes to identify, manage, monitor and report risks that the Kinnell Group is exposed to. More information on the committee structure can be found in section B.1.

## **Key risk areas**

Some risk areas are significantly more material in terms of their potential impact to the Kinnell Group, and some further details on each of these have been included below:

### **Strategic Risk - Failure to achieve Business Plan**

Failure to achieve the projections and goals set out within the Business Plan is a key risk to the Kinnell Group, potentially meaning reduced income and profitability, and inability to put into effect strategic business initiatives set out within the plan. Ultimately, failure to achieve the business plan impacts the viability of the Kinnell Group, and therefore is a key risk to the business.

### **Market Risk**

The investment portfolio has shown moderate volatility recently, mostly in response to Brexit implications and we expect this will continue, although overall returns remain within appetite. Nevertheless, the Profit & Loss remains volatile to the monthly unpredictability of the markets due to the impact of fair value accounting. This risk is mitigated through using appropriately skilled investment managers and reducing volatility in the portfolio by moving assets to less risky asset classes. Investments will follow a defensive approach to protect capital, aiming for low volatility, and returns in excess of agreed benchmarks, but within the consideration of both the cost of capital under Solvency II and the actual capital risk in order to achieve a balanced efficient return.

### **Reserve Risk**

With the long tail nature of our business we are exposed to claims arising in a pattern different to assumed in the technical provisions. This risk is mitigated by:

- Monthly management information tracking loss ratio changes, key risks and early warning indicators, in order to monitor key assumptions used within the technical provisions; and
- Obtaining an actuarial calculation and validation (experience analysis) of the reserves, provided by the Chief Actuary, including external actuarial peer review.

### **Regulatory Risk**

As we operate in a highly regulated environment, we are cognisant of the exposure to potential regulatory action that may be punitive for the business, financially or reputationally. This risk is mitigated through establishing systems and controls that monitor our adherence to regulatory obligations and in particular to our treatment of customers.

### **Brexit Risk**

The KH SII Group does not currently underwrite new business in any of the remaining EU27 bloc, however, there are a number of small run-off books in the Republic of Ireland, France, Belgium and the Netherlands, and therefore, there is likelihood of claims requiring servicing. As existing passporting rights shall endure during the implementation period, claims arising on those policies shall be serviced for the duration of 2020 in the expected manner. It is possible that the implementation period would see a trade deal agreed between the UK and the bloc, which would ensure continuance of those passporting rights. In the event that such a deal is not agreed with the bloc; it will be necessary for the KH SII Group to avail itself of temporary permissions/run-of regimes in the individual jurisdictions; and the KH SII Group has taken legal advice in respect of those local arrangements. The KH SII Group continues to review the implications of withdrawal from the EU in order to ensure service continuity for all customers.



## **Operational Risk**

The Kinnell Group has a low appetite for operational risk. The Kinnell Group acknowledges that some level of operational risk is inherent in any business operation, however, the business keeps operational risk at the lowest degree possible through application of the governance, risk, and control frameworks, and associated resources.

The structure of the Key Risk Indicator (“KRI”) dashboard provides an expandable view of risk from the high-level risk appetites set by the Board down to the granular metrics that are managed at an operational level and aggregated upwards into the Board metrics.

The KRI dashboard also incorporates operational risk events and near misses and is reviewed by each monthly Executive Committee and the Board Risk Committee, to ensure that the business frequently assesses the Company's actual risk profile against the Board-approved risk appetite settings. This allows the second line of defence to provide effective challenge & reporting of its assessment of the Kinnell Group's risk profile to the Board. This challenge and review process provides for the potential that risk metrics can be added or removed, risk tolerances can be amended, and emerging risks can be incorporated prior to Board reporting and approval.

Due to the nature and size of the Kinnell Group, and considering the proportionality principle, operational risk is relatively low in relation to our business activity. Exposure to people, systems and control failures, external fraud, conduct risk, and IT security / cyber risks are considered within the risk management framework to ensure that appropriate focus is maintained that will identify any significant issues that suggest fundamental control failures.

## **Solvency II**

The Solvency II (‘SII’) regime has been effective since 1 January 2016 and establishes a new set of EU wide capital requirements, risk management and disclosure standards. The KH SII Group is required to meet a Minimum Capital Requirement (“MCR”) and a Solvency Capital Requirement (“SCR”), which is calibrated to seek to ensure a 99.5% confidence of the ability to meet obligations over a 12-month time frame.

The KH SII Group calculates its SCR in accordance with the standard formula prescribed in the SII regulations.

The KH SII Group has met the key deliverable requirements of the PRA. The Own Risk and Solvency Assessment (“ORSA”) was submitted in October 2019. Quantitative Reporting Templates (“QRTs”) have been submitted to the PRA for all quarters in 2019. All submissions were made before the last submission dates.

## **Solvency Ratio**

### KH SII Group

At the 31<sup>st</sup> December 2019 KH SII Group had total own funds of £9.01m. These are split between Tier 1 and Tier 3.

The own funds supported the KH SII Group Solvency Capital Requirement of £6.94m resulting in a ratio of eligible funds to meet the SCR of 130% and a surplus of £2.07m.

### ***KH SII Group Solvency Capital Requirement (SCR)***

	<b>31 December 2019 (£)</b>	<b>31 December 2018 (£)</b>
<i>Solvency Capital Requirement</i>	6,939,425	7,815,375
<i>Surplus</i>	2,072,952	1,773,693
<i>Ratio of Eligible Own Funds to SCR</i>	130%	123%

### ***KH SII Group Own Funds***

	<b>31 December 2019 (£)</b>	<b>31 December 2018 (£)</b>
<i>Own Funds – Tier 1</i>	8,663,685	9,218,236
<i>Own Funds – Tier 3</i>	348,692	370,652
	9,012,377	9,589,068

### **GPI Solo**

At the 31<sup>st</sup> December 2019 GPI had total own funds of £11.68m. These are split between Tier 1 and Tier 3.

The own funds supported the Solvency Capital Requirement of £6.94m resulting in a ratio of eligible funds to meet the SCR of 168% and a surplus of £11.68m. The Minimum Capital Requirement (MCR), a minimum level below which the amount of financial resources should not fall was £2.36m, resulting in a ratio of eligible funds to meet the MCR of 480%.

### ***Solvency Capital Requirement (SCR)***

	<b>31 December 2019 (£)</b>	<b>31 December 2018 (£)</b>
<i>Solvency Capital Requirement</i>	6,936,576	7,477,795
<i>Surplus</i>	4,744,858	4,244,609
<i>Ratio of Eligible Own Funds to SCR</i>	168%	157%

### ***Own Funds***

	<b>31 December 2019 (£)</b>	<b>31 December 2018 (£)</b>
<i>Own Funds – Tier 1</i>	11,332,765	11,362,752
<i>Own Funds – Tier 3</i>	348,669	370,652
	11,681,434	11,733,404

### **Information on any non-compliance with the Minimum Capital Requirement (MCR) or SCR**

During the full reporting period GPI was compliant with its MCR.

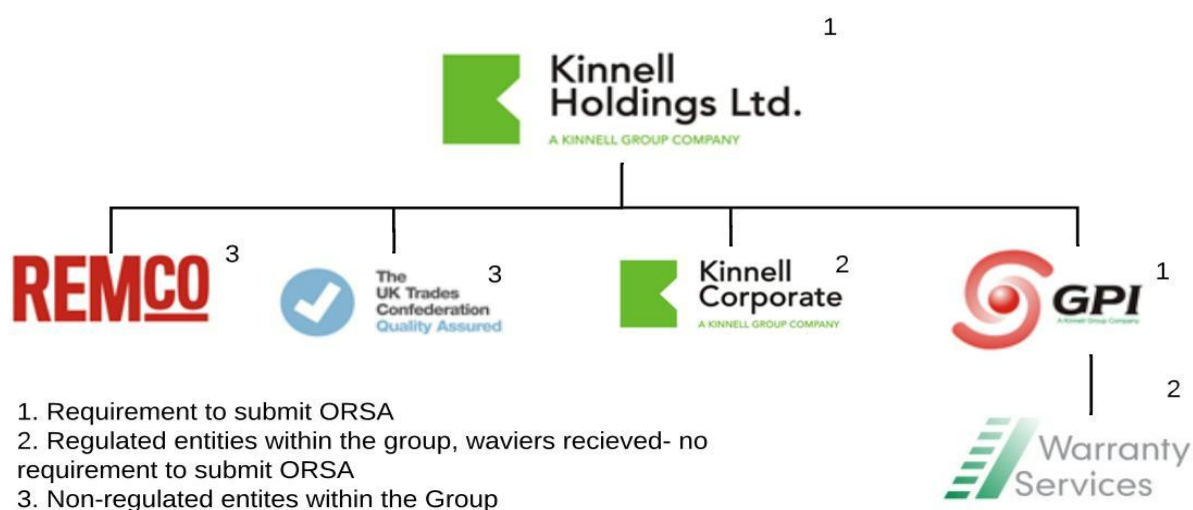
## A. Business and Performance

### A.1 Business

The Kinnell Group of companies comprises of six entities, each performing different but complementary roles within the same sector. The regulatory Group for Solvency II (SII) purposes comprises of Kinnell Holdings Limited (hereafter referred to as KHL) and Guarantee Protection Insurance Limited (hereafter referred to as GPI). This report has been produced in relation to the regulatory Group for SII purposes and comprises of KHL and GPI (hereafter referred to as KH SII Group).

GPI is wholly owned by KHL and is the only active insurer within the Kinnell Group. In addition to GPI, two more Kinnell Group companies undertake regulated financial activities: Warranty Services Limited (WSL) and Kinnell Corporate (KCL), and both are authorised and regulated by the FCA. The Kinnell Group has applied direction<sup>2</sup> from the PRA by way of a waiver to exclude all other subsidiaries from Group Supervision, apart from GPI. The KH SII Group is regulated under the Solvency II (SII) Directive, and accordingly is required to provide a number of qualitative and quantitative reports.

The Kinnell Group structure is shown below:



GPI is a UK based solo insurance entity, regulated and authorised by the PRA via its small insurer Category 5 team and regulated by the FCA. Information can be obtained from the Financial Services Register under firm reference number 207658. The company is registered in England under Company Number 03326800 with a registered address of 14 Castle Street, Liverpool, Merseyside, L2 0NE. GPI is wholly owned by Kinnell Holdings Limited (hereafter referred to as KHL). KHL is a non-trading privately owned holding company registered in Scotland under company number (SC295513).

<sup>2</sup> Direction given by PRA 15<sup>th</sup> December 2015 under section 138A of the Financial Services and Markets Act 2000

GPI is a dual regulated insurer with licenses to effect contracts of insurance in the following material lines of business;

- Fire and Natural Forces (8)
- Damage to Property (9)
- Miscellaneous Financial Loss (16)

All 2019 premium was written within the UK under class 16 Miscellaneous Financial Loss.

GPI conducts its insurance activities within the UK with only a small limited amount of business currently in run off in the EEA.

The external independent auditor for the annual report for the year ending 31<sup>st</sup> December 2019 was:

**PricewaterhouseCoopers LLP**

141 Bothwell Street  
Glasgow  
G2 7EQ

GPI is authorised by the Prudential Regulation Authority (PRA) and is regulated by the Financial Conduct Authority (FCA) and the PRA.

**Prudential Regulation Authority**

20 Moorgate  
London  
EC2R 6DA

**Financial Conduct Authority**

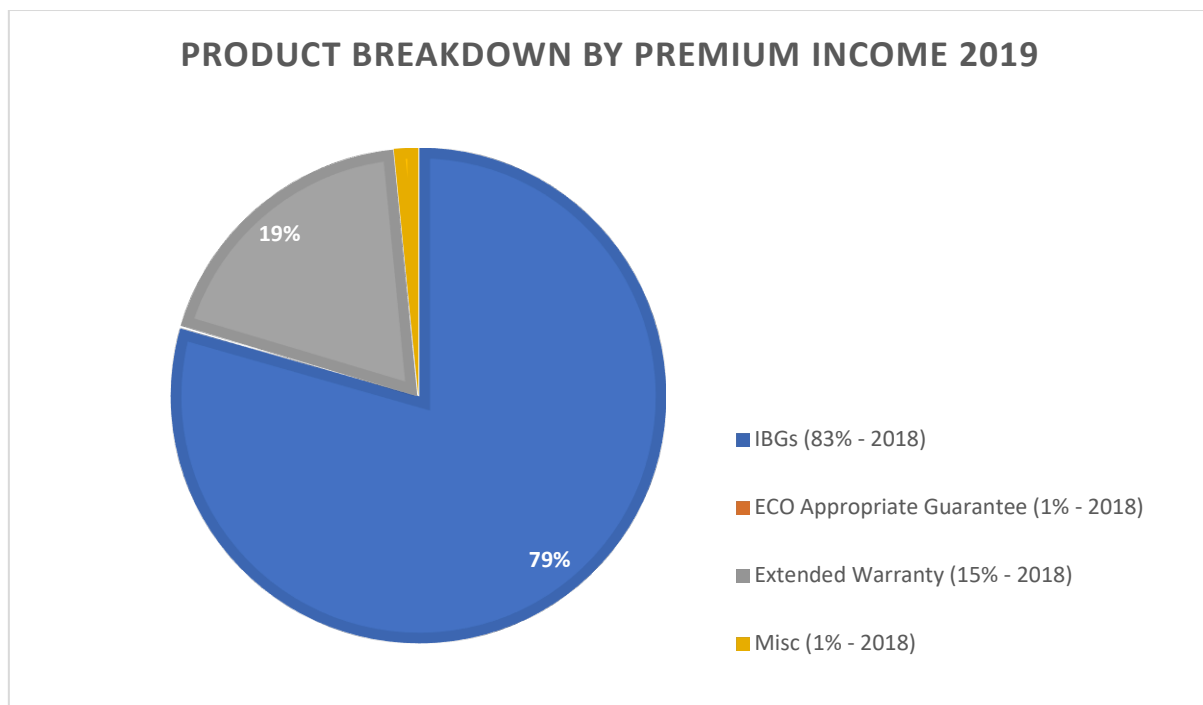
12 Endeavour Square  
London  
E20 1JN

As a specialist underwriter GPI retains experience and expertise in the provision of long-term Insurance Backed Guarantees (IBGs) and Latent Defects Insurance (LDI) for construction and related work, with a historic niche in timber treatment, damp proofing, roofing, and double glazing. During 2019 GPI continued to focus principally on these core markets and products. The company wholly owns Warranty Services Ltd (WSL) which is an insurance intermediary with significant operational capability and experience in the administration and distribution of IBGs to home improvement contractors, such as those who are members of Competent Person Schemes. GPI, via WSL, has also been involved in the provision of IBG based products to contractors in respect of the Energy Company Obligation (ECO), the Green Deal, and also to firms who have joined the Renewable Energy Consumer Code (RECC) scheme, all of which have been sponsored by Government. The extent of involvement in these areas has varied in line with changes to Government policy and incentives available to the industry.

Overall, business introduced to GPI by WSL contributed approximately 62% of the premium income written by GPI in 2019. GPI also provides an underwriting solution for a small number of insurance intermediaries and an appointed representative in respect of niche insurance products in the miscellaneous financial loss class of business.

During the year, a Loss Portfolio Transfer and Adverse Development Cover (LPT/ADC) reinsurance contract was commuted and rewritten in the year for a cost of £1.2 Million. The contract covers all business written in the period 1<sup>st</sup> January 2003 to 31<sup>st</sup> December 2019 and offers protection to the claims costs occurring from these policies.

The mix of products underwritten by GPI for the 2019 financial year is demonstrated in the chart below:



The KH SII Group’s risk appetite is aligned to provide focus around driving consolidation and concentration on the core business activities as described above.

The business continues to embed appropriate and proportionate strategic values and culture to support corporate governance and prudent risk management. Further information on these are contained later in the report.

## Our promises and values



### Our Promises.

We are committed to providing the highest standard of service, products and experiences for all.

### We will:

#### Serve You.

We will deliver products that fulfil your requirements and maintain the service levels that help us to help you, communicating with you as often as you would like us too and keeping you updated with any changes in a timely manner.

#### Protect You.

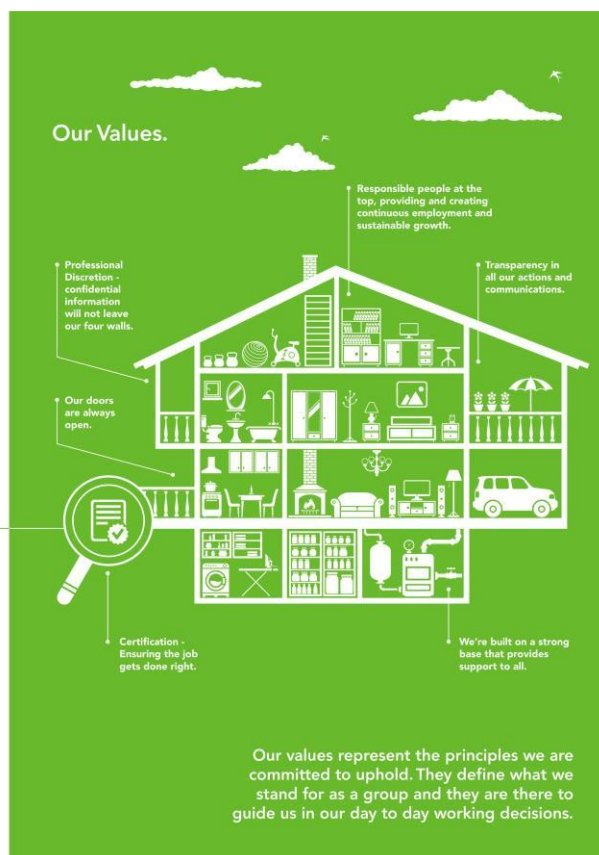
We will seek to protect our customers, their customers (the homeowner) and our business from fraudulent activity, whilst protecting our reputation by continuing to comply with our risk framework.

#### Be Open, Honest & Fair.

We always aim to protect the homeowner and continue to provide valuable protection. We are respectful and will treat you like family, removing restrictions that stop you providing good customer service.

#### Be Proactive.

We will strive to get it right first time, every time. And if we don't, we will try our best to resolve it. We are always looking to improve our products and services to provide a better experience - we continually ask for your feedback and use it to serve you better.



## A.2 Underwriting Performance

### Gross Written Premium (GWP)

During the course of the year, the Company's written premium income was £3.3m which is at a consistent level with the prior year of £3.4m. The strategic policy is to reduce non-core insurance premium, and associated claims costs, and to focus growth on the core products of Insurance Backed Guarantees and structural warranties within Board approved risk tolerances. All premium was written within the UK under class 16 Miscellaneous Financial Loss.

### Unearned Premium Reserve (UPR)

GPI earns premium on a straight-line basis over the term of the insurance policy and this remains the Board approved policy until any claims or actuarial information would suggest this should be altered based on the incident of risk. The balance is held as an Unearned Premium Reserve on the balance sheet and unwound over the term of the policy.

### Operating Expenses and Claims Paid and Incurred

Expenses have been closely managed during the year and are marginally lower than the prior year. Whilst there has been a deterioration in legacy closed schemes claims, our core business claims have performed favourable to management expectations.

## Underwriting Performance

<i>Material Class of Business</i>	<i>100% Miscellaneous Financial Loss</i>	
	<i>100% UK &amp; Ireland</i>	<i>100% UK &amp; Ireland</i>
<i>Geographical Split of Business</i>	<i>2019 (£m)</i>	<i>2018 (£m)</i>
<i>Gross Written Premium</i>	3.34	3.36
<i>Technical Provisions</i>	19.68	19.78
<i>Movement in UPR</i>	0.43	0.30
<i>Claims Paid and Incurred</i>	2.45	1.76
<i>Operating Expenses</i>	1.29	1.42
<i>Expenses as a % of Premium</i>	39%	42%

## Reinsurance

GPI currently underwrites 100% of the risks that it takes on and sets its appetite accordingly. From time to time though there may be reasons to seek reinsurance on individual business opportunities or lines of business in order to protect the potential impact on the capital, and the Board has a set Risk Appetite for considering such options.

Consistent with the prior financial year, a Loss Portfolio Transfer and Adverse Development Cover reinsurance contract was commuted and rewritten in the year for a cost of £1.2m. The contract covers all business written in the period 1 January 2003 to 31 December 2019 and offers protection to the claims costs occurring from these policies. This resultant risk transfer also provides a material beneficial reduction in capital requirement in relation to these policies.

Whilst the terms of the agreement include a commute and rewrite option at the 30 June 2020 (2019: 31 December 2019) the Board has decided not to exercise that option and run on the reinsurance arrangement to its conclusion.

The Board continues to monitor their reinsurance strategy in 2020.

## A.3 Investment Performance

GPI's Board-approved investment strategy is to follow a defensive approach to protect capital, aiming for low volatility, and returns in excess of agreed benchmarks, taking into account both the cost of capital under SII and the actual capital risk in order to achieve a balanced efficient return. GPI utilises the services of appropriate external investment managers to manage its investments, who are currently LGT Vestra.

In 2019, the investment portfolio remained fixed income predominantly. For a more efficient capital allocation the portfolio was allocated to only Government and Corporate Bonds matched to the expected cash outflows over the policy term. Bonds have a lower associated capital charge which reduces the Market risk component of the capital requirement. More information can be found in section E2.

The company had no investments or equities in securitisations during the period. The table on the following page summarises the investment performance during 2019 and 2018.

<b>Investment Performance</b>	<b>Net Investment Income</b>	<b>Net Investment Expense</b>	<b>Net Realised Gains and Losses</b>	<b>Changes in fair value</b>	<b>Net Investment Result</b>
<b>2019 (£m)</b>					
<b>Managed Funds</b>					
<i>Government Bonds</i>	255,974	-	(96,007)	18,783	178,750
<i>Corporate Bonds</i>	212,344	-	(48,022)	181,625	345,947
<b>Loans and Receivables</b>	17,804	-	-	-	17,804
<b>Investment in Subsidiary</b>	750,000	-	-	-	750,000
<b>Cash and Cash Equivalents</b>	19,666	(2,872)	-	-	16,794
<b>Investment Property</b>	-	-	-	-	-
<b>Other Investment Income</b>	14,336	-	-	-	14,336
	1,270,124	(2,872)	(144,029)	200,408	1,323,631

<b>Investment Performance</b>	<b>Net Investment Income</b>	<b>Net Investment Expense</b>	<b>Net Realised Gains and Losses</b>	<b>Changes in fair value</b>	<b>Net Investment Result</b>
<b>2018 (£m)</b>					
<b>Managed Funds</b>					
<i>Government Bonds</i>	277,352	-	(28,897)	(201,855)	46,600
<i>Corporate Bonds</i>	189,954	-	(20,470)	(218,635)	(49,151)
<b>Loans and Receivables</b>	19,721	-	-	-	19,721
<b>Investment in Subsidiary</b>	350,000	-	-	-	350,000
<b>Cash and Cash Equivalents</b>	7,338	(3,187)	-	-	4,151
<b>Investment Property</b>	-	-	-	5,000	5,000
<b>Other Investment Income</b>	28,090	-	-	-	28,090
	872,455	(3,187)	(49,367)	(415,490)	404,411

#### A.4 Performance of other activities

The Kinnell Group intends to grow insurance and non- insurance related income from a number of initiatives. These are expected to include:

- Developing further products within the current contractor base.
- Through extension of the Competent Persons Scheme into related / adjacent specialisms, developing products for those areas of need.
- Exploring opportunities for non-insurance income from the development of broking activities and remedial repair services external to the Kinnell Group.
- Also exploring opportunities in the London market using reinsurance as a strategic tool.



## A.5 Any other information

### COVID-19 Pandemic

The valuations reported within this report are based on information up to 31 December 2019. Therefore, based on the KH SII Group's interpretation of Article 77 (2) of the Solvency II Directive, the valuations and technical provisions do not reflect the impact of COVID-19.

The coronavirus pandemic is currently affecting all aspects of our personal and professional lives, the health of the world's population, global economic performance and the financial markets. Despite all of these uncertainties, the Kinnell Group is well prepared for the situation. This applies in the context of our operational resilience but also in the context of our capital strength. All of the Kinnell Group's operations are now being fully supported by home working. The Kinnell Group has worked to keep its employees safe and taken steps so that key work can continue even if public life remains highly constrained. The current pandemic could have wide ranging impacts, and these have been considered in order to assist in planning and evaluating the impact on the business. The Kinnell Group continues to align its approach to the guidance of the UK Government. The solvency ratio as at 31 December 2019 is 130%. The impact of COVID-19 on the KH SII Group's solvency position has been assessed, taking into consideration relevant stresses given the circumstances. After consideration of the relevant stresses at the time of writing, the SCR would not breach the regulatory requirements or of the KH SII Group's own risk appetite. The KH SII Group is expected to continue to have funds available in excess of the regulatory requirements without needing to take contingency action. The relevant stresses have taken into consideration the impact on the underwriting result arising from a potential spike in deposit claims, as well as the impact on investments the impact on which is mitigated due to GPI's strategic asset allocation leading to the majority of our investments being held in gilts and government bonds. There is no exposure to equities. Contingency options have been identified to reduce the KH SII Group's exposure to financial and operational risks, should there be further market or operational shocks.

## B. System of Governance

The Board-approved corporate governance framework is designed to deliver an appropriate culture to promote prudent management; improve accountability and transparency; and promote good conduct and corporate values throughout the business. All companies within the Kinnell Group aim to uphold sound principles of good governance in all their business affairs proportionate to the size, nature, and scale of the business. GPI as the insurer has specific obligations under the Solvency II Directive, the Senior Managers & Certification Regime, and the FCA's regulatory framework to ensure this is delivered. To ensure a consistent approach to governance a holistic and integrated Kinnell Group-wide governance framework is utilised, to ensure that the specific regulatory requirements of GPI are met as a standard, and where appropriate adopted across the other companies within the Kinnell Group as best practice. This is overseen by a Kinnell Group-wide Board and Committee structure.

Specifically, the framework sets out:

- GPI's management responsibilities map
- the general organisational structures within the Kinnell Group;
- the role of the Board;
- the role of Board/Executive level committees;
- arrangements for management oversight (including the Senior Managers & Certification Regime);
- governance of risk and activities that the Kinnell Group considers necessary to support a robust risk management framework, and;
- the policy management framework.

The Board ensures an annual assessment of the adequacy, design, and effectiveness of the system of governance through a Board Effectiveness Review which is undertaken by the Chairman, who is an independent non-executive director. Consideration is given to the appropriateness and proportionality of the system of governance reflecting on the past, present and future business risk profile. This review is also designed to identify individual training needs and to ensure that the Board retains a balance of skills, knowledge, diversity, independence, and experience as required by the business.

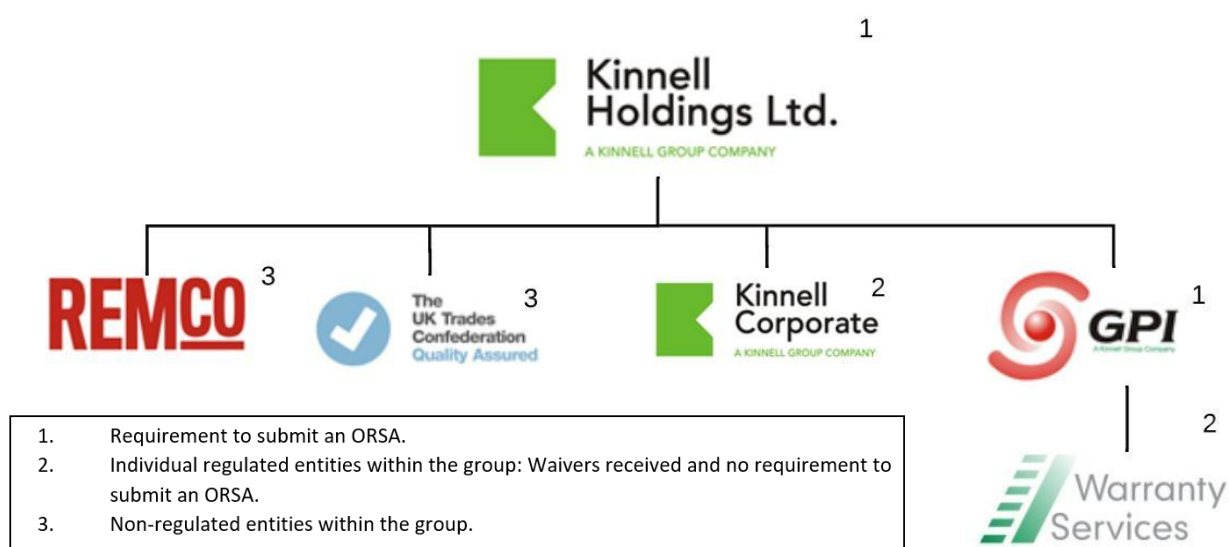
This assessment is supported by our internal audit function who undertake a review of the systems of governance on a bi-annual basis. In addition, the internal annual risk and control self-assessment process that is undertaken across all areas of the business provides a continuous assessment of the operational systems and controls to ensure effective corporate governance.

Governance refers to the way the Kinnell Group directs, controls, and manages its business affairs. By implementing a governance framework, the Kinnell Group aims to prevent the following risks:

- The risk of ineffective corporate governance;
- The risk of internal delegation authority levels being breached;
- The risk of regulatory breaches;
- The risk that the firm is used for money laundering;
- The risk of internal fraud.

## B.1 General information on the system of governance

The chart below illustrates the Kinnell Group structure of companies:



Within each business the role of the Board is to:

- Set the strategic direction of the business;
- Provide leadership and to oversee the management of the business;
- Set the values and tone of the business with regards to conduct; and
- Report to shareholders on an annual basis in accordance with the UK Corporate Governance Code.

Whilst each company within the Kinnell Group has an individually constituted Board of directors (each of which has overall responsibility for governance within the respective company); due to the size, scale, and complementary nature of the businesses the Kinnell Group has adopted a holistic, integrated approach to the implementation of its governance, risk, and compliance frameworks. To achieve this the Kinnell Group has established a unitary operating Board structure - the Group Management Board (GMB). The GMB has full delegated authority from each of the individual entity Boards. This structure ensures that individuals approved under the Senior Managers and Certification Regime with relevant control functions effectively have authority over the whole Kinnell Group. The scope of authority of the GMB is set out in full within the Terms of Reference.

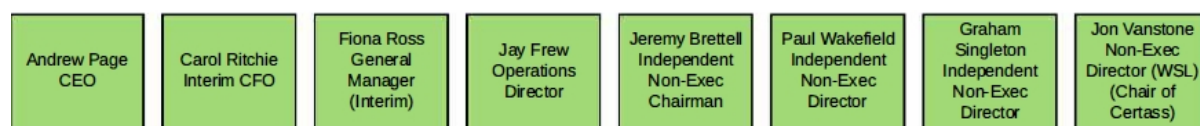
The diagram below illustrates the delegation of authority to the GMB (except in relation to matters reserved for the individual entity Board):



The model adopted ensures ongoing compliance with regulatory obligations to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that:

- it is clear who has which of those responsibilities; and
- the business and affairs of the firms as a Kinnell Group can be adequately monitored and controlled by the directors, relevant senior managers, and governing body of the firm (FCA Handbook, SYSC 2)

The Board now comprises of three independent non-executive directors (one in the capacity of Chairman), one non-executive director (WSL NED & Chairman of Certass, no Senior Managers functions held), four executive directors, including the CEO, CFO (Interim), the Operations Director and the General Manager (Interim). GMB members can serve for a period of 3 years prior to re-election currently with no maximum term. The current composition of the GMB can be viewed in the diagram below:



The corporate governance structure has been designed to include at least two Non-Executive Directors as members of the GMB, and membership of each of the board level committees includes, at a minimum, two Non-Executive Directors. This is to ensure effective, independent challenge, and to prevent any one individual director having unfettered powers of decision. The Chairman of the GMB is responsible for overseeing corporate governance throughout the Kinnell Group, and to evaluate at least annually the role and effectiveness of the GMB.

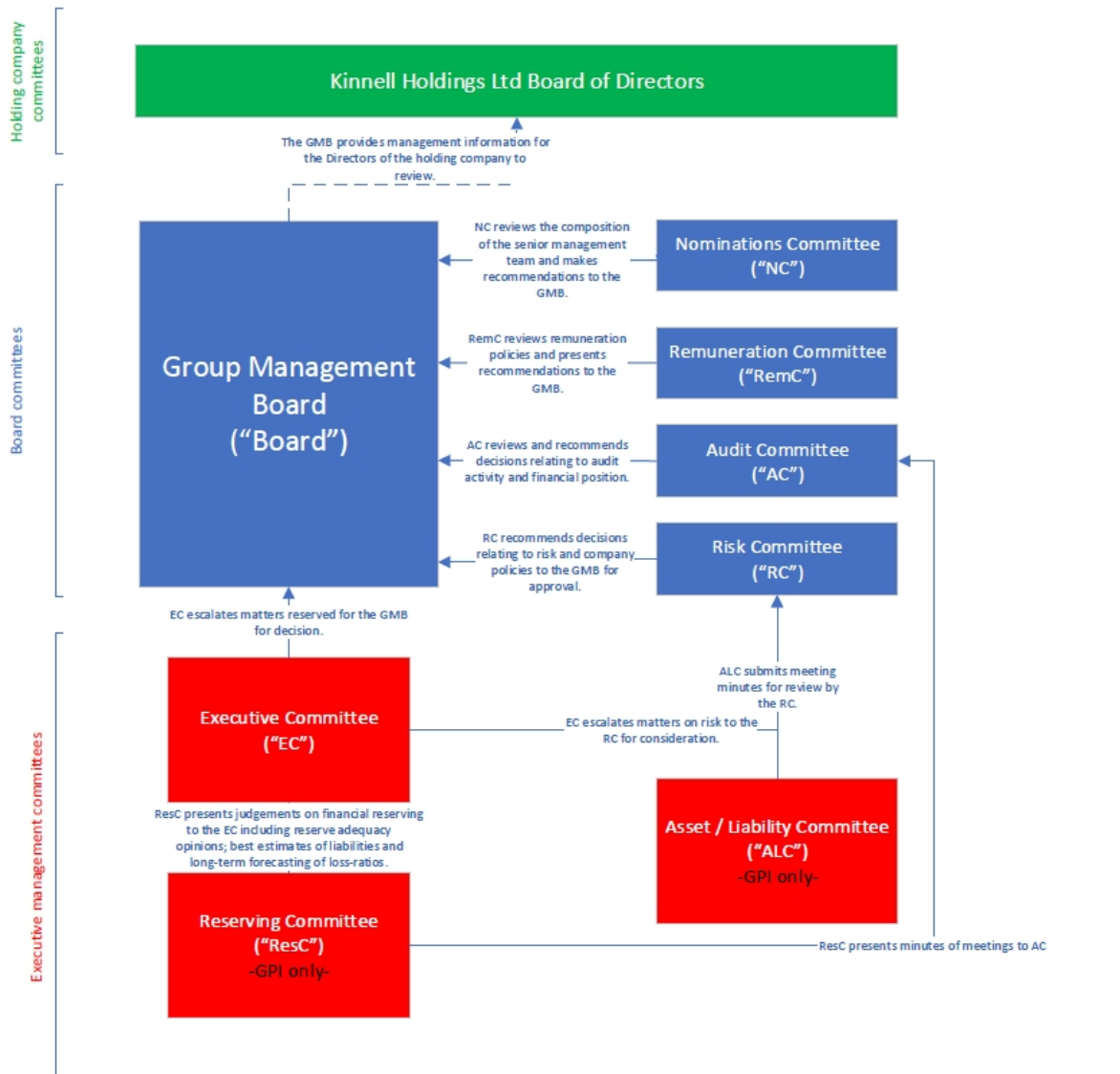
During the reporting period, a number of applications made for Senior Manager functions in December 2018 were approved, with Jay Frew taking up the Executive Director Function (SMF3), Blair Houston taking up the Compliance Oversight function (SMF16), Jennifer Reid taking up the Other Overall Responsibility Function (SMF18) in terms of responsibility for recruitment, training and development of the business' conduct rules staff, and Jeremy Brettell taking up the Chair of the Remuneration Committee Function (SMF12).

Further changes to the Governance Structure throughout 2019 include the appointment of a new Independent Non-Executive Director, Graham Singleton. Graham took up the role of Chair of the Audit Committee (SMF11), meaning that Paul Wakefield stepped down from this role, and became a member of the Risk Committee. Graham also took up the position of Non-Executive Director of Warranty Services Ltd at the same time. Successful applications were made for Andrew Page to undertake additional responsibilities for GPI, these being responsibility for insurance mediation and the overall responsibility for the firm's risk management arrangements in respect of the financial risks posed by climate change. A successful application was also made for Jay Frew to undertake the Chief Operating Officer Function (SMF24). In January 2020, Fiona Ross took up the role of General Manager (Interim), and subject to a pending application, she will split the SMF24 Function with Jay Frew, with each individual holding separate and distinct responsibilities. At the end of May 2020, Fiona Ross commenced maternity leave, at which point the pending application was withdrawn and her responsibilities have been reallocated across senior management.

The GMB is supported by a number of sub-committees (see following diagram) that have been established to:

- support the strategic objectives of the Kinnell Group;
- provide challenge and oversight;
- ensure sound and prudent management of the business, and;
- ensure sound and prudent internal controls and the business retains an effective and appropriate internal and external audit function;
- oversee the implementation of a robust risk management framework.

The corporate governance framework has been structured in such a way as to ensure ongoing compliance with regulatory requirements, specifically to: establish, implement, and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities (as outlined in FCA Handbook, SYSC 4, and PRA Rulebook for Solvency II firms - Conditions Governing Business Section 2: General Governance Requirements).



The Nomination and Remuneration Committees are responsible for:

- Undertaking activity in respect of nomination and remuneration by way of a jointly held Nomination and Remuneration Committee;
- Nominating and appointing Executive and Non-Executive Directors with a balance of skills, knowledge, experience, and diversity, and;
- Overseeing the implementation of remuneration policies and practices that ensure sound and prudent management of the business, prevents excessive risk-taking, and promotes the long-term success of the Kinnell Group.

The Risk Committee is responsible for:

- Oversight of all risk and control activity;
- Setting the Board level risk appetites and risk strategy;
- Ensuring ongoing regulatory and Solvency II compliance.

The Audit Committee is responsible for:

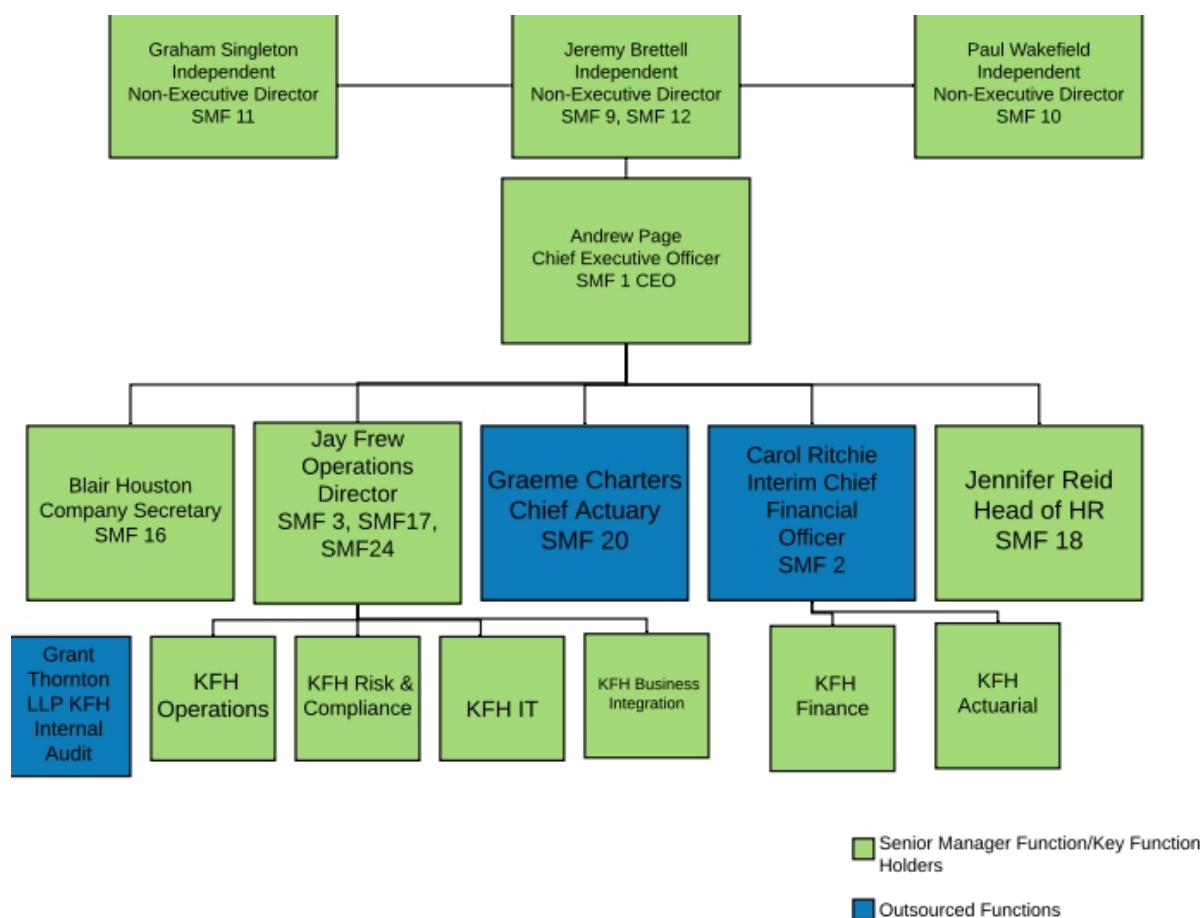
- Oversight of the effectiveness of systems and internal controls;
- Oversight of internal and external audit activities;
- Monitoring of any significant pending legal actions;
- Review and challenge of the Kinnell Group's financial statements.

In addition to the board committees, there are several executive committees within the corporate governance structure:

- The Executive Committee: the GMB delegates the operational management, implementation of risk management framework, and operational oversight of the business to the Executive Committee.
- The Asset and Liability Committee: is responsible for monitoring and reviewing the assets of the business to ensure that assets are invested consistently with the time horizon of the future liabilities of the business, and to ensure that the GMB is furnished with appropriate recommendations in respect of these matters. Actuarial input and oversight is provided by way of membership of the Chief Actuary (SIMF 20).
- The Reserving Committee: The Reserving Committee is a subcommittee of the Audit Committee. The committee considers matters in relation to key reserving judgements and assumptions; oversees quarterly calculations of Best Estimate of Liabilities; considers long-term claims forecasts; trends in loss ratios over time; prior period development and its drivers; and oversees sensitivity analysis performed to assess the variability of reserves under changes to the various model assumptions. The Reserving Committee considers both Best Estimate and UK GAAP reserves. This committee is not a decision-making authority and formally reports into the Audit Committee.

The Senior Managers and Certification Regime (SMCR) came into force on 10<sup>th</sup> December 2018. The regime aligns the regulation of insurance with the banking and supervision rules, with its primary purpose to strengthen accountability and ensure that Senior Insurance Managers conduct themselves with honesty, integrity, and skill. GPI has in place a governance map that reflects the SMCR and the allocation of responsibilities within the business. The diagram over the page summarises the key reporting lines captured on the SMCR poster detailing GPI's Senior Managers and their designated Senior Management Functions (SMFs).

## Senior Managers and Certification Governance Map



As part of the wider regime, firms are also required to allocate prescribed responsibilities to Senior Managers to ensure that their duties are clearly defined, further enhancing the overall management of the business and corporate governance framework. The current allocations for GPI's prescribed responsibilities for Senior Management Functions (SMFs) are detailed below:

PRESCRIBED RESPONSIBILITIES			
PR #	PR Description	FCA/PRA	PR Holder
A	Responsibility for the firm's performance of its obligations under the Senior Managers Regime	Dual	Andrew Page
B	Responsibility for the firm's performance of its obligations under the employee Certification Regime	Dual	Andrew Page
B-1	Responsibility for the firm's obligations for conduct rules training and reporting	FCA	Andrew Page
C	Responsibility for compliance with the requirements of the regulatory system about the management responsibilities map	Dual	Blair Houston
D	Responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime	FCA	Jay Frew



F	Responsibility for: a) leading the development of and b) monitoring the effective implementation of policies and procedures for the induction, training and professional development of all members of the firm's governing body	Dual	Jeremy Brettell
G	Responsibility for monitoring the effective implementation of policies and procedures for the induction, training and professional development of all of the firm's SMF managers and key function holders (other than members of the firm's governing body)	Dual	Andrew Page
H	Responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm	PRA	Andrew Page
I	Responsibility for leading the development of the firm's culture by the governing body as a whole	PRA	Jeremy Brettell
M	Responsibility for overseeing the development of, and implementation of the firm's remuneration policies and practices	Dual	Jeremy Brettell
N	Responsibility for the independence, autonomy and effectiveness of the firm's policies and procedures on whistleblowing	Dual	Graham Singleton
O	Responsibility for managing the allocation and maintenance of the firm's capital, funding (where applicable) and liquidity	PRA	Carol Ritchie
Q	Responsibility for the production and integrity of the firm's financial information and its regulatory reporting	PRA	Carol Ritchie
T	Responsibility for the development and maintenance of the firm's business model by the governing body	PRA	Andrew Page
T-2	Responsibility for the performance of the firm's Own Risk and Solvency assessment (ORSA)	PRA	Andrew Page
U	Responsibility for the firm's performance of its obligations under Fitness and Propriety (in the PRA Rulebook) in respect of notified non-executive directors and those who perform a key function (where applicable for insurers)	PRA	Andrew Page
X	Responsibility for the firm's performance of its obligations under the Outsourcing part of the PRA Rulebook (for CRR and non CRR firms), Conditions Governing Business 7 (for SII firms and third country branches) or Non-solvency II firms: Governance 5 (for large NDFs)	PRA	Andrew Page
Z	Responsibility for the firm's compliance with CASS	FCA	Andrew Page

A number of 'Overall Responsibilities' have also been identified and allocated to the relevant senior managers, and these can be found in the following table:

<b>OVERALL RESPONSIBILITIES</b>	
<b>Identified Overall Responsibility</b>	<b>Overall Responsibility Holder</b>
Responsibility for the development of the business' sales channels and client relationships.	Andrew Page
Responsibility for the development of agency relationships.	Andrew Page
Responsibility for production and distribution of financial promotions.	Andrew Page
Responsibility for reporting to the business' governing body on compliance with laws and regulations.	Blair Houston
Responsibility for the development and management of the business' policy management framework	Blair Houston
Responsibility for reporting to the business' governing body on matters relating to the business' financial position.	Carol Ritchie
Responsibility for insurance product development.	Jay Frew
Responsibility for the business' claims handling function.	Jay Frew
Responsibility for the business' complaints handling function.	Jay Frew
Responsibility for reporting to the business' governing body on matters relating to risk.	Jay Frew
Responsibility for recruitment, training and development of the business' conduct rules staff.	Jennifer Reid
Board-level responsibility for the supervision of risk management activity.	Paul Wakefield
Board-level responsibility for the supervision of audit activity.	Graham Singleton
Responsibility for the firm's risk management arrangements in respect of the financial risks posed by climate change	Andrew Page

The company believes this allocation ensures proportionality as the structure of responsibilities mirrors the internal operational framework by retaining Senior Manager prescribed responsibilities within the appointed Executive Directors and Non-Executive Directors, while also broadening the SMCR responsibilities across staff at key function level to reflect operational delegations. GPI's management responsibilities map is formally reviewed on a quarterly basis to allow any changes to responsibilities or reporting lines to be appropriately reflected.

## **Policy Management**

Policy management and governance is an essential part of GPI's corporate governance framework and is intrinsically linked to effective risk management as it:

- provides a standardised approach to policy design and development;
- establishes and communicates minimum operating standards across the business;
- provides structure to the approach to risk management;
- provides clarity for all staff regarding roles and responsibilities, reporting lines, and risk and control activities, and;
- ensures that all staff are compliant with regulatory and legal requirements.

One of the underlying risk frameworks established is the Policy Management Framework. This is essentially a register of all policies and ensures that all key company policies are drafted in a standardised format; have an assigned policy owner, and; are subject to frequent formal review. In line with the overall approach to governance, policies are implemented across all entities within the Kinnell Group unless specifically stated within the version control page that the policy is applicable or not applicable to a particular entity within the Kinnell Group.

### **Remuneration Principles**

Fixed remuneration (i.e. salary) is determined on the basis of the role and position of each individual employee and is based on a number of factors including professional experience, education, responsibility, technical job requirements, seniority, and local market conditions. Review of all staff remuneration is undertaken on an annual basis, in accordance with the Kinnell Group's remuneration policy, and involves input from the Finance department, the Human Resources department, and the Executive management team as well as external independent benchmarking where this is deemed necessary. Any outputs from this process are then presented with recommendations to the Remuneration Committee, who are responsible to review and then make relevant recommendations to the GMB for formal approval.

All remuneration decisions balance general performance, business and risk management objectives, individual objectives, and the interests of the Kinnell Group's stakeholders (including customers, shareholders, management, and employees). This being the case, metrics of performance have both a financial and non-financial component. Remuneration decisions shall therefore be made with a view to incentivising prudent risk management and appropriate controls, the sustainability of the Kinnell Group as a business, and regard for Kinnell Group's customers.

In considering recommendations relating to remuneration decisions, the Remuneration Committee may consult directly with any members of the GMB, appropriate executives and members of risk, compliance and legal, and appropriate external expertise as the committee may deem appropriate.

The Kinnell Group is a living wage employer adhering to the voluntary living wage set by the Living Wage Foundation which is considered when making any remuneration decisions.

The Kinnell Group operates a bonus (non-fixed remuneration) scheme, which is set out in a yearly bonus proposal document. Recommendations are made by Management to the Remuneration Committee, who will review and where necessary consult with KHL Board, then make recommendations to the GMB for approval.

Each bonus proposal provides a series of controls (weighting, caps, and deductions for breaches as appropriate), the purpose of which is to weight bonus payments in favour of factors such as a clean customer risk record; a clean regulatory/compliance record; a clean individual appraisal; and that performance generally is achieved with due consideration to the short and longer-term risks involved. Bonus proposals are calculated in such a manner as to encourage the sustainability of the Kinnell Group as a business; prudent conduct and risk management; and actively discourage short-termism and excessive risk taking. In addition to this the proposal includes provisions for downward adjustment where appropriate, or other provisions the Remuneration Committee deem appropriate. The Kinnell Group does not presently operate any share-based incentive schemes and participates in an automatic-enrolment workplace pension scheme. Any non-fixed remuneration element is generally limited to a maximum of 25% of salary.

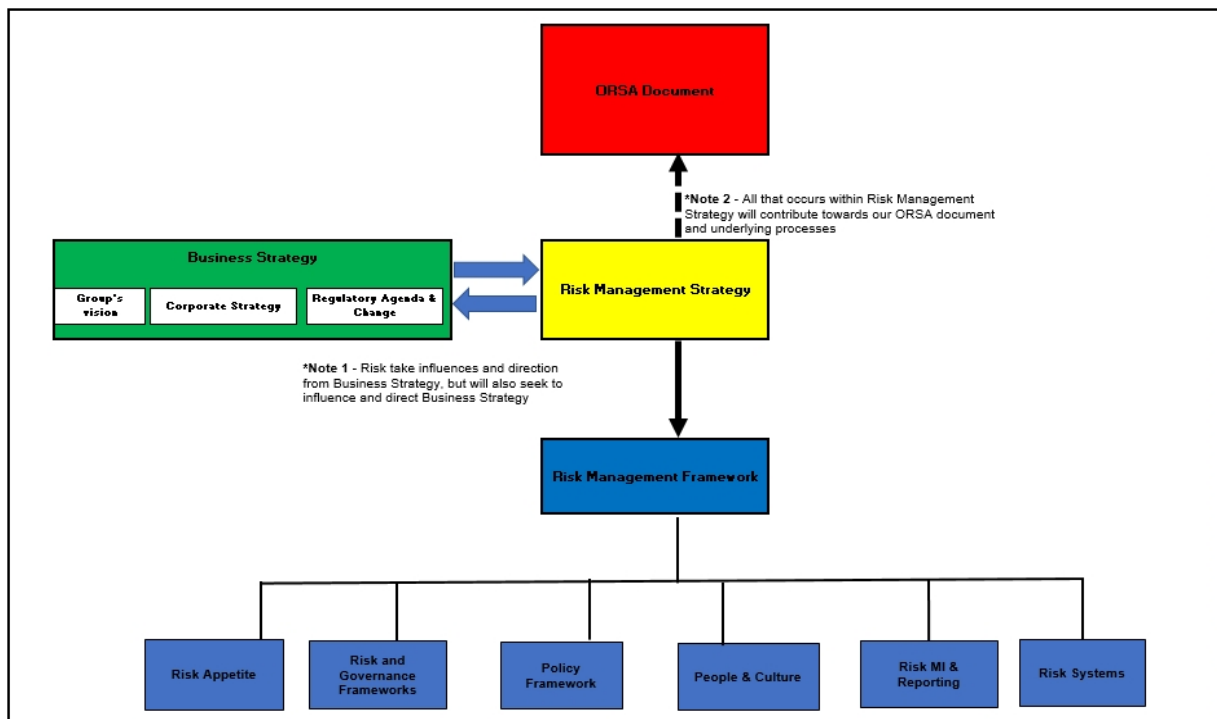
## B.2 Fit and proper requirements

The Kinnell Group has a fit and proper review process with all new applicants to the company subject to complete vetting in accordance with the recruitment and vetting policy. On a yearly basis, all existing employees are required to complete a declaration confirming that their personal circumstances have not changed in a material way which would affect their fitness and propriety. The Head of HR sample checks no less than 10% of these declarations on an annual basis to validate these declarations. Such sample checking includes the procurement of a criminal record disclosure and a credit check. Where an employee - being subject to a sample check - has already been subject to a 'Standard' level criminal background check, 'Basic' level criminal background check shall be sufficient for all further checks.

On an annual basis, the Risk and Compliance function carry out second line oversight and assurance spot checks on 10% of employees subject to the additional annual checks (as detailed above) and perform spot checks on an additional 10% of the employee fitness and propriety annual declarations.

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

The Kinnell Group's business risk management strategy sets the strategic objectives, principles and high-level plans for the Risk and Compliance function that support Kinnell Group's business activities and corporate strategies. This includes a vision statement for Risk and Compliance that provides context in respect of the approach the function seeks to apply. The risk management strategy includes definition of the Risk Management Framework (RMF), which is governed by a series of underlying risk frameworks and policies that are subject to GMB approval. GMB approval is a fundamental step within the Kinnell Group's corporate governance framework to ensure that the RMF remains aligned with the GMB's approved strategy and risk appetite statements. The RMF incorporates established points of review by, and, escalation to, the GMB. All parts of the RMF are subject to third line assurance oversight.



The adopted approach to risk management includes the following key stages:

#### Identification:

All first line personnel are required to identify and understand the risks associated within their respective business area. Additionally, the GMB members are responsible for overseeing the operational risks identified by the business, as well as identifying all strategic risks to the business and the Kinnell Group as a whole.

Risks are identified by a number of methods including through the forum of the Executive Committee (ExeCo); the formal annual Risk and Control Self-Assessment process; risk event/near miss reporting; horizon scanning exercises; compliance monitoring; and by reviews of business as usual activities. Once risks are identified they are recorded onto a risk form and presented to the Committee for review and measurement, and then escalated to the Board Risk Committee as required.

#### Measurement:

Once a risk has been identified, the materiality of the risk in relation to the threat significance to the Kinnell Group is assessed by understanding the likelihood of it occurring and the impact if it did. The materiality of the risk is recorded on a risk form and submitted into the ExeCo for review and challenge.

The impact and likelihood of identified risks are measured using a traditional 5x5 risk matrix. Utilising the adopted 5x5 risk matrix, risks are assessed and measured using an impact scale ranging from negligible to severe, with a severe threshold being set at a very low financial value of £2,000. In addition to financial measures, impact is also assessed in terms of potential/actual customer detriment, reputational damage, regulatory action, and impact on operating capabilities of people, processes, and systems. This ensures that all risks are captured, measured, monitored, and escalated via the governance structure to enable effective and transparent risk reporting and to ensure that the GMB are satisfied that objectives are being met at all times within the defined risk appetite, and within the sufficiency of the operational risk sub module.

#### Managing:

Once the materiality of the risk has been defined, it is then the responsibility of the first line of defence (with oversight, challenge, and assurance from the second line of defence) to identify and implement any controls or mitigating actions in relation to the risk, and report any changes in the risk and control environment.

Once the identified risks and controls have been reviewed through the ExeCo and then approved by the Board Risk Committee, they are logged onto the central risk register and monitored and reported by the Risk and Compliance function.

#### Monitoring:

The effectiveness of the established RMF in delivering the GMB-approved strategy and risk appetite is measured and monitored through a set of Key Risk Indicators (KRIs). The structure of the KRI dashboard provides an expandable view of risk from the high-level risk appetites set by the GMB down to the granular metrics that are managed at an operational level, and aggregated upwards into the GMB metrics.

All KRIs and related risk tolerances have been proposed initially by Executive Management prior to review, challenge, and approval by the GMB via the Risk Committee. The KRI dashboard also incorporates Operational risk events and near misses and is reviewed by the Risk Committee via the Executive Committee, to ensure that the business frequently assesses the Kinnell Group's actual risk profile against the GMB-approved risk appetite statements. This assists the second line of defence in providing challenge and effective reporting of its assessment of the Kinnell Group's risk profile to the GMB.

The challenge and review process provides for the potential that risk metrics can be added or removed, risk tolerances can be amended, and emerging risks can be incorporated prior to GMB reporting and approval. The KRI dashboard is supported by a central risk register that captures all risks from each operational business unit in order that risk transparency and materiality can be continually assessed. The central risk register supports the ongoing identification, assessment, monitoring, and review process that is incorporated within the Risk and Compliance function's second-line oversight activity.

#### Reporting:

The Risk and Compliance function are responsible for regular reporting of the risk management framework to all levels of the business including executive (via the ExeCo) and Board-level (via the Board Audit and Risk committees and the GMB).

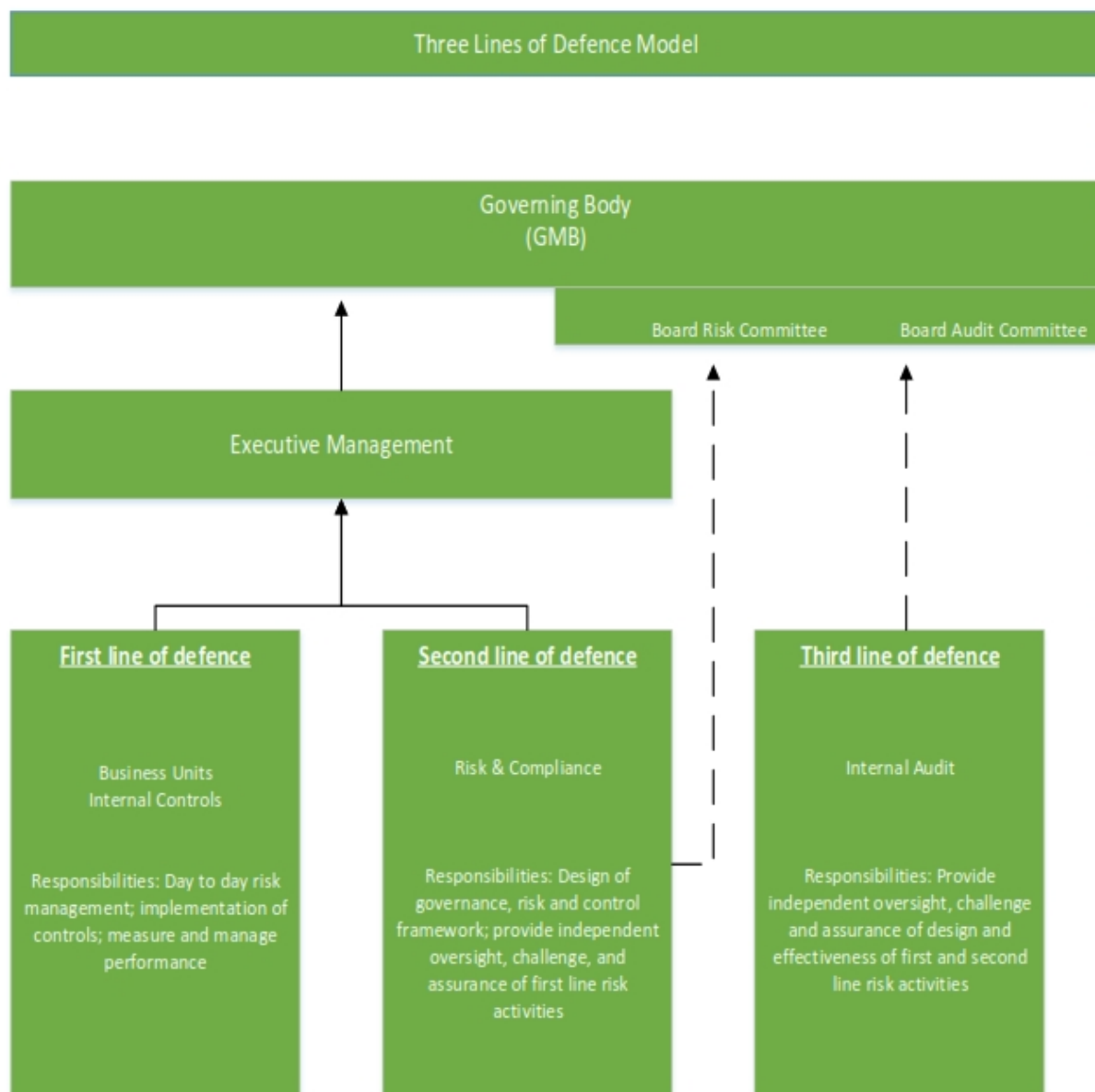
Reporting includes (but not limited to) the following elements:

- the central risk register;
- the control framework and an assessment of the effectiveness of controls;
- the KRI dashboard;
- risk events/near misses;
- emerging risks;
- regulatory horizon scanning;
- a summary of the top risks to the business;
- any findings from monitoring and testing activity.

Reporting formats and contents based on the above elements are tailored according to the committee level.

## Risk Governance

To ensure effective governance of the approach to risk management, Kinnell Group implements a traditional `three lines of defence` model as illustrated in the diagram below:



The first line of defence includes all personnel across the business units who are responsible for:

- identifying, mitigating, and managing risk on a day to day basis,
- implementing the internal control framework;
- implementing a set of control policies and procedures;
- reporting on risk and control activity to the Executive management team via the Executive Committee.

The second line of defence consists of the Risk and Compliance, and Legal functions, who are responsible for:

- the design of the governance, risk, and control frameworks;
- providing independent oversight, challenge, and assurance of first line risk activities;
- reporting on the effectiveness of the implementation of the governance, risk, and control frameworks to the Executive management team via the ExeCo, and to the GMB via the Audit and Risk Committees.

The third line of defence consists of the Internal Audit function (currently outsourced to Grant Thornton LLP) who are responsible for:

- providing independent oversight, challenge, and assurance of the design and effectiveness of first- and second-line risk activities;
- reporting on the effectiveness of risk activities to the GMB via the Audit Committee.

The provision of the External Audit is by PricewaterhouseCoopers LLP.

### **Own Risk & Solvency Assessment**

Governance is central to the prudential regulatory requirements contained within the Solvency II Directive (2009/138/EC). The primary objective being to drive effective risk management through a risk-based capital requirement. The regulation requires that insurers captured by the directive establish and maintain an Own Risk and Solvency Assessment (ORSA). An ORSA is effectively a risk management process that seeks to document, consider, and equate an insurer's established systems and controls to its balance sheet strength. It therefore forms an important and integral part of a firm's risk management framework.

The Own Risk and Solvency Assessment (ORSA) process constitutes the continuous identification and management of financial and non-financial risk within the KH SII Group. The ORSA report is a fundamental document that supports and informs the GMB and the Executive Management team in pursuit of its strategy and to understand the risks faced by the KH SII Group, its appetite to endure and accept those risks, and to provide a clear and unambiguous process to manage capital in a prudent and stable manner.

GPI is captured by the Solvency II Directive and therefore is required to establish and maintain an ORSA. GPI is part of a group from a regulatory perspective, and the ORSA therefore provides reflection of the risks faced by GPI as a solo entity, as well as taking into consideration the risk exposures of the KH SII Group.

Regulatory waivers for the remaining regulated entities within the Kinnell Group (namely Warranty Services Ltd and Kinnell Corporate Ltd) were applied for and approved by the PRA which removes the requirement to produce an individual ORSA for these entities within the KH SII Group.

The ORSA is conducted annually, and principally is based on financial year end results. A formal timeline is adopted annually in order that relevant and appropriate re-fresh reviews are undertaken for all aspects of the ORSA and ORSA Policy. This will include the pro-active engagement of the Risk Committee and the GMB at various points during the process in order that their effective challenge forms an embedded part of the review process.

GPI has in place an ORSA policy that sets out the key established processes, procedures and controls that support the establishment, maintenance, and embedment of an ORSA within the KH SII Group.



The ORSA is integrated into the business and strategic planning processes. It is recognised that the ORSA is an on-going process that reflects the KH SII Group's risk profile and capital requirements at any given time, relative to the strategy being pursued.

At each Executive Committee meeting, there is due consideration given to the Kinnell Group's risk profile, and the Committee would, if any significant financial issue or potential risk crystallisation be identified, escalate the matter immediately to the GMB. This would be done to facilitate a decision as to whether to re-run the models to reflect the impact and consider any necessary actions in mitigation. The subsequently updated ORSA would then be formally reviewed by the Risk Committee prior to GMB approval. In the absence of any escalation, the GMB formally reviews the document annually.

In addition, the Executive Committee, Risk Committee, or GMB consider that if any one of the following events occurred then the need for an out-of-cycle ORSA may have been / will have been triggered (formal GMB approval will always be sought in these circumstances):

- an intended acquisition or divesture;
- establishing a new line of business;
- a major amendment to the established risk appetite settings;
- a major amendment to the established reinsurance arrangements;
- a portfolio transfer or major changes to the mix of assets;
- a significant change in any related regulation (that would potentially impact our balance sheet strength);
- a new or re-assessed threat to solvency identified by Stress and Scenario testing or any other method;
- a request from the PRA to undertake an out of cycle ORSA.

The Stress and Scenario tests employed will be approved by the Risk Committee and performed at least annually, or more frequently as determined by the Risk Committee, or potentially the PRA.

In order for an out-of-cycle ORSA to be undertaken, all underlying processes will be prepared for the possibility of doing so at any point in time.

The availability and quality of data used within the ORSA process will be continually assessed to seek to ensure that it retains the highest standards in terms of completeness and appropriateness.

An out-of-cycle ORSA shall be undertaken within 4 weeks from the identification of a trigger event.

It is expected that future iterations of the ORSA report will continue to be refined and developed in accordance with the Kinnell Group's risk management enhancements and feedback sought from significant stakeholders. The development of the report will assist the Kinnell Group in meeting its strategic objectives as it responds to an evolving marketplace. The Kinnell Group will continue to invest in sustainable and integrated processes, including the ORSA process, to seek to ensure that it maintains sufficient capital resources aligned to the risks driven from established business activities, this will also maintain capital resources in excess of regulatory requirements (refer to section E – Capital Management).

The GMB has approved the use of the Standard Formula (SF) as the most appropriate calculation of GPI's Solvency Capital Requirement. This decision has been independently confirmed by our retained external actuarial consultants (OAC Plc).

## B.4 Internal control system

The Kinnell Group implements internal controls to support the risk management framework. This helps the business to successfully achieve its objectives by:

- providing management and the GMB with oversight of assets, risks, and resources;
- helping to ensure that the business is profitable, solvent, and compliant;
- enhancing the effectiveness of business operations;
- ensuring reliability of financial processes and reporting;
- ensuring compliance with relevant laws and regulations, and;
- helping to minimise the overall risk exposure of the business consistent with approved risk appetites.

An internal control is not a specific procedure that is undertaken once, but rather part of a framework of continually operating processes and activities undertaken by all levels of personnel within the Kinnell Group to ensure that the business successfully achieves its objectives. The Kinnell Group is cognisant of its regulatory obligations, and its internal control systems will ensure compliance with the relevant regulatory requirements.

The Kinnell Group's internal control framework operates through a range of 'business as usual' policies, procedures, and activities that are undertaken by all levels of personnel within the Kinnell Group and aims to mitigate risk within the business. The internal control framework is made up of a number of diverse mechanisms for mitigating and managing risks that might impact the ability of the business in achieving its objectives, such as policies, authority levels, segregation of duties, reconciliation processes, management reviews, or IT systems flags.

Regular monitoring and assessment of controls can help to minimise risk exposure by identifying gaps in the internal control framework; identifying issues with control effectiveness or implementation; and by providing an opportunity for control enhancement where necessary.

GPI has designed its internal controls to be robust, reliable, cost-effective, comprehensive, and proportionate to the size, nature, and scale of the business. In addition to the business as usual reviews of the internal control framework, a Kinnell Group-wide annual Risk and Control Self-Assessment (RCSA) review process is undertaken by all Heads of Departments and the Executive Management team, with the assistance of the second line Risk and Compliance function. GPI ensures compliance activity is implemented through continuous monitoring and testing of the internal control framework, externally outsourced functions, Appointed Representatives, and compliance with wider external obligations that arise. The Risk and Compliance function undertakes regular horizon scanning activities to ensure that all key compliance controls and activities are fit for purpose and aligned to the current regulatory landscape.

## B.5 Internal audit function

The Kinnell Group is committed to ensuring that internal audit provides assurance to the GMB that major business risks are being managed, and that the framework for risk management and internal control is operating effectively. Reflecting the scale of the business, the GMB considers that this can most effectively be achieved by outsourcing the IA function to an appropriately skilled and resourced partner selected via a tender process set by the Audit Committee. The current Internal Audit Appointment is Grant Thornton LLP. By utilising an outsourced Internal Audit provider, the business is able to retain independence & objectivity between internal audit and other key functions of the business.

The Kinnell Group operates a three lines of defence governance model. The Internal Audit function constitutes the 'third line' of defence by providing independent review, challenge, assurance, and validation of the effectiveness of the internal controls. The Internal Audit function is not responsible for establishing or maintaining internal controls, as this is the responsibility of the 'first line', however, the effectiveness of the internal systems of control can be enhanced by the recommendations from Internal Audit reviews.

The Internal Audit function provides assurance, evaluation, and verification of the extent to which management controls ensure that:

- the company's assets are safeguarded from significant losses, including those caused by fraud, waste, inefficiency, and commercially unsound practices;
- relevant laws, rules and regulations are complied with;
- business units, employees and advisors are complying with the relevant internal policies and procedures;
- operations are conducted effectively, efficiently, and economically in accordance with company policies and procedures;
- management information systems are reliable and secure;
- systems under development are monitored, that appropriate internal controls are built in, are consistent with business needs, and are proportionate and benchmarked to industry best practice;
- significant business risks are identified and effectively managed, and;
- where relevant major business projects achieve their objectives.

The Internal Audit function provides this assurance, evaluation, and verification by setting an annual plan aligned to the risk-based approach adopted by the business. This includes resource planning and a defined set of internal audit projects undertaken on an annual basis completed and reported to the Audit Committees spread throughout the year. The plan is set annually but is subject to amendment driven by any material change effecting the business.

## B.6 Actuarial function

Reflecting the current scale of the business, the GMB decided that the KH SII Group is best served by utilising the services of both an external actuarial firm as well as developing an in-house actuarial capability. This aids decision making and quality of management information as the skill set is increasingly embedded into the business. The Chief Actuary role is still fulfilled by an OAC senior actuary, as an external supplier; the actuarial firm OAC have been our chosen supplier of actuarial and modelling services for the past five years. Specific OAC staff are allocated to GPI, reflected within our Senior Managers & Certification Regime structure and the SMF 20.

## B.7 Outsourcing

As part of KH SII Group's business, certain functions are outsourced to third parties. KH SII Group does not contract out any of its regulatory obligations and remains responsible for complying with these obligations. The GMB is responsible for determining which business functions are to be outsourced; for setting the risk appetite in respect of outsourcing; and for delegating to suitable owners and relationship managers the management and control of those outsourced functions. The GMB is responsible for satisfying itself that the provisions of the outsourcing policy have been met in respect of each outsourced function. Prior to contemplating the shortlisting or engagement of prospective providers, the GMB shall instruct a needs assessment. The needs assessment shall:

- identify the key stakeholders who must be engaged in respect of the proposed outsourcing arrangement and shall identify at what stage those stakeholders are to be engaged; at a minimum, the stakeholders shall include the finance function for the purposes of examining the financial strength of proposed providers; the members of the GMB for evaluating the merits of the commercial and consumer case for outsourcing; the legal function for contractual concerns; the risk & compliance function for conduct risk matters; the IT Director for any data security concerns, and the Data Protection Officer for any privacy and data protection matters;
- set out the objectives and scope of the outsourcing project (what is to be achieved, by when, by whom and to what standard);
- set out the parameters of any request for proposal document that is to be issued to prospective providers.

Where prospective providers have been shortlisted, they shall be bound to non-disclosure agreements if they are to have access to any information prior to the commencement of a formal agreement. Where the prospective provider does not have access to information prior to entering into the outsourcing agreement; the outsourcing agreement itself shall have a non-disclosure agreement included within the final service level agreement.

Each service provider shall be reviewed at least once yearly in accordance with the Compliance Monitoring Plan by the CEO, the relationship manager or Risk and Compliance for the outsourced function. The activities undertaken during the review shall depend on the types of activities undertaken by the service provider and may include training audits; information security audits; governance audits; service level agreement compliance audits; and audits of any other activity undertaken by the provider on our behalf.

The purpose of the review is to identify any issues and potential areas of action and enhancement. The results of the review are presented at the Executive Committee for consideration under the terms of reference of that committee. Each provider shall be subject to a credit check at least yearly. If ongoing supervision uncovers undesirable outcomes such as improper performance of the outsourced function, or ultra vires actions, or consumer or commercial detriment, the GMB shall consult with both the relationship manager responsible for the outsourced function, and with the Kinnell Group's legal function. Particular cognisance is given to the provisions of the service level agreement and to the termination provisions of the arrangement. The GMB shall contemplate appropriate measures such as termination of the contract; switching providers; or increased supervision and shall decide upon the appropriate response.

The table below depicts the main areas of external and intra-Group outsourcing arrangements.

<b>Area of outsourcing</b>	<b>Outsource Provider</b>	<b>Location of provider</b>
Claims handling	Warranty Services Ltd Anglian Windows Plastic Windows Guarantee Ltd	UK
Policy Administration & Operations	Warranty Services Ltd Certass Ltd	UK
Human Resources	Kinnell Holdings Ltd	UK
IT Services	Warranty Services Ltd	UK
Actuarial Function	OAC PLC	UK
Internal Audit	Grant Thornton UK LLP	UK
Loss Adjusting	Sedgwick Outsource Services Ireland Limited	Republic of Ireland

## B.8 Any other information

### **COVID-19 Pandemic**

The Kinnell Group continuously monitors the effectiveness and adequacy of its system of governance, including the effectiveness of specific functions, and believes them to be operating effectively. This assessment takes into account the nature, scale and complexity of the risks inherent in its business. There has been no need for specific changes to the System of Governance as the result of the COVID19 pandemic. This is because the System of Governance is designed to be robust to significant external events. During the COVID-19 pandemic, there has been continued involvement and input from the Board, including from the non-executive directors. The Executive are conducting daily meetings to monitor the COVID-19 situation and the GMB and non-executive directors have received weekly updates describing the financial and operational impacts on the Kinnell Group. Feedback has been provided on these topics to executive management.

The Risk function is responsible, among other things, for assessing and monitoring risks and the control environment. This also includes the ongoing assessment of risks resulting from pandemics such as COVID-19. In order to assess current developments, the Risk function has analysed the current and potential future impacts of the current pandemic on the Kinnell Group's risks and the effectiveness of controls in the home working environment. Financial risks have been closely monitored with at least weekly assessment of the KH SII Group's solvency position. Our ability to continue to meet our customers' needs has been supported by a move to home working. Operational risks associated with this move have been mitigated by the investments made by the Kinnell Group in IT to support this home working. Further information on the monitoring of risks is provided within Section C.

## C. Risk Profile

### **Appetite and Sensitivity**

The Risk appetite set by the GMB defines how much risk the Kinnell Group is willing and comfortable to take in the pursuit of its strategic objectives. The Risk Appetite Statements have been approved by the GMB and include several significant risks faced in its normal course of business. The Risk Appetite Statements are documented in the ORSA and in the wider Risk Management Framework and are reviewed by the GMB to seek to ensure that their defined appetite for risk is appropriately reflected and can therefore be relied upon to direct business operations.

The stress testing performed provides increased understanding of the potential significant changes to the KH SII Group's risk profile when key underlying components are shocked. This is in addition to the SCR capture of a 1 in 200-year event over a 1-year horizon at a 99.5% limit.

While this is heavily assumptive, the outputs assist the KH SII Group in developing appropriate management actions aimed at effectively managing the potential impacts. More importantly though, the stress testing outputs are used to confirm the appropriateness of the KH SII Group's capital resources. Indeed, it was stress test outputs that identified that an area of further development to mitigate risk was further protection via ADC/LPT reinsurance which could transfer a large proportion of this risk and was pursued at that time by the KH SII Group.

A range of plausible and feasible stress tests have been considered and derived from the business strategy and key risks identified from the Kinnell Group risk management framework and ORSA process. Stress and scenario testing have been modelled, and additional scenarios and reverse stress testing undertaken.

The tests are chosen by assessing the risks that could have the most material financial impact to GPI. They are selected using the 5x5 matrix of measurement of risk, based on likelihood and impact as detailed in the firms Risk Management Strategy and Risk Management Framework. This allows quantification of highest inherent risk scores prior to the implementation of controls or mitigating actions, which form the basis of the tests.

### C.1 Underwriting risk

#### **Underwriting and Core Products**

GPI ensures that proportionate, robust underwriting processes exist to demonstrate to the GMB that major business risks associated with ongoing and new insurance risks that are being underwritten are managed, and that the framework for onboarding and assessment of risks is aligned to the risk appetites set by the GMB, the risk management framework, and internal control framework. The risk management and mitigation tools used monitor loss or adverse changes in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.

The current appetite statements are set by the GMB and drive the business core strategy as follows:

- There is no appetite for undertaking activities that are not aligned with the GMB approved core strategy, and/or undertaking activities for which the KH SII Group does not currently hold the necessary skills and capabilities;
- GPI will only underwrite products within its core area of expertise; being insurance backed guarantees, related extended warranty products, structural warranties and ECO funded projects;

- GMB approval must be sought for any new risks with a contract value in excess of £250,000;
- GPI seeks to limit its term exposure to 10 years for new business with the exception of ECO or Government led business, which has a regulatory requirement of 25 years. GMB approval must be sought for any new risks outside of this tolerance;
- GPI will not write any (new) business outside the UK without GMB approval;
- Any new reinsurance will require GMB approval and any reinsurance placed must be with an 'A-' rated reinsurer (rating assessed using rating agencies S&P and AM Best; the higher of which will be applied).

GPI carries out a number of stress tests on its reserves, the stress tests carried out provide understanding and output of significant analytical changes due to changes in the key deliverables. As this is heavily assumption based dependent on historical data, or estimations of stressed parameters, further scenario testing is carried out. These strategic scenarios allow a greater level of understanding of the risks surrounding potential alternative futures and how the company will manage these risks.

### Sensitivity Analysis

Some high-level sensitivity tests are set out below to demonstrate the impact on the Technical profit and loss account and Profit reserves in the event of a 10% increase on Net operating expenses and claims costs.

	Increase/(decrease) in own funds (capital)	Increase/(decrease) in own funds (capital)
	2019 (£'000)	2018 (£'000)
10% increase in incurred claims costs	(214)	(155)
10% increase in net operating expenses	(164)	(164)

A 10% decrease in both these cost lines creates a reverse effect of the above and increases the own funds capital.

The non-life underwriting risk allocation within the standard formula capital requirement pre-diversification is £5.60m.

### C.2 Market risk

Market risk is the risk of loss resulting from changes in the value of assets and liabilities (including off-balance sheet assets and liabilities) due to fluctuations in risk factors such as interest rates, foreign exchange rates and stock prices and the risk of loss resulting from changes in earnings generated from assets and liabilities.

The market risk allocation within the standard formula capital requirement pre-diversification is £1.94m.

## Foreign currency risk

GPI undertakes certain claims transactions denominated in Euros for its smaller schemes that are in run off. As a result of this small exposure to exchange rate fluctuations arise. Key Risk Indicators are set to highlight any deterioration of GPI's exposure to this risk and should developments become adverse then the currency risk appetite would be reassessed, with possible action such as foreign currency hedging reviewed, although this isn't currently required given the immateriality of the transactions involved.

The following table details the Company's sensitivity to a 10% increase and decrease in the Euro against the GBP on the Euro balance at year end. This demonstrates the low level of risk exposure associated with currency fluctuations.

	Increase/(decrease) in own funds (capital)	Increase/(decrease) in own funds (capital)
	2019 (£'000)	2018 (£'000)
10% increase to € rate on held balance at year end	(20.9)	(9.2)
10% decrease to € rate on held balance at year end	20.9	9.2

## Interest rate risk

Interest rate management is important as the interest rate is a vital input to the calculation for future liabilities. GPI cannot manage the interest rate but can look to manage the impact of any rate change. This is completed through a complex matching exercise calculated by the Chief Actuary, where discounted liabilities (based on the issued risk-free rate) are mapped by maturity to assets of the same characteristics. This matching allows the detriment of interest rate change to be mitigated. GPI will review the portfolio, rebalancing it at approximately 6-monthly intervals.

The Company invests in mixed term debt at fixed interest rates. When interest rates rise, it is usual for the fixed rate securities to decline in value. A decline in interest rates will in general have the opposite effect. There is also an impact on the Profit and Loss Account in respect of the income received from debt securities.

The sensitivity analyses on the profit for the financial year below have been determined based on the exposure to interest rates movement of 0.5% increase or decrease. These parameters are set by management's assessments of the reasonably possible change in interest rates within an annual horizon.

The interest rate change impact on Bonds is calculated using the modified duration of bonds, being the market value cashflows timed to maturity. The fixed interest debtors are inherently not affected by a change in interest rates.



0.5% increase to interest rate on interest bearing assets:

	Increase/(decrease) in own funds (capital)	Increase/(decrease) in own funds (capital)
	2019 (£'000)	2018 (£'000)
Bonds	(216)	(275)
Cash and cash equivalents	34	24

A 0.5% decrease to interest rates creates a reverse effect of the above to the own funds.

The Company's method for sensitivity to interest rate fluctuations has not changed significantly over the financial year.

### Pricing change risk

GPI is exposed to price risk arising from fluctuations in the value of financial instruments because of changes in the market prices and the risks inherent in all investments. Pricing risk is material to GPI as the company has a high ratio of investment funds in relation to annual premium, driven in the main because the business written has a long tail. GPI manages the risk by ensuring it maintains a time-matched concentrated portfolio and utilises the resources of high calibre investment managers. The investment managers are provided with the appropriate mandate detailing GPI's risk appetite and corresponding risk thresholds. The investment mandate is set to capital protection on a low risk strategy.

For the small amount of property owned an external bi-annual valuation carried out by a RICS surveyor is obtained, with management assessing the valuation for property in the intervening periods.

The Company's sensitivity to a 5% increase/decrease on market prices is as follows:

	Increase/(decrease) in own funds (capital)	Increase/(decrease) in own funds (capital)
	2019 (£'000)	2018 (£'000)
5% increase in movement in fair value of debt securities	737	770
5% decrease in movement in fair value of debt securities	(737)	(770)

A 5% decrease to market prices creates a reverse effect of the above to the own funds.

The Company's method for sensitivity to pricing risk management has not changed significantly over the financial year.

## Investment Risk

GPI has appointed professional investment managers LGT Vestra LLP to manage funds on a discretionary basis in line with its investment policy. Invested assets are held directly by GPI and not in nominee. Performance of medium and long-term investments are measured against inflation and agreed market indices aiming for an appropriate return. The return of the short-term reserves is monitored against benchmark cash rates and the credit rating of the holding institutions. The level of capital volatility is monitored by the Asset and Liability Committee (ALC) to ensure the risk profile remains appropriate for GPI. The ALC is responsible for monitoring and reviewing the assets of the business to ensure that assets are invested consistently with the time horizon of the future liabilities of the business, and to ensure that the GMB is furnished with appropriate recommendations in respect of these matters. The shape of the liability tail is used to co-ordinate the asset classes, term, and liquidity to ensure appropriateness and the shape is set by the Chief Actuary (SMF 20). GPI manages its own cash deposits matched to the actuarially assessed short term cash flow schedule. GPI manages its own investment properties, inter-company loans, and any other investments not covered above.

### C.3 Credit risk

Credit risk is most simply defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms.

GPI manages its credit risk through the following actions:

- GPI receives most of its income through direct debit, which mitigates credit risk of customers. Payment sources of residual lines of income are diverse and don't form any material concentration areas. Therefore, credit and counterparty risks are centred upon the recoverability of current assets, and management of concentration risk of investments in line with good risk management and impact to capital requirement of SII SCR calculation.
- Ceasing all new loans and effectively managing the repayment plan for loans in situ, most of which are inter-company arrangements.
- Employee loans in exceptional circumstances are permitted under the discretionary agreement of the Executives, although the gross loan must be capped at the expected net pay amount of the individuals notice period, to negate credit risk.
- In addition to cash, the investment mandate provided to the investment managers permits only investment grade securities. The information is supplied by independent rating agencies where available and if not available, GPI uses other publicly available financial information and its own trading records to provide a form of rating
- All future investment decisions are considered under the Solvency II framework and the prudent person principle.
- Investments are time horizon matched in low volatility, appropriately liquid assets to match the expected liabilities both in value and time. The investment managers ensure the portfolio is spread across funds to minimise concentration risk adhering to the prudent person principle.

GPI does not have any significant credit risk exposure beyond its subsidiary Warranty Services Limited to any single counterparty out with the UK government. The credit risk on liquid funds and financial instruments is limited through the high credit ratings assigned by international credit-rating agencies to the bank counterparties.

All bonds and gilts are at a minimum BBB+ credit rating.

Reinsurance assets are reinsurers' share of claims paid. All reinsurers are minimum A- rating.

Loans and insurance receivables, and investment in subsidiaries generally do not have a credit rating.

The carrying value of assets are neither past due nor impaired.

The counterparty default risk allocation within the standard formula KH SII Group capital requirement pre-diversification is £451k. The standard formulas Solo capital requirement pre-diversification is £446k.

## C.4 Liquidity risk

Liquidity risk is defined as the risk of incurring losses due to an inability to meet payment obligations in a timely manner when they become due. The Kinnell Group has short/medium and long-term cash requirements and balances the liquidity in its portfolio to match this. It manages liquidity risk through the following actions:

- The KH SII Group does not routinely require a regular drawdown from investments, and accumulated income is reinvested.
- The KH SII Group monitors all planned spends beyond the cash flow needs of business as usual and operates a 3-year budgeting process to identify future spends and liquidity requirements.
- The KH SII Group is unlikely to routinely need access to capital held within investments, as its' business as usual requirements are serviced via business as usual cash flow.
- In the event of the KH SII Group moving to a wind down situation then the liquidity of short-term assets and access to these would be required to be reviewed as the cash cycle from trading as a going concern would not be operating but this would form part of a run off plan.
- KH SII Group holds liquidity to service requirements for a period no less than 12 months in ready access cash.
- KH SII Group has no Expected Profits in Future Premium.

## Cash Management

All cash accounts in GPI and the KH SII Group are maintained at a suitable level of credit. In addition to the above the firm has no appetite for the balance in the current account to dip below a determined amount for three consecutive days.

- KH SII Group has no appetite for the monthly projected Liquidity Coverage Ratio to dip below 150% during the next 12 months. The assets of the business are managed by the ALC to maintain this statement.
- All connected counterparty exposures to be less than 20% of total 'Bank' cash deposits.
- All expenses payments shall be paid within payment terms to ensure efficient use of cash resources.
- Currency accounts shall be converted to Sterling within one week of deposit to self-hedge. A residual set equivalent is permitted to be held in currency accounts.
- A cash and dividend policy is in operation for all regulated firms.
- All cash deposits are held as instant access funds which should be deposited with institutions with a minimum short-term rating A- or B+++ (based on the higher of Standard & Poors and Fitch rating agencies). This includes overnight deposits within the investment portfolio cash management account

## Time Horizon assessment

GPI has divided its technical reserves into those expected to be held for immediate, short, medium, and long term. This is decided in line with the claims tail expectation forecast and investments and is managed to meet the investment objective and ensure this mix of terms.

- Immediate 0 - 1 year
- Short term 1 – 2 years
- Medium term 3 – 5 years
- Long term 5 – 25 years

The duration of the liabilities is matched to the investments. The long tail of GPI's technical reserves requires this matching process to be evaluated for appropriateness and this occurs on an annual basis.

## C.5 Operational risk

The Kinnell Group has a low appetite for operational risk. The Kinnell Group acknowledges that some level of operational risk is inherent in any business operation, however, the business keeps operational risk at the lowest degree possible through application of the governance, risk, and control frameworks, and associated resources.

Due to the nature and size of the Kinnell Group, and considering the proportionality principle, Operational Risk is relatively low in relation to our business activity. Exposure to people, systems and control failures, external fraud, conduct risk, and, IT security / cyber risks are considered within the risk management framework to ensure that appropriate focus is maintained that will identify any significant issues that suggest fundamental control failures.

The operational risk allocation within the standard formula capital requirement pre-diversification is £327k, which is the same as the standard formula GPI capital requirement.

## C.6 Other material risks

The following section outlines some other material risk appetite statements that exist within the business.

### **Customer & Conduct Risk Appetite Statement:**

The Kinnell Group has zero appetite for conduct risk and/or customer detriment. By monitoring appropriate measures for fair treatment to customers including complaints data, customer feedback and claims management information we seek to avoid customer detriment and reduce the exposure to conduct risk. Utilisation of tailored internal training models on customer service, fair treatment and ethical conduct further reduces the business's exposure to this risk.

### **Reserve Risk**

The overall provision for unexpired risks is deemed sufficient when it exceeds 125% of the best estimate of premium provision calculated by the independent actuaries. Presently GPI holds sufficiency well in excess of this ratio and therefore has minimal exposure. This is monitored on an ongoing basis.

With the long tail nature of its business GPI is exposed to claims arising in a pattern different to that assumed in the technical provisions. This risk is mitigated by:

- ✓ Setting a clear reserving policy for our business based on what is now a significant history of claims i.e. over the last 15 years;
- ✓ Setting reserves on a prudent basis including an element of margin for uncertainty.

## Capital Adequacy

At year end, KH SII Group holds a 130% solvency coverage (123% - 2018) and GPI holds a 168% solvency coverage (157% - 2018), which is within the prescribed appetite of minimum 110%.

The fluctuations of this ratio are monitored monthly via Key Risk Indicators.

The KH SII Group and GPI is exposed to a number of factors that affect its capital adequacy. The collection of all of these factors have the ability to detrimentally effect profit and subsequently reduce the amount of own funds available for capital resources.

## Reinsurance Exposure

Any new reinsurance will require GMB approval and any reinsurance placed must be with an 'A-' rated reinsurer (rating assessed through the use of rating agencies Standard & Poors and AM Best; the higher of each will be applied). GPI currently has exposure to counterparty risk through its ADC/LPT reinsurance agreement although this is limited to only the ADC proportion as the LPT element is made on a funds withheld basis.

## Claims Risk

For GPI, claims incidences have been largely predictable but generally show some overlap with market risk in that an economic downturn can, to a limited extent, result in higher contractor failure rates which would therefore bring more installations into eligibility for claim should any installation prove to be defective. It is comforting that the significant economic crisis experienced during 2008/9 did not result in an exponential rise in claims - certainly we can identify higher contractor failure rates and higher claims but at a modest level.

A more likely point of volatility is the cost of claims. Reserves have been established assuming current levels of claims remediation costs with an implicit assumption that the net impact of inflation stress tests proves immaterial. The business is therefore exposed to a more significant "spike" in claims remediation costs. This risk is heavily mitigated through the establishment of an in-house remediation company (The Remedial Company Ltd) which undertakes the bulk of the repairs for the 10-year IBG book. The introduction of The Remedial Company Ltd has brought cost of claim volatility down over recent years and is now stabilising. This repair cost is monitored on a monthly basis through the operational risk dashboard and there are management actions in place to further lower costs through operational efficiencies within The Remedial Company Ltd.

It should be noted that the Board has identified the development and extension of The Remedial Company Ltd services externally as a strategic opportunity, and it is likely therefore that some investment in that business will occur to deliver the strategic opportunities identified. Such additional development costs will be ring-fenced and accounted for separately so that the underlying internal claims costs, and subsequent impact on reserves and liabilities, are not distorted.

Lastly, we can be exposed to a spike in high value claims, in particular in structural warranties that can have significantly higher contract values. This risk is mitigated on a go-forward basis through reducing underwriting risk appetite to a cap of £250k in any one loss event, but older policies do exist with higher exposures. While any single large loss is possible in any year, the likelihood of an amalgamation of large losses is extremely remote. Looking forwards, we anticipate greater use of reinsurance to further mitigate larger one-off exposures.

## **Regulatory Risk**

As the Kinnell Group operates in a highly regulated environment, we are cognisant of the exposure to potential regulatory action that may be punitive for the business, financially or reputational. This risk is mitigated through establishing systems and controls that monitor our adherence to regulatory obligations and in particular to our treatment of customers.

## **Strategic Risks**

The exposure to changes in political appetite in the carbon emissions arena and Government generally has reduced in line with our reduced involvement in the insurance of ECO/Green Deal obligations introduced by the Government. However, this does remain an area of significant opportunity, especially with greater cohesion and cooperative working with Certass, and this is reviewed accordingly.

Brexit risks are constantly reviewed, and this is seen as an opportunity to create valuable strategic relationship with EU/non-UK insurers.

## **Operational Resilience**

The Kinnell Group's ability to protect and sustain its critical processes in times of operational stress, pressure and disruption is a key risk that the business is aware of, and is continually working to identify these pressures and enhance the controls and processes in place to limit the operational impact felt should a situation arise. The Kinnell Group recognises that this risk is wider than just IT and cyber risks, and has carried out projects in identifying the Kinnell Group's critical processes, people and infrastructure, in order that it can plan a response should a risk event take place, and restore the critical functions of the business in as short a time frame as possible, meaning minimal disruption to business operations and the Kinnell Group's customers.

## **Cyber Risk**

As a financial services Firm, GPI is vulnerable to becoming a target of data breaches, due to the volume and sensitive nature of the data they hold. In the near future, cyberattacks are going to become more sophisticated as technology develops, and the rise of artificial intelligence can aid attackers. In December 2018, the Firm was subject to a cyber security audit by our internal auditors, Grant Thornton, who made a number of recommendations of enhancements that we could make to our IT infrastructure. These are currently being implemented by the Head of IT, which includes staff training and additional malware protection. The Head of IT is also in the process of obtaining a Cyber Essentials certification for the Firm which helps us to guard against the most common cyber threats and demonstrate our commitment to cyber security. Advances will be monitored to ensure our systems remain as robust as possible to prevent any possible attack.

## **Group Risk**

KH SII Group SCR is calculated on a standard formula basis (SF). In order for the SF to be considered for appropriateness, the risks that are in addition to the solo firms require to be considered at group level, with a subsequent assessment of whether the risk profile of the KH SII Group is materially different to that of the solo.

The SII insurance undertaking (GPI) dominates the KH SII Group significantly and is the predominant business at all levels of the Kinnell Group. The materiality of any further risks noted at Kinnell Group level are heavily diluted by the scale of the Insurance undertaking relative to other Kinnell Group entities. The consideration of appropriateness is not static, and is an on-going process developed to ensure assessments are kept live and maintained to reflect changes to the businesses and the

overarching risk profile. Whilst it is noted that the materiality of additional KH SII Group risks is minor, it is recognised that there are other risks, not solo specific that bite only at KH SII Group level and must be deliberated. The non-exhaustive lists that have been reviewed and their assessment to date are:

- **M&A Risks**

The shareholder entered into a Sale and Purchase agreement on 22 October 2019 which requires certain conditions precedent to be met prior to a legal acquisition occurring including regulatory approvals. At the balance sheet date the conditions precedent had not yet been met. The Sale and Purchase agreement includes a longstop date, five months from the date of signing the Sale and Purchase agreement, terminating the agreement unless an extension is agreed by both parties.

The conditions precedent had not been met by the longstop date and have not been met as at the signing of the financial statements. It is understood by the Directors that the vendor has subsequently agreed to extend the longstop date to 31<sup>st</sup> December 2020, with an irrevocable option for the proposed acquirers to extend the longstop date to 31<sup>st</sup> March 2021, in order to provide the potential acquirer with additional time to satisfy the conditions precedent (inter alia; by submitting a completed change in control form and having this approved by the regulators).

- **Transaction risks**

All the risks involved in intra-Group transactions, which may not be transparent, may result in inappropriate transfers, especially between regulated and unregulated entities and may affect the soundness of regulated entities.

- **Review assessment:**

There are no intercompany transfers of this nature that occur beyond the trading interaction that occurs between the solo firm and is captured in its SCR.

- **Moral hazard risks**

When an entity of Kinnell Group engages in excessive risk-taking under the assumption that the Kinnell Group as a whole, or another Kinnell Group entity, will assist it in the event of problems occurring.

- **Review assessment:**

Whilst all other Kinnell Group companies are operated under a high level of corporate governance that would not lend itself to this type of conduct, the materiality of other companies' size on the Kinnell Group is minor.

- **Double-gearing risk**

The risk that funds will be committed several times, that is, for both the parent company and the subsidiaries.

- **Review assessment:**

Parent company and the respective subsidiary Boards understand that no cross-party guarantees are appropriate in order to include unencumbered capital. As described earlier the SII insurance entity is the overall dominating entity and does not rely on parent capital to satisfy its capital requirement.

- **Contagion Risk:**

The risk that financial problems, especially insolvency, of a member of the Kinnell Group will bring about deterioration in condition of other members.

- **Review assessment:**

The other members are not of a size to influence the main SII insurance entity.

- **Reputational risk:**

Even in the case of strict legal separation, reputation and market-access of the financial group may be harmed by the financial distress of another.

- **Review assessment:**

The Kinnell Holdings Limited Group does not operate as a single unified brand, and in addition the stakeholders of the different Kinnell Group companies are all markedly different. Materiality of the other entities again becomes relevant here, as their significance to the overall SII insurance entity is vastly reduced.

- **Conflict of interest risk**

- **Review assessment:**

The risk of potential conflicts is more or less always present. Research indicates that risk of conflicts of interest increases with the number of activities and products offered. The Kinnell Holdings Limited Group offers predominately one product (IBGs), and we actively manage the conflict of interest declaration register across all Kinnell Group companies, and in accordance with the Insurance Distribution Directive (IDD) a Conflicts of Interest Policy was rolled out in 2018. The materiality of influence from other sources is vastly diluted by the dominance of the insurance entity on Kinnell Group activities.

## C.7 Any other information

### COVID-19 Pandemic

The COVID-19 pandemic has the potential to have significant impacts on each of the main risk categories covered above (Cyber and Data Protection, Liquidity, Solvency, Credit, Reserve and Claims, Reinsurance, and People). Taking each of these in turn:

- Cyber Risk and Data Protection is heightened due to the home working business model to which we have adapted. There is an increased risk of malware infection which is being monitored by the Head of IT and reported into the GMB on a regular basis, to ensure we are not exposed to an unacceptable level of risk which may have a financial impact.
- Liquidity Risk is heightened due to the uncertainty of how the IBG and the insurance market in general will react to the pandemic, and how this will in turn impact the firm's liquidity resources. Our liquidity and cash flows projections are being investigated and reviewed by the business, and discussed at both GMB and Executive level, to ensure we are as aware as possible of the potential risks facing the KH SII Group and mitigating plans can be put in place. The liquidity risk is managed and mitigated by our strategic asset allocation which focusses on liquid gilts and government bond investments. GPI therefore has readily available funds to meet customer claims and to continue to meet the Company's financial obligations as they fall due, without needing to take contingency actions.
- Solvency Risk is heightened due to market uncertainty, with the potential for income levels to be adversely affected and the potential for an increase in both claims and general expenses as a result of the pandemic. Work is being carried out to gain a greater understanding of and



monitor potential future income and expenditure levels, and what actions can be carried out to minimise any potential adverse impact.

- Credit risk is heightened due to 3rd parties ability to make payments. This has been observed by a marked increase in the number of contractors cancelling direct debit mandates. This risk is being mitigated by ongoing work to make contact with contractors with pending charges to collect payment and to enable policies to be issued to consumers. Credit risk is also heightened by 3rd parties who collect money on our behalf, and risk that they do not make the payments as they fall due. This is being mitigated by work is ongoing to contact key 3rd parties to better understand their current position. GPI's investments securities, in particular, have heightened credit risk, however, GPI's risk exposure is limited due to liquid funds being held with high credit rated bank counterparties and financial instruments being UK government bonds. The investment securities credit risk position is monitored regularly.
- Reserve and Claims risk is heightened due to the increased potential for contractors to cease trading, activating the first trigger of the IBG and increasing the likelihood of a spike in future claims received. Claims behaviours are being monitored to ensure we can react quickly to any changes.
- Reinsurance Risk is heightened due to an increased risk that GPI will be unable to obtain further reinsurance cover due the increased strain suffered by reinsurers throughout the pandemic. A number of options being considered moving forward to mitigate the impact of not having sufficient reinsurance cover in place.
- People Risk is heightened due to a number of key person dependencies identified throughout the business, which may cause difficulties if individuals were to contract the virus. There is also a risk that due to the change to the working environment staff do not/are unable to work to maximum efficiency, and a risk that general staff morale is impacted. This is being monitored through daily Executive Team meetings, and managers keeping in regular contact with their respective departments.

Based on the analysis carried out by the Risk function using the latest information available it is expected that the KH SII Group will be resilient to these risks.

The statements on the risks associated with the COVID-19 pandemic are subject to the proviso that risk identification and assessment are of a provisional nature at the time of reporting.

## D. Valuation for Solvency Purposes

### D.1 Assets

The table below sets out the valuation of each asset class for both KH SII Group and GPI. All valuations are based on the Company's and KH SII Group year-end valuation of 31<sup>st</sup> December 2019.

The valuation method for SII purposes for the different asset types are described below. Where the valuation is different to the UK GAAP financial statements the difference in method is provided. Further information on the valuation of assets for UK GAAP financial statements can be found within the Company's financial accounts.

#### KH SII Group

<b>Asset Type</b> <b>2019</b>	<b>Assets per Solvency II</b>	<b>Variance</b>	<b>Assets per UK GAAP</b>
<i>Property UK</i>	225,000	-	225,000
<i>Investment Securities</i>	14,763,777	-	14,763,777
<i>Cash and Cash Equivalents</i>	4,133,059	-	4,133,059
<i>Investments in Subsidiary Undertakings</i>	1,900,100	-	1,900,100
<i>Subsidiary Receivables</i>	689,644	194,329	883,973
<i>Insurance and Intermediary Receivables</i>	334,558	-	334,558
<i>Deferred Tax</i>	348,692	-	348,692
<i>Reinsurance Receivable</i>	74,649	-	74,649
<i>Reinsurance Recoverable</i>	170,196	(170,196)	-
<i>Any other Assets not shown elsewhere</i>	2,900,000	822,313	3,722,313
	<b>25,539,675</b>	<b>846,446</b>	<b>26,386,121</b>

#### GPI - Solo

<b>Asset Type</b> <b>2019</b>	<b>Assets per Solvency II</b>	<b>Variance</b>	<b>Assets per UK GAAP</b>
<i>Property UK</i>	225,000	-	225,000
<i>Investment Securities</i>	14,763,777	-	14,763,777
<i>Cash and Cash Equivalents</i>	4,124,596	-	4,124,596
<i>Investments in Subsidiary Undertakings</i>	1,900,000	-	1,900,000
<i>Subsidiary Receivables</i>	689,644	194,329	883,973
<i>Insurance and Intermediary Receivables</i>	324,270	-	324,270
<i>Deferred Tax</i>	348,669	-	348,669
<i>Reinsurance Receivable</i>	74,649	-	74,649
<i>Reinsurance Recoverable</i>	170,196	(170,196)	-
<i>Any other Assets not shown elsewhere</i>	2,900,000	822,251	3,722,251
	<b>25,520,801</b>	<b>846,384</b>	<b>26,367,185</b>

## Property UK

Land and buildings are valued for Solvency II purposes on the same basis as the annual Financial Statements, which follow UK GAAP. The property held at the balance sheet date was valued independently and reported on 23 December 2019 by DM Hall, Chartered Surveyors, it was prepared in accordance with RICS Valuation – Professional Standards in place at that time and was carried out in their capacity as External Valuers.

## Investment securities

Our investments are valued for Solvency II purposes on the same basis as the annual Financial Statements, which follow UK GAAP which represents fair value. The investments are valued at quoted prices in active markets for the same assets and this is carried out by external investment managers, LGT Vestra LLP.

As at 31st December 2019, the total value of our financial investments was £14.76m, analysed as follows:

	£
Government Bonds	7,516,971
Corporate Bonds	7,246,806
	<b>14,763,777</b>

The investment portfolio is managed by LGT Vestra LLP. The investment mandate held by them is categorised as Low Risk and aims for capital protection alongside a modest yield. The benchmark return is 2% after fees and is currently under review.

## Cash and cash equivalents

The KH SII Group holds £4,064,706 in cash deposits in addition to the £68,353 of cash held within the investment portfolio, which are valued for Solvency II purposes on the same basis as the annual Financial Statements, which follow UK GAAP which represents fair value. The cash is held to meet any short-term liabilities and spread appropriately to limit counterparty and concentration risks.

## Investment in subsidiary undertakings, including participations

The KH SII Group holds investments in subsidiaries for strategic purposes. Intangible assets are fully amortised.

## Subsidiary Receivables

The KH SII Group holds a loan due from its subsidiary. The Solvency II value of this is discounted using the EIOPA yield curve over the term of loan. There is not a material difference to the UK GAAP valuation.

## Insurance and intermediary Receivables

These balances relate to balances due from intermediaries relating to direct insurance operations. These are valued for Solvency II purposes on the same basis as the annual Financial Statements, which follow UK GAAP

## Deferred Tax

The KH SII Group holds a deferred tax asset in relation to overpayment of tax in prior years. The asset can only be utilised through application to future profits. Current financial projections of the KH SII Group indicate that the deferred tax asset of £348,692 is expected to be utilised in the foreseeable future.

This is valued for Solvency II purposes on the same basis as the annual Financial Statements, which follow UK GAAP.

## Reinsurance receivables

Reinsurance receivables relate to the amount owed to us from our reinsurers arising from claims payments made. These are valued for Solvency II purposes on the same basis as the annual Financial Statements, which follow UK GAAP.

## Reinsurance recoverables

Reinsurance recoverables relate to the simulated risk transfer recoveries from the ADC/LPT Insurance contract. The average value of the ADC recoveries across 20,000 simulations using the Monte Carlo simulation method generates the best estimate value of the reinsurance contract for SII valuation purposes. The asset is not recognised under UK GAAP which creates the difference between the two valuation methods.

## Other assets

The remaining assets are valued on the same basis between Solvency II and the UK GAAP balance sheet apart from the large prepayment of reinsurance premium relating to the ADC/LPT reinsurance contract. Prepayments are not recognised for SII valuation purposes which creates the difference between the two valuation methods.

## D.2 Technical Provisions

### Components of Technical Provisions

Technical Provisions represent the current cost of insurance liabilities at the balance sheet date. They are calculated on a discounted cash flow basis and include the following high-level components to be calculated separately:

- Best estimate of claims provisions being claims expected to be incurred at the balance sheet date
- Best estimate of premium provision being claims expected to be incurred after the balance sheet date on contracts incepted prior to that date
- Risk Margin representing the amount a third party would require in addition to the best estimate to assume liability, calculated on a cost of capital basis.

No significant simplifications of the calculation of Technical Provisions are used, and sources of uncertainty, magnitude and likelihood are explained under the different components.

Set out in the table below is a summary of the Solvency II and UK GAAP valuations of technical provisions split between best estimate and risk margin. The reconciling items between UK GAAP and Solvency II are included in the table on page 49.

## KH SII Group and GPI Solo

	Liabilities per Solvency II	Liabilities per UK GAAP
Technical Provisions	10,886,619	19,672,236
Risk Margin	1,717,431	-
	<b>12,604,050</b>	<b>19,672,236</b>

The only material line of business that the Company writes is Miscellaneous Financial Loss and as such the table above covers this class in its entirety.

### Gross claims cash flows and reinsurance recoveries

Our best estimate calculations have been completed on a deterministic basis as per the Directive. GPI has a very small reinsurance portfolio, with only 0.001% of the Technical Provisions covered. The reinsurance contract is on a 50% quota share basis and is placed with an A- rated insurer.

The combined ADC/LPT reinsurance contract transfers the risk of the insurance contracts it covers, and the benefit of the contract is recognised through the premium reserve component of the non-life underwriting module of the SCR. It does not affect the Technical Provisions.

### Claims reserve

The current claims provisions have been developed over time to separate best and prudent elements. The claims provisions on a UK GAAP basis have been used as a starting point for the expected nominal value of the Solvency II future cash flow. We have excluded elements within our UK GAAP provisions which we consider to represent prudence. We have also only included expenses which relate to the cost of handling existing business.

Projected cash flows are estimated by applying payment patterns to the estimate of gross claims and recoveries. These payment patterns have been calculated based on historic trends for each Solvency II line. However, given the relative short-term nature of the payment cycle of outstanding claims, the impact of discounting on our technical provisions is limited. In addition, the short tail nature of the actual claims cost results in low levels of uncertainty. This also applies to the magnitude and likelihood of this Technical provision component not being accurate, as the period open to variable change is short.

### Premium reserve

Premium reserve replaces unearned premium reserve (UPR). Premium reserves are split between future claims element and future expense element. To determine the nominal amount of future claims we take the amount of the UPR for each cohort of business within the UK GAAP accounts and multiply it by the planned loss ratio for the current year. We have included in the amount for expenses which represent our estimate of the cost of handling the remaining element of this business. Sources of uncertainty within this calculation are driven from use of historic trending. Assumptions are used that the past experience will be replicated in the future. However, uncertainty is created if events of the past do not then occur in the future, and conversely, events not in past data, manifest in the future. This is countered by an additional calculation to recognise this. Events Not In Data ('ENID') is used to reduce uncertainty driven by using past data. In addition to the ENID calculation, loss ratios are recalibrated every year, to ensure the most appropriate relevant data is used. The loss ratio data becomes more stable, as more years of data is added to the experience analysis. The recalibration every year reduces the magnitude of any uncertainty as well as the likelihood.

## Discounting

Claims, premium and expense cash flows have been discounted using the EIOPA yield curve.

## Risk Margin

To calculate the risk margin, we have estimated the SCR using the Standard Formula. We have then projected future SCRs using run off patterns for different elements of the SCR. We have discounted and summed the projected SCR's and multiplied this by the cost of capital.

As a key input of the risk margin calculation is the SCR using the standard formula, the ADC/LPT reinsurance contract is relevant here. The reduction through the premium reserve component of the non-life underwriting module of the SCR generates a lower risk margin output.

## Data adjustments and recommendations

Overall, we consider that the Technical Provisions are prepared on a suitable basis, in line with the approach laid down in the legislation and sources of interpretation we have referred to. It is expected that our approach will continue to develop from evolution of industry practice including guidance by the Regulator and our ongoing internal reviews.

### D.3. Other liabilities

Set out in the table below are our other liabilities under Solvency II and UK GAAP. For Solvency II purposes, we have adopted the figures that appear in our UK GAAP financial statements for Other liabilities.

#### KH SII Group

	Liabilities per Solvency II	Liabilities per UK GAAP
Creditors arising out of direct insurance operations	424,386	424,386
Other creditors including taxation and social welfare	3,165,665	3,165,665
Accruals and deferred income	333,197	333,197
<b>Total</b>	<b>3,923,248</b>	<b>3,923,248</b>

#### GPI - Solo

	Liabilities per Solvency II	Liabilities per UK GAAP
Creditors arising out of direct insurance operations	424,386	424,386
Other creditors including taxation and social welfare	518,823	518,823
Accruals and deferred income	292,108	292,108
<b>Total</b>	<b>1,235,317</b>	<b>1,235,317</b>

## D.4 Alternative methods for valuation

No alternative valuation methods are used by the KH SII Group, apart from the valuation of Investment in subsidiary undertakings, including participations, where the KH SII Group holds investments in subsidiaries for strategic purposes. The Solvency II value is lower than the UK GAAP carrying value as intangible assets held by the subsidiary are deducted from the Solvency II valuation.

## D.5 Any other information

### **COVID-19 Pandemic**

Please note that these additional comments on COVID-19 are unaudited. The recent volatility in financial markets and the impact on asset values is being monitored with management plans in place to react as necessary. Investment valuation reports are obtained daily to reassess our exposure and we consider the existing strategic asset allocation is still appropriate. The valuations reported do not reflect the impact of COVID-19 based on the KH SII Group's interpretation of Article 77 (2).

The financial impact of potential claims is difficult to estimate at this stage although we anticipate an increase due to the higher possibility of the activation of the first trigger of IBG, contractors ceasing trading, which could cause a spike in claims in the future. Reinsurance arrangements in place provide further mitigation. However, whilst there is still a significant degree of uncertainty, KH SII Group expects to continue to meet its solvency and capital requirements as required by regulation. The impact of COVID-19 is continuing to evolve at a fast pace, and therefore it is not practicable to quantify the potential financial impact on the KH SII Group at the time of writing.

## E. Capital Management

### E.1 Own funds

KH SII Group is exclusively funded through retained earnings and maintains an efficient capital structure, consistent with the KH SII Group's risk profile and the regulatory requirements of its business. The Company does not hold any other capital such as subordinated debt, preference shares or borrowings.

The KH SII Group's objectives in managing its capital are:

- to match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- to maintain financial strength to support new business growth;
- to satisfy the requirements of its policyholders and regulators;
- to retain financial flexibility by maintaining strong liquidity;
- to allocate capital efficiently to support growth; and
- to comply with quantitative requirements of Pillar 1 of the Solvency II Directive.

Capital Management is embedded within the Risk Management Framework as detailed in Section B3.

The Chief Financial Officer is responsible for the day to day monitoring of KH SII Group and GPI's capital position and monthly updates are provided to the Executive Committee, Board Risk Committee and the Board.

In addition, the ORSA, Medium Term Capital Management Plan (MTCMP) and detailed projections consider capital management over the planning period with no identified short comings. A range of stress and scenario testing has been undertaken and has not highlighted any deficiencies not already captured within the SCR (Standard Formula).

#### **Group Own Funds**

At the 31<sup>st</sup> December 2019, KH SII Group had total funds of £9.01m. These are split between Tier 1 and Tier 3.

The own funds supported the Group Solvency Capital Requirement of £9.01m resulting in a ratio of eligible funds to meet the SCR of 130% and a surplus of £2.07m.

Tier 1 are arising from retained profits arising from past underwriting and investment surpluses. They are available to fully absorb losses on a going-concern basis, as well as in the case of winding-up, meeting all criteria of Article 94 of Directive 2009/138/EC to be classified as Tier 1 own funds. All KH SII Group's Tier 1 funds are unrestricted.

#### **KH SII Group**

<b>Own Funds</b>	<b>31 December 2019</b>	<b>31 December 2018</b>
Own Funds – Tier 1	8,663,685	9,218,236
Own Funds – Tier 3	348,692	370,832
<b>Total</b>	<b>9,012,377</b>	<b>9,589,068</b>

The decrease in Own Funds in the year relates to the impairment of investments in subsidiary undertakings, the utilisation of the deferred tax asset and a small increase in best estimates due to a deterioration in legacy closed schemes, whereas the core business claims have performed favourably to management expectations.



The following table reconciles the differences (reconciliation reserve) between the equity in the financial statements and the excess of the assets over liabilities as calculated for solvency purposes:

<b>Reconciliation of Basic Own Funds to Equity in UK GAAP Financial Statements</b>	<b>31 December 2019 £m</b>	<b>31 December 2018 £m</b>
<b>Total Equity in UK GAAP Financial Statements</b>	<b>2.791</b>	<b>2.867</b>
<b>Deduct items not recognised in Financial Statements</b>		
1. Risk Margin	(1.717)	(1.899)
2. Difference between BEL and Technical Provisions	8.786	9.499
3. Movement in valuation of subsidiary	0	0
4. Difference between Tangible Assets	(0.001)	(0.002)
5. Difference between Prepayments	(1.017)	(1.029)
6. Introduction of Reinsurance Recoverable	0.170	0.154
<b>Solvency II – Basic Own Funds</b>	<b>9.012</b>	<b>9.590</b>

The differences in relation to the equity in the financial statements and the excess of the assets over liabilities as calculated for solvency purposes relates to the following six adjustments:

1. The risk margin calculation is a SII calculation and is not recognised within the UK GAAP financial statements.
2. The difference between the Best Estimate of Liabilities and the UK GAAP financial statements relates to timing differences on revenue recognition. This difference is more pronounced in GPI's comparison as the timing differences can be spread up to 25 years. The straight-line earning pattern in the financial statements does not match to the ultimate expected liability of the Solvency II valuation.
3. The Solvency II valuation of the Investment in subsidiary requires the deduction of any intangible assets held by the subsidiary from the UK GAAP financial Statement value.
4. Tangible assets are not recognised in the Solvency II valuation.
5. The Solvency II valuation of prepayments is to recognise cost at onset; however, UK GAAP financial reporting requires the cost to be incurred straight line over the term of the prepayment.
6. The Solvency II valuation of Reinsurance recoverables is the simulated risk transfer recoveries and is not recognised within the UK GAAP financial statements.

None of the KH SII Group's own funds are subject to transitional arrangements and the KH SII Group has no ancillary own funds. No deductions are applied to own funds and there are no material restrictions affecting their availability. The Tier 3 own funds based on deferred tax is not transferable as the asset is tied to profits made by GPI Solo.

There is potential volatility in the reconciliation reserve regarding point 2 in relation to the valuation of Best Estimate of Liabilities. This occurs in two areas.

The first is if there was movement in the discount rate applied to the Best Estimate calculation, this is countered by a time matched investment portfolio in government and corporate bonds, to serve the output of the expected liabilities. This asset liability method helps to protect against volatility in this area. Information on Interest rate risk can be found on page 39.

The second area of volatility in this area is regarding the sensitivity of loss ratios used to calculate the Best Estimate of Liabilities. The long-term nature of the majority of policies increases the sensitivity of the calculation due to the large value of unearned premium reserve in relation to annual gross written premium. This is reflected in proportionally large value of the Non-Life Underwriting risk of the SCR calculation, which is detailed in section E2.

### **GPI – Solo Own Funds**

At the 31st December 2019 GPI had total own funds of £11.68m. These are split between Tier 1 and Tier 3.

The own funds supported the Solvency Capital Requirement of £6.94m resulting in a ratio of eligible funds to meet the SCR of 168% and a surplus of £4.74m. The Minimum Capital Requirement (MCR), a minimum level below which the amount of financial resources should not fall was £2.36m, resulting in a ratio of eligible funds to meet the MCR of 480%.

Tier 1 are arising from retained profits arising from past underwriting and investment surpluses. They are available to fully absorb losses on a going-concern basis, as well as in the case of winding-up, meeting all criteria of Article 94 of Directive 2009/138/EC to be classified as Tier 1 own funds. All GPI's Tier 1 funds are unrestricted.

Tier 3 funds are in relation to a deferred tax asset. This has arisen from overpayment of tax in prior years and can only be used against future profits. It is expected to be utilised in the foreseeable future.

<b>Own Funds</b>	<b>31 December 2019</b>	<b>31 December 2018</b>
Own Funds – Tier 1	11,332,765	11,362,752
Own Funds – Tier 3	348,669	370,652
<b>Total</b>	<b>11,681,434</b>	<b>11,733,404</b>

The marginal decrease in Own Funds in the year relates to the utilisation of the deferred tax asset and a small increase in best estimates due to a deterioration in legacy closed schemes, whereas the core business claims have performed favourably to management expectations.

The following table reconciles the differences (reconciliation reserve) between the equity in the financial statements and the excess of the assets over liabilities as calculated for solvency purposes:

<b><i>Reconciliation of Basic Own Funds to Equity in UK GAAP Financial Statements</i></b>	<b>31 December 2019 £m</b>	<b>31 December 2018 £m</b>
<b><i>Total Equity in UK GAAP Financial Statements</i></b>	<b>5.460</b>	<b>5.008</b>
<b><i>Deduct items not recognised in Financial Statements</i></b>		
1. Risk Margin	(1.717)	(1.899)
2. Difference between BEL and Technical Provisions	8.786	9.499
3. Movement in valuation of subsidiary	0	0
4. Difference between Tangible Assets	(0.001)	(0.002)
5. Difference between Prepayments	(1.017)	(1.027)
6. Introduction of Reinsurance Recoverable	0.170	0.155
<b><i>Solvency II – Basic Own Funds</i></b>	<b>11.681</b>	<b>11.734</b>

The differences in relation to the equity in the financial statements and the excess of the assets over liabilities as calculated for solvency purposes relates to the following six adjustments:

1. The risk margin calculation is a SII calculation and is not recognised within the UK GAAP financial statements.
2. The difference between the Best Estimate of Liabilities and the UK GAAP financial statements relates to timing differences on revenue recognition. This difference is more pronounced in GPI's comparison as the timing differences can be spread up to 25 years. The straight-line earning pattern in the financial statements does not match to the ultimate expected liability of the Solvency II valuation.
3. The Solvency II valuation of the Investment in subsidiary requires the deduction of any intangible assets held by the subsidiary from the UK GAAP financial Statement value.
4. Tangible assets are not recognised in the Solvency II valuation.
5. The Solvency II valuation of prepayments is to recognise cost at onset; however, UK GAAP financial reporting requires the cost to be incurred straight line over the term of the prepayment.
6. The Solvency II valuation of Reinsurance recoverables is the simulated risk transfer recoveries and is not recognised within the UK GAAP financial statements.

None of the Company's own funds are subject to transitional arrangements and the Company has no ancillary own funds. No deductions are applied to own funds and there are no material restrictions affecting their availability. The Tier 3 own funds based on deferred tax is not transferable as the asset is tied to profits made by the Company.

There is potential volatility in the reconciliation reserve regarding point 2 in relation to the valuation of Best Estimate of Liabilities. This occurs in two areas.

The first is if there was movement in the discount rate applied to the Best Estimate calculation, this is countered by a time matched investment portfolio in government and corporate bonds, to serve the output of the expected liabilities. This asset liability method helps to protect against volatility in this area. Information on Interest rate risk can be found on page 39.

The second area of volatility in this area is regarding the sensitivity of loss ratios used to calculate the Best Estimate of Liabilities. The long-term nature of the majority of policies increases the sensitivity of the calculation due to the large value of unearned premium reserve in relation to annual gross written premium. This is reflected in proportionally large value of the Non-Life Underwriting risk of the SCR calculation, which is detailed in section E2.

## E.2 Solvency Capital Requirement and Minimum Capital Requirement

KH SII Group SCR is calculated on an accounting consolidation method. The KH SII Group applies the standard formula for the calculation of the Solvency Capital Requirement.

	31 December 2019 £m	31 December 2018 £m
GPI SCR	6.937	7.478
Kinnell Holdings Ltd SCR	0.002	0.337
<b>KH SII Group SCR</b>	<b>6.939</b>	<b>7.815</b>

The diversification benefit increases by £2k at KH SII Group level.

### KH SII Group

SCR – By Risk Category	31 December 2019 £m	31 December 2018 £m
Non-Life Underwriting risk	5,599,696	6,103,783
Market risk	1,942,107	2,720,732
Counterparty default risk	450,557	429,895
Diversification benefit	(1,379,533)	(1,747,377)
<b>Basic Solvency Capital Requirement</b>	<b>6,612,827</b>	<b>7,507,033</b>
Operational risk	326,599	308,342
<b>Solvency Capital Requirement</b>	<b>6,939,426</b>	<b>7,815,375</b>

The Minimum consolidated KH SII Group solvency capital requirement is £6.94m.

No capital add-on is applied and undertaking specific parameters (USPs) are not used. The KH SII Group's SCR is calculated by applying the Standard Formula method without use of any simplifications.

The KH SII Group minimum capital requirement (MCR) is equivalent to the Solo MCR for GPI and is calculated as a linear function of a set or sub-set of the following variables: GPI's technical provisions, written premiums, capital at risk, deferred tax, and administrative expenses. The variables are measured net of reinsurance.

### GPI – Solo SCR

GPI's SCR is calculated by applying the Standard Formula method without use of any undertaking specific parameters (USPs). The Board and its external advisors have confirmed its appropriateness.

The calculation of the SCR under SF and the extensive interaction with external consultants to prepare and understand the drivers within the capital modelling process has highlighted two key drivers of the model kernel for GPI, being Non-Life Underwriting Risk and Market Risk.

A summary of the breakdown of the SCR at 31 December 2019 is shown below:

<b>SCR – By Risk Category</b>	<b>31 December 2019 £m</b>	<b>31 December 2018 £m</b>
Non-Life Underwriting risk	5,599,696	6,103,783
Market risk	1,942,097	2,114,958
Counterparty default risk	445,520	424,134
Diversification benefit	(1,377,336)	(1,473,422)
<b>Basic Solvency Capital Requirement</b>	<b>6,609,977</b>	<b>7,169,453</b>
Operational risk	326,599	308,342
<b>Solvency Capital Requirement</b>	<b>6,936,576</b>	<b>7,477,795</b>

The material impact of the ADC/LPT insurance contract can be seen on the Non-Life Underwriting risk module. In addition, the continuing rebalancing of assets into a more efficient matched structure of Government and Corporate Bonds reduces the associated Market risk calculation of the portfolio.

The minimum capital requirement (MCR) is calculated as a linear function of a set or sub-set of the following variables: GPI's technical provisions, written premiums, capital at risk, deferred tax, and administrative expenses. The variables are measured net of reinsurance.

The overall MCR calculation outputs for current and prior years are shown below.

<b>Overall MCR Calculation</b>	<b>31 December 2019 £m</b>	<b>31 December 2018 £m</b>
Linear MCR	2,362,716	2,256,795
SCR	6,936,576	7,477,795
MCR Cap	3,121,459	3,365,008
MCR Floor	1,734,144	1,869,449
Combined MCR	2,362,716	2,256,795
Absolute floor of the MCR	2,153,325	2,221,825
<b>Minimal Capital Requirement</b>	<b>2,362,716</b>	<b>2,256,795</b>

The reduction in the SCR relating to the application of the ADC/LPT reinsurance contract affecting the Non-Life underwriting risk module and investment portfolio rebalance affecting Market risk, in turn drives a reduction in the MCR, as its output is driven as a percentage of the SCR.

The SCR at 31 December 2019 is calculated to be £6,936,576.

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

KH SII Group, nor GPI has not opted to use the duration-based equity risk sub-module, of the Solvency II regulations.

### E.4 Differences between the standard formula and any internal model used

KH SII Group, nor GPI does not use nor has any short-term intention of using an internal model therefore no differences exist.

## E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement

During the full reporting period KH SII Group and GPI were compliant with their MCR and SCR.

## E.6 Any other information

We have set out to fully comply with the Standard Formula calculation of MCR and SCR and are not aware of any non-compliance. There is a risk within areas of interpretation as to the methodologies and procedures in arriving at these outputs. The GMB utilises the expertise of its internal and external advisors to ensure that industry benchmarking, shared knowledge, procedures, and learnings help to mitigate this. To date we have not identified any area where these uncertainties are likely to lead to a material misstatement of our capital requirements.

### **COVID-19 Pandemic**

Please note that these additional comments on COVID-19 are unaudited. In view of the Solvency II solvency ratio of 168% as at 31 December 2019 and the stress tests performed, the KH SII Group does not expect any breach of its Solvency Capital Requirement. This statement also applies in the context of the current COVID-19 pandemic. Based on the information available at the end of March and under current laws and regulation, we expect GPI to continue to be sufficiently capitalised in compliance with the regulatory Solvency Capital Requirement. The risks associated with the further course of the current pandemic are assessed on the basis of specific analyses. The KH SII Group is continuing to monitor its solvency position as described in Section C and has identified contingency options which can be taken if necessary. The impact of COVID-19 is continuing to evolve at a fast pace, and therefore it is not practicable to quantify the potential financial impact on the Company at the time of writing.

## Appendix i: Directors' statement in respect of the SFCR

We acknowledge our responsibility for preparing the SFCR in all material respects in accordance with the PRA Rules and the Solvency II Regulations.

We are satisfied that:

- a) throughout the financial year in question, the insurer has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable to the insurer; and
- b) it is reasonable to believe that the insurer has continued so to comply subsequently and will continue so to comply in future.

On behalf of the Board

*C A Ritchie*

C A Ritchie (Jul 14, 2020 12:01 GMT+1)

Carol Ritchie

Interim CFO

Date: Jul 14, 2020

## Appendix ii: External independent auditor's opinion

### Report of the external independent auditors to the Directors of Kinnell Holdings Limited ('the Company')

#### Report on the Audit of the relevant elements of the Group Solvency and Financial Condition Report

##### Opinion

We have audited the following documents prepared by the Company as at 31<sup>st</sup> December 2019:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Group Solvency and Financial Condition Report of the Company as at 31<sup>st</sup> December 2019, (**'the Narrative Disclosures subject to audit'**); and
- Group templates S.02.01.02, S.23.01.22, and S32.01.22 (**'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 Group Solvency and Financial Condition Report'**.

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:

- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Group Solvency and Financial Condition Report;
- Group templates S.05.01.02 and S.05.02.01;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Group Solvency and Financial Condition Report (**'the Responsibility Statement'**).

In our opinion, the information subject to audit in the relevant elements of the Group Solvency and Financial Condition Report of the Company as at 31<sup>st</sup> December 2019 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.

##### 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 *Auditors' Responsibilities for the Audit of the relevant elements of the Group 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 Group Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard 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.



## Conclusions relating to going concern

ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the Group Solvency and Financial Condition Report is not appropriate; or
- the directors have not disclosed in the Group Solvency and Financial Condition Report any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Group Solvency and Financial Condition Report is authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

### Emphasis of Matter - Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' sections of the Group Solvency and Financial Condition Report, which describe the basis of accounting. The Group Solvency and Financial Condition Report 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 Group Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Group Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

### Other Information

The Directors are responsible for the Other Information.

Our opinion on the relevant elements of the Group Solvency and Financial Condition Report does not cover the Other Information and we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Group Solvency and Financial Condition Report, 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 Group Solvency and Financial Condition Report, or our knowledge obtained in 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 Group Solvency and Financial Condition Report or a material misstatement of the Other Information. 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 Group Solvency and Financial Condition Report

The Directors are responsible for the preparation of the Group Solvency and Financial Condition Report 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, as detailed below:

Modification to exclude 6 companies from group supervision.

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

The Directors have elected to comply with the External Audit Part of the PRA Rulebook for Solvency II firms as if it applied to the Company, notwithstanding that the Company is a small firm for external audit purposes (as defined in the PRA Rulebook).

### **Auditors' Responsibilities for the Audit of the relevant elements of the Group Solvency and Financial Condition Report**

It is our responsibility to form an independent opinion as to whether the information subject to audit in the relevant elements of the Group Solvency and Financial Condition Report is prepared, in all material respects, in accordance 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 Group Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 Group Solvency and Financial Condition Report.

A further description of our responsibilities for the audit is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditors' report.

This report, including the opinion, has been prepared for the Board of Directors of the Company in accordance with our letter of engagement dated 22<sup>nd</sup> November 2019 and External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook as if it applied to the Company, and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose or to any other party save where expressly agreed by our prior consent in writing.

### **Report on Other Matters**

The Directors have requested that we consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Company's statutory financial statements as if the Company was subject to the External Audit Part of the PRA Rulebook for Solvency II firms. 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.



*PricewaterhouseCoopers LLP  
Chartered Accountants  
141 Bothwell Street  
14 July 2020*



# GUARANTEE PROTECTION INSURANCE LIMITED

Solvency and Financial  
Condition Report

Disclosures

31 December

**2019**

(Monetary amounts in GBP thousands)

## General information

Participating undertaking name	GUARANTEE PROTECTION INSURANCE LIMITED
Group identification code	213800X5UHKV2UWAE715
Type of code of group	LEI
Country of the group supervisor	GB
Language of reporting	en
Reporting reference date	31 December 2019
Currency used for reporting	GBP
Accounting standards	Local GAAP
Method of Calculation of the group SCR	Standard formula
Method of group solvency calculation	Method 1 is used exclusively
Matching adjustment	No use of matching adjustment
Volatility adjustment	No use of volatility adjustment
Transitional measure on the risk-free interest rate	No use of transitional measure on the risk-free interest rate
Transitional measure on technical provisions	No use of transitional measure on technical provisions

## List of reported templates

- S.02.01.02 - Balance sheet
- S.05.01.02 - Premiums, claims and expenses by line of business
- S.05.02.01 - Premiums, claims and expenses by country
- S.23.01.22 - Own Funds
- S.25.01.22 - Solvency Capital Requirement - for groups on Standard Formula
- S.32.01.22 - Undertakings in the scope of the group

S.02.01.02

Balance sheet

		Solvency II value
		C0010
<b>Assets</b>		
R0030	Intangible assets	
R0040	Deferred tax assets	349
R0050	Pension benefit surplus	
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	19,789
R0080	<i>Property (other than for own use)</i>	225
R0090	<i>Holdings in related undertakings, including participations</i>	1,900
R0100	<i>Equities</i>	0
R0110	<i>Equities - listed</i>	
R0120	<i>Equities - unlisted</i>	
R0130	<i>Bonds</i>	14,764
R0140	<i>Government Bonds</i>	7,517
R0150	<i>Corporate Bonds</i>	7,247
R0160	<i>Structured notes</i>	0
R0170	<i>Collateralised securities</i>	0
R0180	<i>Collective Investments Undertakings</i>	2,700
R0190	<i>Derivatives</i>	0
R0200	<i>Deposits other than cash equivalents</i>	200
R0210	<i>Other investments</i>	0
R0220	Assets held for index-linked and unit-linked contracts	
R0230	Loans and mortgages	690
R0240	<i>Loans on policies</i>	0
R0250	<i>Loans and mortgages to individuals</i>	
R0260	<i>Other loans and mortgages</i>	690
R0270	Reinsurance recoverables from:	170
R0280	<i>Non-life and health similar to non-life</i>	170
R0290	<i>Non-life excluding health</i>	170
R0300	<i>Health similar to non-life</i>	
R0310	<i>Life and health similar to life, excluding index-linked and unit-linked</i>	0
R0320	<i>Health similar to life</i>	
R0330	<i>Life excluding health and index-linked and unit-linked</i>	
R0340	<i>Life index-linked and unit-linked</i>	
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	
R0370	Reinsurance receivables	75
R0380	Receivables (trade, not insurance)	335
R0390	Own shares (held directly)	
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	4,133
R0420	Any other assets, not elsewhere shown	
R0500	<b>Total assets</b>	<b>25,540</b>

## S.02.01.02

## Balance sheet

		Solvency II value
		C0010
<b>Liabilities</b>		
R0510	Technical provisions - non-life	12,604
R0520	<i>Technical provisions - non-life (excluding health)</i>	12,604
R0530	<i>TP calculated as a whole</i>	
R0540	<i>Best Estimate</i>	10,887
R0550	<i>Risk margin</i>	1,717
R0560	<i>Technical provisions - health (similar to non-life)</i>	0
R0570	<i>TP calculated as a whole</i>	
R0580	<i>Best Estimate</i>	
R0590	<i>Risk margin</i>	
R0600	Technical provisions - life (excluding index-linked and unit-linked)	0
R0610	<i>Technical provisions - health (similar to life)</i>	0
R0620	<i>TP calculated as a whole</i>	
R0630	<i>Best Estimate</i>	
R0640	<i>Risk margin</i>	
R0650	<i>Technical provisions - life (excluding health and index-linked and unit-linked)</i>	0
R0660	<i>TP calculated as a whole</i>	
R0670	<i>Best Estimate</i>	
R0680	<i>Risk margin</i>	
R0690	Technical provisions - index-linked and unit-linked	0
R0700	<i>TP calculated as a whole</i>	
R0710	<i>Best Estimate</i>	
R0720	<i>Risk margin</i>	
R0740	Contingent liabilities	0
R0750	Provisions other than technical provisions	
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	
R0780	Deferred tax liabilities	
R0790	Derivatives	0
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	
R0820	Insurance & intermediaries payables	424
R0830	Reinsurance payables	
R0840	Payables (trade, not insurance)	3,499
R0850	Subordinated liabilities	0
R0860	<i>Subordinated liabilities not in BOF</i>	
R0870	<i>Subordinated liabilities in BOF</i>	0
R0880	Any other liabilities, not elsewhere shown	
R0900	<b>Total liabilities</b>	16,527
R1000	<b>Excess of assets over liabilities</b>	9,012

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)											Line of business for: accepted non-proportional reinsurance				Total	
	Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Misc. financial loss	Health	Casualty	Marine, aviation and transport		Property
	C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0200
<b>Premiums written</b>																	
R0110 Gross - Direct Business												3,341					3,341
R0120 Gross - Proportional reinsurance accepted																	0
R0130 Gross - Non-proportional reinsurance accepted																	0
R0140 Reinsurers' share																	0
R0200 Net												3,341					3,341
<b>Premiums earned</b>																	
R0210 Gross - Direct Business												3,773					3,773
R0220 Gross - Proportional reinsurance accepted																	0
R0230 Gross - Non-proportional reinsurance accepted																	0
R0240 Reinsurers' share																	0
R0300 Net												3,773					3,773
<b>Claims incurred</b>																	
R0310 Gross - Direct Business												2,075					2,075
R0320 Gross - Proportional reinsurance accepted																	0
R0330 Gross - Non-proportional reinsurance accepted																	0
R0340 Reinsurers' share												-75					-75
R0400 Net												2,149					2,149
<b>Changes in other technical provisions</b>																	
R0410 Gross - Direct Business												-433					-433
R0420 Gross - Proportional reinsurance accepted																	0
R0430 Gross - Non-proportional reinsurance accepted																	0
R0440 Reinsurers' share																	0
R0500 Net												-433					-433
<b>Expenses incurred</b>												1,855					1,855
R1200 Other expenses																	
R1300 Total expenses																	1,855







S.23.01.22

**Own Funds**

**Basic own funds before deduction for participations in other financial sector**

**Own funds when using the D&A, exclusively or in combination of method 1**

- R0450 Own funds aggregated when using the D&A and combination of method
- R0460 Own funds aggregated when using the D&A and combination of method net of IGT
- R0520 Total available own funds to meet the consolidated group SCR (excluding own funds from other financial sector and from the undertakings included via D&A )
- R0530 Total available own funds to meet the minimum consolidated group SCR
- R0560 Total eligible own funds to meet the consolidated group SCR (excluding own funds from other financial sector and from the undertakings included via D&A )
- R0570 Total eligible own funds to meet the minimum consolidated group SCR (group)
- R0610 **Minimum consolidated Group SCR**
- R0650 **Ratio of Eligible own funds to Minimum Consolidated Group SCR**
- R0660 **Total eligible own funds to meet the group SCR (including own funds from other financial sector and from the undertakings included via D&A )**
- R0680 **Group SCR**
- R0690 **Ratio of Eligible own funds to group SCR including other financial sectors and the undertakings included via D&A**

**Reconciliation reserve**

- R0700 Excess of assets over liabilities
- R0710 Own shares (held directly and indirectly)
- R0720 Forseeable dividends, distributions and charges
- R0730 Other basic own fund items
- R0740 Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds
- R0750 Other non available own funds
- R0760 **Reconciliation reserve**

**Expected profits**

- R0770 Expected profits included in future premiums (EPIFP) - Life business
- R0780 Expected profits included in future premiums (EPIFP) - Non- life business
- R0790 **Total Expected profits included in future premiums (EPIFP)**

<b>Total</b>	<b>Tier 1 unrestricted</b>	<b>Tier 1 restricted</b>	<b>Tier 2</b>	<b>Tier 3</b>
C0010	C0020	C0030	C0040	C0050
0				
0				
9,012	8,664	0	0	349
8,664	8,664	0	0	
9,012	8,664	0	0	349
8,664	8,664	0	0	
6,939				
124.85%				
9,012	8,664	0	0	349
6,939				
129.87%				
C0060				
9,012				
349				
0				
8,664				
0				

5.25.01.22

Solvency Capital Requirement - for groups on Standard Formula

- R0010 Market risk
- R0020 Counterparty default risk
- R0030 Life underwriting risk
- R0040 Health underwriting risk
- R0050 Non-life underwriting risk
- R0060 Diversification

R0070 Intangible asset risk

R0100 **Basic Solvency Capital Requirement**

**Calculation of Solvency Capital Requirement**

- R0130 Operational risk
- R0140 Loss-absorbing capacity of technical provisions
- R0150 Loss-absorbing capacity of deferred taxes
- R0160 Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC
- R0200 **Solvency Capital Requirement excluding capital add-on**
- R0210 Capital add-ons already set
- R0220 **Solvency capital requirement for undertakings under consolidated method**

**Other information on SCR**

- R0400 Capital requirement for duration-based equity risk sub-module
- R0410 Total amount of Notional Solvency Capital Requirements for remaining part
- R0420 Total amount of Notional Solvency Capital Requirements for ring fenced funds
- R0430 Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios
- R0440 Diversification effects due to RFF nSCR aggregation for article 304
- R0470 Minimum consolidated group solvency capital requirement

**Information on other entities**

- R0500 Capital requirement for other financial sectors (Non-insurance capital requirements)
- R0510 *Credit institutions, investment firms and financial institutions, alternative investment funds managers, UCITS management companies*
- R0520 *Institutions for occupational retirement provisions*
- R0530 *Capital requirement for non-regulated entities carrying out financial activities*
- R0540 Capital requirement for non-controlled participation requirements
- R0550 Capital requirement for residual undertakings

**Overall SCR**

- R0560 SCR for undertakings included via D&A
- R0570 **Solvency capital requirement**

Gross solvency capital requirement	USP	Simplifications
C0110	C0090	C0120
1,942		
451		
0		
0		
5,600		
-1,380		
0		
6,613		
C0100		
327		
0		
0		
0		
6,939		
0		
6,939		
0		
0		
0		
0		
0		
6,939		
0		
0		
0		
0		
0		
0		
0		
0		
0		
6,939		

**USP key**

**For life underwriting risk:**  
 1 - Increase in the amount of annuity benefits  
 9 - None

**For health underwriting risk:**  
 1 - Increase in the amount of annuity benefits  
 2 - Standard deviation for NSLT health premium risk  
 3 - Standard deviation for NSLT health gross premium risk  
 4 - Adjustment factor for non-proportional reinsurance  
 5 - Standard deviation for NSLT health reserve risk  
 9 - None

**For non-life underwriting risk:**  
 4 - Adjustment factor for non-proportional reinsurance  
 6 - Standard deviation for non-life premium risk  
 7 - Standard deviation for non-life gross premium risk  
 8 - Standard deviation for non-life reserve risk  
 9 - None

S.32.01.22

Undertakings in the scope of the group

	Country	Identification code of the undertaking	Type of code of the ID of the undertaking	Legal Name of the undertaking	Type of undertaking	Legal form	Category (mutual/non mutual)	Supervisory Authority
Row	C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080
1	GB	213800X5UHKV2UWAE715	LEI	Guarantee Protection Insurance Limited	Non life insurance undertaking	Companies limited by shares	Non-mutual	Prudential Regulatory Authority
2	GB	213800X5UHKV2UWAE715GB001	Specific code	Kinnell Holdings Limited	Insurance holding company as defined in Article 212(1) (f) of Directive 2009/138/EC	Companies limited by shares	Non-mutual	Prudential Regulatory Authority
3	GB	213800X5UHKV2UWAE715GB999	Specific code	Millburn Insurance Company Ltd	Life insurance undertaking	Companies limited by shares	Non-mutual	Prudential Regulatory Authority
4	GB	213800X5UHKV2UWAE715GB000	Specific code	Warranty Services Limited	Other	Companies limited by shares	Non-mutual	Prudential Regulatory Authority
5	GB	213800X5UHKV2UWAE715GB001	Specific code	Kinnell Corporate Limited	Other	Companies limited by shares	Non-mutual	Prudential Regulatory Authority
6	GB	213800X5UHKV2UWAE715GB001	Specific code	Confederation Holdings Limited	Other	Companies limited by shares	Non-mutual	Prudential Regulatory Authority
7	GB	213800X5UHKV2UWAE715GB001	Specific code	Remedial Company Limited	Other	Companies limited by shares	Non-mutual	Prudential Regulatory Authority

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Undertakings in the scope of the group

Country	Identification code of the undertaking	Type of code of the ID of the undertaking	Criteria of influence					Inclusion in the scope of Group supervision		Group solvency calculation		
			% capital share	% used for the establishment of consolidated accounts	% voting rights	Other criteria	Level of influence	Proportional share used for group solvency calculation	YES/NO	Date of decision if art. 214 is applied	Method used and under method 1, treatment of the undertaking	
C0010	C0020	C0030	C0180	C0190	C0200	C0210	C0220	C0230	C0240	C0250	C0260	
1	GB	213800X5UHKV2UWAE715	LEI	100.00%	100.00%	100.00%		Dominant		Included in the scope		Method 1: Full consolidation
2	GB	213800X5UHKV2UWAE715GB001	Specific code							Included in the scope		Method 1: Full consolidation
3	GB	213800X5UHKV2UWAE715GB999	Specific code	100.00%	100.00%	100.00%		Significant		Not included in the scope (art. 214 b)	2015-12-15	No inclusion in the scope of group supervision as defined in Art. 214 Directive 2009/138/EC
4	GB	213800X5UHKV2UWAE715GB000	Specific code	100.00%	100.00%	100.00%		Significant		Not included in the scope (art. 214 b)	2015-12-15	No inclusion in the scope of group supervision as defined in Art. 214 Directive 2009/138/EC
5	GB	213800X5UHKV2UWAE715GB001	Specific code	100.00%	100.00%	100.00%		Significant		Not included in the scope (art. 214 b)	2015-12-15	No inclusion in the scope of group supervision as defined in Art. 214 Directive 2009/138/EC
6	GB	213800X5UHKV2UWAE715GB001	Specific code	100.00%	100.00%	100.00%		Significant		Not included in the scope (art. 214 b)	2015-12-15	No inclusion in the scope of group supervision as defined in Art. 214 Directive 2009/138/EC
7	GB	213800X5UHKV2UWAE715GB001	Specific code	100.00%	100.00%	100.00%		Significant		Not included in the scope (art. 214 b)	2015-12-15	No inclusion in the scope of group supervision as defined in Art. 214 Directive 2009/138/EC