Liberty Mutual Insurance Europe Limited

Solvency and Financial Condition Report
As at 31st December 2016

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SUMMARY

Introduction

This Solvency and Financial Condition Report (SFCR) has been prepared to satisfy the requirements of Article 292 of the Delegated Acts for the implementation of Solvency II, for Liberty Mutual Insurance Europe Limited (LMIE), or the ‘Company’ for the year ended 31 December 2016. This is the first such Report following the implementation of the Solvency II regime for 2016.

LMIE operates within the Liberty Specialty Markets (LSM) organisation, representing Liberty Mutual Group’s (LMG) Global Specialty business unit in the London Market, together with Liberty Syndicate 4472 at Lloyd’s. Our policies and procedures are written at LSM level, this is because we manage our business and strategy at LSM level, whilst maintaining appropriate oversight over legal entities.

LMIE writes a diverse portfolio of lines of business, including property, general liability, directors and officers, professional indemnity, credit and suretyship, and has a branch network encompassing a number of offices in key European cities, together with Hong Kong and Malaysia, and Dubai, where business is written through an LSM intermediary.

The Company took the decision to cease its branch activities in Asia, resulting in the exit from the Malaysia branch during the year, with cessation of branch activities in Hong Kong planned for 2017. In addition, the Company closed a number of UK branch network offices during the preceding year, allowing it to focus on a strategy of growth in European markets.

LMIE is assessing the various options available which would enable the company to continue to support our current and potential future offerings within Europe, following the UK decision to leave the EU.

Business and performance

On a UK GAAP basis, the Company reported profits before tax of $44.4m (2015: $36.8m), and after taking into account tax and gains on the investment portfolio, total comprehensive income of $38.6m, compared to total losses of $13.4m in 2015, a year in which LMIE suffered significant unrealised losses in its investment portfolio, in common with many of its peers.

System of governance

The Board of directors is responsible for the governance of the company and they have established a robust corporate governance framework as an effective means of meeting that responsibility. The board is headed by an independent non-executive chairman, who is responsible for leadership of the board and ensuring its effectiveness. The board gives the President and Managing Director the responsibility for the running of the company’s business.

The Board delegates certain matters to the following Board Committees in accordance with the terms of reference of those committees:

- Audit Committee
- Board Executive Committee
- Investment Committee
- Nomination Committee
- Remuneration Committee
- Reserving Committee
- Risk Management Committee

The Board and Committees are supported by LMIE key control functions of Actuarial, Risk Management, Compliance and Internal Audit. Each function is headed by an individual who performs either a Senior Insurance Management Function or Significant Influence Function role.

The governance structure is reviewed on an annual basis by the Head of Governance in order to ensure that it is effective and appropriate to the organisation. There have been no material changes in the system of governance during the period.

LMIE requires all persons who perform key functions and are classified as Senior Insurance Managers, i.e. those persons who effectively run the business, to have adequate knowledge and experience to enable sound and prudent management of risks facing the company and to be of good repute and integrity.

The Company operates within a Risk Management and Internal Control Framework (RMF) which is designed to enable LSM's operations to engage with risk in a controlled fashion consistent with the Board's appetite and available capital capacity in order to generate risk adjusted returns to the Liberty Mutual Group.

Risk profile

The LSM Risk Universe Policy sets out how LSM undertakes the categorisation of exposed risks. The business objectives of the Risk Universe policy are to ensure that:

- All risks that could impact the on-going viability of the company are identified.
- Identified risks are measured and managed in the most appropriate method.
- All risks are owned by the most appropriate Executive and that each risk is reported through the correct committee or working group.

Risk Management is responsible for preparing the Own Risk and Solvency Assessment ("ORSA") report. The purpose of the ORSA process is to inform the Board of the ongoing assessment of the risk to LMIE both due to its current activities as well as those arising from its business strategy and future plans. It also informs all stakeholders concerned, on how LMIE plans to mitigate these risks and how much current and future capital is required to both maintain solvency and support the achievement of the business plan.

LSM has two approaches to risk management defined by how the risk is categorised in the Risk Universe Policy. Intrinsic risks, which we actively seek, are managed through the use of risk appetites that are cascaded. Operational risks and other risks (strategic and group risk) for which LSM has limited appetite are managed through the Operational Risk & Internal Controls Policy and associated procedures.

Valuation for solvency purposes

LMIE prepares its annual financial statements under UK GAAP, and in particular under FRS 102 and 103. Its financial statements are presented in US dollars, the functional currency of LMIE.

As at 31 December 2016, LMIE total assets and liabilities under Solvency II valuation rules are \$3,336.1m and \$2,328.8m respectively. The Solvency II values are derived on a fair value basis under the EIOPA guidelines on valuation. In addition, Solvency II reporting formats require some reclassification of assets and liabilities from the categories reported in the financial statements.

The valuation and reclassification differences are extensively described in Section D of this report. The key valuation differences relate to the treatment of technical provisions.

Capital management

The purpose of own funds management is to maintain, at all times, sufficient own funds to cover the Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) with an appropriate prudence margin as approved by the LMIE Board. The Company holds quarterly board meetings, in which the proportion of own funds over SCR and MCR are monitored and managed.

As part of own funds management, LMIE prepares ongoing annual projections and reviews the structure of own funds and future requirements. The business plan, which forms the base of the ORSA, contains a two year projection of funding requirements and this helps focus actions for future funding.

LMIE currently uses the standard formula (SF) to calculate capital requirements. However, the internal model is used alongside the SF to help LMIE understand and manage risks to its business, and challenge SF outputs where appropriate.

The capital of LMIE comprises share capital, share premium and reconciliation reserves, categorised as Tier One.

As at 31st December 2016 the SCR was \$710m and LMIE had own funds in support of this of \$1,007m. LMIE complied with its capital management policy throughout the period.

Approval by the Liberty Mutual Insurance Europe Limited (LMIE) Board of Directors

of the Solvency and Financial Condition Report

For the financial year ended 31st December 2016

The Directors are responsible for preparing the SFCR in accordance with the Prudential Regulatory Authority (PRA) rules and SII Regulations.

The PRA Rulebook for SII firms in Rule 6.1(2) and Rule 6.2(1) of the Reporting Part requires that the Company must have in place a written policy ensuring the ongoing appropriateness of any information disclosed and that the Company must ensure that its SFCR is subject to approval by the Directors.

Each of the Directors, whose names and functions are listed in Directors' Report of the UK GAAP financial statements, confirm that, to the best of their knowledge:

(a) Throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA rules and SII Regulations as applicable; and

(b) It is reasonable to believe that, at the date of the publication of the SFCR, the Company continues to comply, and will continue to comply in future.

On behalf of the board.

J A R Dunn

Group Finance Director

M Moore

Group Chief Underwriting Officer

19th May 2017

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Report of the external independent auditor to the Directors of Liberty Mutual Insurance Europe Limited ('the Company') pursuant to Rule 4.1(2) of the External Audit Part of the PRA Rulebook applicable to Solvency II firms

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

Opinion

Except as stated below, we have audited the following documents prepared by the Company as at 31 December 2016:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at **31 December 2016, ('the Narrative Disclosures subject to audit'**); and
- Company templates S02.01.02, S17.01.02, S23.01.01, S25.01.21 and S28.01.01 ('**the Templates subject to audit'**).

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**relevant elements of the 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 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S05.01.02 and S05.02.01;
- the written acknowledgement by management of their responsibilities, including for the preparation of the solvency and financial condition report ('**the Responsibility Statement'**).

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

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of Liberty Mutual Insurance Europe Limited as at 31 December 2016 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, and as supplemented by supervisory approvals and determinations.

This report is made solely to the Directors of the Company in accordance with Rule 2.1 of External Audit Part of the PRA Rulebook for Solvency II firms. Our work has been undertaken so that we might report to the Directors those matters that we have agreed to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Directors, for our work, for this report, or for the opinions we have formed.

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Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & I)), including ISA (UK) 800 and ISA (UK) 805. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the 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
We have nothing to report in respect of the following matters in relation to which the ISAs (UK & I) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the Solvency and Financial Condition Report is not appropriate; or
- the directors have not disclosed in the 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 Solvency and Financial Condition Report is authorised for issue.

Emphasis of Matter – Basis of Accounting
We draw attention to the 'Valuation for solvency purposes', 'Capital Management' and other relevant disclosures sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The 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 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 Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of these matters.

Other Information

The Directors are responsible for the Other Information. Our opinion on the relevant elements of the 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.

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In connection with our audit of the 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 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 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 Solvency and Financial Condition Report

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

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

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

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

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK & I) 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 Solvency and Financial Condition Report.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: https://www.frc.org.uk/Our-Work/Audit-and-Actuarial-Regulation/Audit-and-assurance/Standards-and-guidance/Standards-and-guidance-for-auditors/Auditors-responsibilities-for-audit/Description-of-auditors-responsibilities-for-audit.aspx. The same responsibilities apply to the audit of the Solvency and Financial Condition Report.

Report on Other Legal and Regulatory Requirements.

In accordance with Rule 4.1(3) of the External Audit Part of the PRA Rulebook for Solvency II firms we are required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Company's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Ernst & Young LLP

Ernst & Young LLP
London
19 May 2017

The maintenance and integrity of the Company's website is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Solvency and Financial Condition Report since it was initially presented on the web site.

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

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

- The following elements of template S12.01.02
  - Rows R0110 to R0130 – Amount of transitional measure on technical provisions
- The following elements of template S17.01.02
  - Rows R0290 to R0310 – Amount of transitional measure on technical provisions
- The following elements of template S22.01.21
  - Column C0030 – Impact of transitional measure on technical provisions
- The templates S05
- The template S19, and
- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

SECTION A - BUSINESS AND PERFORMANCE

SECTION A. 1 – Business

A.1.1 Name and legal form of the undertaking

Liberty Mutual Insurance Europe Limited (LMIE) is a regulated insurance company incorporated in the United Kingdom (Registration number 1088268). The ultimate parent company of LMIE is Liberty Mutual Holding Company Inc.; a company incorporated in the United States of America.

A.1.2 Name of the supervisory authority responsible for the financial supervision of the undertaking and external auditor

The Prudential Regulatory Authority (PRA) is responsible for the prudential supervision of the Company. Prudential Regulatory Authority, Bank of England, Threadneedle St, London, EC2R 8AH. The Company is part of a Group regulated in Spain, for Solvency II purposes.

A.1.3 Name of the external auditor

The Company's external auditors are Ernst & Young LLP, 25 Churchill Place, London E14 SEY.

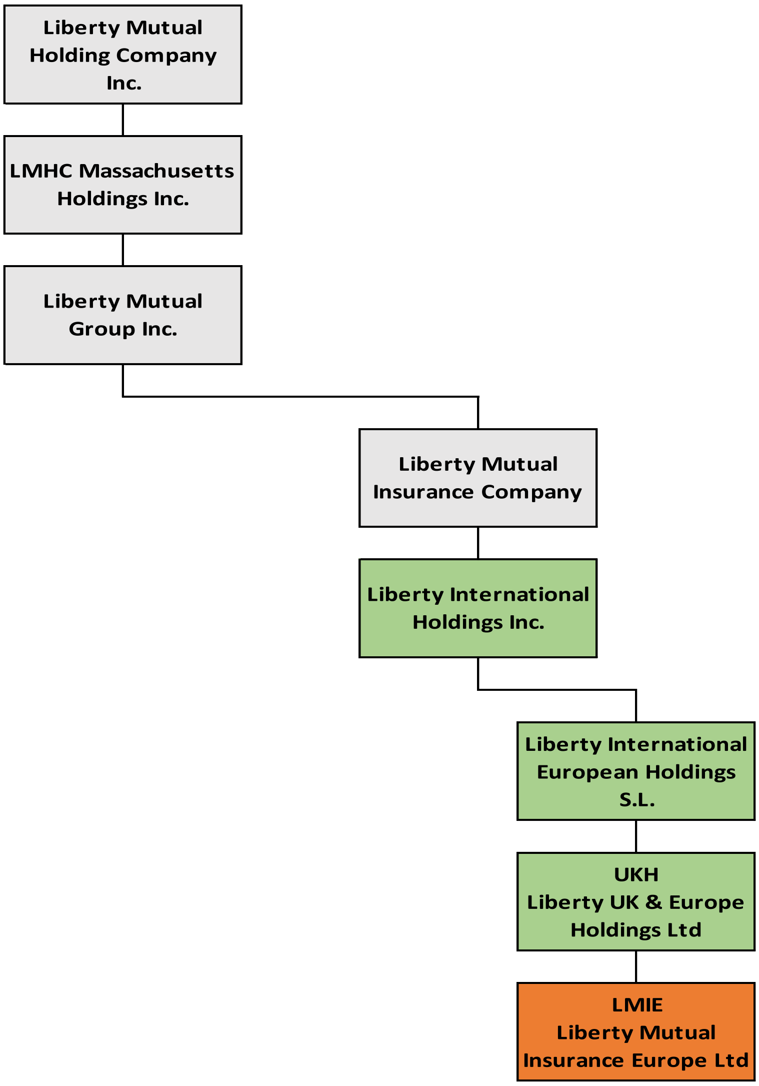
A.1.4 Holders of qualifying holdings

Table of controllers	**% of shares and voting rights held**
Liberty UK and Europe Holdings Limited	100%
Liberty International US European Holdings LLC	100%
Liberty International European Holdings Cooperative U.A.	100%
Liberty International US Netherlands LLC	10%
Liberty International Netherlands Holdings C.V.	100%
Twee US Dutch LLC	99%
Liberty International US Dutch Een LLC	1%
Liberty International European Holdings S.L.	100%
Liberty International Netherlands V.O.F.	100%
Liberty International Holdings Inc.	100%
Liberty International Holdings LLC	100%
Liberty Mutual Insurance Company	100%
Liberty Mutual Group Inc.	100%
LMHC Massachusetts Holdings Inc	100%
Liberty Mutual Holding Company Inc	100%

LMIE is wholly owned by the immediate parent company, Liberty UK and Europe Holdings Limited.

A.1.5 Details of the undertaking's position within the legal structure of the group

The following is a summarised organisation structure showing LMIE’s positioning within the overall Liberty group structure.



LMIE sits within the international holding structure of Liberty Mutual Holding Company Inc. The organisation chart shown is a summarised view of the overall Liberty structure and there are a number of companies within the hierarchy.

In addition, Liberty Mutual Group Asset Management Inc. the specialist investment management arm of LMG, who manage the investment portfolio of LMIE is a wholly owned subsidiary of the Liberty Mutual Group Inc.

A.1.6 The undertaking's material lines of business and material geographical areas where it carries out business

LMIE is one of the key legal entities that makes up Liberty Specialty Markets (LSM) which is part of Global Specialty business unit within Liberty Mutual Group (LMG). LSM manages its business through three key management Pillars which consist of a number of divisions made up of a number of lines of business. These lines differ from the Solvency II lines of business which mainly comprise, General Liability, Fire and other damage to Property and Credit and Suretyship. The lines managed by LSM have been mapped to the appropriate Solvency II lines of business in this report.

The Company predominantly operates from the United Kingdom and through a branch structure in mainland Europe. In addition, it has a branch in Malaysia which it plans to exit in 2017.

A.1.7 Significant business or other events that have occurred over the reporting period and up to the date of the report

Through its European branch structure, the Company has significant operations and employees in the EU and enjoys a number of benefits from the UK being a member of the EU.

On 23rd June 2016, through a referendum, the UK voted to leave the EU and on 29th March 2017, Article 50 of the Lisbon Treaty was triggered by the UK Government commencing the process of formal negotiation between the UK and the EU on the UK's exit which is expected to occur during a two year period. A high degree of uncertainty exists around what the terms of the UK's relationship with the EU will be and whether any benefits of the current membership of the EU will remain. In order to continue to support our current and potential future offerings within Europe, LSM is assessing the various options available which would enable both the company and LSM to continue to operate within the EU.

SECTION A. 2 – Underwriting Performance

A.2.1 Underwriting performance by Solvency II Lines of Business

The following table outlines the Company's key financial performance indicators during the year ended 31 December 2016 by Solvency II lines of business.

$m	General liability	Credit and suretyship	Fire and other damage to property	Miscellaneous financial loss	Marine, aviation and transport	Motor vehicle liability	Other motor	Total
Gross written premium	594.7	204.3	219.4	138.7	42.5	1.8	0.2	1,201.6
Net earned premium	384.9	53.5	153.3	(0.3)	35.3	25.4	3.2	655.3
Net claims incurred	(170.9)	(40.2)	(129.9)	(0.8)	(27.2)	(23.8)	(3.0)	(395.8)
Expenses	(207.9)	(25.9)	(53.7)	3.4	(13.8)	(3.6)	(0.6)	(302.1)
Underwriting performance	6.1	(12.6)	(30.3)	2.3	(5.7)	(2.0)	(0.4)	(42.6)

Overview and highlights

In 2015, the Company made a strategic decision to exit its business in South East Asia and to increase focus on its UK and European operation. The sale of its branches is ongoing with the Malaysian branch completing during the year and the cessation of the Hong Kong branch planned for 2017. During 2016, the Company also made a strategic decision to exit its UK regional business.

General Liability

The General Liability lines maintained good performance during 2016 despite challenging market conditions and a number of large losses in the Casualty lines in the latter part of the year. Improved loss experience in the D&O and Professional Indemnity lines contributed to the strong performance for the year.

Credit and Suretyship

Credit and Suretyship generated an underwriting loss in the year driven by adverse development on prior year claims.

Fire and other damage to property

Property experienced a number of large losses in the UK during the year which has had a direct adverse impact on the overall result of this line of business. Gross written premiums are also impacted by the exit of the company from the UK regional business during the year.

Miscellaneous Financial Loss

Performance on this line of business remains in line with expectations as we have a 100% quota share arrangement on this line.

Marine, Aviation and Transport

The Marine. Aviation and transport generated a loss in the year driven by current year losses on the Aviation line. Gross written premium performance on this line of business was also adverse compared with prior year.

Motor Vehicle liability and Other Motor

In 2015, the Company exited from its motor line of business and the 2016 results reflect the run off of this line.

A.2.2 Underwriting Result by material geographical area

The Company does not disclose results by detailed geographic segment and is managed by underwriting division as detailed above. The following table summarises the underwriting performance of the Company by its material geographic areas.

$m	United Kingdom	France	Spain	Netherlands	Germany	United States of America
Gross written premium	667.2	103.1	35.7	38.8	29.5	51.0
Net earned premium	392.7	39.4	21.4	30.5	13.6	15.7
Net claims incurred	(258.4)	(21.4)	(7.5)	(15.1)	(7.3)	(11.7)
Expenses	(187.4)	(17.7)	(17.2)	(10.9)	(6.7)	(4.9)
Underwriting performance	(53.1)	0.3	(3.3)	4.5	(0.4)	(0.9)

The above results have been prepared on the same basis as QRT S.05.02.01 which requires the information to be reported by a mix of risk location and location from which premium is written.

SECTION A. 3 – Investment Performance

The investment portfolio is managed by Liberty Mutual Group Asset Management Inc. the specialist investment management arm of LMG. In accordance with investment guidelines, the portfolio is approved by the LMIE Investment Committee, then by the LMIE Board. There is a minimum credit rating requirement of investment grade and an average quality requirement of A. Limits are also established by issue, counterparty, asset type and rating. Securities must be readily marketable.

The Company's investment portfolio is made up predominantly of debt securities and other fixed income securities. The following summarise the investment results for the year.

USD$m	31 December 2016
Cash and deposits	0.6
Collateralised securities (interest)	0.3
Collective Investment Undertakings	0.8
Corporate bonds	47.6
Government bonds	24.1
Total Investment income	**73.4**

SECTION A. 4 – Performance of Other Activities

Material Leasing arrangements for both finance and operating:

At 31 December 2016, the Company had future minimum rentals payable under operating leases rechargeable from its service company as follows.

USD$m	Less than one year	Later than one year and not later than five years	Later than five years
Operating lease expense (rent)	7.1	22.6	47.1

SECTION A. 5 – Any Other Information

No other material events have occurred during the year.

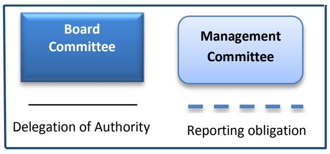
SECTION B - SYSTEM OF GOVERNANCE

SECTION B. 1 – General Information on the System of Governance

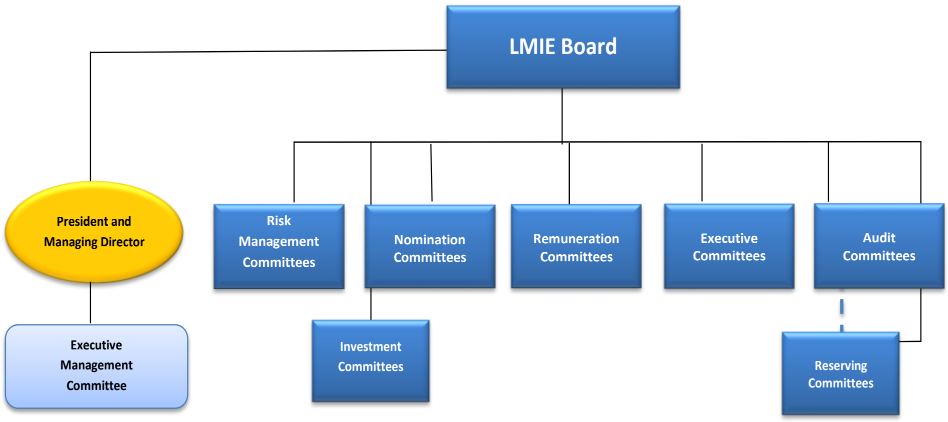
LMIE's corporate governance framework is the system by which the company is directed and controlled. The board of directors is responsible for the governance of the company and they have established a corporate governance framework as an effective means of meeting that responsibility.

B.1.1 Role and responsibilities of the management or supervisory body

The ultimate supervisory body of the company is the board of directors which has the responsibility of ensuring that the principles of good governance are observed at the board, sub-committees of the board and throughout the organisation. The board and sub-committees are set out below with a description for each of its main roles and responsibilities.



Board Committee structure



B.1.1.1 Overview of the role of the Board

Segregation of Board Responsibilities:

The board is headed by an independent non-executive chairman, who is responsible for leadership of the board and ensuring its effectiveness. The board gives the President and Managing Director the responsibility for the running of the company's business. The role of the independent non-executive directors is to scrutinise and challenge the performance of management in meeting agreed goals and objectives and to monitor the reporting of performance. They satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and effective. The Board of Directors are supported by the Legal, Governance and Company secretarial teams.

Overview of the Board Committees

The Board delegates certain matters to the following Board Committees in accordance with the terms of reference of those committees:

- Audit Committee
- Board Executive Committee
- Investment Committee
- Nomination Committee
- Remuneration Committee
- Reserving Committee
- Risk Management Committee

B.1.1.2 Audit Committee

The Audit Committee is responsible for assisting the Board in terms of the financial reporting processes, internal controls, performance of the internal and external audit processes and any other matters that may impact the financial results of the Company.

The Committee membership consists of the Chairman of the Board and two highly skilled and experienced independent Non-Executive Directors and is attended by senior management. A quorum of two is needed for approvals and decisions. The attendees of the Committee collectively have extensive finance, actuarial, insurance, regulatory, economics, accounting and management skills.

The Committee meets at least four times a year with the mandate to convene additional meetings as circumstances require. The Chairperson of the Committee is the Chairman of the Board and the Chairman reports at each Board meeting on the activities of the Committee. The Committee meet with the external auditors and Head of Internal Audit without members of management present. The responsibilities of the Audit Committee include:

- Monitoring the financial statements and making recommendations to the board.
- Reviewing the consistency of, and any changes to accounting and reserving policies.
- Reviewing the appropriateness of management’s tax strategy and controls.
- Keep under review the operating effectiveness of the Company’s internal controls, including the adequacy of policies and procedures related to financial crime.
- Review the procedures for handling allegations from whistle-blowers their subsequent investigation and appropriate follow up.
- Consider and approve the remit of the Internal Audit function, monitoring its resources, reviewing its effectiveness and approval of the annual Internal Audit plan.
- Receive all significant reports relevant to internal controls, whether or not delivered by the internal audit function and review and monitor management’s responsiveness to the findings and recommendations of the internal auditor or other internal control reports.
- Oversee all aspects of the relationship with the external auditor including approval of the annual audit plan and scope of the audit engagement and review of the external audit findings.

B.1.1.3 Board Executive Committee

The Board Executive Committee (BEC) is responsible for dealing with certain matters delegated to it by the Board relating to the day-to-day management of the business and implementation of the strategic aims and objectives set by the board. The Committee membership is comprised of three Executive Directors. The Chairman reports formally to the Board on its proceedings. The BEC considers and, if thought fit, approves and authorises executive management to carry out a range of duties subject to amounts within any requisite LSM protocols. These duties include:

- Approval and authority to execute any regulatory returns and filings which are not specifically reserved to the board.
- Powers of Attorney and other official documents as may from time to time be required.
- Review and approve the remuneration of any independent non-executive director.
- Matters pertaining to bank mandates.
- Engagement of an advisor for audit- or tax-related services.
- Any new non-terminable financial obligation.

B.1.1.4 Investment Committee

The Investment Committee is responsible for assisting the Board in coordinating the oversight of the Company's Investment and Market Risk policies and procedures designed to ensure that the Company has sufficient assets to cover claims as they fall due. The Committee also seeks to optimise investment income and achieve an active return based on an acceptable level of active risk. The Committee also has oversight for the management of treasury issues.

The Committee membership comprises two Executive Directors and an experienced independent Non-Executive Director. A quorum of two is needed for approvals and decisions.

The Committee meets four times a year with the mandate to convene additional meetings as circumstances require. The Chairperson of the Committee is the Group Finance Director who has a position on the Board and reports at each Board meeting on the activities of the Committee. The Investment Committee shall exercise the following duties;

- Make recommendations to the Board regarding; the long-term framework and strategy for the investment of assets and the appointment of Investment Manager(s).
- Ensure that the Investment Manager(s) are subject to an Investment Management Agreement setting out the scope of their authority as approved by the Committee.
- Approve the investment management policy covering market risk; liquidity risk; asset liability management; asset concentration and credit risk and investment strategy.
- Approve the translation of these policies into Investment Guidelines and ensure that they are incorporated into the Investment Management Agreement.
- Ensure, with reference to the policies, Investment Guidelines and procedure documents, that investment controls are adequate, including the supervision of Investment Manager(s).
- Review the investments held; Fund performance against stated investment objectives; Investment Manager(s) operational performance and compliance with Investment Guidelines and Investment Management Agreement.
- In conjunction with the Investment Manager(s), set minimum liquidity levels for the Company to meet any cash requirements as they fall due.
- Review the markets and conclude as to the investment conditions to determine the market risk appetite, informing the Risk Management Committee of its decision.

- Ensure that the capital modelling output is based on relevant and accurate asset holdings data and market risk related inputs.

B.1.1.5 Nomination Committee

The Nomination Committee is responsible for assisting the Board in ensuring that the Board remains balanced both in terms of skill and experience and between executive and non-executive directors; and leads the process for appointments to the Board and make recommendations to the Board ensuring there is a formal, rigorous and transparent procedure.

The Committee membership consists of a minimum of three directors, one Executive Director and two non-executive directors. The Committee meets at least once a year and at other such times as the Chairman of the Committee requires. The Chairperson of the Committee is the Chairman of the Board. The main responsibilities of the Committee are to:

- Regularly review the structure, size, diversity (in skill and person) and composition (including the skills, knowledge and experience) of the board and make recommendations to the Board with regard to any changes.
- Consider succession planning for senior executives in the course of its work, taking into account the challenges and opportunities facing the Company.
- Be responsible for identifying and nominating for the approval of the Board, candidates to fill board vacancies as and when they arise.
- Evaluate the balance of skills, knowledge, experience and diversity on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.
- Keep under review the time required from non-executive directors and assess whether the non-executive directors are spending enough time to fulfil their duties.
- Ensure that on appointment to the board, non-executive directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, committee service and involvement outside board meetings.
- For the appointment of a chairman, the Committee should prepare a job specification, including the time commitment expected. A proposed chairman’s other significant commitments should be disclosed to the board before appointment and any changes to the chairman’s commitments should be reported to the board as they arise.
- Make recommendations to the board concerning the membership of the board committees and any matters relating to the continuation in office of any director at any time, including the reappointment of Independent Non-Executive Directors if required under their service contracts, suspension or termination of service of any executive director as an employee of the Company subject to the provisions of the law and their service contract.

B.1.1.6 Reserving Committee

The Reserving Committee is responsible for assisting the Board in overseeing the operational and functional integrity of the reserving process and monitoring conformity to the Reserving Risk Appetite specified by the Board and is responsible for making proposals to the Board regarding reserves for the purposes of financial reporting bringing together underwriting, claims, actuarial and finance professional knowledge and judgement.

The Committee membership consists of at least three members, including the Group Finance Director and Group Chief Underwriting Officer both of whom are directors on the board.

The members of the Committee are appointed or removed by the Board, on the recommendation of the Nomination Committee.

The Committee meets four times a year with the mandate to convene additional meetings as circumstances require. The Chairperson of the Committee is the Group Finance Director who reports at each Board meeting on the activities of the Committee.

The main responsibilities of the Committee are to:

- Review quarterly reports from the Actuarial Function (Head of Reserving) setting out its professional views on the level of reserves, together with the key uncertainties affecting the reserves and their potential financial impact.
- Oversee the actuarial reserving process and the Technical Provisions Policy,
- Review quarterly reserves booked by the Finance Department on an accident year basis, taking into consideration the views of the Head of Reserving and the Chief Actuary.
- Review the booked reserves and verify that they are within the bounds specified in the Reserving Risk Appetite set out by the Board.
- Review the Reserving Risk Policy and Procedures, Key Risk Indicators and Key Control Indicators in conjunction with the Risk Management Function.
- Brief the Audit Committee on key judgements and uncertainties to inform its recommendation to the Board regarding the level of reserves for the purposes of the financial statements.

B.1.1.7 Remuneration Committee

The Remuneration Committee is responsible for setting the remuneration policy across the Company; and determining the total individual remuneration package of in scope executives including basic salary and short- and long-term incentive awards. The Committee membership consists of the Chairman of the Board and one independent non-executive director. The Committee meets at least once a year and at other such times as the Chairman of the Committee requires. The Chairperson of the Committee is the Chairman of the Board. The main responsibilities of the Committee are to:

- Determine the remuneration policy and review its on-going appropriateness.
- Within the terms of the agreed policy determine the total individual remuneration package of each executive director and other designated senior executives as determined by the Committee from time to time as being in scope.
- When setting remuneration policy for directors, review and have regard to pay and employment conditions across the Company.
- Oversee any major changes in core employee benefit structures.
- Agree the policy for authorising claims for expenses from the directors.
- Ensure that all provisions regarding disclosure of remuneration are fulfilled.
- Ensure that applicable Group protocols and procedures are complied with in the determination of the policies and awards referred to above.
- Ensure compliance with gender pay gap requirements and all legal and regulatory requirements relating to remuneration applicable to the Company.

B.1.1.8 Risk Management Committee

The Risk Management Committee is responsible for assisting the Board in providing independent oversight of the Company's risk management framework, including risk appetite, regulatory capital and the risk function and to make appropriate recommendations as appropriate to the Board. The Committee also oversees the Company's conduct risk framework, a key component of the overall risk management framework, ensuring the company is operating within agreed conduct risk appetite. The Committee oversees the company's compliance with laws and regulations.

The Committee membership consists of three Non-executive directors and the President and Managing Director. The Committee meets four times a year with the mandate to convene additional meetings as circumstances require. The Chairperson of the Committee is an independent Non-Executive Director who has a position on the Board and reports at each Board meeting on the activities of the Committee. The main responsibilities of the Committee include:

- Review and make recommendations to the board on risk appetite in the context of business strategy taking account of the economic and financial environment.
- Review the risk appetite framework including how it is defined, understood and used throughout the business.
- Review and challenge the Company's current and forecast performance against risk appetite, including 1) key risk and control indicators, risk events and emerging risks and 2) the adequacy of remedial plans to strengthen primary key controls and thereby return (or ensure) risk indicators (remain) within tolerance.
- Review emerging risks and make recommendations to the Board regarding their identification, measurement and any mitigating action proposed and monitor the progress of those actions to ensure controls are effective.
- Before a decision to proceed is taken by the Board, advise the Board on the risk aspects of proposed strategic transactions and make recommendations to the Board regarding the Own Risk and Solvency Assessment (ORSA).
- Review the risk management and internal control frameworks including the conduct risk framework; risk management principles and policies, and management's efforts regarding the establishment of cultural awareness of risk and compliance with such policies, and consider approval of significant policies.
- Consider, review, assess and approve the annual Risk Management plan including the remit and resources of the Risk Management function and monitor and review the effectiveness of the Risk Management function.
- Receive reports from Risk Management on the performance first line management in mitigating risks and from Compliance function on the performance of first line management in adhering to company policies.
- Oversee the internal model including methodology, assumptions, validation (internal and independent) and governance. Reviewing output of the internal model including the SCR and the Standard Formula SCR calculations.
- Review the adequacy and appropriateness of scenario and reverse stress tests.

B.1.1.9 Executive Management Committee

The Board delegates the day-to-day management of the Company, to the President and Managing Director, who has executive responsibility for running LMIE and has established a management executive committee to assist in discharging that responsibility effectively under approved terms of reference.

In addition to the above there are a variety of delegations of authority and protocols that operate across LMIE. These can be summarised as:

- Individual Underwriting Authorities - established by the Chief Underwriting Officer (CUO) these set out the scope of each underwriter's authority to commit the company to an insurance or reinsurance policy.
- Individual Claim Authorities - established by the CUO and cascaded to the Head of Claims these set out the scope of each claim handler's authority to commit the company in respect of claims made upon the company.
- LMIE Finance protocols established by the Finance Director set out the scope of individual staff authority to make or authorise payments and the applicable controls.
- LMIE Claims protocols established by the Head of Claims under authority from the President and Managing Director set out the authority of the President and Managing Director, Head of Claims and individual claims handlers in respect of claims (including claims settlement agreements) and commutations.
- Global Specialty management protocols - LMIG's Global Specialty (GS) Strategic Business Unit (SBU) management team has established various protocols setting out how matters that are decided in LMIE should be decided by the company in conjunction with members of the GS management team.

B.1.1.10 Delegation of board authority and decision making

The board delegates decision-making powers to board committees and the running of LMIE to the President and Managing Director, who in turn delegates to executive management. The Board Committee and Management Committee memberships are set down in Board and Committee membership lists. Each Committee has a terms of reference and the performance of the Committee against its Terms of Reference is reviewed annually by the Head of Governance.

The board itself remains responsible for, and makes the final decisions on, areas delegated for consideration to a committee, except where the Board has previously indicated that a decision itself can be delegated to a board committee. Matters which cannot be delegated to a committee for a decision can nevertheless be delegated to an ad hoc or standing board committee, or specified senior management, for finalisation after board has approved in principle.

B.1.1.11 LMIE Key Functions

The following sections set out a summary of the LMIE key control functions of Actuarial, Risk Management, Compliance and Internal Audit. Each function is headed by an individual who performs either a Senior Insurance Management Function or Significant Influence Function role.

Actuarial function:

The Actuarial Function is headed by the Chief Actuary. The authority, resources and independence of the Actuarial Function are detailed in section B.7.1 Governance of the Actuarial Function. The activities of the Actuarial function are reported to the Board or its sub committees, the Risk Management Committee or Audit Committee as appropriate. The Chief Actuary reports directly to the President and Managing Director and is a member of the Executive Management Committee.

The Actuarial function co-ordinates work carried out by the Actuarial, Capital Management, Underwriting, Exposure Management, Reinsurance and Finance teams in calculating technical provisions; providing an opinion on underwriting policy and reinsurance arrangements and contributing to the effective implementation of the risk management system.

Risk Management

The Risk Management function is headed by the Chief Risk Officer (CRO). The authority, resources and independence of the Risk Management Function are detailed in section B.3 Risk Management. The activities of the Risk Management function are reported to the Board or its sub-committee, the Risk Management Committee as appropriate. The CRO reports directly to the President and Managing Director and is a member of the Executive Committee. The CRO also has a reporting line directly to the Chair of the Risk Management Committee who is an independent Non-Executive Director.

LSM's approach to risk management centres on the principle that 'risk' is fundamental to the way in which LSM operates. It is embedded in the roles and responsibilities of individuals and committees throughout the organisation's first line functions. The Risk Management function role is primarily one of facilitator, developing and maintaining effective risk processes and systems. Risk Management offers appropriate challenge and oversight across the business, in order to provide second line assurance to the Board that risk taking remains consistent with its appetite and appropriately controlled.

Compliance Function

The Compliance function is led by the Head of Compliance. The authority, resources and independence of the Compliance Function are detailed in section B.5.2 Description of How the Compliance Function is implemented. The activities of the Compliance Function are reported to the Board and its sub-committees, the Risk Management Committee or Audit Committee as appropriate. The Head of Compliance reports directly to the President and Managing Director and is a member of the Executive Management Committee.

The Compliance Function is responsible for assisting the business in ensuring compliance and monitors and oversees the business in this regard. The Compliance Function interprets, advises, monitors and reports on all regulatory matters for LSM.

Internal Audit

Internal Audit is an independent, objective assurance and consulting activity designed to help LSM accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of Risk Management, control and Governance processes.

The Head of the Internal Audit Function reports functionally to the Chairman of the Audit Committee and administratively to General Counsel with direct access to the President and Managing Director. The authority, resources and independence of the Internal Audit Function are detailed in section B.6.3 Independence and Objectivity. The findings of the Internal Audit function are reported to the Audit Committee. The Chairman of the Audit Committee is also the Chairman of the Board and provides a summary of the Committee's activities to the Board.

Group Structure

The Company benefits from the full financial strength of the Liberty Mutual Insurance Group. Boston-based Liberty Mutual Insurance Group is a diversified global insurer and amongst the largest P&C insurers in the world based on gross written premium. The company also ranks in the Fortune 100 list of largest corporations. Liberty Mutual Insurance Group offers a wide range of insurance products and services through three strategic business units: Global Consumer Markets; Commercial Insurance and Global Specialty. The company is a part of the Global Speciality business unit.

B.1.2 Material changes in the system of governance

There have been no material changes in the system of governance during the period.

The governance structure is reviewed on an annual basis by the Head of Governance in order to ensure that it is effective and appropriate to the organisation. Included in that review is a review of all board and committee minutes against the relevant terms of reference to ensure that the board and committees are performing all of their duties and not acting outside of their authority. The annual effectiveness review ensures that the performance of the board, its committees and individual directors is formally evaluated. The review considers, amongst other things, the balance of skills, experience, independence and knowledge of the company on the board and its committees.

LMIE adheres to the provisions of the Companies Act and, where appropriate, LMIE applies the principles and provisions of the UK Corporate Governance Code in order to meet the standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders

B.1.3 Remuneration Policy

B.1.3.1 Principles of the remuneration policy

The Liberty Speciality Markets remuneration policy applies to all employees of Liberty Mutual Insurance Group (LMG) assigned to LSM which includes the Company. As a member of LMG, LSM's remuneration policy is based on the LMG compensation philosophy: to be competitive to market; to pay for performance; and to provide pay growth through promotional opportunities.

The policy describes the components of fixed and variable pay delivered to employees and demonstrates how good corporate governance and sound risk management prevent excessive risk taking which are the keystones of LMG's compensation philosophy, and apply equally to LSM and LMIE.

LMG is committed to attracting, developing and retaining the best talent and motivating these employees to succeed. This is achieved through robust remuneration program design and assessment and performance management practices, LMG (and by extension, LSM and LMIE) commits to this aim by ensuring that:

- Employees are paid fairly and competitively against the local market with respect to total compensation, with the potential for increased total compensation in return for exceeding performance expectations.
- Base salaries offer a significant proportion of compensation to make sure that employees live well.
- Incentive schemes are designed in such a way as to reward short and long term performance and ensure that employees are not incentivized to engage in inappropriate risk taking. For members of the administrative, management or supervisory body, Key Function Heads and other person's whose activities may have a material impact on LSM's risk profile ("Material Risk Takers") (together "Control Persons"),this involves having a substantial proportion of variable pay deferred for a minimum of three years.
- A consistent approach for termination payments is adopted and individual performance is taken into account when determining any payments due. LSM will comply with any statutory minimums in circumstances where they are applicable.

Recognising its independent responsibility with respect to ensuring the above commitments are kept, the Company aims to ensure that:

- Performance goals are clearly designed and communicated to employees at all levels of the organization through a robust, but transparent, performance management process.
- Performance goals are aligned with the long term strategy of the business and the requirements of each individual employee.
- Customers and the insurance markets are protected from any negative impact associated with mismanagement of remuneration at any level of the organization.
- It is consistent with applicable legal obligations and regulatory requirements, including (as appropriate) those relating to the Directive, the FCA, the PRA and Lloyd's, and any other relevant code of practice issued by a regulatory body.

The Remuneration Policy is overseen and approved by the Board of Directors and is reviewed annually. The Board have appointed a Remuneration Committee to set remuneration policy and practices across the Company to ensure alignment of pay practices with all relevant legislation and regulations.

The Board of Directors review and approve all elements of remuneration for subject employees and ensure that strong risk management practices are in place. It does this on an annual basis to ensure:

- A clear distinction between operating and control functions, to avoid conflicts of interest, both in the operating of the organization, as well as in terms of remuneration.
- Impartiality when it comes to executive pay.
- That final decisions regarding remuneration are taken in such a way as to protect the long-term interests of the company's stakeholders.

The LMIE Board may consult with key LMG and LSM corporate functions (Human Resources, Compensation & Benefits, Risk Management, Global Compliance & Ethics, Internal Audit, Finance and Strategic Planning etc.) to ensure that incentive schemes do not expose LMIE, LSM or LMG to undue risk taking or endanger its capital or liquidity.

B.1.3.2 Share options, shares or variable components of remuneration

LMG has many elements of remuneration. Due to LMIG's group structure, remuneration programs may be made available to LSM employees through and administered by one or more LMG affiliates. However, the Board remains responsible for ensuring that all remuneration components comply with the Remuneration Policy. Remuneration elements typically consist of the following categories:

- Fixed Remuneration (base salary, benefits, perquisites and any allowances)
- Variable Pay (short-term and long-term)
- Retirement Benefits

Fixed Remuneration

Fixed Remuneration is predominantly base salary, although it may also include fixed allowances which are typical market practice in some countries. Fixed remuneration is aligned to the local market and is reviewed for all employees on an annual basis during the Salary Review process. It may also be assessed due to a promotion, transfer or other change of role throughout the year.

Benefits at LMG are designed to offer a competitive package to all employees. All benefits provisions is reviewed regularly to ensure that a legally compliant, as well as competitive position is maintained at all times

In keeping with our compensation philosophy, the Company aims to pay at the median in each country and market in which we operate.

Variable Remuneration

Variable remuneration – Short Term Performance

Variable remuneration plans offered to LMG employees are designed to reward both short and long term performance. Rewards are calculated by reference to individual targets, usually a percentage of salary, which differs depending on level of seniority and market norms. However, awards from variable remuneration schemes are discretionary. Based on the plan rules, payments can be restricted or not paid at all.

Short term performance is measured by achievement of individual (personal) objectives and business objectives measured over a one year timeframe. Individual performance is measured against targets that are established every year and can be financial or non-financial. In addition, employees' behaviour can also increase or decrease their performance rating. In each calendar year, both the 'what' and the 'how' of individual performance achievement are measured and rated.

Business unit and overall business performance is measured against annually established targets which take account of the prior year performance, business plans and the operating environment. Typical measures of performance include, but are not limited to, Return on Equity (ROE), Pre-Tax Operating Income (PTOI), Gross Underwriting Profit and Net Underwriting Profit. These targets are reviewed by the Remuneration Committee to the LSM Board of Directors.

Variable remuneration – Long Term Performance

Long term performance is generally measured by reference to profit against the business plan and growth against a defined peer group over a period of three financial years, commencing with the financial year in which the award is made. Long term performance for eligible employees is paid at the beginning of the fourth year following the cycle. Typical measures include Pre-Tax Operating Income (PTOI), Accumulated Other Comprehensive Income (AOCI) and Return on Equity (ROE).

As an unlisted mutual holding company, LMIG has no share price that can be utilized or shares to be granted through stock options, so most long term incentive schemes operate as cash plans or through performance derived unit values for grants.

B.1.3.3 Supplementary pension schemes for members of the Board and other key function holders

It is the policy of LMG (and LSM and LMIE) that pension plans should provide security to employees in their retirement. Pensions are designed to be appropriate for the country of operation, legally compliant, and also sustainable for the business. They aim to be generous enough to provide long-term stability for employees without acting as a barrier for exit. The Company's remuneration Policy does not include any supplementary pension or early retirement schemes for members of the Board or other key function holders. The Company offers all staff the opportunity of making contributions into a defined benefit contribution scheme, which the company will match up to a limit.

B.1.4 Material transactions during the reporting period

Material transactions include transactions with shareholders, with persons who exercise a significant influence on the undertaking, and with members of the administrative, management or supervisory body. During the reporting period the following material transactions occurred:

Liberty UK & Europe Holdings Limited (LUEHL) injected USD100 million ordinary share capital on 23 March 2016 into the Company for solvency and liquidity capital purposes.

SECTION B. 2 – Fit and Proper Requirements

B.2.1 Specific requirements concerning skills, knowledge and expertise applicable to the persons who effectively run the undertaking

LMIE requires all persons who perform key functions and are classified as Senior Insurance Managers, i.e. those persons who effectively run the business to fulfil the following requirements at all times:

a) Their professional qualifications. Knowledge and experience are adequate to enable sound and prudent management (**fit**); and
b) They are of good repute and integrity (**proper**)."

The professional competence (**Fit**) is based on the person's experience, knowledge and professional qualifications, and also whether the person has demonstrated due skill, care, diligence and compliance with relevant standards in the area that he/she has been working in. Such a person should also be of good repute (**Proper**), and the assessment includes taking relevant references.

For the propriety assessment, the person in question must be assessed by LMIE to establish that they meet LMIE's minimum requirements for a 'Fit & Proper' person. These requirements include being able to demonstrate appropriate levels of probity, honesty, integrity, reputation, competence & capability, previous experience, knowledge of their area and financial soundness. In order to establish this, a person's credit & criminal record, professional qualifications (including Continuous Performance Development or equivalent training requirements) and supervisory experiences will be checked, alongside the recruitment process which will involve a CV review, interview and reference check.

In addition, every person carrying out a Senior Insurance Manager Function must be approved by the regulator to do so. Senior Insurance Managers must also comply with the PRA Conduct Standards and the FCA Conduct Rules.

Some requirements have been, or can be, assessed as 'collective knowledge', i.e. that not every member in the management body (or any function) are expected to possess expert knowledge, competence and experience within all areas of LMIE, but that they as a whole have the ability to provide sound and prudent management of the LMIE.

B.2.2 Process for assessing the fitness and propriety of the persons who effectively run the undertaking

The specific requirements outlined above will be reviewed using the Fit & Proper process adopted by LSM. This evaluation will normally take place on an annual basis, or alternatively at any time that there is a material change such as internal promotion or move. The process is performed by the Compliance function and consists of the following:

- Assessment of the person's professional and formal qualifications, knowledge and relevant experience within the insurance sector, other financial sectors or other businesses and whether these are adequate to enable sound and prudent management; take account of the respective duties allocated to that person and, where relevant, the insurance, financial, accounting, actuarial and management skills of the person.

- Take account of the respective duties allocated to individual members to ensure appropriate diversity of qualifications, knowledge and relevant experience to ensure that the business is managed and overseen in a professional manner; and an assessment of that person's honesty and financial soundness based on evidence regarding their character, personal behaviour and business conduct including any criminal, financial and supervisory aspects relevant for the purpose of the assessment.

Evidence of the outcomes of this assessment must be retained. The records of this will be maintained in the following places (where appropriate); within the performance review, within the record of the recruitment process, within minutes of board meetings which record annual performance reviews, within training records & Continuous Performance Development, and within reports relating to annual board effectiveness reviews.

In the case of recruitment, HR will be responsible for recruiting appropriate staff.

The procedures outlined above ensure that all those holding controlled functions:

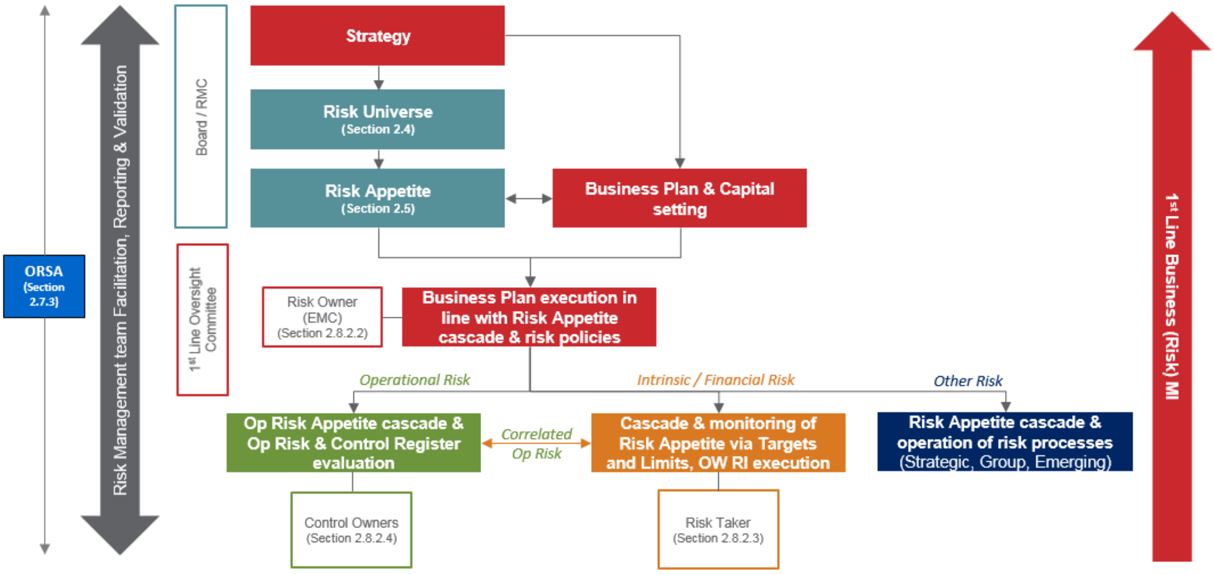
- Meet the requirements of the Regulators' 'fit and proper' test and follow its principles;
- Comply with the Statement of Responsibilities; and
- Report anything that could affect their ongoing suitability

SECTION B. 3 – Risk Management System

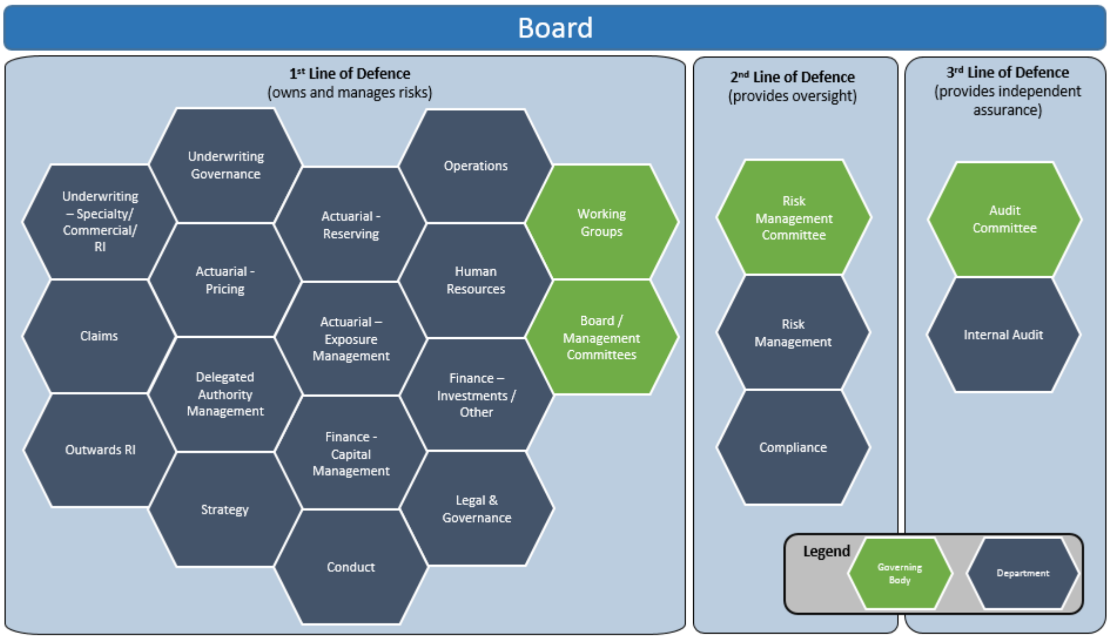
B.3.1 Description of the Risk Management System

The Risk Management and Internal Control Framework (RMF) is designed to enable LSM's operations to engage with risk in a controlled fashion consistent with the Board's appetite and available capital capacity in order to generate risk adjusted returns to the Group. It also sets LSM's approach to how we define risk and cascade risk appetite and the processes for ensuring the appropriate and timely identification, reporting, monitoring and management of risk and capital.

The following diagram outlines how risk management information and reporting is cascaded / escalated through the organisation:



LSM has adopted the Three Lines of Defence model for risk management and underpins this with clear roles and responsibilities for each of the departments and individuals involved in risk management across the organisation. Whilst Risk Management is a second line of defence function, there are key functions (Capital Management & Actuarial) who contribute to and have responsibilities within the risk management system.



The Risk Universe sets out the full scope of risk categories to which LSM could be exposed and forms the basis for their monitoring, measurement and reporting. Risk categories are defined as either intrinsic, operational, or other risks. Intrinsic risks are those risks with which LSM actively engages for the pursuit of profit, for example insurance (premium and reserve) risk. Intrinsic risks are managed via Board-approved risk appetites. Operational risks are those risks that LSM does not actively seek in order to generate profit, but nonetheless engages with to fulfil business objectives.

Risks are only accepted where they are aligned with the strategy and LSM has the appropriate expertise to manage them; risks that do not meet these criteria are not accepted. All risks accepted must have an expected reward that is commensurate with the risk, and contribute to ROE in the long term; LSM has no appetite for unrewarded risks.

The Risk Management team's main role is maintaining and facilitating the Risk Management Framework (RMF) to allow the business to take risks in a controlled fashion, including the periodic validation of first line activities and reporting. Other responsibilities include: supporting the business in cascading Risk Appetite and designing appropriate controls and Management Information (MI) to enable this to flow through to front line risk taking; managing the processes of Internal Model Validation, ORSA, Stress Testing and Reverse Stress Testing; Maintaining the Operational Risk & Control Register; and maintaining the Emerging Risk Log and facilitating the Emerging Risks process.

The Chief Risk Officer (CRO) prepares a quarterly report for inclusion at the Risk Management Committee meetings. The report details the risk profile summary, risk strategy, risk categories and position against risk appetites for each category of risk. The Risk Management Committee (RMC) is in place and reviews risks across core areas of the business including those areas responsible for cascading risk appetite and monitoring and managing risk levels across the risk universe. The RMC is responsible for the oversight of the all elements of the RMF, including consideration of forward-looking and horizon-scanning aspects of risk management. The RMC escalates material matters to the Board for review, discussion and challenge

The results of any risk management reviews/validation of first line risk management activities or reporting will also be outlined in the CRO reports; these will be conducted on a risk/rotational basis and external subject matter experts will be used where appropriate. The reporting is designed to provide assurance to the RMC and Board that the underlying processes are operating effectively, highlighting any exceptions and remedial actions taken during the period to date and provide a holistic view of risk levels across the full scope of risks faced by the organisation.

B.3.2 Implementation of the Risk Management System

RMF support the business planning and capital setting process which was initiated with a review of the proposed changes to Board-level risk appetites.

The Board Risk Appetite statements are reviewed at least annually through the Business Planning and Capital Setting process and may be revised at any point in the year in response to an actual or projected change in strategy or business planning, subject to Board approval.

The following diagram has been created to demonstrate how the annual Risk Appetite review process is incorporated into the overall strategy and business planning (including capital setting) cycle.

SECTION B. 4 – Own Risk and Solvency Assessment

B.4.1 Own Risk and Solvency Assessment Process

Risk Management is responsible for preparing the Own Risk and Solvency Assessment (“ORSA”) report. This involves summarising the outcomes of the RMF, including the evolution of the risk profile and performance against risk appetites. Risk Management will also evaluate capital requirements as calculated by the Capital Management Team and Actuarial against actual levels of capital held by each entity.

LMIE projects its solvency needs for the two years coming based on the approved LSM business plan. It then tests the impact of certain scenarios on the projected solvency as a result of changes in projected profits, own funds and regulatory capital requirements. The details on the solvency projections are reported in the LMIE ORSA.

The drafting of the ORSA report will, however, require input from a number of areas around the business. This includes: Finance, Actuarial, Strategy, and Capital Management. Risk Management worked with these teams to obtain the relevant information for the ORSA report. A mapping of ORSA report inputs to the business area responsible is maintained at a granular level via the ORSA Record, which assists in providing a roadmap for future iterations of the ORSA report. Data inputs are subject to data quality standards as set out in the Data Policy.

The ORSA Record captures sources of information used in producing the ORSA report, as a significant part of the ORSA process involves collating and referencing risk management activities and business decisions that have taken place throughout the year.

The ORSA process and reports are ultimately owned by the LSM Board, which delegates some of its powers of challenge and review to its associated committees. The Risk Management Committee considers the ORSA reports in detail, provide comments and feedback to Risk Management and recommend the ORSA reports to the Board for final sign-off. The Strategic Planning and Analysis (SPA) Committee provides expert challenge and sign-off of the quantitative inputs to the ORSA which are prepared as part of the business planning and regulatory capital-setting process.

The ORSA is a process as well as a report. The ORSA includes both the economic capital position of LMIE and its regulatory capital position, by reference to the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR), as at 31st December 2016.

ORSA reports for LMIE have been prepared for review by the RMC and submission to the relevant regulator at least annually. The ORSA reports are produced in line with the annual business planning exercise. Key elements of the ORSA, for e.g. the quarterly capital assessment forms part of the quarterly CRO report to the RMC and the Board.

As part of the ORSA embedding process, Risk Management, through the quarterly Chief Risk Officer Report to the RMC / Board, have presented some of the more fluid elements of the ORSA, such capital and solvency positions. This is summarised in the annual ORSA report reviewed and signed off by the Board.

We believe that our Internal Model (IM) calculation is more reflective of our own view of risk although we would highlight that it has not been subjected to validation and has known limitations. The Standard Formula is therefore used for the setting of regulatory capital via the Solvency Capital Requirement.

Ad hoc ORSA reports may be prepared at any time following material changes to each entity's business. These can be identified through a number of ORSA triggers, including but not limited to:

- Acquisitions/disposals;
- Change in risk profile leading to Standard Formula inappropriateness;
- Current trading/investment environment changes leading to a material actual or projected change in capital and solvency profile.

The evaluation of ORSA triggers is considered on a quarterly basis.

SECTION B. 5 – Internal Control System

B.5.1 Description of Internal Control System

LSM operate a centralised Operational Risk and Control Register, Magique, which is managed by Risk Management. Magique captures all operational risks and the controls used to mitigate them. Executive Operational Risk Owners are responsible for ensuring that the risks captured in Magique adequately cover the areas for which they have responsibility. In addition they are required to assess whether the controls in these areas are appropriately designed to mitigate the risks to an acceptable level, as well as reporting any areas of concern the relevant oversight committee. Control owners are required to provide an assessment of the design and performance of each control which drives an overall RAG rating.

LSM maintains a Liberty Attestation Process (LAP) control framework that is designed to mitigate the risk of financial misstatement. All LAP controls are signed off on a monthly basis, requiring attestation from all Executive Risk Owners that they are satisfied that the key controls for their respective areas have been performed and operating as expected. In addition to this they have to attest that they are not aware of any changes in their control environment.

B.5.2 Description of how the Compliance Function is implemented

The Compliance function has in place a Policy and Plan that was approved by the Risk Management Committee in December 2016. The LSM Compliance Policy and Plan is in scope of the LSM Documentation standards and therefore requires approval on an annual basis or when significant changes are made to them.

No changes have been made to the LSM Compliance Policy or Plan outside of its normal annual review cycle.

The RMC has the following formal responsibilities in respect of LSM's Compliance Function:

- Review annually the risk management and internal control frameworks.
- Review risk management principles and policies, and management's efforts regarding the establishment of cultural awareness of risk and compliance with such policies, and consider approval of significant policies.
- Review reports on legal and regulatory compliance and development
- Review the adequacy of regulatory risk mitigation programmes

SECTION B. 6 – Internal Audit Function

B.6.1 Internal Audit Policy

The Internal Audit Policy provides a summarised view of the areas in which Internal Audit operates, its main objectives and the approach to reach these. This document contains the Internal Audit Mission Statement and Internal Audit Charter. The Internal Audit Policy is reviewed on an annual basis by the Head of Internal Audit and approved by the Audit Committee. There has been no significant changes to the policy during the 2016 reporting period.

B.6.2 Operations and Assurance

The primary role of Internal Audit is to help the Board of Directors and Executive Management protect the assets, reputation and sustainability of the organisation to ensure that Liberty Specialty Markets (LSM) and its customers prosper. Internal Audit serves the Audit Committee of the Board of Directors and Executive Management by:

- Delivery of the risk-based Internal Audit Plan;
- Performing independent and objective evaluations of internal control processes;
- Providing assurance as to the effectiveness of internal control processes;
- Advising on the adequacy, effectiveness and efficiency of systems, controls and operation; and
- Helping the organisation to develop a systematic, disciplined approach to evaluate and improve the effectiveness of Risk Management, control and Governance processes.

The primary responsibilities of Internal Audit apply to all relevant legal entities and operating units within LSM, as well as any joint ventures, business partnerships and outsourced arrangements and are to:

- Conduct independent reviews in accordance with standards for the professional practice of internal auditing codified by the Institute of Internal Audit (IIA) that evaluate:
    - The reliability of financial reporting
    - Safeguarding of assets
    - The efficiency and effectiveness of significant business control processes
    - Compliance with policies, procedures, laws and regulations

- Provide periodic reports of audit findings, together with agreed actions for Management to address internal control deficiencies

- Monitor the completion of Management Actions arising from audit findings

- To provide management with advice about the establishment of effective control systems and procedures as necessary / required

- Evaluate the potential for the occurrence of financial crime and how LSM manages fraud risk

- Co-ordinate work with Management to help identify key risks and controls from an understanding and on-going evaluation of LSM's business strategy, products and operational processes. Since it is not practical for Internal Audit to provide total assurance on all controls, resources will be focused on the delivery of the annual risk based Internal Audit Plan

- Develop and deliver the risk-based Internal Audit Plan, which is evaluated annually across a three-year horizon. The LSM Risk Register identifies the risk universe and the top corporate risks ranked by likelihood and impact. The Internal Audit Plan is informed, but not determined, by the Risk Register and views of management. The audit plan is approved by the Audit Committee on an annual basis and reviewed / approved for changes on a quarterly basis The audit plan is designed to review controls in place to mitigate identified risks

- As part of the creation of the Internal Audit Plan, the work of other assurance providers will be considered in order to maximise coverage and efficiency of the assurance opinion provided. To the extent that Internal Audit places reliance on the work performed by other assurance providers, the independence, objectivity, skill set, and scope of the work will be assessed to ensure that the assurance provided by Internal Audit meets the required professional standards

- Liaise with External Audit, ensuring that wherever possible reliance is placed upon the work conducted by Internal Audit; and

- Internal Audit may receive additional requests from the Audit Committee, Board of Directors or Management to assist with reviewing internal control related issues or provide advice about the enhancement thereof. Internal Audit will conduct this work with due regard to its independence and objectivity and in line with IIA standards.

B.6.3 Independence and Objectivity

Internal Audit is an independent, objective assurance and consulting activity designed to help LSM accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of Risk Management, control and Governance processes.

Internal Audit reports functionally to the Chairman of the Audit Committee and administratively to the General Counsel. The Head of Internal Audit is directly responsible to the Audit Committee. In order to maintain independence, Internal Audit maintains direct access to the President & Managing Director and Chairman of the Audit Committee. Annually the Head of Internal Audit will meet in isolation with the Audit Committee to confirm that their independence and objectivity has not been impaired by undue influence.

In accordance with Article 271(2) of Delegated Regulation (EU) 2015/35there are no persons within the Internal Audit function who assumes any responsibility for any other function or carry out activities that are inappropriate with respect to the nature, scale and complexity of the risks inherent in the business or poses a conflict of interest risk.

SECTION B. 7 – Actuarial Function

B.7.1 Governance of the Actuarial Function

The Actuarial Function performs the effective implementation of Article 48 of the SII directive 2009/138/EC.

The Actuarial Function reports to the LSM Board. The Chief Actuary reports to the President and Managing Director and is responsible for the work carried out in the Actuarial Function. The work relied upon by the Actuarial Function is carried out by many different departments within LSM with the Chief Actuary co-ordinating this work. The work is carried out by the Actuarial, Capital Management, Underwriting, Exposure Management, Reinsurance and Finance teams. The Chief Actuary escalates any matters to the Executive Committee and/or the LSM Board as appropriate.

The Chief Actuary is a Fellow of the Institute and Faculty of Actuaries, with over 10 year post qualification experience and subject to professional standards. As such the work carried out will meet the independence and free from influence requirement of Solvency II. The Actuarial Function consists of members of LSM's actuarial team. The Actuarial Function reports its recommendations to the LSM Board in order to maintain its independence.

The actuarial function is implemented through carrying out the following tasks:

a) coordinate the calculation of technical provisions;
b) ensure the appropriateness of the methodologies and underlying models used as well as the assumptions made in the calculation of technical provisions;
c) assess the sufficiency and quality of the data used in the calculation of technical provisions;
d) compare best estimates against experience;
e) inform the administrative, management or supervisory body of the reliability and adequacy of the calculation of technical provisions; oversee the calculation of technical provisions in the cases set out in Article 82;
f) express an opinion on the overall underwriting policy;
g) express an opinion on the adequacy of reinsurance arrangements;
h) contribute to the effective implementation of the risk management system referred to in Article 44, in particular with respect to the risk modelling underlying the calculation of the capital requirements set out in Chapter VI, Sections 4 and 5 and to the assessment referred to in Article 45.

B.7.2 Coordinating the calculation of Technical Provisions

In coordinating the calculation of technical provisions, the actuarial function will, at a minimum:

- Apply methodologies and procedures to assess the sufficiency of technical provisions and ensure that their calculation is consistent with the underlying principles.
- Assess the uncertainty in the estimates.
- Apply judgment as appropriate, using any relevant information and the knowledge and expertise of the individuals involved.

- Ensure that problems related to data quality are dealt with appropriately and that, where there are deficiencies in data quality, appropriate alternative methods are applied, subject to proportionality.
- Ensure that risks are appropriately categorised into homogeneous risk groups.
- Factor in relevant market information.
- Track against previous estimates and justify any material differences.
- Ensure appropriate allowance is made for embedded options and/or guarantees.

With regard to technical provisions, the actuarial function will also:

- Ensure that methodologies and models used to calculate the technical provisions are appropriate, both in themselves and with regard to the specific lines of business they are applied to, taking into account the way the business is managed and the available data.
- Ensure that management actions included in the calculation of technical provisions are objective, reasonable and verifiable.
- Assess whether the IT systems used in the actuarial reserving procedures are adequate for that purpose.
- Review revised best estimates against past best estimates and use the insights gleaned to improve the quality of current best estimates.
- Compare observed values against the assumptions used in the calculation of technical provisions, in order to evaluate the appropriateness of the data used and the methods applied in their estimation.
- Inform the board on the reliability and adequacy of the calculation of technical provisions, on the degree of uncertainty in the ultimate outcome and the circumstances that might lead to a significant deviation from the best estimate. It must clearly set out how it arrived at its opinion and explain any concerns it may have as to the sufficiency of technical provisions.
- Determine when data is of insufficient quality to apply a standard actuarial method and a case-by-case approach should be followed instead. It must apply judgment to establish assumptions and safeguard the accuracy of the results.

B.7.3 Providing an opinion on underwriting policy and reinsurance arrangements

The actuarial function's opinion on underwriting policy will include the following issues:

- Opinion on the overall business plan and sufficiency of premiums to cover future losses in expected and stressed scenarios
- Inclusion of the analysis and results of the actuarial function's assessment
- Consideration of any concerns that the actuarial function may have as to the adequacy of the business plan
- Outline recommendations to improve the plan and considerations of realistic alternatives to the current business plan
- Inclusion of an assessment of the consistency of the plan with the risk appetite
- Assessment of the consistency of the plan with the assumptions used in the estimation of the technical provisions
- Comment on the sufficiency of premium to cover any option or guarantees in the future
- Consideration of exposures to external and internal influences such as inflation, legal risk or changes in mix,

- Consideration of anti-selection, of whether the underwriting process and controls used to manage the risk of anti-selection have been effective and of the likelihood of any anti-selection

The actuarial function's opinion on the adequacy of reinsurance arrangements will include:

- Opinion on the adequacy of the reinsurance arrangements
- Consideration of any concerns that the actuarial function may have as to the adequacy of the reinsurance arrangements, including recommendations for improvement and consideration of alternative structures.
- Assessment of consistency of the reinsurance arrangements with the risk appetite and underwriting policy.
- Analysis of effectiveness of risk mitigation including impact on capital requirements and claims volatility
- Analysis of the adequacy of the reinsurance providers taking into account their credit standing.
- Expected cover under stress scenarios in relation to underwriting policy.
- The adequacy of the calculation of technical provisions arising from reinsurance.

The actuarial function will provide written reports to the board at least annually documenting the tasks undertaken and highlighting any shortcomings identified, and how such deficiencies could be remedied.

B.7.4 Contribution to the effective implementation of the risk management system

In respect of the contribution to the effective implementation of the risk management system, the actuarial function's opinion on underwriting policy will include discussion of the following issues:

- Outline the actuarial function's role in the wider risk management framework of LSM
- Highlight how the actuarial function contributes to the SCR calculations
- Highlight how the actuarial function contributes to the ORSA
- For LSM, indicate any inconsistencies between the technical provisions, the reinsurance arrangements, the overall underwriting policy and the related assumptions and values in the internal model

SECTION B. 8 – Outsourcing

B.8.1 Description of the Outsourcing Policy

LSM has in place an Outsourcing Policy that ensures that all material outsourcing arrangements within LSM are assessed properly and managed effectively throughout their lifecycle from inception to termination. The rationale for LSM's outsourcing is multi-faceted and depends upon a number of different considerations. From a business perspective, any outsourcing arrangement must be commercially viable, and a business case must be made before inception of the arrangement.

However, in addition to this, outsourcing arrangements must be evaluated to check that they do not refrain LSM from meeting its regulatory requirements.

There are a number of checks which a service provider has to go through before inception to make sure that this is not the case:

- the provider must not adversely affect LSM's ability to comply with regulatory obligations or service to policyholders,
- they must not adversely affect the ability of the regulators to carry out their supervisory powers; and,
- they must be able to meet all applicable legal and regulatory requirements (potentially involving fitness and propriety assessments on individuals)

Furthermore, there are several other components making up the rationale for outsourcing arrangements including consideration as to whether the agreement will allow LSM to monitor and control its operational risk exposure, reviewing any conflicts of interest and ensuring that LSM has appropriate contingency arrangements in place to allow business continuity should a significant loss of service from the provider occur.

Regardless of jurisdiction, the service provider will be expected to go through the same thorough assessment as to their suitability to engage in an LSM outsourcing arrangement. LSM will ensure that any service provider located outside of the UK will undergo an assessment which is in keeping with LSM's risk appetite. In the case of any provider located outside of the UK, further advice must be sought from the Compliance function and General Counsel.

Lastly, it should be noted that all outsourcing arrangements are subject to the thorough standards and processes regardless of whether or not the service provider is within or outside the LSM group of companies or the Liberty Mutual Insurance Group (LMIG). Providers within the LSM group of companies or the LMIG will be dealt with at an appropriate 'arms-length'.

B.8.2 Outsourcing Register

Outsourcing of any critical or important operational functions or activities and the jurisdiction in which the service providers of such functions or activities are located are as follows:

Description of services provided	Jurisdiction
Head Office IT Support	USA
Various Claims services	UK
Binder Management services	UK
Exposure Management services	UK
Investment Management	USA

SECTION B. 9 – Statement of Adequacy

The governance structure and corporate governance framework in place to ensure that LMIE meets a good standard of governance, is assessed annually by the Board. The last assessment was completed in November 2016. There have been no material changes to the system of governance during the reporting period. This governance structure is deemed adequate for the company's risk profile.

SECTION B. 10 – Any Other Information

During the reporting period there was no other material information to disclose regarding LMIE's system of governance.

SECTION C – RISK PROFILE

The LSM Risk Universe Policy sets out how LSM undertakes the categorisation of exposed risks. The business objectives of the Risk Universe policy are to ensure:

- All risks that could impact the on-going viability of the company are identified.
- Identified risks are measured and managed in the most appropriate method.
- All risks are owned by the most appropriate Executive and that each risk is reported through the correct committee or working group.

SECTION C. 1 – Underwriting Risk

Underwriting risk arises from two sources - adverse claims development (reserve risk) and inappropriate underwriting (premium risk).

a) Measures used to assess risks:

Reserve risk is managed by frequent reviews of estimates by the Claims department.

Underwriting risk is managed by having in place a clear underwriting philosophy, procedures and controls in relation to pricing, rigorous selection criteria and the diversification of risks. Reinsurance is another important method for the management of underwriting risk.

Material risk exposures are managed through the insurance risk appetites, which cover the following areas:

- Exposure management – modelled exposure limits by natural catastrophe/other peril region (set at the LSM level) and cascaded to entity.
- Delegated authorities – limits on the level of premium to be written through delegated authorities.
- Broker exposure – limits on the level of premium from individual brokers.
- Underwriting – underwriting guidelines over pricing, business plan premium, line size limits etc.
- Portfolio concentration – limits on line of business concentration, short- and long-tail premium concentration, and long-tail reserves.

Actual levels of risk vs. risk appetite measures are continually monitored, and LMIE may either revise approved business plans to stay within appetite, or if appropriate, revise appetite where it is reflective of a change in the external / internal environment.

b) Material risks that LMIE is exposed to:

LMIE exposures are predominantly in long tail liability business. Realistic Disaster Scenarios (“RDS”) are prepared by the Exposure Management Team and reviewed by the Exposure Management Working Group. These are reported as part of quarterly Chief Risk Officer reports to the Risk Management Committee.

c) Risk concentration:

Insurance risk concentration occurs due to the concentration of an insurance operation in a particular geographic area, industry or insurance peril. It may also occur as a result of a correlation between individual insured perils. The Company has the largest exposures by premiums and reserves to the SII LoBs General Liability, Fire and Other damage and Motor.

d) Risk mitigation:

LMIE manages insurance risks by monitoring and controlling the nature of an accumulation by geographic location of the risks in each line of business underwritten, the terms and conditions of the underwriting and the premiums the Company charges for taking on the risk. Some of the key risk mitigation strategy for insurance risk are pricing guidelines, review of large and unusual transactions and purchase of reinsurance.

In addition to managing insurance risk through the use of risk appetites and the purchase of reinsurance, there are specific operational processes related to the acceptance, measurement and management of insurance risk exposures. LMIE had no investment in Special Purpose Vehicles during the reporting period, hence no risk transfer took place. The overarching approach to the management of all operational risks is covered by the Operational Risk and Controls Policy (see operational risk below).

e) Process for monitoring the effectiveness of Insurance risk mitigation techniques:

The RMC actively monitors the effectiveness of the above risk mitigation techniques. Sensitivity testing over the business plan has been performed along with the results of stress tests over capital, and reverse stress tests, where the focus is on identifying potential management actions to mitigate the effect of threats to the viability of the business. The results of the stress tests indicate that LMIE's capital was adequate to absorb the calculated losses. We feed findings from the PRA annual General Insurance stress tests into our own stress and scenario testing. RSTs have been considered at an LSM level, impacts and management actions were determined at the entity level where applicable.

The LMIE Actuarial Function Opinions (dated 30th November 2016) on the Underwriting Policy and the Adequacy of Reinsurance Arrangements were presented to the LMIE Board concluded that:

1 The business plan is appropriate as premiums are sufficient to cover expected claims and expenses in aggregate; and

2 The outwards reinsurance strategy is in line with risk and underwriting policy.

SECTION C. 2 – Market Risk

Market risk refers to the risk of losses on LMIE's investment portfolio, arising from fluctuations in the market value of the underlying investments. LMIE has a clear investment strategy that is reviewed regularly, which has a number of objectives; to match investments to LMIE's claims liabilities in terms of both currency and duration, to hold a diversified portfolio of investment types and, within that overall context, to maximise the return generated at an agreed board level of risk.

Material risk exposures are managed through the market risk appetites, which are detailed in LSM's Risk Management and Internal Control Framework, which cover the following areas:

- Net interest rate risk – limit on interest rate-sensitivity measure as a proportion of total market risk.
- Credit and spread risk – limit on credit and spread-sensitivity measure as a proportion of total market risk.
- Credit and spread risk – minimum security ratings.
- Private equity risk – limit on private equity-sensitivity measure as a proportion of total market risk.
- Exchange rate risk – limit on exchange rate-sensitivity measure as a proportion of total market risk.
- Portfolio duration risk – limit on yield curve sensitivity measure.

The short-term effects of a flight to safety and GBP depreciation actually benefitted LMIE's portfolio from an unrealised gains and currency matching perspective, although developments in the macroeconomic environment continue to be closely monitored as outlined in the Strategic & Emerging Risk section.

In addition there are permitted investments guidelines and exposure limits which are approved by the Investment Committee.

LMIE has a dedicated investments team responsible for the oversight of its invested assets. Assets are selected and held subject to the market risk and liquidity risk appetites set by the Board.

From a market risk perspective this involves the investment of assets within agreed boundaries of interest, spread, credit, private equity, exchange rate and portfolio duration risk. LMIE also maintains sufficient liquidity to meet liabilities as they fall due.

These procedures ensure that LMIE meets the requirements of the 'prudent person principle' set out in Article 132 of the Solvency II Directive, namely that:

- LMIE only invests in assets and instruments whose risks LMIE can properly identify, measure, monitor, manage, control and report;
- All assets, in particular those covering the Minimum Capital Requirement and the Solvency Capital Requirement, are invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

The Investment Committee makes recommendations to the Board regarding the long term framework and short term investment strategy for the investment of LSM's assets. The Investment Committee's market outlook will help inform the risk appetites that are recommended to the Board.

The investment portfolios are managed by Liberty Mutual Group Asset Management Inc. the investment management arm of LMG, in accordance with investment guidelines approved by the Board of LSM. There is a minimum credit rating requirement of BBB- and an average quality requirement of A. Limits are also established regarding issue, counterparty, asset type and rating concentrations. Securities must be readily marketable.

In addition to managing market and liquidity Risk through the use of risk appetites and monitoring the environment, there are specific operational processes related to the acceptance, measurement and management of Market and Liquidity Risk exposures.

The overarching approach to the management of all operational risks is covered by the Operational Risk and Controls Policy.

SECTION C. 3 – Credit Risk

Credit risk arises from the possibility of default by one or more counterparties. This risk is managed by carrying out appropriate due diligence on prospective counterparties, looking at the credit ratings of reinsurers and monitoring these over time (a minimum rating of ‘A’ is required for any of LMIE’s reinsurance programmes) and having in place a robust credit control system.

Material risk exposures are managed through the credit risk appetites, which cover the following areas:

- Reinsurers – acceptance of credit concentration risk as a result of using a single reinsurance provider.
- Reinsurers – minimum credit ratings.
- Delegated authorities and brokers – due diligence process.
- Delegated authorities – limits on exposure to individual coverholders.
- Brokers – limit on Value at Risk (VaR) measure.

The position against the Tier 2 risk appetites for the six areas above are monitored and reported on a quarterly basis to the RMC and Board. Tier 2 appetites are those that sit one level below the Core risk appetites which are set at the capital impact level.

LSM’s reinsurers both LMG and non LMG) at the time of placing the risk (i.e. during the live period of the contract) were at least of S&P A- rating or collateralised and moreover, no RI programme would be considered by LSM with a carrier that was less than this rating, unless there was an appropriate level of security provided (e.g. collateral held) in line with LSM’s risk appetite LSM accepts that there will be a commensurate increase in its entity capital requirements (based on IM) due to the strategy of using LMG as a reinsurance provider and this is factored into the entity capital calculations. In addition, the RMC is provided quarterly information on ongoing Review of LMG Financial Statements and Rating; LMG’s own reinsurance programme; periodic reports from LMG to board that there are no material risks likely to impact LMG Credit Ratings and Underwriting and reserving risk exposures to LMG and related entities

In addition, the quarterly CRO report tracks the internal RI purchase as a % of GWP and LMG RI recoverable proportion to the available capital resources. This is in line with the PRA prudent person principle.

In addition to managing credit risk through the use of risk appetites and monitoring thereof, there are specific operational processes related to the acceptance, measurement and management of credit risk exposures. The overarching approach to the management of all operational risks is covered by the Operational Risk and Controls Policy (see below).

SECTION C. 4 – Liquidity Risk

Liquidity risk refers to the possibility of LMIE having insufficient cash available to settle claims and other liabilities as they fall due.

Liquidity risk exposures are managed through the liquidity risk appetites, which focus on ensuring that investment grade bonds exceed a specified percentage of the total investment portfolio. These appetites are managed alongside the market risk appetites, using the same procedures as outlined in the market risk section above. In particular, the liquidity risk appetites cover the following areas:

- Investment grade bonds – minimum weighting within the LMIE portfolio;
- Maintaining a diversified and appropriately liquid portfolio aimed at minimising the mismatch in cash flows between assets and net liabilities.

Both these appetites also help meet the requirements of the 'prudent person principle' set out in Article 132 of the Solvency II Directive and discussed in the market risk section.

LMIE calculates expected profit in future premium (EPIFP) using a method proposed by an EIOPA task force (based on QIS5). This methodology is broken down as follows:

1. Take into account the best estimate calculation already computed, i.e. net technical provisions as at 31.12.2016;
2. Calculate a new best estimate under the assumption that no more premiums are to be received in the future, and other assumptions would be unchanged.
3. The difference between the two best estimates for homogenous risk groups (taking into account positive differences only) is the EPIFP.

Capital, Liquidity and other contingency plans to mitigate risk and meet projected requirements over the planning period are deemed appropriate including under stressed conditions. The short-term effects of a flight to safety and GBP depreciation actually benefitted LMIE's portfolio from an unrealised gains and currency matching perspective, although developments in the macroeconomic environment continue to be closely monitored as outlined in the Strategic & Emerging Risk reporting to the Board and the RMC.

SECTION C. 5 – Operational Risk

Operational risk covers the risks arising from the failure of internal processes, people or systems, or from external events.

LMIE has limited appetite for operational risks, which are an unavoidable consequence of conducting business, and therefore seeks to manage and reduce exposure through an appropriate system of controls and an appropriate risk culture.

A specific area of focus within operational risk is conduct risk, which comes under the operational risk bracket as it is a regulatory requirement covering customer focus and market integrity. Conduct risk requirements slightly differ to standard regulatory requirements under operational risk and therefore it has a separate risk appetite.

Outsourcing is also noted as a specific area of operational risk, which is managed through the Outsourcing Policy maintained by Compliance.

The primary mechanism for operational risk mitigation is controls, which are "a mechanism which supports the achievement of LSM's corporate objectives within its agreed appetite by either preventing or detecting issues. Controls are embedded into day to day business processes and mitigate business risks identified by the Risk Owners". Examples of the types of controls are:

- Preventative: E.g. underwriting guidelines/authorities, documented policies & procedures
- Detective: E.g. underwriting exception reports

The Risk Management team work with control owners across the organisation to ensure that all the controls they are responsible for are appropriately documented.

A key control is one that is important to LSM or one of the legal entities at an overall level (rather than being a control which is just important for a specific function within LSM, however it is expected that there will typically be at least 1 key control for each function and risk).

Incident reporting is an important aspect of effective operational risk management. LSM allocates incidents into two categories:

- Loss event
- Near miss

A loss event is defined as an incident or occurrence that has led to loss or damage to finances, property or reputation which could impact the organisation's ability to achieve its objectives.

A near miss is defined as an event or occurrence that could have but did not result in loss or damage to finances, property or reputation which could impact the organisation's ability to achieve its objectives.

Incidents will normally be identified by an individual or their manager/head of department as part of business as usual processes. In addition, the Risk Management team will validate completeness of incidents reported via an annual review of all controls for which the heads of departments are responsible.

The Risk Management team will enter all reported incidents into the risk management system, Magique, in order to keep track of historical losses or near misses. This will allow oversight into areas where the aggregation of multiple incidents may give risk to a review of the controls in place.

Magique is LSM's Operational risk register which captures risks and controls against those risks. LSM monitors these controls on a regular basis through Magique.

Magique is a new system and therefore reporting was developed further during 2016. During 2017, the RM team have targeted various stakeholders across the organisation to deliver training and guidance on Magique.

SECTION C. 6 – Other Material Risks

LMIE recognises that along with the benefits of being part of the LSM organisation, there is also a risk that matters could arise in one part of the organisation that negatively impact the other parts of the organisation. To mitigate the impact of this, the chairman of any committee reviewing risk information ensures that due attention is given to each legal entity. LSM recognises that this must continue even in times of stress to one entity.

LMIE's Risk Universe also identifies sources of 'other risk' which are not fully captured via the quantitative risk modelling process:

- Strategic risk
- Group risk
- Emerging risk

Risk appetite statements for insurance risk incorporate a number of metrics that also cover elements of strategic risks (e.g. delegated authority arrangements and brokers); these are included and measured under insurance risk.

There are no quantitative risk appetite statements for group or strategic risk; they are either controlled to an acceptable level and/or monitoring measures are put in place, with reporting on an exceptions basis.

The identification of emerging risks is an important part of LMIE's Risk Management process. Identification of emerging risks comes from multiple sources and processes across LSM, and all identified emerging risks are recorded by the Risk Management team in the Emerging Risk Inventory.

SECTION C. 7 – Any Other Information

LSM has two approaches to risk management defined by how the risk is categorised in the Risk Universe Policy. Intrinsic risks, which we actively seek, are managed through the use of risk appetites that are cascaded. Operational risks and other risks (strategic and group risk) for which LSM has limited appetite are managed through the Operational Risk & Internal Controls Policy and associated procedures.

Through the setting of risk appetites the LSM Board is acknowledging the existence of these risks and setting the boundary of risk taking that is acceptable given the current business environment. Risk Owners are empowered to manage their risks within the boundaries set.

As part of the 2016 LMIE ORSA, the sensitivity of profits, own funds, capital requirements and solvency ratio to changes in premiums, expenses and investment income was tested.

Stress and scenario testing specifically applied to the LMIE balance sheet was also completed during Q3 2015 in respect of the PRA's General Insurance Stress Test (GIST) exercise. Following on from the results of the sensitivity tests and RSTs a series of contingency plans (CP) have been reviewed by the Board. These CPs will form part of the Recovery plan that is being developed with Compliance and will be presented to the Board in 2017 for approval.

SECTION D – VALUATION FOR SOLVENCY PURPOSES

LMIE has prepared its Solvency II balance sheet in accordance with Article 75 of the Solvency II Directive 2009/138/EC. The major valuation and classification differences between the UK GAAP standards, under which LMIE prepares its financial statements, and Solvency II are explained in this section, along with the material lines of Solvency II assets and liabilities.

USD$000's	Section Ref	Statutory Accounts (UK GAAP)	Solvency II valuation adjustments	Solvency II classification adjustments	Solvency II
Deferred Acquisition Costs	D.1.1	92,441	-92,441	-	-
Deferred tax assets		-	-	-	-
Pension benefit surplus	D.1.2	4,333	-		4,333
Property, plant and equipment held for own use	D.1.3	11,231	-11,231	-	-
Investments	D.1.4	2,367,315	10	-86,347	2,280,968
Bonds		*2,218,851*	*10*	*23,241*	*2,242,102*
Government Bonds			-	915,574	915,574
Corporate Bonds		2,218,851	10	-907,604	1,311,258
Collateralised securities			-	15,271	15,271
Collective Investments Undertakings		*13,493*	-	*21,157*	*34,650*
Deposits other than cash equivalents		*134,970*	-	*-130,754*	*4,216*
Reinsurance recoverable	D.1.5	969,867	-656,860	311,058	624,065
Deposits to cedants	D.1.6	29,415	-	-	29,415
Insurance and intermediaries receivables	D.1.7	443,742	-	-311,058	132,684
Reinsurance receivables	D.1.8	56,803	-	-	56,803
Cash and Cash equivalents	D.1.9	89,651	-	104,987	194,638
Any other assets	D.1.10	31,782	-	-18,630	13,152
Total Assets		**4,096,580**	**-760,522**	**-**	**3,336,057**
Technical Provision	D.2	*2,783,034*	*-743,817*	*186,418*	*2,225,634*
Deferred tax liabilities	D.3.1	14,999	-1,611	2	13,390
Insurance & intermediaries payables	D.3.3	22,695	-		22,695
Reinsurance payables	D.3.2	166,466		-166,466	-
Payables (trade, not insurance)	D.3.4	58,246	-	-19,952	38,294
Any other liabilities, not elsewhere show	D.3.5	28,803	-	-2	28,801
Total Liabilities		**3,074,242**	**-745,428**	**-**	**2,328,813**
Excess of assets over liabilities		1,022,338	-15,093	-	1,007,245

SECTION D. 1 – Assets

As at 31 December 2016, the LMIE Solvency II valuation of total assets is $3,336.0m. The Solvency II balance sheet can be viewed in the Appendix – QRT's.

D.1.1 Deferred acquisition costs

LMIE deferred acquisition costs are costs arising from the conclusion of insurance contracts that are incurred during the reporting period but which relate to a subsequent reporting period. Under UK GAAP, deferred acquisition costs are amortised over the period in which the premiums are earned.

The Solvency II valuation of deferred acquisition costs is nil.

D.1.2 Pension benefit surplus

LMIE operates a defined contribution pension scheme for its employees. The assets of the scheme are held separately from those of LMIE in an independently administered entity.

In addition, LMIE has a closed defined benefit pension scheme which provides retirement benefits based upon final salary. The scheme is administered by a separate board of Trustees which is legally separate from the Company. FRS 102 allows the company to recognise any scheme surplus on its balance sheet provided that it is able to recover the surplus either through reduced contributions in the future or through refunds from the Scheme. As at 31 December 2016, the pension benefit surplus in respect of the defined benefit scheme under Solvency II valuation is $4.3m.

The pension surplus asset is recognised by LMIE and is valued in accordance with IAS19, which is similar to FRS 102 and is consistent with the valuation under Solvency II. The pension scheme assets and liabilities are reported on a net basis on the balance sheet. There is no difference in value between UK GAAP and Solvency II for pension benefit surplus.

D.1.3 Property, plant and equipment held for own use

As at 31 December 2016, LMIE held plant and equipment held for its own use under UK GAAP of $11.2m. LMIE initially recognises tangible assets, including computer equipment, fixture, fittings and office equipment, at cost. Subsequently, it is depreciated over the estimated useful economic lives of the assets on a straight line basis, subject to tests for impairment

The Solvency II valuation of property, plant and equipment held for own use is nil, in accordance with the IFRS revaluation model, as the assets are deemed to have no market or fair value.

D.1.4 Investments

As at 31 December 2016, the Solvency II valuation of investments is $2,280.9m. The investments held under UK GAAP are valued at $2,367.3m.

Under Solvency II, investments excluding participations are measured using fair value principles, which align with the accounting policy adopted by LMIE for UK GAAP reporting purposes, as a result there are no measurement differences between the two bases. Differences arise as a result of reclassification of holdings, most significantly between deposits and cash and cash equivalents, and in addition accrued income on investments is treated as an integral part of the investment valuation under Solvency II, whilst being separately reported on the UK GAAP balance sheet.

LMIE uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) price in an active market for identical assets or liabilities. In accordance with Solvency II Guideline 7, active markets exist where financial assets are traded on an exchange and pricing information is provided by leading financial market data. Quoted in an active market in this context means quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted price is usually the bid price.

- Level 2: quoted (unadjusted) price for identical assets or liabilities are not available, the instrument is valued using inputs that are observable either directly or indirectly including quoted prices (adjusted) for similar assets or liabilities in active markets. Inputs such as interest rates, yield curves, implied volatility or credit spreads and market-corroborated inputs are observable at commonly quoted intervals.

- Level 3: when neither the quoted prices nor the observable inputs are available, unobservable inputs are used to measure fair value by use of valuation techniques. The objective of using the valuation technique is to estimate what the fair value would have been on the measurement date.

In accordance with Article 75 of the SII Directive all investments are accounted for fair value at the period end on the Solvency II economic balance sheet. The LMIE Investment Manager values the portfolio in accordance with the fair value hierarchy at the period end.

Investments - Bonds

The Solvency II valuation of total Bonds is $2,242.1m.

Investments - Government Bonds

The Government bonds Solvency II valuation is $915.6m. Under this class of investment asset, the U.S Treasury Bonds are valued in accordance with market quoted prices. Redeemable fixed-interest securities are reviewed on a holding by holding basis, these investment assets are valued in accordance with the Solvency II Directive Articles 10 (3), level 2 valuation technique.

The Solvency II adjustment relates to classification of fixed income assets. In the statutory accounts, $915.6m of fixed income assets are classed under Corporate Bonds. In accordance with the Solvency II Delegated Article, these assets are classed as Government Bonds.

Investments - Corporate Bonds

The Solvency II valuation of Corporate Bonds in accordance with Article 10(3) of the Solvency II Directive is $1,311.3m. Corporate bonds are redeemable fixed-interest securities, valued in accordance of Solvency II Directive Articles 10 (3). There is no direct quoted market pricing, level 2 valuation technique are applied to determine the fair value of these corporate bonds. The Solvency II adjustments of $915.6m relates to classification of fixed income assets. In accordance with the Solvency II Delegated Article, these fixed income assets are re-classed to Government Bonds.

Investments - Collateralised Securities

The Solvency II valuation of Collateralised Securities is $15.3m as at 31 December 2016. These asset backed securities (ABS) are reported under the collateralised securities and are reviewed regularly by LMIE Investment Managers. The ABS is complied with the 5% retention rules in Article 254. There is no direct pricing for these asset backed securities, in accordance with SII Delegated Article, level 2 valuation techniques are used to determine the fair value of asset backed securities. In the Statutory Accounts, the collateralised securities is reported under a different class of investment assets and is nil. The difference in value relates to classification of collateralised securities.

Investments – Collective Investments Undertakings

The Solvency II valuation of Collective Investments Undertakings is $34.7m.

Liquidity funds are reported under Collective Investments Undertakings (CIU) the valuation provided by the fund manager is reviewed by the Investment Manager. In accordance with Article 10(5), level 3 valuation techniques are applied to these liquidity funds. Private equity fair value is determined by applying level 3 valuation technique in accordance with Article 10(5).

The Solvency Capital Requirements has been calculated on the look-through basis for collective investments undertakings as required in Article 84 (1). The adjustment for Solvency II purposes relates to the reclassification of balances treated as cash and cash equivalents under UK GAAP. There are no Solvency II valuation adjustments made to this class of investments as they are reported at fair value.

Investments - Deposits other than cash equivalents

The Solvency II valuation of deposits other than cash equivalents is $4.2m.

Deposits with credit institutions are also held at fair value. These typically consist of callable on-demand deposits with very short maturities, which are not always held to maturity. There is no direct quote for these short term callable on demand deposits, consequently level 2 valuation techniques are applied. The Solvency II adjustments of $130.8m comprises two reclassification adjustments: $105.0m relates to reclassification to cash and cash equivalents and $21.2m relates to reclassification to collective investment undertakings.

D.1.5 Reinsurance recoverable

The Solvency II valuation of Reinsurance Recoverable in relation to TP's is $624.0m,

The difference between the UK GAAP and Solvency II valuation of $345.8m is disclosed under section D.2 - Technical Provisions, as these comprise future cash flows arising from reinsurance recoverable in respect of gross technical provisions.

D.1.6 Deposits to cedants

The Solvency II valuation of deposits to cedants is $29.4m and is measured at fair value. There is no difference in valuation between Solvency II and UK GAAP.

D.1.7 Insurance and intermediaries receivables

The Solvency II valuation of insurance and intermediaries receivables is $132.7m, compared to $443.7m under UK GAAP. The SII balance constitutes trade receivables which are past due from intermediaries, and are valued for Solvency II purposes at fair value. Non-overdue amounts have been transferred to Technical Provisions as they are considered to be future cash flows. In the statutory accounts, amounts not yet due for payment remain recorded as receivables using historical cost and are subject to periodic assessment for recoverability.

D.1.8 Reinsurance receivables

The Solvency II valuation of reinsurance receivables is $56.8m, comprising reinsurance recoverable due in respect of paid claims. These are measured at fair value. There is no difference in valuation between Solvency II and UK GAAP.

D.1.9 Cash and cash equivalents

The Solvency II valuation of cash and cash equivalents is $194.6m.

In accordance with the Solvency II Directive, cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash and that are subject to an insignificant risk of changes in value. The investments that meet the definition of a cash equivalent have a maturity of three months or less from the date of acquisition, and are held for the purposes of meeting short-term cash commitments rather than for investment or other purposes.

Under UK GAAP valuation, the Cash and Cash equivalents are $89.7m. The difference of $105.0m is a classification adjustment from short-term highly liquid investments as disclosed in section D.1.4.

D.1.10 Any other assets

The Solvency II valuation of any other assets is $13.1m. These largely consist of prepaid expenses.

Under UK GAAP the valuation is $31.8m which primarily comprises of prepayments and accrued investment income. The valuation difference of $18.6m relates to a reclassification of accrued income, included within the overall investment valuation..

The company reviews prepayments and other debtors and any material amounts which are paid, or to be paid, over 12 months, which will be stated at market value and discounted using the effective interest rate method if applicable.

SECTION D. 2 – Technical Provisions

D.2.1 Technical Provisions by Line of Business

The Company has applied appropriate methodologies and procedures to assess the sufficiency of the Technical Provisions (TPs) and the calculation is consistent with the requirements set out in Articles 76-86 of the SII Directives.

The TPs consist of the claims technical provision, the premium technical provision (which together form the best estimate liability) and the risk margin.

The TPs have been estimated at a homogeneous line level. The segmentation of lines are based on obligations that are managed together and which have similar characteristics. Direct General Liability and Direct Fire and Other Damage to Property business represent over 85% of the LMIE TPs. The Company has no exposure to Health or Life TPs, including Periodic Payment Orders.

D.2.2 Technical Provisions Valuation Methodology

The relevant Solvency II Directive and Delegated Acts text and associated guidance require the TPs to represent a best estimate plus a risk margin, where the best estimate corresponds to the probability-weighted average of future cash flows, taking account of the time value of money.

Technical Provisions valuation methodology of the Company groups the following key components:

- Claims Provisions: best estimate provisions that relate to earned exposure.
- Premium Provisions: best estimate provisions that relate to unearned exposure and include policies which are bound but not yet incepted at the valuation date.
- Risk Margin: additional provision to bring the above best estimate to the level required to transfer the obligations to a third part undertaking.

The Claims and Premium Provisions would include allowance for future premiums, expenses and Events Not In Data (ENIDs). Payment projections are then derived for all the future cash in-flows and out-flows.

D.2.2.1 Claims Provisions

The gross claims provisions are calculated separately for attritional, large and catastrophe claims with no margin allowance for prudence. The methodology is the same as that used to estimate the Actuarial Function's view of the UK GAAP reserves (with no margin for prudence), before allowance for ENIDs, expenses and discounting.

The methods used to estimate the Claims Provisions are deterministic claims-based and exposure-based methods and are in line with best practice non-life actuarial techniques, such as the Chain Ladder and Bornhuetter-Ferguson methods.

The process for estimating the reinsurance recoveries follows a netting-down approach of the gross claims provisions. The gross attritional, large and catastrophe splits do not apply. Instead, reinsurance claims provisions are estimated for Proportional and Non-Proportional outwards reinsurance treaties separately.

Reinsurance bad debt (counterparty default) is taken into account using the credit rating of each individual reinsurer and their ability to pay.

D.2.2.2 Premium Provisions

Premium provisions relate to claim events occurring after the valuation date and during the remaining in-force coverage of policies.

The ultimate premium by year of account is broken down into the following components:

- Earned (included in claims provisions)
- Unearned incepted
- Unincepted but legally bound (BBNI)
- Unbound

The analysis and split of premium between unearned incepted, BBNI and unbound is carried out at the policy level. Earning patterns are calculated by policy taking into account inception and expiry date. The inception date of a policy is used to determine whether it is incepted or not, except for delegated authorities where the underlying inception profile is used. The commitment date recorded on source underwriting systems is used to determine whether a policy is bound or not except for delegated authorities – see Definition of an Existing Contract.

The ultimate premium that is unbound is not included in the Technical Provisions. The gross Premium Provisions are calculated separately for unearned incepted and BBNI:

Unearned Incepted claims are calculated as the unearned incepted premium multiplied by the underwriting year prior loss ratio from the latest actuarial reserve analysis.

BBNI claims are calculated as the BBNI premium multiplied by the business plan loss ratio for each line of business.

D.2.2.3 Definition of an Existing Contract

Under SII all existing contracts are included in the valuation as opposed to incepted contracts under UK GAAP Technical Provisions. Contracts are recognised as existing once LMIE becomes a party to the contract or when the contract between undertaking and policyholder is legally formalised. The source underwriting systems record the commitment date, written date and the inception date of the contract.

For binder and delegated authority business this is assessed on a “look through” basis with the boundaries of the actual underlying contracts of insurance being tested. The Company’s approach is to include one months of new business of underlying inceptions for each delegated authority.

D.2.2.4 Outwards Reinsurance

The key principle followed for LMIE reinsurance premium provisions is to ensure the best estimate underlying the technical provisions is consistent with the inwards policies (The Principle of Correspondence). In addition, for existing reinsurance contracts, any contractually bound contracts are also included in full with no consideration to the future inwards business.

The SII valuation assumes that future reinsurance purchases will be made in line with the current business plan (a future management action) and that an equivalent reinsurance spend and benefit will be available to cover unearned and BBNI business.

The future claims inflow on unearned and BBNI business is adjusted for the probability of counterparty default. The methodology takes into account both the probability of default and the loss given default.

D.2.2.5 Future Premium

The estimation of the TPs allows for claims cashflows to be offset by premiums receivable (gross of reinsurance) and premiums payable (on outwards reinsurance) that are expected to occur in the future but are not overdue at the valuation date.

The premium receivable and payable for Claims Provisions and Premium Provisions are valued consistently with the UK GAAP basis other than the additional allowance for BBNI business. Therefore the premium receivable and payable are both larger than the GAAP basis.

Any potential lapses in premiums are taken account in the cashflow analysis.

D.2.2.6 Expenses

SII requires the best estimate to include all cashflows arising from expenses that will be incurred servicing the policies over their lifetime.

Allocated loss adjustment expenses (“ALAE”) figures are included within the claims numbers used for premium provisions and claims provisions.

Expenses have been split for analysis purposes into acquisition costs, unallocated loss adjustment expenses (“ULAE”) and other additional expenses including Investment Management Expenses.

Acquisition Costs:

Gross and reinsurance acquisition costs by year of account and line of business are supplied from the underwriting source systems.

ULAE:

ULAE provision is estimated using the same methodology as the UK GAAP reserves.

Investment Management Expenses and Other Expenses:

The actual and budgeted investment management expenses incurred by LMIE on a per annum basis are used as the basis to estimate the total investment management expense provision for the run-off of the current liabilities, assuming a future rate of management expense inflation and that the expenses will reduce in line with the managed assets.

Other expenses have been derived using the Company's expense model to derive an estimate of the headcount and associated cost for each department which supports the legally bound contracts over the life of their future cashflows.

D.2.2.7 Events not in Data (ENIDs)

SII requires that the best estimate technical provisions be a probability weighted average of all possible future outcomes.

The methods used such as Chain Ladder and Bornhuetter-Ferguson are based to a degree on historical information and therefore do not allow for all future outcomes.

ENIDs are those events of high severity but very low frequency that are missing from our historical data sets and exposure information. An example of an ENID would be a latent claim such as the health hazard losses from asbestos and pollution that emerged in the 1980's.

By their nature any methodology applied will be subjective for ENIDs. The Company has taken the following approach:

- An uplift factor is obtained by comparing the current claims best estimate to the best estimate excluding the observations beyond the 1 in 200 year point from internal analysis of reserve risk and underwriting risk.
- For claims relating to earned business the reserving risk distribution is used.
- For claims relating to premium provisions the attritional and large combined underwriting distribution is used.
- No uplift has been applied to catastrophe claims.
- The uplift factor has been applied to the undiscounted claims reserves.
- A minimum uplift is applied by line.

D.2.2.8 Cashflows and Discounting

The best estimate technical provisions under SII take into account the time-value of money using the relevant risk-free interest rate term structure. This is undertaken for each material currency.

Claims and premium provisions are converted to deterministic cash flows by application of quarterly payment patterns. Ceded cash flows are assumed to be equal to those applied to the gross with a quarter lag.

The term structures used for discounting have been supplied by EIOPA for each currency. The Company has relied upon EIOPA to prepare these yield curves.

D.2.2.9 Risk Margin

The Risk Margin is calculated using a cost of capital approach. The cost of capital approach requires the Risk Margin to be calculated by determining the cost of providing the Solvency Capital Requirement (SCR) necessary to support the Technical Provisions over their lifetime. Therefore, the approach requires the Technical Provisions and SCR to be calculated for each future year until the business is fully run off.

The claims run-off pattern applied to the Technical Provisions and SCR for each future year until the business is non-linear using a risk based approach.

A cost of capital rate of 6% per annum is used as the cost of holding the projected SCR in the future.

The Risk Margin is calculated for the whole business and allocated to SII lines of business.

D.2.2.10 Options and Guarantees

The Company has no material options and guarantees that require explicit consideration or adjustment within the TPs.

D.2.3 Comparison of GAAP and SII Valuation of Technical Provisions

The table below presents a comparison of the Company’s UK GAAP provisions to those on a SII basis as at 31 December 2016. Note that the Company’s UK GAAP reserve estimates contain margins when compared with the SII best estimate.

Comparison of gross and net technical provisions estimates as at 31 December 2016

($m's, applicable period-end balance sheet rates)

	Q4 2016		
	UK GAAP [A]	S2 Basis [B]	UK GAAP vs. S2 Basis [C] = [A] - [B]
Gross of Reinsurance			
Claims reserve (incl Risk Margin)	(1,976)	(2,633)	657
ULAE (and other SII expenses)	(32)	(91)	59
UPR (Net of DAC)	(592)	-	(592)
Premium debtors	311	499	(188)
Gross TP	**(2,289)**	**(2,226)**	**(64)**
Reinsurance			
Claims reserve	719	888	(169)
Bad Debt	(2)	(2)	-
UPR (Net of RI DAC)	163	-	163
Ceded Premium Creditors	(186)	(262)	76
Reinsurance TP	**693**	**624**	**69**
Net GAAP / SII TP (including future premium)	**(1,596)**	**(1,602)**	**5**

The material differences from moving from a UK GAAP to SII basis are:

- An increase in gross and reinsurance claims reserves as a result of moving from the GAAP concept of holding a UPR to the Premium Provisions concept in SII.
- An increase in gross claims reserves as a result of holding a Risk Margin under SII being greater than the removal of the GAAP reserve margin at this valuation date.
- Allowance for ENIDs and discounting for the time value of future cashflows largely offset each other at this valuation date.
- An increase in gross premium debtors and reinsurance premiums creditors as a result of the wider definition in SII to consider all existing, legally bound, contracts as opposed to incepted contracts under UK GAAP.
- An increase in expense provisions under SII to cover the wider definition of all expenses that will be incurred servicing the in-force policies over their lifetime.

A quantitative summary of the technical provisions by Solvency II Line of Business is provided in the table below:

Non-Life Technical Provisions by Best Estimate Liability and Risk Margin
$ millions

Solvency II Line of Business	Gross BEL	Reinsurance Recoverable BEL	Risk Margin	Total TP
General liability - Direct	1,564	(438)	73	1,199
Fire and other damage to property - Direct	254	(65)	10	199
Credit and suretyship - Direct	80	(26)	7	61
Motor vehicle liability - Direct	41	(0)	3	43
All Other Lines	181	(94)	12	99
Total non-life obligation	2,121	(624)	105	1,602

General Liability Insurance

The General Liability Line makes up 74% of the SII TPs. GAAP reserves for direct casualty (general liability), financial lines (D&O and E&O), and professional lines are the starting point for the calculation of TPs for this SII line. The UK segment of this line is impacted by the change in the Ogden Discount Rate from plus 2.5% to minus 0.75% in February 2017. SII adjustments are applied to the GAAP reserves (net of future premium) to obtain the SII TPs. The most material adjustments that result in an increase in the TPs are for:

- $73m for the Risk Margin
- $40m for additional expense provisions
- Offset by $57m for the profit in the Premium Provisions

Fire and Other Damage to Property

The Fire and Other Damage to Property Line makes up 12% of the SII TPs. GAAP reserves for direct property and energy lines are the starting point for the calculation of TPs for this SII line. SII adjustments are applied to the GAAP reserves (net of future premium) to obtain the SII TPs. The most material adjustments that result in a small decrease in the TPs are for:

- $32m for the profit in the Premium Provisions
- Offset by $10m for the Risk Margin and $8m of additional expense provisions

Credit and Suretyship

The Credit and Suretyship Line makes up less than 2% of the SII TPs. GAAP reserves for direct surety, financial, political and credit risk lines are the starting point for the calculation of TPs for this SII line. SII adjustments are applied to the GAAP reserves (net of future premium) to obtain the SII TPs. The most material adjustments that result in a decrease in the TPs are for:

- $65m for the profit in the Premium Provisions
- Offset by $7m for the Risk Margin and $5m of additional expense provisions

No other Solvency II Line of Business make up more than 5% of the Company's total SII TPs, and the aggregate change relative to the GAAP basis across all the other SII Lines is less than 1% of the total TPs.

D.2.4 Changes in Technical Provisions from prior Reporting Period

There were no externally audited Technical Provisions at the prior reporting period. Therefore, this section is excluded for the first reporting period of the SFCR.

D.2.5 Assumptions and Use of Expert Judgement

D.2.5.1 Future Management Actions within the Technical Provisions

A key assumption within the valuation of the reinsurance Technical Provisions is that the reinsurance programmes will be renewed with similar terms to those currently in place and that the Company will continue to write a similar book of gross business in line with the 2017 business plan. Deviations from this could have a material impact on the technical provisions required.

No other future management actions were explicitly allowed for in the Technical Provisions.

D.2.5.2 Reserving Methods

The methods used are in line with best practice in non-life actuarial techniques.

D.2.5.3 Assumption Selection

All modelling assumptions are documented by the Actuarial Function in line with UK professional standards.

D.2.5.4 Consistency with Financial Market Information

Future Inflation:

Other than in the choice of the expected loss ratios, the Company's reserving methods do not make an explicit assumption for future claims inflation. The Chain Ladder method makes an implicit assumption that historic trends in inflation will persist into the future.

Currency Rates of Exchange:

Future exchange rates are assumed to be equal to the current level.

Reserving Cycle:

Where possible allowance has been made for the reserving cycle.

D.2.5.5 Expert Judgement

The use of Expert Judgement is documented in the Actuarial Function Report. All modelling selections contain judgement.

D.2.6 Uncertainty associated with the Technical Provisions

There is a wide range of possible outcomes in assessing the Company's TPs. The TPs represent a best estimate plus a risk margin, where the best estimate corresponds to the probability-weighted average of future cash flows, taking account of the time value of money. Some of the key uncertainties in valuing the TPs include:

1. For all actuarial projections there are a range of possible results. The final outcome will depend on the actual development of claims. All actuarial techniques use the historic data to predict the likely development by line of business. Unforeseen changes may affect the suitability of that data and would be expected to have an impact on the accuracy of the results. Such issues would include unexpected claims inflation, changes in legislation and the emergence of new types of claim.

2. Over the years the Company has expanded into new areas of business or changed the makeup of accounts. These lines of business may not have fully developed history on which to base projections. For these lines we have typically selected market benchmarks. The accuracy of the results is dependent on the suitability of benchmarks used. The assessment of the appropriateness of these benchmarks may not be possible for some time. Additionally long tail lines of business may still not be fully developed so the results will be dependent on the tail selected.

3. Actuarial techniques rely on the appropriateness of the historic data. The final outcome may rely on the development of individual claims reserves. It may take a considerable length of time for these claims to settle.

4. Some underwriting lines of business have results that are dependent on the performance of certain key contracts, either through large exposures or through a large volume of business being written under the contract, relative to the size of the account.

5. Estimates make no provision for potential future claims arising from new latent caused or lines of claim not as yet materially recognised in the historical experience unless identified through our discussions with LMIE underwriters, claims specialists or other senior management

6. Some of the Company's casualty lines of business are exposed to catastrophe events. Some lines are also exposed to natural catastrophes. For these lines the ultimate claims are highly dependent on the future incidence of these events.

7. No provision has been made for post balance sheet events occurring after 31st December 2016 in our estimates, other than the change in the Ogden Discount Rate from +2.5% to minus 0.75% within the General Liability line .

8. A large part of the Company's TPs comprise long-tailed Casualty and Financial Institutions exposures which are inherently more uncertain in their nature and particularly

sensitive to the effects of the global financial crisis and subsequent economic downturn since 2008.

9. Loss Ratios used in projections may be subject to an additional degree of uncertainty in the current soft market conditions and following the significant growth of the Company's book since 2002.

10. Another feature of long-tailed casualty lines in a soft market is that they tend to exhibit a "reserving cycle" in that, for a number of reasons, there is strong empirical evidence suggesting claims development patterns show a tendency to lengthen.

11. The Company writes material and increasing amounts of business through coverholders and facilities. This can lead to lengthened development in lines which are a combination of open market and binding authority business as the proportion of binding authority business increases.

12. The outward treaty reinsurance programmes are denominated predominantly in US dollars. An uncertainty arises in the estimation of recoveries due to movements in foreign exchange rates before the losses are settled in a non-settlement currency.

13. There is uncertainty in the market around case estimates as a percentage of incurred claims reducing, which would suggest case estimates are becoming weaker.

14. There is uncertainty in the market that more recent years of Casualty business will perform relatively better than older years after allowing for rate movements and inflation due to improvements in underwriting.

15. Technical Provisions are impacted by economic variables. The general methods used by the Actuarial Function implicitly allow for inflation by assuming the weighted average rate of future inflation will occur in the future. If future inflation was above the past long term rate then the undiscounted technical provisions would increase.

16. Quantification of ENIDs are inherently difficult to value. The Actuarial Function has had to determine what is not included within its original best estimate and to determine what the best estimate would be for the very low frequency, high severity ENIDs. ENIDs are challenging to validate due to the absence of historical observations by their nature in the LMIE dataset.

17. The timing of future payments is always uncertain and can greatly be affected by many variables. The timing of the Company's cashflows and the yield curves by currency provided by EIOPA impact the discounting credit within the TPs.

18. The uncertainty associated with the Premium Provisions is greater than the earned reserves as a result a greater impact future economic and market conditions and as a result of the potential for insured catastrophes.

D.2.7 Matching Adjustment

The matching adjustment referred to in Article 77b of Directive 2009/138/EC has not been applied by the Company. Therefore no quantification is provided of the impact of a change to zero of the matching adjustment on that undertaking's financial position, including on the amount of technical provisions.

D.2.8 Volatility Adjustment

The volatility adjustment referred to in Article 77d of Directive 2009/138/EC has not been used by the Company. Therefore no quantification is provided of the impact of a change to zero of the volatility adjustment on that undertaking's financial position, including on the amount of technical provisions.

D.2.9 Transitional Risk free Interest Rate-term Structure

The transitional risk-free interest rate-term structure referred to Article 308c of Directive 2009/138/EC has not been applied by the Company. Therefore no quantification is provided of the impact of not applying the transitional measure on the undertaking's financial position, including on the amount of technical provisions.

D.2.10 Transitional Deduction

The transitional deduction referred to Article 308d of Directive 2009/138/EC has not been applied by the Company. Therefore no quantification is provided of the impact of not applying the deduction measure on the undertaking's financial position, including on the amount of technical provisions.

SECTION D. 3 – Other Liabilities

The Solvency II valuation of total liabilities (including Technical Provisions) is USD$2,328.0m. The material classes of liabilities other than Technical Provisions and their valuation methods are listed below.

D.3.1 Deferred tax liabilities

The Solvency II valuation of deferred tax liabilities is $13.3m.

Deferred tax is recognised in respect of temporary differences arising due to Solvency II adjustments. The Solvency II measurement of deferred tax is consistent with Article 296 (1)(b).

The UK GAAP valuation of deferred tax liabilities is $15m.

Deferred tax arises from timing differences that are differences between taxable profits and total comprehensive income as stated in the financial statements. These timing differences arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is recognised on all timing differences at the reporting date. Unrelieved tax losses and other deferred tax assets are only recognised when it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and that are expected to apply to the reversal of the timing difference.

D.3.2 Reinsurance payables

The Solvency II valuation of reinsurance payables is nil, this compares to $166.5m reported under UK GAAP, which is recognised at fair value. The difference arises from reclassification of amounts payable in respect of reinsurance premiums to technical provision in Section D.2.

D.3.3 Insurance and intermediaries payables

The Solvency II valuation of insurance and intermediaries payables is $22.7m. These are recognised when legally binding and measured at the fair value of the consideration received less directly attributable transaction costs.

There is no difference in valuation between Solvency II and UK GAAP.

D.3.4 Payables (trade, not insurance)

The Solvency II valuation of payables (trade, not insurance) is $38.2m, this compares to $58.2m under UK GAAP, which is recognised at fair value.

The difference of $19.9m arises from reclassification of amounts payable in respect of reinsurance premiums to technical provisions representing future cash flows.

D.3.5 Any other liabilities not elsewhere shown

The Solvency II valuation of other liabilities, not elsewhere show is $28.8m, these consist of accruals for general operating expenses and are reported at fair value.

SECTION D. 4 – Alternative Methods for Valuation

LMIE do not have alternative methods for valuation.

SECTION D. 5 – Any Other Information

LMIE do not have any other information under Solvency II balance sheet valuation.

SECTION E – CAPITAL MANAGEMENT

SECTION E. 1 – Own Funds

E.1.1 Objective, Policies and Processes for managing Own Funds

The purpose of own funds management is to maintain, at all times, sufficient own funds to cover the Solvency Capital Requirement (SCR) and Minimum capital Requirement (MCR) with an appropriate prudence margin. The Company holds quarterly board meetings, in which the proportion of own funds over SCR and MCR are reviewed.

As part of own funds management, LMIE prepares ongoing annual projections and reviews the structure of own funds and future requirements. The business plan, which forms the base of the ORSA, contains a three year projection of funding requirements and this helps focus actions for future funding.

The solvency monitoring plan is set out in the tiers below which will apply to both the Standard Formula (SF) and the Internal Model (IM) (one-year) calculations. LMIE currently uses the standard formula (SF) to calculate capital requirements as its internal model (IM) has not yet been approved. However, the internal model is used alongside the SF to help LMIE understand and manage risks to its business, and challenge SF outputs where appropriate.

>125% of the SF and IM (one-year) calculations	• Quarterly SCR updates in line with the SF Policy and IM update cycle • Potential to pay dividends if solvency exceeds 125% on both SF and IM basis • Board decision subject to degree of excess capital, plan and volatility
115% - 125% of the SF and IM (one-year) calculations	• No dividends will be paid • Quarterly SCR updates in line with the SF Policy and IM update cycle • Monitor risk of solvency deteriorating in the following three months
110% - 115% of the SF and IM (one-year) calculations	• No dividends will be paid • Full quarterly re-run of the SCR • Capital contingency planning activity • Monitor risk of solvency deteriorating in the following three months
100% - 110% of the SF and IM (one-year) calculations	• No dividends will be paid • Regular communication to PRA • Board approval of capital remediation plan (the remediation plan shall include an allowance for scenarios that are expected to self-correct, for example an unforeseen, sharp and steep fall in financial markets) • Action: restore capital to an appropriate level determined by the Board over a period of at least 6 months
SF SCR - MCR	• 2 months to submit a recovery plan • 6 months to restore SCR cover (capital injection or reduce risk profile)
MCR (between 25% and 45% of SCR)	• 3 months to restore MCR cover • Capital injection or reduce risk profile

LMIE believe the selected margins above, both the IM one-year capital and the SF calculations are appropriate for the following reasons:

- They reflect a sufficient margin for the LMIE business model and risk profile, supported by a solvency monitoring plan (set out below);
- LMIE policyholders benefit from a guarantee from our parent company, which is as a consequence reflected in the credit rating of LMIE; and
- LMIE parent company has demonstrated a record of recapitalising LMIE, the directors believe that there is no reason to expect that LMIE would not be recapitalised in the event that this is what is required in the future.

Business plans are prepared over a three year time line. LMIE do not anticipate changes in future business plans that will significantly alter future capital requirements. However, as the impact of Brexit is felt there remains the possibility that capital requirements, and therefore solvency ratios, will be affected by any structural adjustments that are necessary, as preparations are made to leave the EU.

E.1.2 Structure, Amount and Quality of Own funds by Tier

LMIE's capital requirement is supported by the two components: ordinary share capital and reconciliation reserve, both of which qualify as unrestricted Tier 1 capital and are available to cover the SCR and MCR. LMIE's own funds are primarily held within LMIE's primary investment portfolio, which are designed to ensure they are liquid within appropriate timeframes. Surplus funds are held in US dollars, LMIE's reporting currency.

SII Own Funds	Tier 1 unrestricted	SCR	MCR
USD1,007m	USD1,007m	USD710m	USD245.9m

LMIE is required to satisfy local solvency requirements in certain non-EU jurisdictions. In some cases this requires holding funds in local custody accounts, but these funds are considered to be fungible and not ring-fenced from UK requirements.

The Reconciliation Reserve is made up as follows:

Reconciliation reserve (unaudited)	USD$m
Excess of assets over liabilities	1,007
Other basic own fund items - Ordinary share capital (gross of own shares)	290
Other basic own fund items - Share premium account related to ordinary share capital	100
Reconciliation reserve	617

The changes to Own Funds during the reporting period are:

Day 1 2016	Actuals 2016	Movement amount	Movement %
USD839m	USD1,007m	USD168m	20%

Although the projected solvency ratio was within an acceptable range at 118% on Day 1, USD100mof capital was transferred from LMIE's parent company during 2016 to increase the projected coverage to 132%.

E.1.3 Eligible Amounts of Own Funds to cover the SCR

The eligible amount of own funds to cover the Solvency Capital Requirement is USD1,007m. This is comprised entirely of Tier 1 (ordinary share capital and surplus funds) Basic Own Funds.

E.1.4 Eligible Amounts of Basic Own funds to cover the MCR

The eligible amount of own funds to cover the Minimum Capital Requirement is USD1,007.m. This is comprised entirely of Tier 1 (ordinary share capital and surplus funds) Basic Own Funds.

E.1.5 Material Differences between Financial Statement Equity and SII Excess of Assets over Liabilities

LMIE prepares it financial statements on a new UK GAAP (FRS102) basis. There are no material restrictions affecting the availability and transferability of own funds.

UK GAAP net assets	SII Own Funds	Movement amount	Movement %
USD1,022m	USD1,007m	USD15m	1.5%

There is no material difference between net assets per the financial statements and the excess of assets over liabilities for the purposes of Solvency II.

E.1.6 Description of Ancillary Own Funds

Own funds are made up of basic own funds items.

E.1.7 Description of Deductions from Own Funds

No deductions are applied to own funds and there are no material restrictions affecting their availability and transferability.

SECTION E. 2 – Solvency Capital Requirement and Minimum Capital Requirement

E.2.1 Details of the Solvency Capital Requirement and Minimum Capital Requirement

The Company has not applied to the PRA for the approval of an Internal Model and, as such, is required to use the Standard Formula from 1st January 2016 to determine the regulatory Solvency Capital Requirement. The Company's SCR is subject to supervisory assessment.

The Company has not used undertaking specific parameters in the calculation of the standard formula Solvency Capital Requirement.

In deriving the SF SCR, the Company has relied on the simplifications set out in the following articles of the Delegated Acts:

- Article 107; simplified calculation of the risk mitigating effect for reinsurance arrangements or securitisation in respect of counterparty default risk;
- Article 111: simplified calculation of the risk mitigating effect in respect of counterparty default risk .
- Article 112: simplified calculation of the risk adjusted value of collateral in respect of counterparty default risk .

These articles are applied in the context of Article 88 on proportionality being complied with for the risk mitigation effect.

The table below shows the SCR split by risk category and in aggregate:

Amounts in $m	YE16 Actual
Non Life	559.3
Market	153.3
Counterparty	91.9
Operational	63.6
Div. benefits/Tax offset	-157.5
LMIE Solo SCR	**710.6**
MCR	**246.0**

The table below shows the MCR inputs by Solvency II line of business:

SII Classes	YE16 Actual	
	Net Technical Provisions	Net Written Premium
Motor Liability	40.2	1.8
Other Motor	0.0	0.2
MAT	32.8	26.5
Fire & other damage to property	190.0	159.5
General liability	1,126.4	396.9
Credit & Suretyship	19.8	122.2
Legal expense	10.7	-
Assistance	-	-
Miscellaneous	6.9	1.0
Medical Expense	-	-
Income Protection	-	-
Workers' Comp	-	-
Non-prop. Property RI	8.7	12.1
Non-prop. Casualty RI	33.6	14.1
Non-prop. MAT RI	27.4	2.4
Non-prop. Health RI	-	-
Total	**1,496.5**	**736.7**

E.2.2 Changes in the Solvency Capital Requirement and Minimum Capital Requirement from prior reporting period

There were no externally audited MCR or SCR at the prior reporting period. Therefore, directly comparable figures are not disclosed for the first reporting period of the SFCR.

The Company's risk profile has not changed materially between the year end 2015 and year end 2016. Insurance risk has remained the key driver of overall capital.

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

This section is non applicable.

SECTION E. 4 – Differences between the standard formula and any internal models used

The Company does not have an approved full or partial internal model, according to Article 112(7), to calculate the Solvency Capital Requirement.

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

Compliance with both the MCR and SCR have been maintained during the reporting period.

SECTION E. 6 – Any Other Information

LMIE does not have any other material information to report.

SECTION F – UNDERTAKING WITH AN APPROVED INTERNAL MODEL

This section is non applicable as LMIE does not have an approved internal model.

GLOSSARY OF TERMS

Reference	Description	Reference	Description
ABS	Asset Backed Security	LSM	Liberty Specialty Markets
AF	Actuarial Function	MCR	Minimum Capital Requirement
ALAE	Allocated Loss Adjusted Expenses	MI	Management Information
AOCI	Accumulated Other Comprehensive Income	ORSA	Own Risk and Solvency Assessment
BEC	Board Executive Committee	P&C	Property & Casualty
BBNI	Bound But Not Incepted	PRA	Prudential Regulation Authority
COR	Combined Operating Ratio	PTOI	Pre-Tax Operating Income
CP	Contingency Plans	QRT	Quantitative Reporting Templates
CRO	Chief Risk Officer	RAG	Red, Amber, Green
CUO	Chief Underwriting Officer	RDS	Realistic Disaster Scenario
DGS	Direccion General de Seguros	RI	Reinsurance
EIOPA	European Insurance and Occupational Pensions Authority	RM&ICF	Risk Management and Internal Control Framework
EPIFP	Expected Profit in Future Premium	RMC	Risk Management Committee
ENID	Events not in Data	RMF	Risk Management Framework
EWI	Early Warning Indicator	RMS	Risk Management Solutions
FCA	Financial Conduct Authority	ROE	Return on Equity
GAAP	Generally Accepted Accounting Practices	RST	Reverse Stress Test
GBP	Great Britian Pound	SII	Solvency II
GWP	Gross Written Premium	S&P	Standard & Poor's
HR	Human Resources	SCR	Solvency Capital Requirement
IA	Internal Audit	SF	Standard Formula
ICA	Individual Capital Assessment	SFCR	Solvency and Financial Condition Report
IIA	Institute of Internal Audit	SPA	Strategy, Planning and Analysis
IFRS	International Financial Reporting Standards	SST	Stress & Scenario Test
IM	Internal Model	TP	Technical Provisions
LAP	Liberty Attestation Process	ULAE	Unallocated Loss Adjusted Expenses
LMAL	Liberty Managing Agency Limited	USD	United States Dollar
LMG	Liberty Mutual Group	YOA	Year of Account
LMIE	Liberty Mutual Insurance Europe		
LOC	Letter of Credit		

APPENDIX – QRT'S

S.02.01.02

Balance sheet	Solvency II value
Assets	C0010
Intangible assets	
Deferred tax assets	
Pension benefit surplus	4,333
Property, plant & equipment held for own use	0
Investments (other than assets held for index-linked and unit-linked contracts)	2,280,968
Property (other than for own use)	0
Holdings in related undertakings, including participations	0
Equities	0
Bonds	2,242,102
Government Bonds	915,574
Corporate Bonds	1,311,258
Structured notes	0
Collateralised securities	15,271
Collective Investments Undertakings	34,650
Derivatives	
Deposits other than cash equivalents	4,216
Other investments	0
Assets held for index-linked and unit-linked contracts	
Loans and mortgages	0
Reinsurance recoverables from:	624,065
Non-life and health similar to non-life	624,065
Non-life excluding health	624,065
Health similar to non-life	0
Life and health similar to life, excluding index-linked and unit-linked	0
Deposits to cedants	29,415
Insurance and intermediaries receivables	132,684
Reinsurance receivables	56,803
Receivables (trade, not insurance)	
Own shares (held directly)	0
Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
Cash and cash equivalents	194,638
Any other assets, not elsewhere shown	13,152
Total assets	3,336,057
Liabilities	C0010
Technical provisions - non-life	2,225,634
Technical provisions - non-life (excluding health)	2,225,634
TP calculated as a whole	0
Best Estimate	2,120,533
Risk margin	105,101
Technical provisions - health (similar to non-life)	0
Technical provisions - life (excluding index-linked and unit-linked)	0
Technical provisions - index-linked and unit-linked	0
Contingent liabilities	0
Provisions other than technical provisions	
Pension benefit obligations	
Deposits from reinsurers	
Deferred tax liabilities	13,390
Derivatives	
Debts owed to credit institutions	0
Financial liabilities other than debts owed to credit institutions	0
Insurance & intermediaries payables	22,695
Reinsurance payables	
Payables (trade, not insurance)	38,294
Subordinated liabilities	0
Any other liabilities, not elsewhere shown	28,801
Total liabilities	2,328,813
Excess of assets over liabilities	1,007,245

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
Premiums written																	
Gross - Direct Business				1,797	222	27,561	129,422	467,370	139,100			138,613					904,084
Gross - Proportional reinsurance accepted				0	0	11,292	74,661	106,358	65,217			100					257,627
Gross - Non-proportional reinsurance accepted														21,002	3,604	15,295	39,901
Reinsurers' share				0	0	3,993	52,830	173,125	79,437			139,051		6,920	775	4,018	460,149
Net				1,797	222	34,860	151,252	400,603	124,879	0		-338		14,082	2,829	11,277	741,463
Premiums earned																	
Gross - Direct Business				25,411	3,141	28,821	136,746	476,253	75,010			140,717					886,098
Gross - Proportional reinsurance accepted				0	0	8,134	71,648	88,258	20,091			114					188,245
Gross - Non-proportional reinsurance accepted														20,418	19,553	10,312	50,283
Reinsurers' share				0	0	5,043	64,858	192,922	41,612			141,153		7,114	16,115	530	469,349
Net				25,411	3,141	31,911	143,536	371,588	53,489	0		-322		13,304	3,438	9,782	655,278
Claims incurred																	
Gross - Direct Business				21,045	2,601	19,931	120,110	176,083	57,559			73,110					470,438
Gross - Proportional reinsurance accepted				0	0	3,405	39,094	45,127	10,698			-83					98,241
Gross - Non-proportional reinsurance accepted														11,048	10,206	3,767	25,021
Reinsurers' share				-2,802	-346	472	34,763	57,395	28,075			72,182		3,994	5,886	-1,715	197,902
Net				23,847	2,947	22,864	124,441	163,815	40,182	0		845		7,054	4,320	5,482	395,798
Changes in other technical provisions																	
Gross - Direct Business																	0
Gross - Proportional reinsurance accepted																	0
Gross - Non-proportional reinsurance accepted																	0
Reinsurers' share																	0
Net				0	0	0	0	0	0	0		0		0	0	0	0
Expenses incurred				3,583	443	9,935	36,258	145,378	10,568	0		-3,020		1,592	1,132	3,074	208,943
Other expenses																	93,129
Total expenses																	302,072

S.05.02.01

Premiums, claims and expenses by country

Non-life

	C0010	C0020	C0030	C0040	C0050	C0060	C0070
	Home Country	Top 5 countries (by amount of gross premiums written) - non-life obligations			Top 5 countries (by amount of gross premiums written) - non-life obligations		Total Top 5 and home country
		FR	ES	NL	DE	US	
	C0080	C0090	C0100	C0110	C0120	C0130	C0140
Premiums written							
Gross - Direct Business	567,759	100,049	24,876	33,332	23,141	29,054	778,212
Gross - Proportional reinsurance accepted	86,062	2,714	9,367	4,794	5,498	18,960	127,394
Gross - Non-proportional reinsurance accepted	13,329	420	1,451	743	851	2,937	19,731
Reinsurers' share	235,473	64,735	8,557	8,299	10,466	26,796	354,327
Net	431,677	38,448	27,136	30,570	19,024	24,154	571,009
Premiums earned							
Gross - Direct Business	568,359	105,974	22,568	33,504	22,332	23,866	776,603
Gross - Proportional reinsurance accepted	47,250	2,729	7,836	4,942	1,440	17,610	81,807
Gross - Non-proportional reinsurance accepted	2,962	424	1,042	782	-232	2,576	7,554
Reinsurers' share	225,861	69,770	10,092	8,696	9,939	28,335	352,693
Net	392,710	39,357	21,354	30,532	13,600	15,718	513,271
Claims incurred							
Gross - Direct Business	298,138	61,182	8,407	17,725	12,448	12,214	410,116
Gross - Proportional reinsurance accepted	7,252	1,613	3,803	2,075	596	10,169	25,508
Gross - Non-proportional reinsurance accepted	1,847	411	969	529	152	2,590	6,497
Reinsurers' share	48,852	41,781	5,703	5,240	5,890	13,299	120,766
Net	258,385	21,425	7,477	15,089	7,306	11,674	321,355
Changes in other technical provisions							
Gross - Direct Business							0
Gross - Proportional reinsurance accepted							0
Gross - Non-proportional reinsurance accepted							0
Reinsurers' share							0
Net	0	0	0	0	0	0	0
Expenses incurred	98,446	17,360	16,651	10,573	6,339	4,875	154,244
Other expenses							90,513
Total expenses							244,758

S.17.01.02

Non-Life Technical Provisions

	Direct business and accepted proportional reinsurance												Accepted non-proportional reinsurance				Total Non-Life obligation
	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	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance	Non-proportional property reinsurance	
	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0170	C0180
Technical provisions calculated as a whole				0	0	0	0	0	0	0		0		0	0	0	0
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole																	0
Technical provisions calculated as a sum of BE and RM																	
Best estimate																	
Premium provisions																	
Gross				1,188	0	6,374	40,080	86,993	-30,455	-82		10,453		966	14,610	1,046	131,173
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default				2,034	0	5,213	2,067	-27,983	-2,553	-2,401		10,112		-1,807	-3,800	2,326	-16,792
Net Best Estimate of Premium Provisions				-846	0	1,160	38,013	114,976	-27,901	2,320		341		2,772	18,410	-1,280	147,966
Claims provisions																	
Gross				39,495	2	46,379	214,543	1,477,301	87,809	11,425		13,275		65,088	20,469	13,573	1,989,359
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default				-1,551	0	14,707	62,560	465,894	40,150	3,051		6,726		34,272	11,474	3,574	640,857
Net Best Estimate of Claims Provisions				41,045	2	31,673	151,983	1,011,407	47,659	8,373		6,549		30,817	8,994	9,999	1,348,502
Total best estimate - gross				40,683	2	52,753	254,623	1,564,293	57,354	11,343		23,728		66,054	35,079	14,620	2,120,533
Total best estimate - net				40,200	3	32,833	189,996	1,126,383	19,758	10,693		6,891		33,589	27,405	8,719	1,496,468
Risk margin				2,974	0	2,239	9,773	73,177	7,291	809		816		4,963	1,448	1,610	105,101
Amount of the transitional on Technical Provisions																	
Technical Provisions calculated as a whole																	0
Best estimate																	0
Risk margin																	0
Technical provisions - total				43,657	3	54,992	264,396	1,637,470	64,645	12,152		24,544		71,017	36,527	16,230	2,225,634
Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total				483	0	19,920	64,627	437,910	37,597	650		16,837		32,465	7,674	5,901	624,065
Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total				43,174	3	35,072	199,769	1,199,560	27,049	11,502		7,707		38,552	28,853	10,329	1,601,569

S.19.01.21

Non-Life insurance claims
Total Non-life business

Accident year / underwriting year: Underwriting Year

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

Year	C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0170	C0180
	Development year											In Current year	Sum of years (cumulative)
	0	1	2	3	4	5	6	7	8	9	10 & +		
Prior											1,597,155	1,597,155	1,597,155
N-9	3,339	31,077	61,838	74,803	12,912	23,010	27,123	26,009	3,978	24,873		24,873	288,961
N-8	8,665	34,309	37,383	27,129	31,099	33,094	16,763	2,869	39,339			39,339	230,651
N-7	11,285	27,783	16,605	21,915	15,938	31,751	16,876	2,268				2,268	144,420
N-6	3,532	33,735	40,257	50,368	110,346	30,993	20,359					20,359	289,588
N-5	10,189	70,419	64,420	37,501	34,889	33,953						33,953	251,371
N-4	24,845	61,144	99,664	66,073	42,365							42,365	294,090
N-3	16,999	74,757	60,229	64,499								64,499	216,484
N-2	64,699	125,104	50,101									50,101	239,903
N-1	32,878	176,509										176,509	209,387
N	33,234											33,234	33,234
											Total	2,084,654	3,795,245

Gross Undiscounted Best Estimate Claims Provisions
(absolute amount)

Year	C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0300	C0360
	Development year											Year end (discounted data)
	0	1	2	3	4	5	6	7	8	9	10 & +	
Prior											80,170	79,397
N-9	0	0	0	0	0	0	0	0	0	13,515		13,345
N-8	0	0	0	0	0	0	0	0	116,044			115,082
N-7	0	0	0	0	0	0	0	45,012				44,704
N-6	0	0	0	0	0	0	52,156					51,081
N-5	0	0	0	0	0	118,498						116,079
N-4	0	0	0	0	163,787							160,643
N-3	0	0	0	235,412								231,096
N-2	0	0	401,022									392,068
N-1	0	483,495										471,332
N	320,550											314,531
											Total	1,989,359

S.23.01.01

Own Funds

Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
	C0010	C0020	C0030	C0040	C0050
Ordinary share capital (gross of own shares)	290,225	290,225		0	
Share premium account related to ordinary share capital	100,000	100,000		0	
Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
Subordinated mutual member accounts	0		0	0	0
Surplus funds	0	0			
Preference shares	0		0	0	0
Share premium account related to preference shares	0		0	0	0
Reconciliation reserve	617,020	617,020			
Subordinated liabilities	0		0	0	0
An amount equal to the value of net deferred tax assets	0				0
Other own fund items approved by the supervisory authority as basic own funds not specified above	0	0	0	0	0
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	0				
Deductions for participations in financial and credit institutions	0				
Total basic own funds after deductions	1,007,245	1,007,245	0	0	0
Ancillary own funds					
Unpaid and uncalled ordinary share capital callable on demand	0				
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0				
Unpaid and uncalled preference shares callable on demand	0				
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
Other ancillary own funds	0				
Total ancillary own funds	0			0	0
Available and eligible own funds					
Total available own funds to meet the SCR	1,007,245	1,007,245	0	0	0
Total available own funds to meet the MCR	1,007,245	1,007,245	0	0	
Total eligible own funds to meet the SCR	1,007,245	1,007,245	0	0	0
Total eligible own funds to meet the MCR	1,007,245	1,007,245	0	0	
SCR	710,633				
MCR	245,958				
Ratio of Eligible own funds to SCR	141.74%				
Ratio of Eligible own funds to MCR	409.52%				

Reconcilliation reserve	C0060
Excess of assets over liabilities	1,007,245
Own shares (held directly and indirectly)	0
Foreseeable dividends, distributions and charges	
Other basic own fund items	390,225
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0
Reconciliation reserve	617,020
Expected profits	
Expected profits included in future premiums (EPIFP) - Life business	
Expected profits included in future premiums (EPIFP) - Non- life business	125,234
Total Expected profits included in future premiums (EPIFP)	125,234

S.25.01.21

Solvency Capital Requirement - for undertakings on Standard Formula

	Gross solvency capital requirement	USP	Simplifications
	C0110	C0080	C0090
Market risk	153,329		
Counterparty default risk	91,926		
Life underwriting risk	0		
Health underwriting risk	0		
Non-life underwriting risk	559,254		
Diversification	-136,633		
Intangible asset risk	0		
Basic Solvency Capital Requirement	667,875		

Calculation of Solvency Capital Requirement	C0100
Operational risk	63,616
Loss-absorbing capacity of technical provisions	0
Loss-absorbing capacity of deferred taxes	-20,857
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0
Solvency Capital Requirement excluding capital add-on	710,633
Capital add-ons already set	0
Solvency capital requirement	710,633
Other information on SCR	
Capital requirement for duration-based equity risk sub-module	0
Total amount of Notional Solvency Capital Requirements for remaining part	0
Total amount of Notional Solvency Capital Requirements for ring fenced funds	0
Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios	0
Diversification effects due to RFF nSCR aggregation for article 304	0

S.28.01.01

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

Linear formula component for non-life insurance and reinsurance obligations	C0010
MCR_{NL} Result	245,958

	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
	C0020	C0030
Medical expense insurance and proportional reinsurance	0	
Income protection insurance and proportional reinsurance	0	
Workers' compensation insurance and proportional reinsurance	0	
Motor vehicle liability insurance and proportional reinsurance	40,200	1,797
Other motor insurance and proportional reinsurance	3	222
Marine, aviation and transport insurance and proportional reinsurance	32,833	26,479
Fire and other damage to property insurance and proportional reinsurance	189,996	159,492
General liability insurance and proportional reinsurance	1,126,383	396,945
Credit and suretyship insurance and proportional reinsurance	19,758	122,172
Legal expenses insurance and proportional reinsurance	10,693	0
Assistance and proportional reinsurance	0	0
Miscellaneous financial loss insurance and proportional reinsurance	6,891	973
Non-proportional health reinsurance	0	0
Non-proportional casualty reinsurance	33,589	14,089
Non-proportional marine, aviation and transport reinsurance	27,405	2,426
Non-proportional property reinsurance	8,719	12,099

Linear formula component for life insurance and reinsurance obligations	C0040
MCR_{L} Result	0

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

Overall MCR calculation	C0070
Linear MCR	245,958
SCR	710,633
MCR cap	319,785
MCR floor	177,658
Combined MCR	245,958
Absolute floor of the MCR	3,903
Minimum Capital Requirement	245,958