HSB
A Munich Re company

HSB Engineering Insurance Limited

Solvency and Financial Condition Report

2021

Authorised by: Board of Directors

Authorised on: 23 March 2022

Contents

Executive Summary

The Board of Directors (the Board) presents the Solvency and Financial Condition Report (SFCR) for HSB Engineering Insurance Limited (the Company) for year ended 31 December 2021. This SFCR is published on the Company's website.

The Company is an insurance company underwriting engineering and related property lines risks, which are primarily located in the United Kingdom and the Republic of Ireland (ROI) through its UK operation and ROI branch. The insurance services and services on offer are underpinned by a high level of engineering expertise and claims management capability. The Company is authorised by the Prudential Regulatory Authority (PRA) and regulated by the PRA, the Financial Conduct Authority (FCA) and the Central Bank of Ireland (CBI).

The Company is a wholly owned indirect subsidiary of Munchener Ruckversicherungs-Gesellschaft Aktiengellschaft (Munich Re). The Company has a wholly owned subsidiary undertaking, The Boiler Inspection and Insurance Company of Canada, which underwrites engineering risks in North America, and a wholly owned non-insurance subsidiary company in the UK, HSB Engineering Insurance Services Limited, which provides inspections and consultancy services on plant and equipment.

The Company's total gross written premiums for the year were £84,179,000, which represented an increase of 24% on 2020. This reflected continued strong growth across all the Company's core business lines in the UK and ROI, aided by growth in the Company's online broker trading platform, new product innovations and growth in the latent structural defects insurance book.

The Company reported an improved operating performance in 2021, with a gross combined operating ratio of 90% (2020: 94%) and a net combined operating ratio of 90% (2020: 97%).

During 2021, the Company continued to operate its emergency incident response plan in response to the COVID-19 pandemic, prioritising in particular the safety and wellbeing of employees. Whilst offices remained open and were used on occasion by staff, the Company continued to operate with mainly remote working for all employees, and all business critical activities continued to be delivered well throughout the year. The Company continues to give consideration to the developing risks arising from COVID-19 within its internal risk assessments and is actively monitoring the situation and adapting as required.

The Company has also considered any potential risks arising from the recent Russian invasion of Ukraine and, whilst there are no significant direct impacts on the Company, there is increased risk of short and medium term adverse impacts on the UK and ROI economy, which has been accounted for in the Company's forward looking financial and strategic plans and the situation is being closely monitored.

In November 2021, the Company announced that, subject to regulatory approval, it has agreed to purchase a group of companies, referred to as the 'MD Group', which specialises in UK structural warranties and building surveying and which includes the well-known Premier Guarantee and LABC Warranty brands. MD Group includes MD Insurance Services Limited, a regulated Managing General Agent, which provides structural warranty insurance products, together with several inspection services operations, which provide warranty inspections, technical guidance, specialist claim investigation services and remedial contract works services. The acquisition complements the Company's existing business model and supports the Company's UK growth strategy and ambitions by expanding its specialist core insurance offerings and enhancing its distribution capabilities within the UK construction sector. The Company is targeting completion of the acquisition in 2022 subject to regulatory approval.

The Company has adopted the standard formula for the calculation of its capital requirements as defined under policies the Prudential Regulation Authority (PRA) adopted from Solvency II. The solvency coverage as at 31 December 2021 was 220% (2020: 242%). The decrease in coverage since 2020 was driven by the ring fencing of funds required to support the implementation of the Company's Third Country Branch in ROI, which was approved by the Central Bank of Ireland with effect from 1 January 2021. This implementation was as a response to the UK's exit from the European Union and it enables the Company to continue to operate in the ROI going forward. The Company's capital coverage is, substantially above the Company's Solvency Capital Requirement, and it is forecast to remain strong over the business planning horizon.

The Company has designed and implemented a system of governance that effectively covers the following important areas: the risk management framework, including risk policies, risk strategy and Own Risk and Solvency Assessment (ORSA); key functions; remuneration practices; fit and proper policy; scenario and stress testing; and outsourcing.

The Board is collectively responsible for setting the strategic direction of the Company and defining the overall tolerance for risk, including the review of major risk exposures and the establishment of certain risk limits. The Board is also ultimately responsible for risk governance, ensuring the Company operates within an established framework of effective systems of internal controls, risk management and compliance with policies, procedures, internal controls and applicable laws and regulations. The Board is supported by an Executive Committee of the Board which supports the delivery of the Company's strategy through overseeing the development and delivery of its business plans and financial plans; overseeing the development and implementation of policies and procedures; and identifying and assessing emerging risks and issues along with overseeing associated actions.

The Company uses a capital model (the Company's ORSA model) to quantify the key risks associated with its business activities, including consideration of underwriting risks, market risks, credit risks, and operational risks, on a forward looking basis. The Company's ORSA model is based on the EIOPA Standard Formula.

Under guidance published by the PRA in October 2018, the Company is classified as a small insurer and is therefore not subject to an external audit on its SFCR. However, as the same base data is used for the Solvency II reporting and the statutory accounts, the audit of the statutory accounts gives assurance that the underlying data does not contain any material errors.

A. Business and Performance (Article 51(1)(a))

A.1 Business

Company Information

The Company is a private limited company incorporated in England and Wales and regulated by the PRA, the FCA and CBI.

The Company is a wholly owned general insurance indirect subsidiary of The Hartford Steam Boiler Inspection and Insurance Company (HSBIIC). HSBIIC is a subsidiary of HSB Group which is a wholly owned subsidiary of Munich-American Holding Corporation (MAHC). MAHC is owned by Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft in München (Munich Re Munich, henceforth referred to as Munich Re), a company organized under the laws of Germany and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

The Company has a wholly owned subsidiary undertaking, The Boiler Inspection and Insurance Company of Canada, which underwrites engineering risks in North America, and a wholly owned non-insurance subsidiary

company in the UK, HSB Engineering Insurance Services Limited, which provides inspections and consultancy services on plant and equipment.

During 2021, the Company continued to operate its emergency incident response plan in response to the COVID-19 pandemic, prioritising in particular the safety and wellbeing of employees. Whilst offices remained open and were used on occasion by staff, the Company continued to operate with mainly remote working for all employees, and all business critical activities continued to be delivered well throughout the year.

As a response to the UK's exit from the European Union, with effect from 1 January 2021 the Company implemented a third country branch operation in the ROI under the approval of the Central Bank of Ireland (the CBI), which enabled the Company to continue to operate in the ROI going forward.

In November 2021, the Company announced that, subject to regulatory approval, it has agreed to purchase a group of companies, referred to as the 'MD Group', which specialises in UK structural warranties and building surveying and which includes the well-known Premier Guarantee and LABC Warranty brands. MD Group includes MD Insurance Services Limited, a regulated Managing General Agent, which provides structural warranty insurance products, together with several inspection services operations, which provide warranty inspections, technical guidance, specialist claim investigation services and remedial contract works services.

The Company's independent auditors are EY LLP.

Contact details for the PRA, FCA, BaFin and EY can be found in Appendix I – Company Information.

A simplified group structure showing the Company's two subsidiaries and other material related parties is included in Appendix II - Simplified Group Structure Chart.

Under guidance published by the PRA in October 2018, the Company is classified as a small insurer and is therefore not subject to an external audit of its SFCR. However, as the same base data is used for the Solvency II reporting and the statutory accounts, the audit of the statutory accounts gives assurance that the underlying data does not contain any material errors.

Principal activities

The Company is an insurance company underwriting engineering and related property lines risks, which are primarily located in the United Kingdom and the Republic of Ireland (ROI) through its UK operation and ROI Third Country branch. The insurance services and services on offer are underpinned by a high level of engineering expertise and claims management capability.

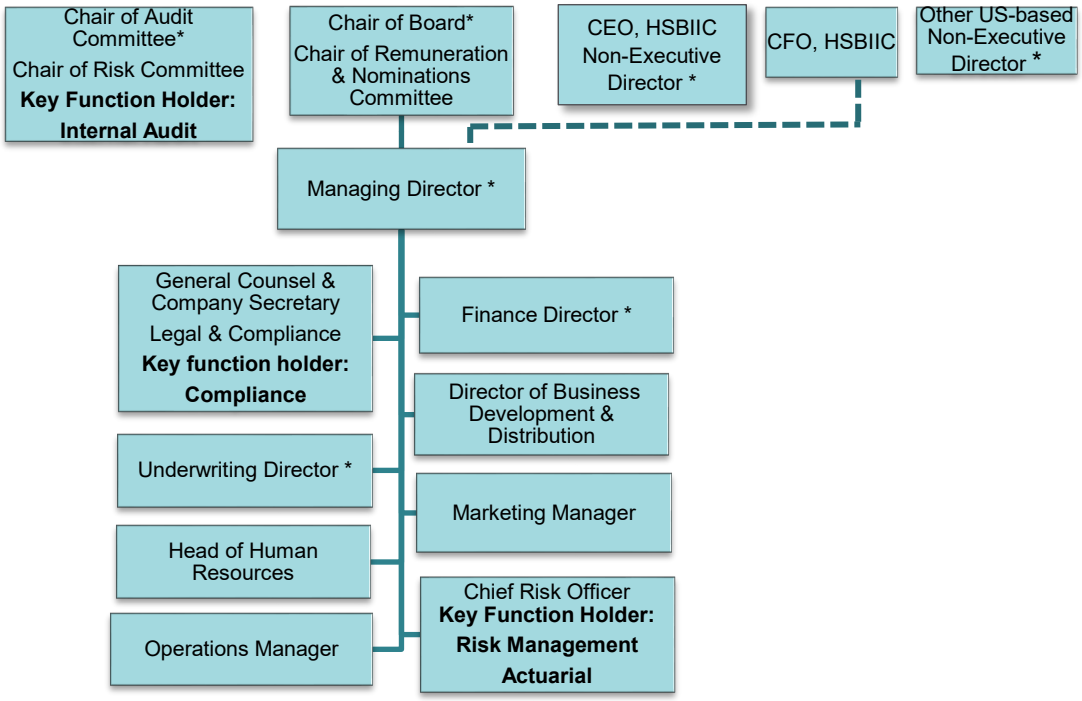
During the year the Company continued to focus on growth in its core business lines in UK and the ROI, aided by growth in the Company's online broker trading platform, new product innovations and growth in the latent structural defects insurance book.

The profit for the year before taxation on the UK GAAP basis of accounting was £15,860,000 (2020: £13,386,000). During the year, the Directors declared and paid a dividend of £8,359,000 (2020: £8,362,000). The Directors do not recommend the proposal of any further dividend in respect of the year ended 31 December 2021 (2020: £nil).

Senior management structure

Figure 1, below, shows the senior management structure of the Company as at the date of this report, including the position of the Key Function Holders for the Risk, Compliance, Actuarial and Internal Audit Functions.

Figure 2 - Organisational Chart



Individuals marked with an asterisk (*) are members of the Company's Board.

A.2 Underwriting performance

Classes of business

The Company's core products of construction, inherent defects, breakdown, plant and computer cover are categorised within the Solvency II class 'Fire and Other Property Damage'. For 2021, in excess of 99% (2020: 99%) of GWP and 93% (2020: 93%) of net best estimate provisions relate to the Fire and Other Property Damage class of business. As a result, classes other than Fire and Other Property Damage are not considered material and are not separately presented in the information in this section.

The Company's All Risk policies in some cases include a small element of third party liability cover. The Company also writes a cyber product which contains a third party liability component. The liability element of these cyber covers was not a material line of business for the Company during 2021.

A split of Premiums, Claims and Expenses by Solvency II class of business is set out in the Quantitative Reporting Template (QRT) S.05.02 in Annexure to this report.

Underwriting performance

Table 1 - Underwriting Income and Expenses by Region for the year ended 31 December 2021

31 December 2021 **£'000**	**Gross written premium (GWP)**	**Gross claims incurred (excluding loss adjusting expenses)**	**Gross expenses incurred (including loss adjusting expenses)**	**Gross Underwriting result**
UK	**67,693**	**16,826**	**35,824**	**6,047**
Europe	**16,486**	**2,477**	**7,212**	**59**
Other	**-**	**(34)**	**(9)**	**73**
Total	**84,179**	**19,269**	**43,027**	**6,179**

31 December 2020 £'000	Gross written premium (GWP)	Gross claims incurred (excluding loss adjusting expenses)	Gross expenses incurred (including loss adjusting expenses)	Gross Underwriting result
UK	55,865	19,212	31,387	1,804
Europe	12,006	1,039	3,180	1,575
Australia	32	88	(4)	(53)
Other	1	(426)	290	139
Total	67,904	19,913	34,853	3,465

The Company's total gross written premiums for the year were £84,179,000, which represented an increase of 24% on 2020. This reflected continued strong growth across all the Company's core business lines in the UK and ROI, aided by growth in the Company's online broker trading platform, new product innovations and growth in the latent structural defects insurance book.

The Company reported an improved operating performance in 2021, with a gross combined operating ratio of 90% (2020: 94%) and a net combined operating ratio of 90% (2020: 97%).

A.3 Investment performance

Table 2 - Investment performance

£'000	**2021 Actual**	**2020 Actual**
Investment income	**1,296**	1,714
Realised gains - fixed interest bonds	**198**	610
Investment expenses - fixed interest bonds	**(170)**	(168)
Interest income - cash and deposits	**(28)**	13
Investment performance in the income statement	**1,286**	2,169
Unrealised losses in other comprehensive income	**(3,518)**	1,464

During 2021, HSBEIL's actively managed portfolio performance of (1.8)% was slightly behind benchmark return of (1.7)%.

A.4 Performance of other activities

As described in section A.1, the Company's main business is underwriting engineering lines of risk in the UK and the Republic of Ireland. The Company does not undertake any other significant activities.

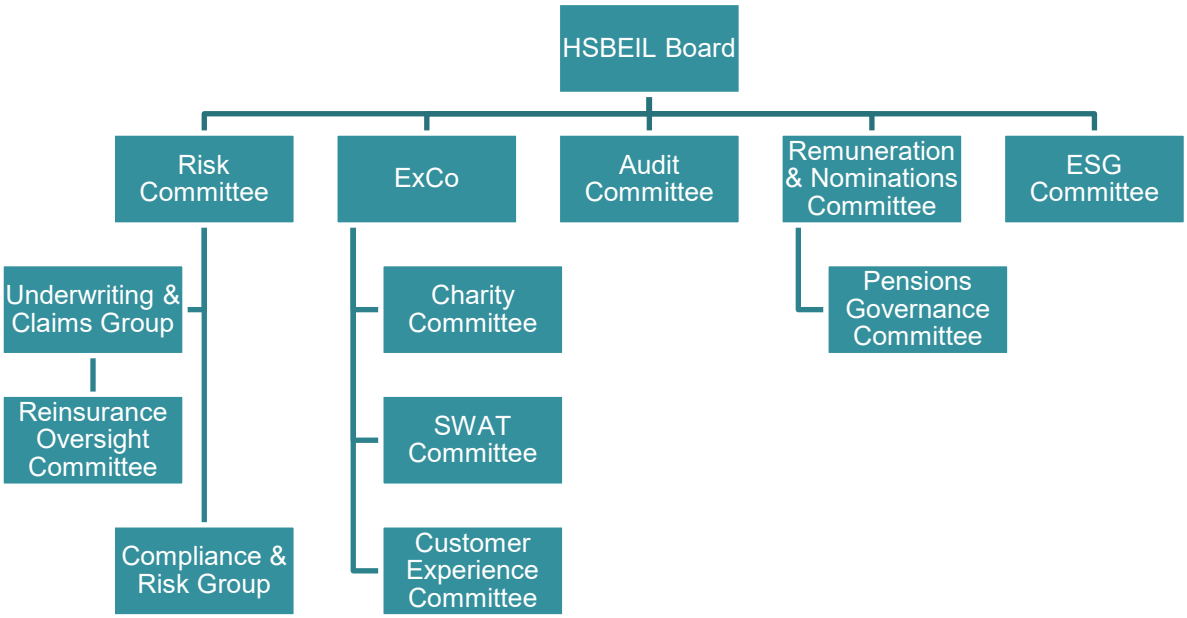
A.5 Any other information

Apart from the information disclosed in above sections, the Company has no other information to disclose about its business and performance.

B. System of Governance (Article 51(1)(b))

B.1 General information on the system of governance

The Company's governance structure is summarised as follows:



Terms of reference describe the structure, purpose and membership of the committees and groups. The Board is comprised of a combination of executives and shareholder representatives and the sub-committees and groups have balanced representation of business and control functions.

The Company complied with the requirements of the Senior Managers and Certification Regime (SMCR) during the year.

The Directors consider that the Company's risk management framework and system of governance is adequate and appropriate for its risk profile and that the Company is adequately capitalised to cover the risks associated with current and planned business activities, while meeting expectations of its clients and shareholders.

Board of Directors

The Board is collectively responsible for the long-term success of the Company. The Board is also responsible for ensuring that the Company operates within an established framework of effective systems of internal controls, effective risk management and compliance with policies, procedures, internal controls and applicable laws and regulations. The Board sets the Company's strategic aims, values and standards, ensures that the necessary financial resources are in place to meet its objectives and reviews management performance. The Board meets not less than two times a year and typically meets quarterly.

As of the date of this report the Board is comprised of three executive directors employed directly by the Company, three non-executive directors who are employed within the HSB Group but not by the Company, and two independent non-executive directors.

The following are the members of the Board as of the date of this report:

Director	Controlled function	Reports to
Jeffrey Herdman (Independent Non-Executive Director – Chair of the Board)	SMF9 (Chair of the Governing Body SMF12 (Chair of the Remuneration Committee) SMF13 (Chair of the Nomination Committee)	
Stephen Worrall (Managing Director and Executive Director)	SMF1 (Chief Executive) SMF3 (Executive Director)	- Chair of the Board - Dotted line report to CFO, HSBIIC
Anya O'Reilly (Finance Director and Executive Director)	SMF2 (Chief Finance) SMF24 (Chief Operations – split role)	- Managing Director (SMF1 Chief Executive) - Dotted line report to CFO, HSBIIC
Stephen Morris (Underwriting Director and Executive Director)	SMF23 (Chief Underwriting Officer) SMF3 (Executive Director)	- Managing Director (SMF1 Chief Executive) - Dotted line report to CUO, HSBIIC
Greg Barats (President and CEO, HSBIIC, and Group Non-Executive Director)	SMF7 (Group Entity Senior Manager)	- Chair of the Board - President and CEO, MAHC, USA
Peter Richter (CFO, HSBIIC, and Group Non-Executive Director)	SMF7 (Group Entity Senior Manager)	- Chair of the Board - President and CEO, HSBIIC
David Firstenberg (Global Chief Underwriting Officer and SVP Risk Mgt)	SMF7 (Group Entity Senior Manager)	- Chair of the Board - President and CEO, HSBIIC
Craig Scarr (Independent Non-Executive Director)	SMF11 (Chair of the Audit Committee) SMF10 (Chair of the Risk Committee)	- Chair of the Board

Appointments to the Board, including executive and non-executive appointments, are made in consultation with HSB Group management. The search for Board candidates is conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the Board, including gender. While the Board retains overall collective responsibility and accountability for the long-term success of the Company, it may delegate responsibility for management of various activities to a Committee and individual directors and/or senior managers.

The following are not members of the Board but hold a controlled function under the SMCR:

Controlled function holder	Controlled function	Reports to
Terry Dyson (Director of Business Development & Distribution)	SMF18 (Other Overall Responsibility) MIPRU2.2 Responsible for Insurance Distribution	Managing Director (SMF1 Chief Executive)
Edward Dobinson (Head of Internal Audit – outsourced service provider, Munich Re UK Services Limited (MRUKS))	SMF5 (Head of Internal Audit)	Chair of the Audit Committee (Internal Audit key function holder)
Derek Newton[1] (Chief Actuary – outsourced service provider, Milliman LLP)	SMF20 (Chief Actuary)	Chief Risk Officer (Actuarial key function holder)
Kelli Close-Smith (General Counsel & Company Secretary)	SMF16 (Compliance Oversight)	Managing Director (SMF1 Chief Executive)
Laura Kettleday (Chief Risk Officer)	SMF4 (Chief Risk)	Managing Director (SMF1 Chief Executive)
Michelle Burgess (Marketing Manager)	SMF18 (Other Overall Responsibility)	Managing Director (SMF1 Chief Executive)
Matthew Johnson (Head of HR)	SMF18 (Other Overall Responsibility)	Managing Director (SMF1 Chief Executive)
Debbie Davies (Operations Manager)	SMF24 (Chief Operations – split role)	Managing Director (SMF1 Chief Executive)

The Company's organisational structure in the form of an organisation chart that reflects positions of key function holders is shown in A1. Other key function holders are mentioned under the section 'Key functions' below.

[1] Jeff Courchene undertakes Head of Actuarial Function role specifically for the branch operation in Ireland. Jeff is employed with Milliman LLP, working closely with Derek Newton

Committees of the Board

Audit Committee

The Audit Committee is composed of a minimum of three members, all of whom are non-executive directors and the majority of which are independent non-executive directors. The Audit Committee is chaired by an independent non-executive director. The Audit Committee typically meets at least quarterly and the chair of the Audit Committee delivers a report to the Board at each Board meeting regarding the activities and issues arising from the Audit Committee meetings.

The key responsibilities of the Audit Committee are to act within the delegated authority of the Board to monitor the integrity of the financial reporting processes, including the statutory financial statements and Solvency II reporting, oversight of the internal audit function and oversight of external audit.

Risk Committee

The Risk Committee is composed of all the Company's non-executive directors and two executive Directors, Stephen Worrall and Anya O'Reilly. The Risk Committee is chaired by an independent non-executive director. The Risk Committee typically meets at least quarterly and the chair of the Risk Committee delivers a report to the Board at each Board meeting regarding the activities and issues arising from the Risk Committee meetings.

The key responsibilities of the Risk Committee are to act within the delegated authority of the Board to review the appropriateness and effectiveness of the Company's strategies, processes and internal controls pertaining to compliance and risk management.

Executive Committee (ExCo)

The ExCo supports the delivery of the Company's strategy (as approved by the Board) through overseeing the development and delivery of the Company's business plans and financial plans; overseeing the development and implementation of policies and procedures; and identifying and assessing emerging risks and issues along with overseeing associated actions.

Remuneration and Nominations Committee (RemNom)

This Committee is composed of the independent non-executive directors and has as standing attendees the Managing Director and the Head of HR. It meets at least twice a year and has responsibility for managing the process to advise and make recommendations to the Board on matters relating to the Board's membership, committee membership and related appointments; and oversight of the implementation of and compliance with the remuneration policy for the Company.

Environmental, Social and Governance (ESG) Group

This Group was formed in 2021 as a sub-committee of the Board. It is responsible for identifying relevant risks and overseeing the Company's strategy in respect of ESG-related matters in order to contribute to the Munich Re Group's Climate Ambition.

Management Groups

Compliance and Risk Group (CRG)

The CRG is composed of heads of all functions across the Company and is chaired by the Chief Risk Officer. Its purpose is to supervise the day to day risk management and compliance advice, monitoring and oversight activities as delegated by the Risk Committee, within the risk appetite and tolerances set by the Board. The CRG serves as an important element of the Company's control environment and forms part of an effective system of internal controls and risk management, operating in compliance with applicable and appropriate regulatory and governance requirements. The CRG reports to the Risk Committee and also recommends tolerances to the Risk Committee with regard to risk appetite, including compliance risk. The CRG meets quarterly.

Underwriting and Claims Group (UCG)

The UCG is chaired by the Underwriting Director and its members are representatives from the Risk and Compliance Functions, Underwriting Strategy and Standards, Finance, Claims and Business Development. Its purpose is to ensure the Company transacts insurance business within the agreed business plans, corporate guidelines, legal permissions and regulatory requirements. Like the CRG, the UCG serves as an important element of the Company's control environment and forms part of an effective system of internal controls, risk management and compliance. It provides oversight in relation to underwriting reviews and monitoring compliance with the Company's policies on product governance. The UCG reports to the Risk Committee on its activities. The UCG meets every quarter. The UCG has a further sub-committee called the Reinsurance Oversight Committee which sets the reinsurance strategy of the Company and monitors the effectiveness of reinsurance arrangements.

Charity Committee

The Charity Committee is chaired by the Underwriting Director and its members are employee representatives. Its purpose is to manage the Company's charitable resources, providing oversight and governance over their deployment. The Charity Committee meets quarterly and reports to the ExCo.

SWAT Committee

The SWAT Committee is chaired by the Finance Director and is composed of heads of all functions. Its purpose is to provide cross functional input on proposals for new or enhanced products, portfolio acquisitions, and/or distribution channels. The SWAT Committee reports to ExCo and meets twice weekly, or as required.

Pensions Governance Committee (PGC)

The PGC is composed of the Head of Human Resources (HR), the Finance Director and an HR Business Partner. Representatives of the Company's Employee Forum Group and Payroll team may also attend meetings of the PGC as observers. It is chaired by the Head of HR and is required to meet at least twice a year. The aims of the PGC are to monitor the Company's defined contribution pension plan's fulfilment of its objectives and to assist the Board in identifying and mitigating business and legal risk relating to operation of the pension plan. The PGC reports into the Remuneration and Nomination Committee.

Customer Experience Committee (CXC)

The Customer Experience Committee was established in 2021, with the objective of driving activities to deliver excellent customer service. The Committee reports to the Company's Executive Committee and it comprises members from customer facing and support functions.

Division of responsibilities

Each functional area and department maintains an up-to-date structure chart showing the management structure of the business operation or function. The organisational charts identify the channels of communication in place to ensure the prompt transfer of information to relevant individuals. A copy of the organisational charts is held on the Company's intranet, which is available to all employees.

Each employee of the Company has a job description that explains the scope of that individual's functions and responsibility, and specifies their reporting line and competence requirements for the role. Responsibility for updating role descriptions rests with the relevant manager, with oversight from the HR department. In addition, key responsibilities of senior managers are documented in the Company's management responsibilities map, which defines the area of accountability from a regulatory perspective, depending on the control function held and their role within the Company. Individuals performing underwriting and claims functions have documented authority levels that are in addition to their role descriptions and which define specific authority levels and types of risk that can be dealt with under their authority without further referral.

Key functions

A Fit and Proper framework (refer to section B.2 below) is followed to ensure functions are led by appropriately skilled people. All individuals with responsibility for a key function ('Key Function Holders') report to the Board via scheduled reporting through the CRG and UCG. Where performance of the key function has been outsourced, each such function has been identified together with the name of the outsourced service provider and the Key Function Holder within the Company who has responsibility for oversight of that function.

The Company has identified the following key functions:

- Risk management - described in section B.3 (Key Function Holder: Chief Risk Officer)
- Compliance - described in section B.3. (Key Function Holder: General Counsel and Company Secretary)
- Internal audit - described in section B.3. The Company's internal audit function has been outsourced to MRUKS. Oversight of the outsourced function is provided by the chair of the Audit Committee. (Key Function Holder: Chair of the Audit Committee)
- Actuarial - described in section B.3. This function has been outsourced to a third party service provider. Oversight of this function is provided by the Chief Risk Officer. (Key Function Holder: Chief Risk Officer)
- Investment management - This function has been outsourced to an intra-group service provider. Oversight of this function is provided by the Company's Financial Controller. (Key Function holder: Financial Controller)
- Claims management - (Key Function Holder: Operations Manager)

- IT - (Key Function Holder: Business Operations Manager)
- Reinsurance - (Key Function holder: Underwriting Director)
- Underwriting - (Key Function Holder: Underwriting Director)
- Finance - (Key Function Holder: Finance Director)

Remuneration, employee benefits and practices

The Company provides a range of benefits to employees, including contractual salary, healthcare, retirement benefits and paid holiday arrangements. Eligible employees are also entitled to overtime and vehicles for business and private use. The variable compensation scheme is solely based on the performance of the Munich Re Group as a whole.

The Company follows remuneration principles as laid out in the Munich Re Group Compensation Policy (MRGCP) which complies with the requirements of Solvency II (including article 275 of Delegated Acts).

Compensation schemes were submitted to the HSB Group President and CEO and senior management of HSBIIC for final approval before award. In addition, the remuneration of the executive directors of the Board and key senior management personnel were approved by the HSB Group President and CEO prior to award.

The Remuneration and Nominations Committee oversee the implementation of the Company's remuneration policy and practices in accordance with Munich Re's policies, also paying attention to the remuneration, including pension rights, variable pay elements and any other compensation payments of the Company's executive team (which comprises the Managing Director, Finance Director, Underwriting Director, and the Company Secretary) and other members of the senior management team.

The Company's remuneration practices were considered to promote sound and effective risk management and did not encourage excessive risk taking.

The Company has a defined contribution scheme and is a contributing employer to a defined benefit scheme operated through its non-insurance subsidiary, HSB Engineering Insurance Services Limited (HSBEISL). The defined benefit scheme was closed to new members with effect from 31 December 2003. From 1 July 2016 the scheme was closed for accrual of future benefits and existing eligible members moved to the Company's defined contribution scheme.

Other than payment for services for those outsourced functions set out in B.7 of this report, and contracted employee salaries and benefits mentioned above, there were no material transactions with the shareholder, with persons who exercise a significant influence on the Company or with members of the administrative, management or supervisory body. As part of fit and proper requirements (discussed in B.2), key persons are required to disclose their interest in and transactions with other entities, if any.

B.2 Fit and proper requirements

The Company ensures that each person who performs a key function is fit and proper at the time of their respective appointment and at all times thereafter during their engagement with the Company. The Company has a Fit and Proper Policy that covers the requirements of the Solvency II framework, the FCA and the PRA and applies to persons who effectively run the Company; are responsible for other key functions within the Company;

or otherwise perform Senior Manager Functions or Certified Functions under the SMCR (referred to jointly as "Key Persons" or individually as a "Key Person").

An individual is fit and proper, if he or she:

- has the personal characteristics;
- possesses the level of competence, knowledge and experience;
- has the qualifications; and
- has undergone, or is undergoing, the training required to enable that individual to perform their role effectively, in accordance with relevant regulatory requirements; and to enable the sound and prudent management of the Company. This also includes consideration of the individual's past business conduct.

In addition to the above, when considering whether an individual is fit and proper to be appointed as an SMF holder, Key Function Holder or non-executive director, the Company:

- obtains the fullest criminal conviction and criminal record certificate(s) it can lawfully request;
- obtains at least six years' worth of references; and
- when asking for a reference from a PRA or FCA approved person, uses the regulatory reference template.

The relevant Key Function Holder, with support from the HR function, also is responsible for ensuring and documenting that each individual performing a key function within their area of responsibility is fit and proper.

The assessment of each Key Person's fitness and propriety is conducted prior to his/her appointment. The body or department which appoints the Key Person, or nominates the Key Person for an election if the Key Person is elected, is responsible for the assessment or reassessment. The results and main points of the assessment are documented. The Head of HR is responsible for preparing the assessment by collecting and collating the relevant information required and providing any other support as may be required by the Board.

The fitness assessment includes, but will not be limited to, a review of employment history, references and educational and professional qualifications in relation to the respective duties allocated to the relevant key function. The fitness assessment is based on the definition of the required knowledge, experience and qualification for the allocated duties. While knowledge and qualification are significant factors, account may be taken of whether further professional training can be arranged in due course to remedy any aspects of the Key Person's qualifications with respect to the fitness requirements that have been identified as deficient during the assessment.

When assessing the propriety of Key Persons, their honesty and financial soundness is assessed based on evidence regarding their character, personal behaviour and business conduct, including any criminal, financial, or supervisory concerns raised in any pertinent jurisdiction.

The fitness and propriety of the Key Persons is reassessed on a regular basis. Each Key Person is obliged to notify the HR department without undue delay if he/she no longer meets the propriety requirements set out in the Company's Fit and Proper Policy or are in danger of no longer meeting such requirements. In the event that the reassessment of the fitness and propriety of a Key Person concludes that a Key Person can no longer be regarded as fit and proper, the Company would take appropriate measures.

For outsourced key functions regardless of whether the provider is an affiliated (Group) undertaking the person with overall responsibility for the outsourced key function is also assessed as fit and proper. The (re)assessment

of the fitness of the person with overall responsibility for the outsourced key function takes into account that whilst the oversight role carries ultimate responsibility for the key function, the level of knowledge required would not need to be as deep as that of the relevant person at the service provider. However, the person with overall responsibility for the outsourced key function at a minimum possesses sufficient knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider. The Company also ensures that the respective person with responsibility for a key function who is employed by the service provider is fit and proper to perform an outsourced key function in accordance with the Company's Fit and Proper Policy, and that the service provider also has checked that individual's fitness and propriety.

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

Risk management includes all strategies, methods and processes to identify, analyse, assess, control, monitor and report the short- and long-term risks that the Company faces or may face in the future. Risk management is performed at all levels of the business.

Risk management objectives

The Risk Management Function has been established to achieve the Company's main strategic goals from a risk management perspective, as follows:

- to protect and increase the value of its shareholder's investment;
- to maintain its financial strength, thereby ensuring that it can meet its liabilities to clients; and
- to safeguard the reputation of the Company and that of its parent, HSB Group, and Munich Re.

In addition to its function as risk supervisors, the Risk Management Function contributes to the development of business solutions within the Company's defined risk appetite. However, the Risk Management Function has no risk-taking role in order to ensure the independence of risk management from risk taking (first vs. second line of defence).

Risk management principles

The Company has set the following risk management principles:

- **Proportionality:** The principle of proportionality implies that risk management should focus on relevant and material risks, i.e. risks with a potential to have a sustained negative impact on the Company.

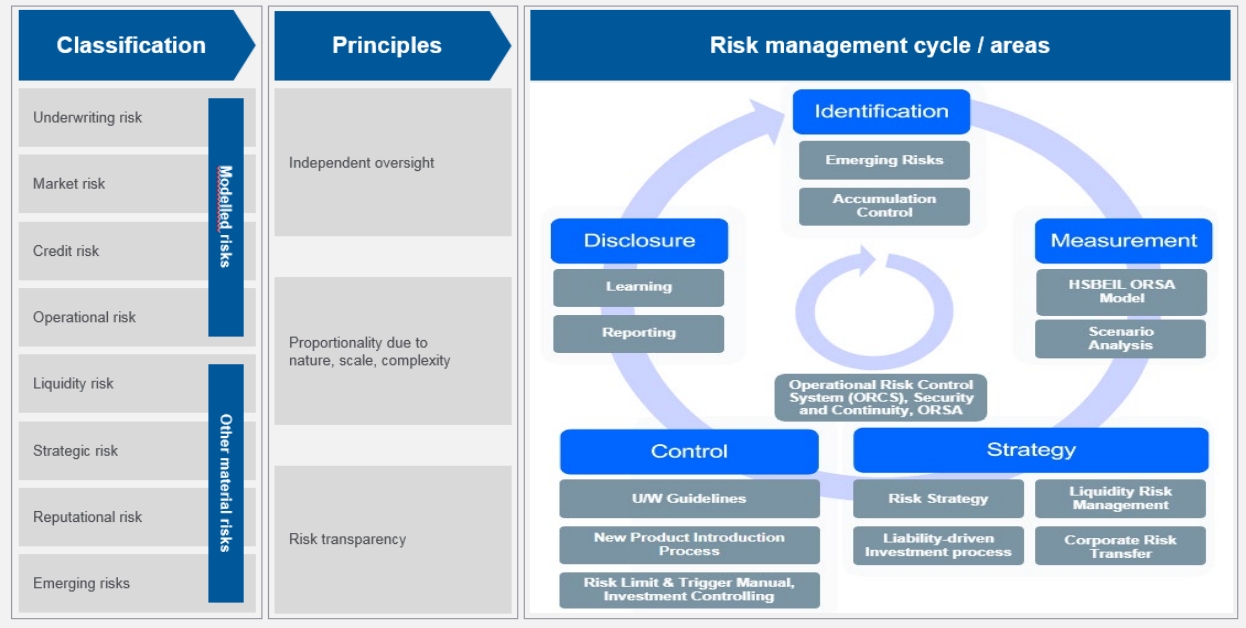
- **Risk transparency:** Risk transparency is essential so that risks are well understood by senior management and can be balanced against business goals which are recorded in business plans.

- **Independent oversight:** Risk Management has full and the unlimited right to information at all times for the performance of their duties. The Board is responsible for setting the strategic direction of the Company and defining the overall tolerance for risk, including the review of major risk exposures and the establishment of certain risk limits. The Board is also responsible for risk governance. The Risk Management Function provides the Board and its committees with relevant risk information and, as appropriate, escalates critical issues to them. Notwithstanding the responsibility of the Board, the CRG is responsible for supervising the day to day risk management and compliance advice, monitoring and oversight activities as delegated by the Risk Committee, within the risk appetite and tolerances set by the Board.

Risk management components

The Company views risk management as an enterprise-wide discipline by which it identifies, measures, exploits, controls, monitors and reports risks from all potential sources for the purpose of achieving its risk management objectives. While the Company derives its risk management principles and policies from its ultimate parent Munich Re, it has adapted the approach to align it with its own organisational structure taking into account local regulatory and legal requirements, local processes and individual requirements stemming from group processes.

The figure below shows the interplay of risk management components:



1. *Risk Identification:* Emerging risks are identified at a Munich Re level through an emerging risks process which is set up to identify new or changing risks with a high degree of uncertainty in terms of occurrence probability and loss amounts. The analysis of dependencies between different risks allows the identification and - as a second step - the mitigation of unwanted accumulatio ns. The new product process also identifies new or changing risks associated to new products and/or distributions.

2. *Risk Measurement*: Risks are measured using the Company's ORSA Capital Model which is based on the European Insurance and Insurance Occupational Pensions Authority ("EIOPA") Solvency II Standard Formula. The ORSA model is complemented by scenario planning and analysis.

3. *Risk Strategy*: The risk strategy is developed as a part of the annual planning process. Investments are managed via a liability-driven investment process. Corporate risk transfer support to keep risk exposure at an acceptable level.

4. *Risk Control*: Operational and business risks are controlled through underwriting guidelines, tools and processes, investment controlling, liquidity risk management, and accumulation control practices. The Company's risk appetite and specific risk tolerances are detailed by its Risk Strategy, which describes risk criteria per risk type and specifies limit and trigger amounts that are relevant from its perspective.

5. *Risk Disclosure*: Risk learning and risk reporting are part of the feedback loops in the risk management process that are necessary to adapt to a changing environment and continuously improve risk

management. Risks are communicated and reviewed quarterly through the Company's Internal Risk Report. In addition, regulatory risk reporting is also performed.

6. *General*: The Operational Risk Control System (ORCS) represents the framework for Munich Re's operational risk management in three dimensions: financial reporting, compliance, and operations. In addition, HSBEIL and Munich Re runs an integrated approach for information security management and business continuity management with Group-wide requirements, objectives, responsibilities, processes and reporting procedures

Risk management governance

The design of the organisational/operational structure and especially the implementation of the four SII Key Functions are essential components of the system of governance. The Board has the responsibility for the overall compliance of the organisational structure.

With the exception of the Internal Audit Function, the Company allows for an organisational combination of the other SII Key Functions. The SII Key Functions are ranked equally and are not authorised to give instructions amongst themselves.

Individual policies and procedures are documented and made available to all employees through the intranet. For key policies and procedures, such as the Company's Code of Conduct, the HR department ensures that all employees have read these policies and procedures as part of the induction process for new employees.

Risk management function

The Company's risk management governance fosters the development and maintenance of an appropriate risk and control culture, covering all material risk categories. In principle, risk management oversight is performed at several levels in the organisation, organised according to the three "lines of defence" model. This structure forms the basis for the effective separation of duties between business segments who take risks and risk management functions that independently perform risk controls:

- First line of defence – Risk taker. Risk takers identify and evaluate risks and take steps to manage and, if necessary, mitigate unwanted risks associated with their business. They own risks of all transactions regardless of the ultimate approval level. There is a clear separation between risk takers and risk monitoring and reporting. The risk takers act within the boundaries set by risk management; risk management is required to be involved in investments and dispensations which exceed the defined delegation of authority.

- Second line of defence – The Risk Management Function, Actuarial Function and Compliance Function. The Risk Management Function is responsible for independent monitoring and assessing the risk profile, including the management of controls and risk reporting. The Risk Management Function ensures that appropriate limits, policies, procedures and measures are in place for all classes of risk. In the context of Solvency II the Actuarial Function and the Compliance Function are also part of the second line of defence.

- Third line of defence –The Internal Audit Function. This function independently verifies that effective risk controls are in place and functioning properly. Audit staff may generally not perform non-audit tasks.

Notwithstanding the responsibilities of the Board, the Chief Risk Officer, as Key Function Holder for the Risk Management function, has the overall responsibility to set standards, processes and develop methods and tools as basis for risk management.

There is clear assignment of roles and responsibilities between Munich Re's central Risk Management Function at group level (Central Function) and the Company's Risk Management Function. The Central Function develops a framework and sets standards, ensures consistent methods, defines risk appetite process and maintains a common risk culture. The Company's Risk Management Function adapts and implements the framework, acts within guidelines, incorporates local specifics, i.e. law and regulation and provides local knowledge.

The Risk Management Function reports directly to a member of the Board and reports quarterly to the Risk Committee.

Actuarial function

The Actuarial Function supports the Board in determining and implementing the substantial and organisational measures needed to ensure compliance with statutory and internal regulations for the Actuarial Function.

The Actuarial Function supports the Risk Management Function in particular in identifying, assessing and managing risks related to technical provisions, underwriting and reinsurance. These topics are also part of the reporting of the Actuarial Function.

Furthermore, the reporting covers potential conflicts of interest as well as risks to the Company on the basis of, for example, insufficient data quality and other deficits. The Actuarial Function may recommend measures for reducing these risks or for removing the weaknesses. When assessing the effectiveness of these recommendations, the Actuarial Function can base its actions on knowledge from the audits by the Internal Audit Function as well as on knowledge from the Risk Management Function, in addition to its own knowledge.

Further details are provided in section B.6.

Compliance function

The Compliance Function assists the Board in its duty to provide an effective system of governance, by developing and implementing the organisational measures needed to ensure that regulations are complied with by the Company and its employees. The Compliance Policy sets out the principles and objectives of compliance and describes the functions and responsibilities of the Compliance Function. Compliance risk assessment is carried out in accordance with the principles of the ORCS.

The Compliance Function prepares a risk analysis for compliance subject areas which it will make available to the Risk Management Function. These results constitute the Top Down view of the compliance risk scenarios. In return, the Risk Management Function ensures the annual results of the Bottom Up view by forwarding the results of the corresponding risk and control assessments to the Compliance Function.

When assessing the appropriateness and effectiveness of the measures taken by the operative divisions for reducing the risk, the Compliance Function can also base its actions on knowledge from the monitoring activities of the Risk Management Function as well as from the audits performed by the Internal Audit Function, in addition to its own knowledge. To this end, the Compliance Function, the Risk Management Function and Internal Audit exchange information on an ongoing basis.

Internal Audit function

Internal Audit supports the Board and managerial staff in carrying out their governance and control responsibilities by providing an objective and independent evaluation of governance processes, effectiveness of controls, risk management and IT systems.

Internal Audit's role is to support the Company through auditing services by bringing a systematic and stringent approach to improve the effectiveness of risk management and of key management and monitoring processes, thus contributing to better corporate governance.

Internal Audit is not responsible for the identification of risks. Nevertheless, it immediately informs the Risk Management Function of facts indicating significant new risks or a changed risk situation.

Further details are provided in section B.5.

Own Risk and Solvency Assessment (ORSA)

The performance of the ORSA for the Company is embedded in the relevant processes e.g. risk management, planning process, capital management. The results and conclusions of the ORSA (ORSA Report) are an important management tool and are taken into account in the strategic decisions on an ongoing basis. The ORSA Policy defines binding requirements for performing the ORSA.

The Risk Management Function is responsible for the execution of the ORSA. The adequacy of the ORSA framework and ORSA Policy is reviewed by the Risk Committee on an annual basis. The Risk Committee makes recommendations to the Board in respect of any matters arising which it considers to require action or improvement.

As part of the process for the ORSA, the Risk Management Function collects the results and findings of the individual procedures and processes throughout the year, which serve as the basis for the ORSA Report. The ORSA Report includes the main findings and conclusions of the ORSA and is approved by the Board on an annual basis. Once the ORSA has been performed and the results have been challenged and approved by the Board, the Risk Management Function and the Board are responsible for ensuring that the results and conclusions of the ORSA are communicated to all relevant staff.

ORSA Capital model

The Company steers its business on an unconsolidated (solo) basis, using its own risk capital model (the Company's ORSA model) to determine its own view of the capital needed to ensure the Company's ability to pay claims even after extreme loss events.

The ORSA model assesses the capital requirement over a three-year time horizon. It is based on the EIOPA Solvency II standard formula for relevant risk classes such as non-life underwriting risk, market, credit, and operational risks. Every risk modelled includes all the risks that the Company is exposed to within the risk class concerned, and by business segment as applicable. An allowance is made for diversification between risk types.

The ORSA model calculates a capital requirement with a confidence level of 99.5%. The value at risk (VaR) with a confidence level of 99.5% gives the economic loss of the Company which, given unchanged exposures, will be statistically exceeded once every two hundred years at most. The VaR 99.5% represents the risk tolerance under Solvency II.

B.4 Internal control system

As part of the Munich Re Group, the Company has adopted Munich Re's Operational Risk Controls System (ORCS) (previously known as its Internal Control System) which systematically links key controls and steering measures with the significant operational risks. The key elements of the ORCS are set out in the Company's ORCS Policy which was approved by the Board and reviewed annually by Risk Management Function.

ORCS comprises a process for the assessment, analysis and steering of the identified operational risks and corresponding controls. Significant control deficiencies are managed through improvement measures, transfer of the underlying risk and/or intensive monitoring. Results are reported up to the board level. The ORCS explicitly covers the significant operational risks linked to financial reporting, compliance, operational, insurance, market, credit, liquidity and other business risks not, or only implicitly, included in the scope of the integrated ORCS such as strategic, concentration and reputational risk.

The ORCS is based on three lines of defence model. The main responsibility for risks and their control lies with the Board (the risk owner). Furthermore, all individuals who are responsible for the performance of the ORCS (i.e. all risk- takers) are required to inform the risk management function, the actuarial function, the compliance function and internal audit of any material facts as described in the relevant guidelines.

The legal and supervisory requirements relevant to the ORCS are based mainly on Solvency II Directives, local regulatory requirements and internal Munich Re group regulations.

B.5 Internal audit function

The effective operation of Internal Audit (IA) is a key part of the control environment required for the Company to achieve its objectives and meet its obligations. The primary objective of IA is to assist the Board and Senior Management in protecting the assets, reputation and sustainability of the organisation through the assessment and reporting of the overall effectiveness of risk management, control and governance processes across the business; and by appropriately challenging Senior Management to improve the effectiveness of those processes.

Due to the size of the business and position within the HSB Group and Munich Re Group, the Company has outsourced its IA Function to the Munich Re UK IA Department. The Head of IA role (SMF5 under the SM&CR) is undertaken by an employee of the outsourced provider, who is responsible for the provision of IA services to the Company. The Head of IA reports to the Chair of the Audit Committee. Per the terms of outsourcing arrangement the IA Function is barred from assuming any other key functions in the Company.

The Head of IA reports to the Audit Committee at least once a year in writing about any major or serious deficiencies ascertained in the reporting period, including the status of measures taken to remedy these deficiencies, and about audit planning for the following year. The report also provides an overview of audits performed in the reporting period, a description of the main anti-fraud activities undertaken and any other important topics from an IA point of view.

Independence and access

The Company's IA Policy states that IA activity will remain free from interference by any element of executive management, including matters of audit selection, scope, procedures, frequency, timing, or report opinion to permit maintenance of a necessary independent and objective mental attitude. The IA Function is authorised to review all areas of the Company and have full, free, and unrestricted access to all activities, records, property, and personnel necessary to complete their work.

IA staff are required to observe the ethics and standards issued by the Deutschen Institut für Interne Revision (DIIR), the Institute of Internal Auditors (IIA) and the Chartered Institute of Internal Auditors (CIIA) of UK and Ireland.

B.6 Actuarial function

The Actuarial Function supports the Board in determining and implementing measures needed to ensure compliance with statutory and internal regulations for the Actuarial Function. The Actuarial Function is outsourced to a third party service provider, and the key function holder is the Chief Risk Officer.

The Actuarial Function Policy sets out the basic principles and methods and the structure required to perform this function. It outlines in particular the objectives and tasks, the area of responsibility and information, disclosure and audit rights of the Actuarial Function.

The overarching objectives of the Actuarial Function are defined as follows:

- to coordinate the calculation of technical provisions for the economic solvency balance sheet;
- to ensure the appropriateness of the methods and underlying models used, and of the assumptions made in the calculation of the technical provisions for the economic solvency balance sheet;
- to evaluate the adequacy and quality of the data used for calculating the technical provisions for the economic solvency balance sheet;
- to provide an opinion on general underwriting and acceptance policy; and
- to provide an opinion on the appropriateness of reinsurance agreements.

Beyond this, it is the Actuarial Function's objective to ensure consistency of the methods used for calculating technical provisions in areas of substantive overlap between the valuation standards of Solvency II and UK GAAP and to consider the impact of the valuation of technical provisions on other positions of the balance sheet.

The Actuarial Function establishes processes for documentation of calculations, and is responsible for following the Munich Re Manual of Methods for technical provisions in the economic solvency balance sheet.

The Actuarial Function performs its tasks independently. To ensure that their independence is not compromised in any way, Actuarial Function staff may not perform any operational tasks in risk acceptance that they are themselves responsible for monitoring.

The Actuarial Function reports to the Board at least once a year in the form of a written Actuarial Function Report. This report contains opinions on:

- the reliability and appropriateness of the calculation of the technical provisions;
- the general underwriting and acceptance policy;
- the appropriateness of the reinsurance agreements; and
- the activities undertaken by the Actuarial Function, including their outcomes.

The Audit Committee and Risk Committees review the written Actuarial Function Report(s) and makes recommendations to the Board in respect of any matters arising from the report(s) which it considers require action or improvement. The Actuarial Function on request reports at least once a year at a meeting of the Audit Committee on its activities and the results of its work.

B.7 Outsourcing

The Company outsources certain functions to services providers where there is rational business purpose to do so (e.g. cost reduction, better quality due to higher degree of specialisation of external service provider, reduction of risk exposure, local regulatory requirements, etc.) and where risk can be effectively managed without imposing extra burden on Management.

The Company classifies all outsourcing arrangements into either a Simple outsourcing or Important Outsourcing. Due diligence is undertaken for all outsourcing arrangements before any final decision is taken. In the case of Important outsourcing additional requirements are followed before outsourcing. These requirements include the production of an outsourcing risk report and approval of the outsourcing arrangement by the Board. Prior consent to the proposed Important Outsourcing is obtained by the Business Owner from the Risk Committee.

All risks associated with Outsourcing are assessed in accordance with and conform to the ORCS Policy, including but not limited to the identification, analysis, assessment, and adequate management of such risks. Proportionate to the nature, scale, complexity and the inherent risks, the results are documented in the Outsourcing Report.

In the event of the Outsourcing of a Key Function, a person within the Company is designated to assume overall responsibility for the Key Function to be outsourced. They are required to be fit and proper and possess sufficient knowledge and experience regarding the Key Function to be outsourced in order to enable them to monitor the performance and results of the service provider.

The Company has established an Outsourcing Policy to establish the requirements for identifying, justifying and implementing all material outsourcing arrangements. In line with the Outsourcing Policy, outsourced services and functions are required to have detailed due diligence performed, a written Outsourcing Agreement in place and the performance of the outsourced activity is reviewed on a regular basis.

B.8 Any other information

There is no other information to disclose in relation to Risk Management other than the information mentioned in preceding sections of this report.

C. Risk Profile (Article 51(1)(c))

The most significant financial risks to which the Company is exposed are set out below. For each category of risk, the Company determines its risk appetite and sets out policies to manage the risk.

There have been no changes to the risks and method used to quantify these measures during the year.

Quantification of risk

The Company uses the Solvency II Standard Formula to quantify the risks associated with business activities for key risk categories for the purposes of the calculation of the Solvency Capital Requirement.

The Company manages capitalisation on the basis of regulatory capital requirements and modelled capital requirement projections. As part of the HSB Group, the Company maintains an AM Best rating of A++. The Company uses these metrics to regularly assess and project its financial strength over the business planning horizon to ensure that its business plans are consistent with its risk appetite.

The Solvency II SCR as at 31 December was determined to be 243% (2020: 242%) before ringfencing of assets for the ROI Third Country Branch, which was implemented on 1 January 2021, and 220% post-ringfencing. The SCR is calculated as follows:

£'m	**2021 Post-ringfencing**	**2021 Pre-ringfencing**
Market risk	**32.8**	34.7
Counterparty default risk	**3.7**	3.6
Non-life underwriting risk	**35.5**	30.4
Diversification	**(14.5)**	(15.4)
Basic Solvency Capital Requirement	**57.5**	53.3
Operational risk	**2.5**	2.5
Loss absorbing capacity of deferred tax	**(2.2)**	(2.2)
Solvency Capital Requirement	**57.8**	53.6
Available own funds	**127.1**	130.2
Solvency coverage	**220%**	243%

Forward looking approach

Risk and stress testing

The risks arising from the business strategy components are linked to risk scenarios and have been considered in the scenario testing using the ORSA model.

The starting point of scenario building is the categorisation of risk being key (or not) and whether it is covered in ORSA model. Based on this approach risks are then identified, categorised and presented to the Risk Committee for review. Scenarios are then selected to reflect the identified key risks. The selected scenarios were reviewed at a meeting of the Risk Committee in October 2021 along with additional risks added to consider other

operational risk events. The approach taken to the assessment of operational risk aligns to Munich Re's operational risk scenarios and economic developments in the year.

Where a risk is considered to be effectively mitigated and the result of mitigation failure is considered remote, the risk mitigation is considered in the scenarios. The failure of risk mitigation is included in the Company's Reverse Stress Testing.

The following table sets out the description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

Scenario		Outcome
1	GLR higher than expected for all 3 years for all segments	Possible mitigating actions identified to resolve below-target capitalisation
2	HSB EIL experiences large losses over a 3 year period including losses related to a large underwriting loss, a cyber-attack and a severe weather event	
3	Adverse UK economic conditions due to Covid-19 pandemic and Brexit outcome.	
4	Adverse global economic conditions due to the impacts from the Covid-19 pandemic	

In the more extreme scenarios, mitigating action would be required to maintain a capital ratio above the Company's defined threshold.

C.1 Underwriting risk

The Company has identified that the principal risks from its general insurance business would most likely arise from inaccurate pricing; fluctuations in the timing, frequency and severity of claims compared to our expectations; inadequate reinsurance protection; and inadequate reserving or from accumulations to perils such as natural catastrophe or cyber risk events. Significant underwriting risks for the Company are the premium and the reserve risks. The Company's appetite for insurance risk is established through its strategic and business planning processes, limited through the criteria in its Risk Strategy and communicated through its corporate underwriting guidelines and any supplementary updates, documented underwriting authorities, underwriting manuals, rating guides and documented procedures for quoting and binding business and claims handling, and approved policy wordings.

The Company attaches great importance to the management of underwriting risks. Key components of its management are the application of highly specialised engineering knowledge and expertise to the risk selection, underwriting, pricing and inspection of risks, product design, as well as the adjusting of claims, loss mitigation and recovery after the loss. Multi-disciplined, collaborative underwriting reviews and portfolio monitoring ensure that the business entered into by the Company is managed in a risk adequate manner. The appropriateness of underwriting guidelines is checked regularly and amendments are made where necessary.

In line with the requirements for Solvency II, the Company's carried reserves are a best estimate of the required amounts. To ensure that reserves remain adequate, the Company performs actuarial projections each quarter as part of its financial closing process and monitors the emergence of actual reported and paid losses as compared to projected expected amounts throughout the course of the year.

Management, together with Risk Management, are responsible for identifying, assessing, monitoring and coordinating accumulations and concentrations that occur across multiple segments and balance sheets. The management team, the Reinsurance Oversight Committee, and the Board are regularly advised of the impact of such accumulations compared to budgeted amounts. Accumulation risks are monitored using scenarios and

model calculations that provide information on the maximum total liability based on corresponding extreme scenarios. This analysis is performed by the HSB Group for the Company. Reinsurance is used to protect legal entity results against such risks and to limit fluctuations in earnings.

Munich Re has established accumulation budgets for natural catastrophe and IT virus exposure. Additional risk concentration exposures are continually being evaluated. The Company works closely with HSB Group to establish and monitor quarterly these global accumulation budgets.

The Company also manages underwriting risk by transferring exposures through the use of both excess of loss and treaty reinsurance programmes. Risk transfer contracts are managed centrally by the HSBIIC Risk and Reinsurance Group with further review by the Reinsurance Oversight Committee.

Risk capital is calculated using the Standard Formula to quantify each of the key sources of underwriting risk and measure the diversification between them.

Quantification of underwriting risk after ROI branch ringfencing as at 31 December 2021 is as follows:

	£m
Premium and reserve risk	23.3
Catastrophe risk:	
Natural	16.1
Man-made	11.4
Cat diversification	(7.8)
Catastrophe risk total	19.7
Lapse risk	2.3
Simple sum	45.3
Diversification benefit	(9.8)
Total	**35.5**

Exposure to catastrophe risks is primarily from business written in the UK (windstorm, floods). Catastrophe exposure is managed through application of agreed limits for catastrophe exposed risks through catastrophe budgets. The Company mitigates catastrophe risk by the purchase of excess of loss cover under HSB Group reinsurance arrangements. Per risk Excess of Loss (XoL) treaty cover is also in place for non-cat events.

C.2 Market risk

Market risk is the largest risk exposure for the Company, primarily due to its investment in its Canadian subsidiary, BI&I, which gives significant exposure to equity risk, currency risk and concentration risk.

The Company is exposed to currency risk from its international business, primarily with its exposure to EUR and USD and less significant exposure to other currencies. On a regulatory basis, the Company has material exposure to CAD through its investment in BI&I. Market price fluctuations impact equity risk, interest-rate risk, credit spread risk, currency risk, but are offset for the purposes of the Solvency Capital Ratio by changes to net asset valuations.

The Liability-Driven Investment process is designed to mitigate market risk to an acceptable level.

Additionally, the Company has set specific limits in respect of currency risk. and manages asset-liability mismatches arising from Foreign Exchange (FX) through a 'natural hedge' approach i.e. seeking to minimise the net asset position held in each of the (non-sterling) major operational currencies of EUR and USD. The Investment Guidelines set out the permitted currencies in which investments may be held.

In the absence of significant CAD liabilities, the balance sheet asset representing the Company's investment at BI&I's Solvency II economic balance sheet value is largely unhedged. This asset-liability mismatch is within risk appetite and is listed as a permitted asset-liability mismatch in the Company's Risk Strategy. Non-permitted mismatches are monitored and managed against the tolerances set out by the Board. The foreign exchange risk arising under a 25% shock scenario (i.e. all major currencies simultaneously move adversely) is monitored and reported at least quarterly.

Holding fixed income bonds exposes the Company to interest rate risk which is modelled using the Standard Formula through application of a shock scenario to the term structure of interest rates. The capital risk charge for interest rate risk also takes into account the impact of the interest rate shock on discounted liabilities (technical provisions).

The capital requirement for spread risk arising from the investment portfolio is calculated based on the credit rating of the counterparty for non-government instruments in line with the Standard Formula. Investment guidelines, which include minimum credit quality, maximum exposure and allowable asset classes, are set and reviewed on an annual basis, with the investment portfolio being monitored quarterly. Risk arising from a concentration of assets held with single name counterparties is reflected in the Company's risk capital requirements based on amounts held by counterparty in excess of thresholds as set out in the Standard Formula.

Prudent person principle

The majority of the Company's investments are held in respect of fixed income securities in Corporate and Government sectors. Solvency II regulations have brought in the 'Prudent Person Principle' in relation to investing in assets. The Company is required to apply this principle, and has ensured that its investment policy and asset acceptability framework are aligned with this Principle for all new asset choices.

Market risk based on the above mentioned measures after ringfencing for the ROI branch is quantified using the Standard Formula at 31 December 2021 as follows:

	£m
Interest rate risk	3.4
Equity risk	15.4
Currency risk	18.9
Spread risk	5.5
Concentration risk	8.0
Simple sum	51.2
Diversification benefit	(18.4)
Total	**32.8**

C.3 Credit risk

Credit risk is defined as the risk of financial loss as a result of a change in the financial position of a counterparty.

The Company is exposed to Credit Risk as a result of:

- Type one exposures - defined as reinsurance failures, (i.e. where a reinsurer fails to meet its obligation to pay its proportion of a claim settlement) or failure of banking counterparties to meet obligations to return cash or investment assets on maturity or on demand; and

- Type two exposures - which consist largely of premium debtors, i.e. delays or failures in the payment of premiums due by counterparties, such as Policyholders, Insurance Intermediaries, Client Companies and Delegated Authority Scheme partners.

Creditworthiness of investment issuers are assessed using credit ratings provided by MEAG, the asset managers of Munich Re. To be declared acceptable in the MEAG risk assessment process, an investment must be evaluated positively both by Munich Re and by external rating agencies. The strict requirements of issuers are also reflected in Munich Re´s Group-wide General Investment Guidelines.

Specific risk limits are described in the Company's Risk Strategy, the Munich Re Counterparty Risk system, and the Munich Re Retro Security Guidelines.

To mitigate credit risk on reinsurance arrangements, reinsurers are selected in line with the Approved Reinsurer list issued by Munich Re. Counterparties within the Munich Re Group (e.g. HSBIIC) are included in this calculation according to credit rating in the same way as external counterparties.

A minimum AM Best credit rating of A- (or equivalent) is required for banks involved in handling cash deposits.

The ageing profile of type two accounts receivables is monitored monthly and internal limits are set for the level of type two receivables more than 90 days overdue.

In addition to modelling the risk capital for credit risk, exposure concentrations are monitored by issuer and rating level, the results of which are summarised quarterly in the Internal Risk Report.

Quantification of credit risk after ringfencing for the ROI branch as at 31 December 2021 is as follows:

	£m
Type one	1.7
Type two	2.2
Simple sum	3.9
Diversification benefit	(0.2)
Total	**3.7**

C.4 Liquidity risk

Liquidity risk is defined as the risk that funds are not available to meet obligations at a reasonable time or at a reasonable cost. This risk is managed through maintaining sufficient cash and through control of the marketable investment portfolio to ensure funds are available to meet obligations.

On a Group-wide basis liquidity risk is centrally managed for a large number of Munich Re Group entities. Detailed liquidity planning at legal-entity and segment level ensures that Munich Re group entities are able to make the

necessary payments at all times. Liquidity requirements are evaluated through the annual planning process and monitored daily and reported monthly. In addition a Liquidity Crisis Plan has been put in place in the event one or more HSB legal entities experience a material surge in payments to clients.

Operational cash flows are monitored weekly by the Finance function. Cash and short term deposits sufficient to meet expected cash outflows are held at targeted levels as set out in the Company's Risk Strategy.

Exposure to Liquidity Risk is managed through the Liability driven investment approach which ensures that:

- deposit concentrations are limited and that there is an appropriate degree of diversification with counterparties; and
- minimum credit rating standards are set for counterparties to minimise risk to cash flows.

In addition the Company sets a minimum level of cash to be held on local deposit. Cash is held in each of the main currencies in which business is transacted.

Management of the insurance-side claims shock as set out in the Munich Re Liquidity Risk Policy is carried out at the level of Munich Re Munich on behalf of the entire Munich Re Group. In order to mitigate this risk at a local level, reinsurance arrangements are in place to limit the net amount payable on a per risk and per event basis. Sufficient liquid resources are held to bridge any timing mismatches between gross payments and ceded recoveries under these arrangements.

Liquidity risk is monitored based on the measures described above and is not quantified in the Standard Formula or the ORSA model. Management deems these procedures to be sufficient to manage liquidity risk given that liquidity related issues or losses will arise only in extreme scenarios.

C.5 Operational risk

Operational risk is defined as the potential loss resulting from inadequate processes, technical failure, human error or external events. This includes criminal acts committed by employees or third parties, insider trading, infringements of antitrust law, business interruptions, inaccurate processing of transactions, non-compliance with reporting obligations and disagreements with business partners.

The Company identifies and mitigates operation risks through its ORCS, described in Section B.4. In addition, operational risk scenarios are considered to quantify operational risks in the ORSA Capital Model as part of the regular and non-regular ORSA process.

The Company adopts a range of measures to mitigate operational risk exposure. Emphasis is placed on the selection and training of managers and staff and the provision of effective guidance, through such measures as documented policies and procedures, operating manuals and systems controls. The Company has a framework for the identification, investigation, capture and reporting of Operational Risk Events, which include loss events, near miss events, recovery events and gain events. Incidents (e.g. process errors, procedure deviations, complaints, fraudulent or suspicious activity etc.) are investigated and reviewed to identify improvement measures and operational risk is an area of particular focus for risk review exercises. Risk, Underwriting and Compliance updates and a quarterly Litigation Report are standing agenda items at the quarterly Risk Committee meetings and are designed to identify and manage operational risk. The Nominated Officer provides a quarterly Anti- Money Laundering and Financial Crime Report to the Risk Committee.

Under SYSC 13.4 of the FCA handbook, the Company notifies the relevant UK regulator of any operational risk matter of which they would reasonably expect notice, including significant failures in systems and controls or significant operational losses. There have been no such notifications during 2021.

Operational risk is considered as part of all outsourcing arrangements as set out in the Company's Outsourcing Policy. Material outsourcing agreements are notified to the regulator under SYSC13.4 and are listed in section B.7.

Operational risk is quantified for the SCR using the Solvency II Standard Formula. For the year 2021 this amounted to £2.5m (2020: £2.2m). Under the stress testing carried out as part of the ORSA process, the maximum foreseeable financial loss due to operational risk is also considered. The risk charge reflected in the ORSA model is the higher of the Standard Formula approach and this maximum foreseeable loss.

C.6 Other material risks

Reputational risk

Reputational risk is the risk that adverse publicity regarding an insurer's business practices and associations, whether accurate or not, will cause a loss of confidence in the integrity of the institution. Reputational risks may result from the realisation of other risks (e.g. strategic risk, group risk, or concentration risk). Therefore, reputational risks are controlled indirectly through the control of the respective risks and risk types.

At the Munich Re level, reputational risks are identified, analysed, and evaluated across the Group by a Reputational Risk Committee.

Strategic risk

Strategic risk is defined as the risk of making wrong management decisions, implementing decisions poorly, or being unable to adapt to changes in our operating environment. The dynamic business environment in which the Company operates creates strategic risks, which generally evolve over time in connection with other risks and have the potential to lead to a significant long-term reduction in value.

The Company counters strategic risks by closely interlinking strategic decision-making processes with risk management. Management also regularly responds to newly identified threats or opportunities with actions that are appropriate to the risk situation. The resulting initiatives are monitored in quarterly internal risk reporting.

Group risk

Group risk is defined as any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole.

Group risk is of relevance to the Company, primarily because it is an entity within the HSB Group and worldwide Munich Re organisation, but also because of its own consolidated structure, which includes subsidiary companies. The Company may incur exposure to group risk both as a consequence of the activities or fluctuating fortunes of its parent company, HSBIIC, or other entities within the Munich Re worldwide organisation and as a consequence of the activities or fluctuating fortunes of its own wholly owned subsidiaries or branch offices.

Given the limited level of influence which the Company has over its exposure to group risk from sources other than its own subsidiaries, it relies on its capital management policy to maintain adequate financial resources even under such extreme stresses as might be incurred with extraordinary group risk materialisation. The Company's

capital management strategy allows for capital reserves to be held to absorb and mitigate risks which are outside its direct control. Specifically, group risk exposure are factored in to the periodic assessment of capital requirements (ORSA).

The risk arising from the activities of the Company's non-insurance subsidiary, HSBEISL, are controlled by common application of the Company's Risk Management Policy to HSBEISL and by common management oversight pursuant to a shared services agreement between the Company and HSBEISL. This outsourcing of certain management functions from HSBEISL to the Company ensures that the impact of the activities of HSBEISL are well understood and controlled to the extent possible.

The risk arising from the activities of the Company's insurance subsidiary, BI&I, are controlled by the application of a local Risk Management Framework at BI&I which is consistent with the Risk Management Framework of the Company and with that of the Munich Re Group.

Analysis of the financial results of HSBEISL is monitored by the Company as part of the regular monthly operational review. The audited results of BI&I are reviewed annually by the Company. The regulatory capital position of BI&I is calculated and reviewed quarterly.

Covid-19

The COVID-19 coronavirus gives rise to inherent uncertainty that will affect the whole market, including a significant risk of disruption to the Global economy and financial markets. The impact of the worldwide Covid-19 pandemic presented increased underwriting, market and operational risk to the Company. The Directors have taken undertaken risk assessments of the potential impact of the COVID-19 pandemic on the Company's expected future operational and financial performance and its capital adequacy position, which considered a range of possible forward looking scenarios, taking account of actions already taken to mitigate the risks to the Company's' employees and operations, as well as actions available in the future as needed.

Climate change risks

The Company faces a range of risks and opportunities arising from future climate change, including the impact on underwriting performance and pricing, impacts to future UK economic growth and impacts on investment market valuations from transitioning to a low carbon economy. Opportunities include the potential to develop services and insurance solutions to aide customers in managing their response to climate change. The Company has determined that the physical and transition risks from climate change do not currently pose a material risk to the Company. Governmental and societal responses to climate change risks are still developing, and are interdependent upon each other, and consequently the future outcomes are not yet known. The Company's ESG Committee is responsible for overseeing the Company's response to climate change and for driving activities to ensure climate change risks and opportunities are appropriately considered in the Company's business strategy.

Geopolitical risks

The Company is inherently exposed to the recent rising geo-political tensions, specifically the Russian invasion of Ukraine, which gives rise to an additional source of uncertainty for global financial markets and potential for increased inflation over a sustained period. The potential exposure is mitigated by the Company's low-risk investment portfolio, responsible investment strategy and product pricing strategies.

C.7 Any other information

There is no other information to disclose about the risk profile of the Company.

D. Valuation for Solvency Purposes (Article 51(1)(d))

D.1 Assets

The table below sets out the material classes of assets shown on the Company's Solvency II Balance sheet, the Solvency II values and the UK GAAP values shown in its financial statements, together with the valuation methods used.

£'000	Solvency II value	Solvency II valuation basis	Financial Statements value	Financial Statements valuation basis
1.1) Deferred acquisition costs	-	Not applicable	11,993	Amortised cost
1.2) Property, plant & equipment	-	Nil for leasehold improvement and fixtures and depreciated cost for other items as an approximation of fair value.	315	*Owned assets:* Amortised cost
1.3) Participations	69,989	Equity method Article 13(1)(b) of the Delegated Act. BI&I: Valuation on SII net asset basis Article 13(4). HSBEISL: Valuation on UK GAAP net asset basis Article 13(5).	53,806	*HSBEISL:* Cost *BI&I:* Deemed cost
1.4) Bonds and deposits	122,656	Marked to Market including accrued interest	121,537	Marked to Market excluding interest
1.5) Reinsurance recoverable	26,242	Refer to Technical Provisions calculation method (section D2)	30,543	Amortised cost
1.6) Insurance receivables	9,799	Marked to Market	10,012	Amortised cost
1.7) Cash and cash equivalents	17,671	Marked to Market	17,671	Marked to Market
1.8) Other assets	5,519	Marked to Market	4,669	Amortised cost (includes accrued interest), also includes Deferred Tax asset
Total assets	**251,876**		**250,546**	

1.1) Deferred acquisition costs (DAC)

Acquisition costs comprise the direct and indirect costs of obtaining and processing new and existing insurance business. Costs which relate to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. Under UK GAAP, these costs are recognised as deferred acquisition costs and

are amortised on the same basis as the related premiums are earned. For Solvency II purposes acquisition costs are factored into the calculation of the technical provisions, so no DAC is recognised separately.

1.2) Property, plant and equipment (PPE) For UK GAAP financial reporting purposes, PPE is measured at cost less accumulated depreciation and accumulated impairment losses, if any. Depreciation is recognised over the estimated useful economic life of each PPE class. For Solvency II, under Article 9 and 16(1) of Delegated Act, PPE is to be valued using the revaluation model of IAS 16. Leasehold improvements and furniture and fittings have been valued at nil for Solvency II as it is considered that these do not have a readily identifiable market value. Judgement is used in the estimation of economic useful life and in the use of approximations to the fair value of these assets.

1.3) Participations

	2021 £'000
Carrying amount as per UK GAAP balance sheet	53,806
Revaluation of participations to net asset value	16,183
Value as per Solvency II balance sheet	**69,989**

The Company's participations are its wholly owned subsidiaries, BI&I and HSBEISL. For UK GAAP financial reporting purposes BI&I is stated at deemed cost and HSBEISL is measured at cost including acquisition costs. There is no active market or available quoted prices for these interests, as the companies are not listed or quoted on any trading exchange.

Since no valuation in an active market is available for the same or similar assets, BI&I is valued at the value of its excess of assets over liabilities on the Solvency II basis as set out in Article 13(4) of the Delegated Act. As a non-insurance company with no valuation available in an active market, and as it is not considered practicable to use Article 13(4) of the Delegated Act, HSBEISL is measured at its UK GAAP net asset value as permitted by Article 13(5) of the Delegated Act. The Company does not hold any goodwill or intangible assets which would be valued at zero under Solvency II.

1.4) Bonds and deposits

	2021 £'000
Government bonds	63,696
Corporate bonds	51,810
Structured notes	6,031
Carrying amount as per UK GAAP balance sheet	121,537
Reclassification of accrued interest from other assets	1,119
Value as per Solvency II balance sheet	**122,656**

Investments are mainly fixed interest instruments including government securities, local authority issues, corporate loans and bonds, overseas bonds and other interest-bearing securities. These are all valued at fair value under both UK GAAP and Solvency II and are categorised as quoted market price in active markets under Solvency II. Fair values are measured using observable market information as inputs. Interest income is

recognised in profit or loss using the effective interest method. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. There are no other significant estimates or judgements used in the valuation of these assets. As required by the Directive, the Solvency II valuation includes accrued interest which is shown as other assets under UK GAAP.

1.5) Reinsurance recoverables

	2021 £'000
Carrying amount as per UK GAAP balance sheet	30,543
Replacement of UPR with premium provision	(3,168)
Discounting	(806)
Adjustment for counterparty risk	(17)
Remove IFRS management margin	(308)
Value as per Solvency II balance sheet	**26,242**

UK GAAP reinsurance recoverables include amounts owed by the reinsurer for estimated losses that have occurred and been reported, the amount of incurred but not reported (IBNR) losses, and the amount of unearned premiums paid to the reinsurer. Under UK GAAP, reinsurance recoverables are based upon gross provisions and are impaired if any event impacts the amount to be received. An additional management margin is held for UK GAAP reflecting a conservative reserving approach.

For Solvency II, reinsurance case reserves and case incurred data is consistent with that used in the UK GAAP calculation. Ultimate loss ratios are selected on a best estimate basis to exclude the conservatism included for UK GAAP reporting. No additional management margin is held for Solvency II. Using actuarial techniques as set out in D.2, judgement is applied in the valuation of the reinsurance IBNR.

Solvency II reinsurance premium provisions are calculated using a gross to net approach based on historical trends of reinsurance recoveries adjusted as applicable for changes in reinsurance structure. The cost of reinsurance premium payable is included in the premium provision.

1.6) Insurance receivables

	2021 £'000
Insurance debtors - intermediaries	8,645
Insurance debtors - out of reinsurance operations	1,367
Carrying amount as per UK GAAP balance sheet	10,012
Adjustment for counterparty risk	(213)
Value as per Solvency II balance sheet	**9,799**

Insurance receivable balances represent premiums due from policyholders and reinsurers ceding business to the Company. Under UK GAAP these are stated at amortised cost and reported separately on the face of the balance sheet. For Solvency II purposes a counterparty default adjustment is added to the UK GAAP amortised cost valuation to reflect the fair value of these receivables. Judgement is applied in setting the provision for bad debt which is based on receivables ageing and detailed knowledge of individual broker accounts.

Where insurance receivables recognised in the financial statements are considered 'not yet due', these receivables are reclassified and presented as future cash inflows within the technical provisions for Solvency II. Since receivables are due from the point of invoicing, no reclassification to premium provisions for Solvency II is required.

1.7) Cash and cash equivalents

Cash and cash equivalents are monies held at bank accounts denominated in GBP, USD, EUR and SEK. Foreign currency balances are converted to GBP using foreign exchange rates prevailing at the reporting date. These are reported at fair value for both financial reporting and Solvency II purposes. There are no significant estimates or judgements used in the valuation of these assets.

1.8) Other assets

	2021 £'000
Carrying amount as per UK GAAP balance sheet	4,669
Reclassify deferred tax asset (see section 3.1)	(346)
Write down of prepayments to nil	(616)
Recognition of leased assets	4,637
Reclassification of accrued interest to investments	(1,119)
Reclassifications to other liabilities	(1,692)
Discounting	(14)
Value as per Solvency II balance sheet	**5,519**

Other assets include prepayments that are stated at amortised cost under UK GAAP. From a Solvency II perspective, prepayments have no value to a third party and are valued at nil. For all other assets, fair value equates to amortised cost. There are no significant estimates or judgements used in valuation of these assets.

D.2 Technical provisions

Technical provisions are valued in accordance with Article 77 of the Solvency II Directive, which states that the value of technical provisions shall be equal to the sum of a best estimate and a risk margin.

The technical provisions per the 31 December 2021 Solvency II balance sheet reconciles to the UK GAAP balance sheet as follows:

£'000	UK GAAP	Replace UPR with premium provision	Adjustment to IBNR	Add provision for investment expenses	Add allowance for ENIDs	Discounting	Solvency II
Unearned premium/ premium provision	56,099	(23,477)	-	-	-	(623)	**31,999**
Case reserves	51,701	-	-	-	-	(1,131)	**50,570**
IBNR	5,573	-	(8,164)	17	355	24	**(2,195)**
Provision for LAE	5,489		(1,259)			(78)	**4,152**
Gross best estimate	118,862	(23,477)	(9,423)	17	355	(1,808)	**84,526**
Risk margin							**6,664**
Gross best estimate plus risk margin							**91,190**

In calculating the technical provisions, the Company does not use any transitional arrangements, including the matching adjustment, the volatility adjustment, use of the transitional risk-free interest rate-term structure and the transitional deduction measure. No significant changes have been made to the methodology of the calculations in the year. Amounts recoverable under reinsurance contracts are calculated on the same basis as the technical provisions and are recognised within assets as reinsurance recoverable. There are no recoverables from special purpose vehicles.

A number of key assumptions are made in the calculation of the technical provisions. Compared with the prior year there were no material changes to these assumptions. These assumptions are as follows:

Claims provisions

The provision for claims outstanding relates to claim events that have already occurred, regardless of whether the claims arising from these events have been reported or not. Expected cash flows are discounted using the relevant risk free interest rate term structure and an adjustment is applied to take account of expected counterparty default risk on reinsurance recoverables.

Undiscounted claims provisions and payment patterns are calculated by qualified actuaries at HSB Group based on the same source data (gross and net cumulative currency-adjusted incurred and paid triangles) as for UK GAAP reporting. The results provided by the actuary are reviewed by Senior Management and the Finance team and an independent review of the claims provision is carried out by the Actuarial Function.

Differences between UK GAAP and Solvency II claims provisions result from discounting in Solvency II (no discounting applied for UK GAAP), the addition of a counterparty default risk adjustment for Solvency II, the

addition of an ENID loading for Solvency II and the removal of management margin which is held for UK GAAP reporting. This management margin is not applied for Solvency II as this is considered to apply an element of prudence for UK GAAP reporting which is not in line with Solvency II best estimate principles.

Each quarter, the reserving actuary provides Management with a summary of the key selections and the rationale for each development period.

Premium provision

The premium provision relates to future cashflows arising from existing and bound contracts as referred to in Article TP2 of the Delegated Act.

The gross cash outflows for the premium provision are calculated by applying assumptions for cancellations, loss ratio, claims expense ratio and expense ratio to the amount of unearned premiums at the balance sheet date. The Unearned Premium Reserve (UPR) used as the input for this process is the same as the gross UPR under UK GAAP reporting. Assumptions for future ratios are set with reference to business plans and in light of recent trends. Assumptions are approved quarterly by the Finance Director.

Where policies are bound but not incepted at the reporting date ("future premiums"), future cashflows are included in the premium provision by applying assumptions for lapses, cancellations, acquisition costs, losses, claims expense and other expenses to the amount of the future premium.

Where premium receivables are not yet due, these amounts are reclassified from receivables on the balance sheet to cash inflows in the premium provision. The Company considers that once invoiced, its premium receivables are due for payment. As a result, UK GAAP premium receivables are not reclassified to the premium provision for Solvency II reporting.

Reinsurance recoveries on future claims (reinsurance premium provision) are calculated on a gross to net basis taking into account current and future reinsurance structure. For the premium provision calculated as at 31 December 2021, no reinsurance recoveries are anticipated. An allowance is made for the associated reinsurance ceded premium cost.

Independent review of the premium provision is carried out by a third party service provider, acting in the capacity of the Actuarial Function as part of their review of the Best Estimate Report.

Risk margin

Risk margin is calculated based on the concept laid out by EIOPA that "the risk margin should be calculated by determining the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirements necessary to support the (re)insurance obligations over their lifetime".

The calculation of Risk Margin follows the scenario set out in Article 31 TP18 of the Delegated Act which sets out the assumptions to be used in calculation of risk margin, namely that the whole portfolio (including reinsurance arrangements) is transferred to a third party and no new business is written and after the transfer, the Company raises eligible own funds equal to the SCR necessary to support the insurance obligations.

The calculation of the risk margin is based on the 'SCR for risk margin' which, as set out in TP18, includes the underwriting risk of the transferred business, counterparty risk from the assets to support the SCR and from reinsurance arrangements, and from operational risk.

During Q3 2021 the Company reviewed the expected run off of the SCR(t). Due to the growth of the Company's Inherent Defects Insurance (IDI) business, which comprises longer term products (10-12yrs), the run off was no longer considered appropriate, and thus an alternative run off was adopted. Previously, the SCR required to support the assets at time t, was calculated using EIOPA's "simplification 3 - simplification of future SCRs" which assumes that the SCR requirement runs off in line with the net Best Estimate technical provisions. A 25% weighted average, weighted towards reducing the SCRs in proportion to the square root of the net best estimate is now used. This gives more weight towards the longer term tails of the IDI business.

As set out in Article TP20 of the Delegated Act, the risk margin is then calculated by applying the EIOPA-set cost of capital at 6% to the discounted run off of SCR for the risk margin calculated above.

Level of uncertainty

The estimation of claims incurred but not reported is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim is generally available. However, the Company's claims are typically reported relatively quickly after the claim event and so the balance displays low levels of volatility.

Engineering and Property Damage business is 'short tail', in that there is not a significant delay between the occurrence of the claim and the claim being reported, this lack of delay following occurrence is also expected within the IDI product however it is noted that there is a longer emergence. The costs of claims notified to the Company at the balance sheet date are estimated on a case by case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims is projected from this data by reference to statistics which show how estimates of claims incurred in previous periods have developed over time to reflect changes in the underlying estimates of the cost of notified claims and late notifications.

The two most critical assumptions as regards to claims provisions are that the past is a reasonable predictor of the likely level of future claims developments and that the rating and other models used for current business are a fair reflection of the likely level of ultimate claims to be incurred. Except as allowed for by addition of an ENID loading, there has been no explicit consideration of any extraordinary unforeseeable changes to the legal, social and economic environment which can affect the cost and frequency of claims that emerge in the future.

The Directors consider that the provision for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, the ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provision established in prior years are reflected in the financial statements in the period in which the adjustments are made. The methods used and the estimates made are regularly reviewed to reflect recent and emerging trends in experience and changes in the risk profile of the business.

D.3 Other liabilities

The table below sets out the material classes of other liabilities shown on the Company's Solvency II Balance sheet, the Solvency II values the UK GAAP values shown in its financial statements, together with the valuation methods used. There have been no changes to recognition and valuation bases used or to estimation methods or techniques during 2021.

£'000	Solvency II value	Solvency II valuation basis	Financial Statements value	Financial Statements valuation basis
3.1) Deferred tax liabilities	2,253	Tax rate applied to difference between valuation of assets and liabilities for tax and valuation for Solvency II	-	Tax rate applied to difference between valuation of assets and liabilities for tax and valuation for financial statements
3.2) Debts owed to credit institutions	-	Marked to Market	-	Marked to Market
3.3) Insurance and intermediaries Payables	7,386	Marked to Market	789	Amortised cost
3.4) Other liabilities	20,896	Marked to Market	24,256	Amortised cost
Total non-technical liabilities	**30,535**		**25,045**	

3.1) Deferred tax liabilities

Deferred tax liabilities arise due to the differences between accounting carrying value and tax carrying value of items on the balance sheet. Deferred tax is measured using tax rates expected to apply when the related deferred tax liability is settled, based on tax rates and laws which have been enacted or substantively enacted.

For Solvency II purposes deferred tax is calculated on the basis of the difference between the values ascribed to assets and liabilities recognised and valued in accordance with Article 75 of Directive 2009/138/EC and in the case of technical provisions in accordance with Articles 76 to 85 of that Directive and the values ascribed to assets and liabilities as recognised and valued for tax. As a result, deferred tax differs from the balance under UK GAAP due to the deferred tax impact of valuation adjustments between Solvency II and the financial statements. There are no other material assumptions or judgements used to determine this balance.

A breakdown of the deferred tax balance is shown below:

	2021 £'000
Deferred tax per UK GAAP statutory accounts	-
Reclassify deferred tax asset	(346)
Deferred tax on write down of leasehold improvements, furniture & fixtures	(79)
Deferred tax on write down of prepayments to nil	(154)
Deferred tax on replacement of UPR with premium provision	2,033
Deferred tax on removal of IRFS management margin	2,348
Deferred tax on provision for investment expenses	(4)
Deferred tax on allowance for ENIDs	(89)
Deferred tax on risk margin	(1,666)
Deferred tax discounting	268
Deferred tax on counterparty risk	(58)
Deferred tax per Solvency II	**2,253**

3.2) Debts owed to credit institutions

Debts owed to credit institutions represent timing differences generating cashbook overdraft balances on bank accounts. These are shown within the cash balance in the financial statements. There are no significant estimates or judgements used in the valuation of these liabilities.

3.3) Insurance and intermediaries payables and other liabilities

	2021 £'000
Carrying amount as per UK GAAP balance sheet	789
Reclassifications from other liabilities	7,689
Reclassifications of reinsurance balances and other creditors	(1,092)
Value as per Solvency II balance sheet	**7,386**

For Solvency II, insurance and intermediaries payables represents the commission payable to brokers and intermediaries. This balance is calculated in accordance with the terms and conditions of the contract with the individual broker or intermediary; no adjustments or judgements are made for valuation purposes. There is a high degree of certainty over the economic outflow due to the relatively short timeframe between the commission liabilities arising and the broker or intermediary receiving payment. This commission payable balance is presented as other liabilities in the financial statements.

It is considered that there is no material difference between the carrying value in the financial statements at amortised costs and the valuation for Solvency II at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction.

3.4) Other liabilities

	2021 £'000
Carrying amount as per UK GAAP balance sheet	24,256
Recognition of lease liabilities	5,011
Reclassifications to insurance receivables	(7,689)
Reclassifications to reinsurance and intermediaries payable	(601)
Discounting	(81)
Value as per Solvency II balance sheet	**20,896**

For Solvency II, other liabilities include £11m of intercompany balances due to the Company's subsidiary, HSB Engineering Insurance Services Limited. Other liabilities also include reinsurance payables which represent the balance owed to reinsurers for the business ceded. The amounts payable are calculated in accordance with reinsurance agreements; no estimation methods or valuation judgements are required for these balances. The timing of expected economic outflows to settle the liability with each reinsurer is contractually based, and in the normal course of business. These balances are presented as insurance and intermediaries payable in the financial statements.

It is considered that there is no material difference between the carrying value in the financial statements at amortised costs and the valuation for Solvency II at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction after the addition of an adjustment for discounting for Solvency II.

The Company has operating lease contracts in place for office buildings in the United Kingdom and Republic of Ireland. The Company has no finance lease arrangements in place.

D.4 Alternative methods for valuations

The Company does not use any other significant alternative methods for valuation.

D.5 Any other information

The Company does not have any other information to report.

E. Capital Management (Article 51(1)(e))

The objective of Own Funds management is to maintain, at all times, sufficient own funds to cover the SCR and MCR with an appropriate buffer. These should be of sufficient quality to meet the eligibility requirements in Article 82 of the Delegated Act. Adherence to risk appetite is monitored against triggers and limits approved annually by the Board. The capital ratio is reviewed each quarter by the Audit Committee on behalf of the Board. The Company manages capitalisation on the basis of regulatory capital requirements and modelled capital requirement projections. As part of the HSB Group, the Company maintains an AM Best rating of A++. The Company uses these metrics to regularly assess and project financial strength over the 2 year business planning horizon (plus current year forecast) to ensure that the business plans are consistent with the risk appetite. During the year there has been no significant change to the objectives, policies and processes employed by the Company.

The Solvency II Solvency Capital Requirement (SCR) as at 31 December 2021 was determined to be £53.6m giving a coverage ratio of 220% (2020: 242%).

The Company's Own Fund items consist only of ordinary share capital and the reconciliation reserve. There have been no changes to Own Fund items in the year and none are expected over the business planning horizon. As shown in S.23.01, the reconciliation reserve comprises:

Excess of assets over liabilities - attribution of valuation differences	**£'000**
Difference in the valuation of assets	1,330
Difference in the valuation of technical provisions	27,672
Difference in the valuation of other liabilities	(5,490)
Total of reserves and retained earnings from financial statements	53,079
Reconciliation reserve	**76,591**
Impact of Ringfencing	(3,106)
Reconciliation reserve – Post Ringfencing	**73,485**

E.1 Own Funds

All of the Company's Own Funds meet the definition of Tier I basic available own funds and comprise share capital plus capital derived from past underwriting and investment surpluses. There are no restrictions on the availability of the Own Funds to cover either the Solvency Capital Requirement or the Minimum Capital Requirement.

Available Own Funds as at 31 December were:

£'000	**2021**	2020
Equity per the financial statements		
Share capital	**53,560**	53,560
Capital contribution	**7,062**	7,062
Retained earnings and other reserves	**46,017**	43,338
Total equity per the financial statements	**106,639**	103,960
Replace UK GAAP technical provisions with undiscounted Solvency II technical provisions	**10,395**	6,910
Add back lease assets and liabilities	**(374)**	(315)
Revaluation of participations	**16,183**	10,717
Write off prepayments	**(616)**	(449)
Write off property, plant and equipment	**(315)**	(268)
Tax adjustment	**-**	179
Discounting	**1,068**	(117)
Counterparty adjustments	**(230)**	(201)
Deferred tax impact of above	**(2,599)**	(1,466)
Available Own Funds	**130,151**	118,950
Impact of Ringfencing	**(3,106)**	-
Available Own Funds – Post Ringfencing	**127,045**	118.950

In 2021 the available own funds increased by £11.9m before ringfencing assets for the ROI branch and by £8.8m after ringfencing.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The Solvency Capital Requirement as at 31 December, under the standard formula, was as follows:

£'000	**Post ringfencing 2021**	**2021**	2020
Market risk	**32,763**	**34,714**	32,374
Counterparty default risk	**3,660**	**3,633**	4,104
Non-life underwriting risk	**35,591**	**30,361**	26,572
Diversification	**(14,519)**	**(15,413)**	(14,300)
Basic Solvency Capital Requirement	**57,495**	**53,295**	48,750
Operational risk	**2,536**	**2,536**	2,272
Loss absorbing capacity of deferred tax	**(2,249)**	**(2,249)**	(1,875)
Solvency Capital Requirement	**57,782**	**53,582**	49,147
Available own funds	**127,045**	**130,151**	118,950
Solvency coverage	**220%**	**243%**	242%

Key drivers for the 2021 risk charges making up the SCR are set out in section C.

None of the risk modules are using simplified calculations or are using undertaking-specific parameters.

The Minimum Capital Requirement is calculated as the linear MCR, subject to a cap of 45% of the SCR, a floor of 25% of the SCR and an absolute floor of €3.7m. On this basis the MCR is equivalent to the floor of 25% of the SCR. The MCR is expected to remain at 25% of projected SCR over the business planning horizon. There have been no material changes to the calculation methodology for SCR or MCR in the period.

£'000	**Post ringfencing 2021**	**2021**	2020
Absolute floor of MCR (€3.7m)	**3,126**	**3,126**	3,338
Linear MCR	**11,595**	**11,595**	9,778
Floor of MCR (25% of SCR)	**14,445**	**13,443**	12,287
Cap of MCR (45% of SCR)	**26,002**	**24,197**	22,116
MCR	**14,445**	**13,443**	12,287

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

The Company does not use the duration-based equity risk sub-module.

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

This section is not applicable to the Company. The SCR has been calculated using the standard formula specified in the Solvency II legislation.

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

The Company has complied continuously with both the MCR and SCR throughout the reporting period.

E.6 Any other information

There is no other material information to be disclosed.

F. Quantitative Reporting Templates

The following QRTs are required for the SFCR. These templates are included as an Annexure to this report.

QRT Ref	QRT template name
S.02.01	Balance Sheet
S.05.01	Premiums, claims and expenses by line of business
S.05.02	Premiums, claims and expenses by country
S.17.01	Non-life technical provisions
S.19.01	Non-life insurance claims information
S.23.01	Own funds
S.25.01	Solvency Capital Requirement - for undertakings on standard formula
S.28.01	Minimum Capital Requirement - only life or only non-life insurance or reinsurance activity

Directors' Responsibility Statement

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

We are satisfied that:

a) throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations applicable to the Company; and

b) it is reasonable to believe that the Company has continued so to comply subsequently and will continue so to comply in future.

Stephen Worrall
Managing Director
23 March 2022

Anya O'Reilly
Finance Director
23 March 2022

Appendix I – Company Information

Company Number
2396114

Directors
G Barats (Non Executive Director)
J Herdman (Independent Non Executive Chairman)
D Firstenberg (Non Executive Director) – appointed 19 April 2021
S Morris
A O'Reilly
P Richter (Non Executive Director)
C Scarr (Independent Non Executive Director)
S Worrall

Company Secretary
K Close-Smith

Registered Office
New London House
6 London Street
London
EC3R 7LP

Auditor
Ernst & Young LLP
No. 1 Colmore Square
Birmingham
B4 6HQ

UK Supervisory Authorities

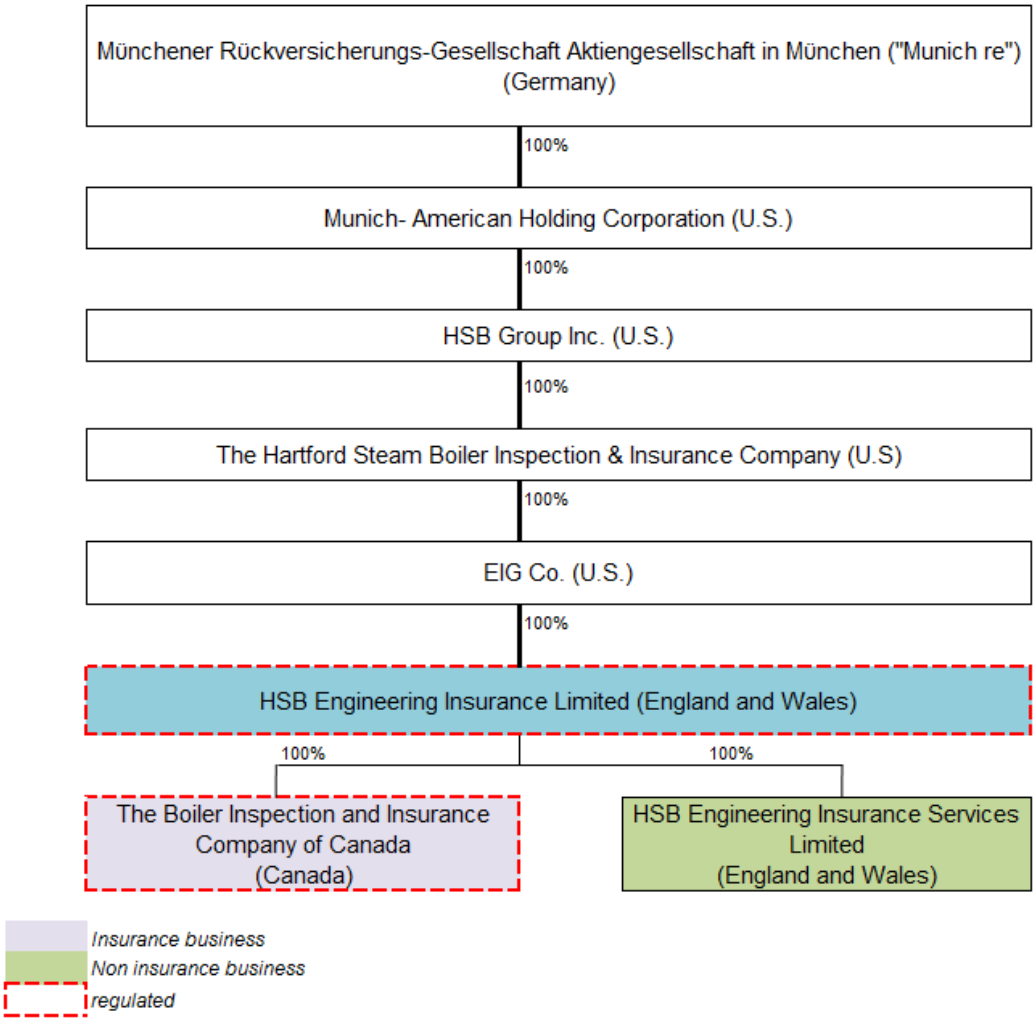
Prudential Regulatory Authority
Bank of England
Threadneedle St.
London
EC2R 8AH

Financial Conduct Authority
20 Endeavour Square
London
E20 1JN

ROI Supervisory Authority
Central Bank of Ireland
New Wapping Street
North Wall Quay
Dublin 1
D01 F7X3

Supervisory Authority of the Munich Re Group
Bundesanstalt für Finanzdienstleistungsaufsicht
Graurheindorfer Str. 108.
53117 Bonn
Postfach 1253

Appendix II – Simplified Group Structure Chart



The simplified legal structure chart above show entities considered to be material related parties. All entities shown are limited companies with the country of incorporation shown in brackets. Percentage ownership is shown in each case.

Annexure – Quantitative Reporting Templates