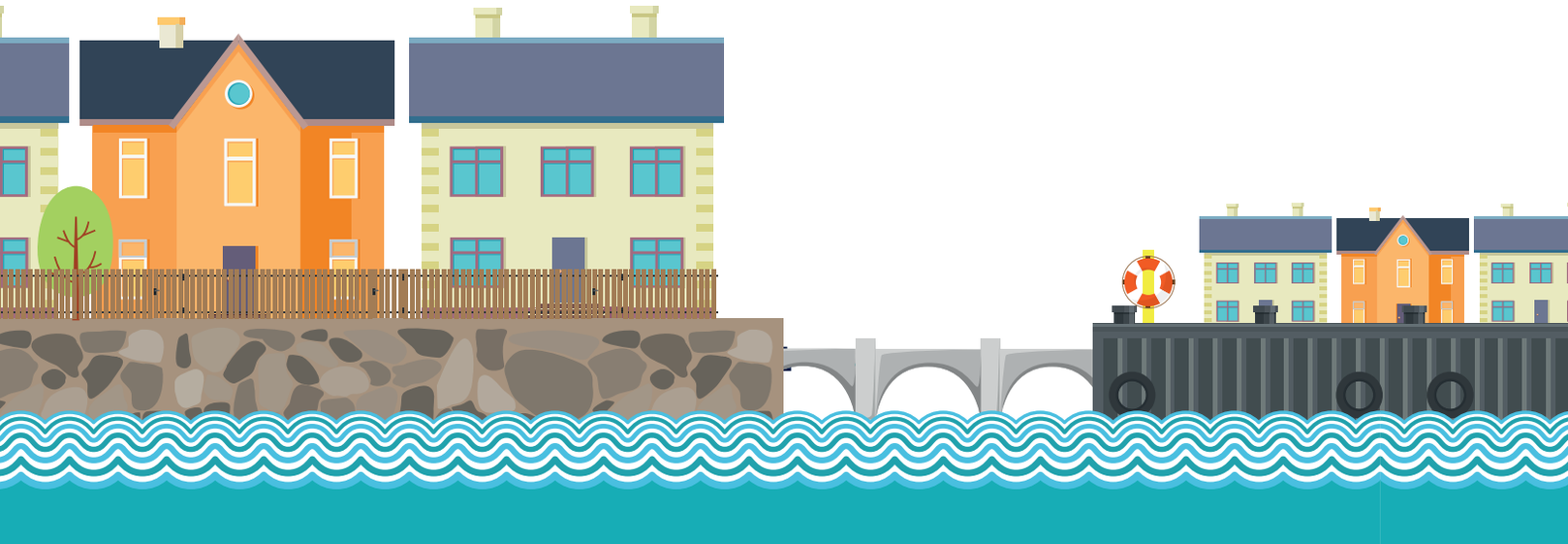
SOLVENCY AND FINANCIAL CONDITION REPORT

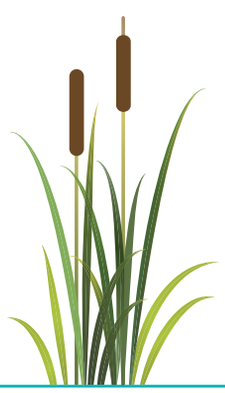
Year ended 31 March 2018

Company No. 08670444

Authorised by the Prudential Regulation Authority and regulated by the Prudential Regulation Authority and the Financial Conduct Authority FRN 706046



CONTENTS



SUMMARY

Flood Re Limited ("Flood Re" or "the Company") is the Scheme Administrator for the Flood Reinsurance Scheme ("Flood Re Scheme") and is principally engaged in the provision of flood peril reinsurance cover within the UK. The Flood Re Scheme is a joint initiative between the UK insurance industry and the UK Government. The Flood Re Scheme was established by the Water Act 2014. Further details of the Scheme can be found on the Company's website at www.floodre.co.uk.

Flood Re's purpose is to promote the availability and affordability of flood insurance for eligible homes, while minimising the costs of doing so, and manage, over its lifetime, the transition to risk reflective pricing for household flood insurance.

In order to do this, Flood Re provides reinsurance cover at a subsidised fixed rate to cedants, resulting in an expected underwriting loss each financial year. The Company finances this through a £180m Levy on UK household insurers. The Levy also finances the purchase of an outwards reinsurance programme to protect the Company up to a £2.133bn (2017: £2.100bn) maximum Liability limit.

Flood Re is a mutual reinsurer and was incorporated in August 2013 as a private UK Company limited by guarantee. Regulations designating the Flood Re Scheme came into force on 11 November 2015, providing Flood Re with the power necessary to fulfil its purpose.

On 1 April 2016, Flood Re was authorised by the Prudential Regulatory Authority ("PRA") and the Financial Conduct Authority ("FCA").

Flood Re launched on 4 April 2016.

Business and performance

The Company reported a profit after tax for the year of £109.7m (2017: £104.1m). Levy Income of £180m (2017: £180m) was offset by an underwriting loss of £29.6m (2017:£34.2m), operating expenses of £16.2m (2017: £15.7m), Investment income of £0.3m (2017: £0.1m) and corporation tax expense of £24.7m (2017: £26.0m).

System of Governance

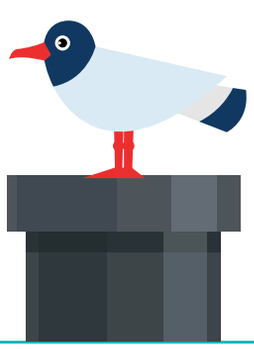
The System of Governance is considered appropriate to the Company given the nature, scale and complexity of the operations.

The governance structure of the Company has operated throughout the year.

The Company ensures that individuals meet the Fit and Proper requirements at all times.

Flood Re uses the UK financial industry standard "three lines of defence" approach to managing risks.

Flood Re's business strategy relies on a number of operational outsourcing arrangements, some of which are regarded as critical and important to the running of the business, as opposed to developing the functionality in-house.



Risk Profile

Flood Re classifies risks into six key areas (Insurance Risk, Credit Risk, Market Risk, Liquidity Risk, Operational Risk and Strategic Risk).

The Company's most significant Insurance Risk exposure is to losses arising from low frequency, high severity flood events. Reinsurance ceded is placed on both a proportional and non-proportional basis and is the Company's primary mechanism for managing and mitigating Insurance Risk up to a £2.133bn (2017: £2.100bn) Liability Limit.

In line with Flood Re's design, the premium the Company charges is not reflective of the underlying risk that is assumed. The Company expects that the assumed premium will not be sufficient to cover the estimated mean cost of claims. This deficiency is met by a Levy raised from all insurers writing home insurance in the UK.

As net premium income during the past 12 months and the forthcoming 12 months is negative, the standard formula results in a zero premium risk charge.

During the year, the Company has experienced relatively benign loss activity. Net reserves remain small in absolute terms so the capital charge for non-life reserve risk is not a material contributor to the overall standard formula SCR.

The Company adheres to the Prudent Person Principle through the application of a conservative Market Risk strategy that prioritises capital preservation over investment return. As at 31 March 2018 the Company had liquid assets of £256.9m (2017: £157.2m) representing 83% (2017: 78%) of the total equity and liabilities and 520% (2017: 371%) of the Solvency Capital Requirements ("SCR").

The Company's maximum exposure to Credit Risk is the gross carrying value of its Levy receivables, reinsurance premium receivables, reinsurance recoveries, trade and other receivables and cash and short-term deposits.

The Company's operating model makes significant use of outsourced service providers to deliver a number of key operational elements. The relationship with, and management of, the outsourced service providers is a key component of the operational risk profile.

The Company has a statutory duty to publish a transition plan, updated on an ongoing basis, that sets out how the market will return to risk-reflective pricing post Flood Re in 2039. The first transition plan was published in February 2016; an update is planned for July 2018.

Valuation for Solvency Purposes

For Solvency II valuation purposes, assets and liabilities are valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

Amounts due but not yet received or paid are included in the SII balance sheet. Amounts not yet due are included in the cashflows used to calculate Technical Provisions.

Solvency II Technical Provisions are calculated applying a probability-weighted average of future cashflows, taking account of the time value of money using the relevant risk-free interest rate and reflect the benefit of the reinsurance programme in place. Exposure relating to legal obligations is included. An explicit risk margin is added to Technical Provisions.

The Solvency II best estimate includes cashflows from expenses incurred servicing existing policies during their lifetime and are allocated between premium and claims provisions.

The Company does not make use of any matching adjustment (Article 77b), volatility adjustment (Article 77d), transitional risk free interest rate term structures (Article 308b) or transitional deductions (Article 308d) referred to in the Solvency II Directive.

Capital Management

The Company is currently working through a partial internal model application process with the PRA. In the interim period, the Company uses the Standard Formula to calculate its SCR. The Company has identified four areas where the standard formula may not be appropriate, given the risk profile of the Company (Premium and Reserve Risk, Catastrophe Risk, Credit Counterparty Risk and Operational Risk). As such, the PRA has set a capital add-on in line with Article 37.1.a.ii of the Solvency II Directive (risk profile deviates significantly from the assumptions underlying the standard formula).

As at 31 March 2018, the Company had available own funds of £214.4m (2017:£100.3m) comprising £185.4m (2017: £75.2m) of basic own funds (tier 1 unrestricted), £4.2m (2017: £3.9m) of deferred tax (tier 3) and £24.7m (2017: £21.2m) of ancillary own funds. The Solvency Capital Ratio as at 31 March 2018 is 425% (2017: 228%).

The PRA has approved Flood Re to use 50% of the SCR, capped at a monetary amount of £75m, as a method by which uncalled Levy II may be recognised as ancillary own-fund items for the period 1 April 2016 to 31 March 2019.

As at 31 March 2018, the Company had an SCR of £49.4m (2017: £42.4m). The largest components of the SCR are Catastrophe Risk £19.5m (2017: £15.2m), Operational risk £6.3m (2017: £4.7m) and a PRA capital add-on of £22.3m (2017: £21.9m).

For the years ending 31 March 2018 and 2017, the Company has complied at all times with the regulatory Minimum Capital Requirements ("MCR") and SCR.

There is no reasonably foreseeable risk of non-compliance with the MCR or SCR and there are no foreseeable dividend distributions.

APPROVAL BY THE BOARD

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

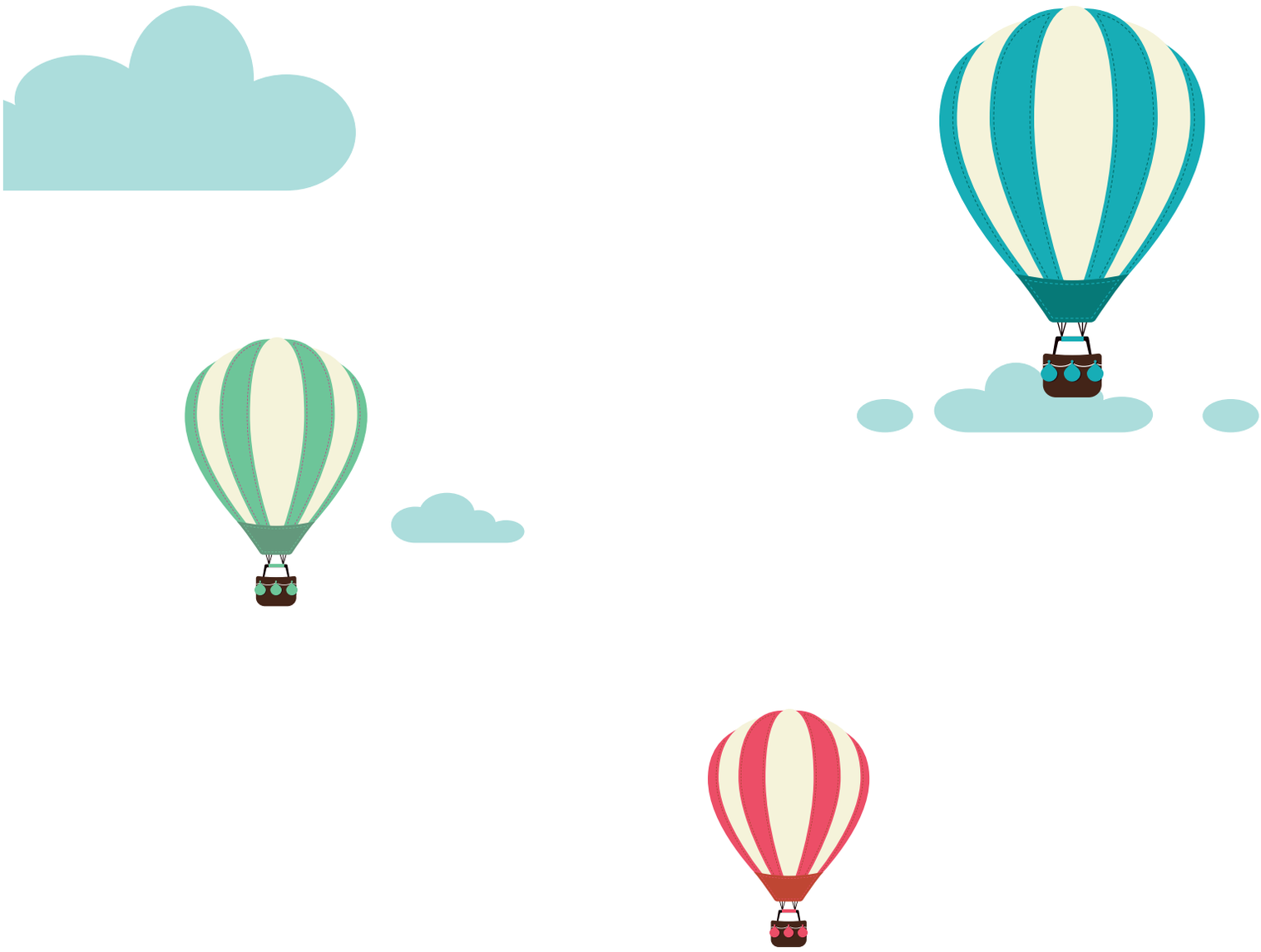
We are satisfied that:

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

b) it is reasonable to believe that Flood Re has continued to comply subsequently and will continue to comply in future.

Andy Bord
Chief Executive Officer

Adam Golding
Chief Financial Officer



AUDIT OPINION

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

Opinion

Except as stated below, we have audited the following documents prepared by the Company as at 31st March 2018:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31st March 2018, ('**the Narrative Disclosures subject to audit**'); and
- Company templates S.02.01.02, S17.01.02, S23.01.01, S25.01.21 and S28.01.01 ('**the Templates subject to audit**').

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**relevant elements of the Solvency and Financial Condition Report**'.

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

- The 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S05.01.02, S05.02.01,S19.01.21;
- the written acknowledgement by management of their responsibilities, including for the preparation of the solvency and financial condition report ('**the Responsibility Statement**').

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

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of Flood Re Limited as at 31st March 2018 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)), including ISA (UK) 800 and ISA (UK) 805. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

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

Emphasis of Matter – Basis of Accounting

We draw attention to the 'Valuation for solvency purposes', 'Capital Management' and other relevant disclosures sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority.

This report is made solely to the Directors of the Company in accordance with Rule 2.1 of External Audit Chapter of the PRA Rulebook for Solvency II firms. Our work has been undertaken so that we might report to the Directors those matters that we have agreed to state to them in this report and for no other purpose.

Our opinion is not modified in respect of these matters.

Other Information

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

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

Responsibilities of Directors for the Solvency and Financial Condition Report

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

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

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

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

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

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the Solvency and Financial Condition Report.

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

Report on Other Legal and Regulatory Requirements.

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

Ernst & Young LLP

.....

Ernst & Young LLP London

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

A. BUSINESS AND PERFORMANCE

A.1 BUSINESS

Name and legal form

Flood Re Limited ("Flood Re" or "the Company") is the Scheme Administrator for the Flood Reinsurance Scheme ("Flood Re Scheme").

The Flood Re Scheme is a joint initiative between the UK Insurance Industry and the UK Government in order to make domestic flood insurance more affordable and available to households in high flood risk areas. The Flood Re Scheme was established by the Water Act 2014 and is expected to be in place for 25 years while the industry transitions to risk-reflective pricing.

Flood Re is a mutual reinsurance company and was incorporated in August 2013 as a private UK Company limited by guarantee.

In accordance with the Government Resources and Accounts Act 2000 (Estimates and Accruals) (Amendment) Order 2015, Flood Re is consolidated into the Department for Environment, Food and Rural Affairs ("DEFRA") annual report and accounts. Flood Re is yet to be classified as a non-departmental public body by the Office for National Statistics.

The registered office is 75 King William Street, London, EC4N 7BE.

Supervisory Authorities

Prudential Regulation Authority, 20 Moorgate, London, EC2R 6DA

Financial Conduct Authority, 25 the North Colonnade, London, E14 5HS

Auditors

Ernst and Young LLP, 25 Churchill Place, Canary Wharf, London, E14 5EY

Qualifying Holdings

For the year ended 31 March 2018, the following four Ordinary Members have qualifying holdings in Flood Re. Individually they account for 10% or more of the voting rights of Ordinary Members.

- UK Insurance Ltd
- Lloyds Bank General Insurance Holdings Limited
- Aviva Insurance Limited
- Royal & Sun Alliance Insurance Plc

All of the above Ordinary Members write UK Household Insurance business and contribute to the Levy I income and gross written premium assumed by Flood Re.

Parent and Group undertakings

None

Material lines of business

Flood Re is engaged in the provision of reinsurance cover for a single risk (property), a single peril (flood), single currency (pounds sterling) within a single territory (United Kingdom).

Under Solvency II, all underwriting transactions are classified and recorded under the Proportional Reinsurance – Fire and other damage to property line of business.

Significant business or events during the period

The results of the Company for the year ended 31 March 2018 show a profit before tax of £134m (2017: £130m) with an income from the Levy of £180m and Gross Written Premium of £32m (2017: £28m). Eligible and available own funds under the Solvency II Directive stand at £214m (2017: £100m). The Flood Re Scheme has paid the costs of all relevant flood claims back to insurers.

At the end of the second year, more than 150,000 policyholders are benefiting from the Flood Re Scheme.

During the year ended 31 March 2018, Flood Re commissioned a report from the University of the West of England exploring the financial viability of Property Flood Resilience ("PFR") measures, including both building resilience into post-flood repair (build back better) and proactive resilience intervention. Flood Re has also collaborated with an independent think tank, The Social Market Foundation ("SMF"), to look at options for incentivising PFR uptake. It concluded that rewarding homeowners' actions will be more effective than penalising a lack of action. In the coming year Flood Re will combine these two strands to understand how to encourage householders to adopt PFR and investigate ways to support practically build back better.

Customers in high flood risk areas should be shopping around to get the best possible flood cover and taking responsibility for protecting their home and community. One powerful way Flood Re raised awareness was by launching a nationwide competition to find the country's Local Flood Heroes. The "Local Heroes" campaign was an important one for Flood Re as it raised awareness of flooding with consumers, policymakers, industry and the media.

Following two years of successful operation Flood Re has progressed from its initial start-up phase to an organisation that is increasingly externally focussed and engaged with our stakeholders.

Andy Bord assumed the role of interim Chief Executive Officer on 11 February 2017. On 13 April 2017, Andy Bord was appointed Chief Executive Officer on a permanent basis.

Michael Bartholomeusz resigned as Chief Risk Officer effective 31 May 2017. Daniel Byrne assumed the role of Chief Risk Officer from 1 June 2017.

The Liability Limit for the year ended 31 March 2018 increased to £2.133bn (2017: £2.100bn) in line with CPI and in accordance with the Regulations.

A.2 UNDERWRITING PERFORMANCE

The following underwriting performance analysis is on an International Financial Reporting Standards ("IFRS") GAAP basis as reported in the Statutory Financial Statements for the years ended 31 March 2018 and 2017.

	2018 £000	2017 £000	Difference £000
Gross written premiums	32,376	27,672	4,704
Gross change in unearned premium provision	(1,321)	(15,385)	14,064
Gross earned premiums	31,055	12,287	18,768
Premium ceded to reinsurers	(74,678)	(75,154)	476
Ceded change in unearned premium provision	660	26,049	(25,389)
Ceded earned premiums	(74,018)	(49,105)	(24,913)
Net earned premium	**(42,963)**	**(36,818)**	**(6,145)**
Fees and commission income	17,683	8,531	9,152
Net Insurance claims	(4,340)	(5,960)	1,620
Underwriting loss	**(29,620)**	**(34,247)**	**4,627**

Flood Re provides reinsurance cover at a subsidised fixed rate to cedants, resulting in an expected underwriting loss each financial year. The Company reported an underwriting loss for the year ended 31 March 2018 of £29.6m (2017: £34.2m). The underwriting loss is in line with expectations and primarily due to:

Negative earned premium of £42.9m (2017: £36.8m)

- During the second full year of underwriting, Flood Re has grown its book of business and assumed 150,051 policies (2017:127,326) resulting in an overall increase in gross earned premium.
- Ceded earned premium has increased by £24.9m to £74.0m (2017: £49.1m). The increase in ceded earned premium is primarily due to the risk attaching earning profile applied to the 50% Quota Share and growth in gross written premium.

The Company pays a market rate when purchasing outwards reinsurance protection compared to the subsidised premium thresholds it applies to assumed business. In addition, the Company is required to purchase reinsurance protection up to the Liability Limit of £2.133bn and the Loss Limit of £100m.

Commission Income of £17.7m (2017: £8.5m)

- The Company receives sliding scale commission income on its outwards reinsurance quota share arrangements. Commission income varies with, and is directly related to, the performance of the underlying inwards reinsurance contracts. During the year, the Company benefitted from benign loss activity. Commission income earns in the same proportion as the ceded premium on the Quota Share.

Net Insurance claims incurred of £4.3m (2017: £6.0m)

- Gross claims incurred reflect relatively benign loss experience in the year with no catastrophic flood loss events.
- The gross loss ratio for the year ended 31 March 2018 was 26% (2017: 92%). Flood Re has experienced £5.6m of favourable prior year loss development, including release of claims margins above best estimate, during the year.
- Net claims incurred reflect the benefit of the outwards reinsurance programme, specifically the 50% Quota Share.
- The Company expects that assumed premium will not be sufficient to cover the estimated mean cost of claims. The gross premium deficiency provision recognises the overall excess of expected claims over unearned premium. During the year, the gross premium deficiency provision has increased to £6.4m (2017: £2.9m).

A.3 INVESTMENT PERFORMANCE

The Company has a conservative market risk strategy that prioritises capital preservation over investment return. The investment mandate agreed between the Company, Government and the Insurance Industry restricts the type, duration and amount of holdings that may be invested in. Flood Re only invests in UK Government backed securities (Gilts, Treasury Notes and UK Government backed liquidity funds). Through its anticipated status as a Public Body, Flood Re has access to the UK Debt Management Office ("DMO") for investment purposes. Short-term deposits with the DMO vary for periods between one day and three months, depending on the immediate cash requirements of the Company.

	2018 £000	2017 £000	Difference £000
Interest income on cash and short-term deposits	291	158	133
Investment management fees	0	0	0
Total investment income	**291**	**158**	**133**

As at 31 March 2018, the Company has £247m (2017: £154m) of short-term deposits invested with the DMO and £9.9m (2017: £3.2m) of cash at bank.

For the year ended 31 March 2018, the Company received interest income on cash and short-term deposits of £0.3m (2017: £0.2m). This represents an annualised investment return on average invested assets of 0.14% (2017: 0.17%).

For the years ended 31 March 2018 and 2017, the Company has not invested in any securitised assets or recognised any realised or unrealised investment gains or losses in equity.

A.4 PERFORMANCE OF OTHER ACTIVITIES

	2018 £000	2017 £000	Difference £000
Levy I Income	180,000	180,000	0
Levy II Income	0	0	0
Total Levy income	**180,000**	**180,000**	**0**

The Flood Reinsurance (Scheme Funding and Administration) Regulations 2015 and The Flood Reinsurance (Scheme and Scheme Administrator Designation) Regulations 2015 (collectively "the Regulations") enable Flood Re, amongst other matters, to raise an annual insurance industry Levy.

The total market Levy of £180m has been set out in the Regulations and is payable in proportion to the relevant insurer's gross written premium compared to the aggregate of all relevant insurers' gross written premium in any one calendar year. The first Levy was recognised on 1 April 2016.

Flood Re also has the ability to issue a compulsory call for additional funding from the industry through a Levy II top up mechanism. Levy II contributions received from the Ordinary Members of Flood Re are recognised in a mutual member account ("MMA") within Equity. Levy II contributions received from non-members are treated as income in accordance with Levy I.

Levy II income for the years ended 31 March 2018 and 2017 was £nil.

	2018 £000	2017 £000	Difference £000
Total operating and administrative expenses	**16,231**	**15,726**	**505**

During the year ended 31 March 2018, the company incurred operating expenses of £16.2m (2017: £15.7m) representing an increase of £0.5m or 3% compared to the prior year.

Operating expenses in the current year include additional costs incurred in relation to strategic initiatives such as the Internal Model Application Process ("IMAP") including model validation.

	2018 £000	2017 £000	Difference £000
Total UK Corporation tax charge (credit)	**24,710**	**26,034**	**(1,324)**

The UK Corporation Tax charge for the year ended 31 March 2018 was £24.7m (2017: £26.0m) calculated at an effective tax rate of 19% (2017: 20%) on the profit before tax of £134.4m (2017: £130m) less £0.8m of adjustments in respect of prior periods relating to research and development tax reliefs available to Flood Re.

A.5 ANY OTHER INFORMATION (cont.)

Not applicable

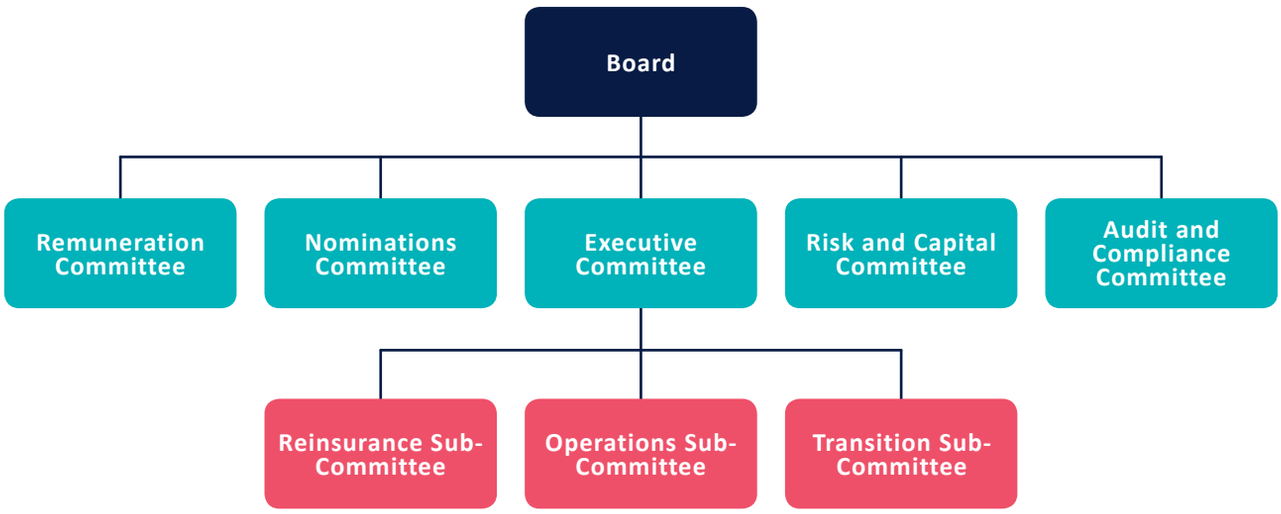
B. SYSTEM OF GOVERNANCE

B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE

The System of Governance comprising the Board and Committee composition and structure, fit and proper requirements, internal control system, risk management framework, key function holders and outsourcing arrangements are considered appropriate to the Company given the nature, scale and complexity of the operations.

B.1.1 General Information on the System of Governance

The Committee structure as at 31 March 2018 is outlined in the diagram below.



The table below shows the composition of the Flood Re Board and Committees (excluding the Executive Committee).

Name	Board	Remuneration Committee	Nomination Committee	Risk and Capital Committee	Audit and Compliance Committee
Mark Hoban	CHAIR	INED	CHAIR	INED	INED
Andy Bord	CEO and ED				
Judith Eden	INED	INED	INED	INED	INED
Huw Evans	SID	CHAIR	INED		
Adam Golding	CFO and ED				
David Hindley	INED	INED	INED	CHAIR	INED
Claire Ighodaro	INED	INED	INED	INED	CHAIR
Paul Leinster	INED	INED	INED	INED	INED

CHAIR = Chairperson of the Board or Committee, SID = Senior Independent Non-Executive Director, INED = Independent Non-Executive Director, CFO = Chief Financial Officer, CEO = Chief Executive Officer, ED = Executive Director

Board

The Flood Re Board maintains overall responsibility for the governance of the Company, setting strategic aims and providing the leadership to put them into effect within the scope of Flood Re's Articles and the powers that the Company has been granted under the Water Act 2014, the Flood Reinsurance (Scheme Funding and Administration) Regulations 2015 and the Flood Reinsurance (Scheme and Scheme Administrator Designation) Regulations 2015 (collectively "the Regulations").

Remuneration Committee

Flood Re's Remuneration Committee is responsible for setting the remuneration of the Executive Directors and Chair and overseeing Flood Re's overall Remuneration Policy. Fees for the Chair and other Independent Non-Executive Directors are determined annually by the Remuneration Committee and approved by the Board.

Nominations Committee

The Nominations Committee reviews the structure, size and composition (including the skills, knowledge, experience and diversity) required of the Board and makes recommendations to the Board with regard to any changes. The Committee continues to actively monitor succession planning for Directors and other Senior Executives across the organisation.

Risk and Capital Committee ("RCC")

The RCC is responsible for the oversight of the risk management framework and capital adequacy; ensuring that all risks to the Company are identified, assessed and monitored in line with the risk appetite and policies. The RCC also provides guidance, review and oversight of risk management and capital assessment. During the year, the RCC has continued to focus in particular on Flood Re's internal model application to the PRA and on enhancing the risk management framework.

Audit and Compliance Committee ("ACC")

The ACC is responsible for acting independently from Flood Re's Executive Team, to ensure that the interests of Members and stakeholders are properly protected in relation to financial reporting and internal control. The ACC has oversight of the internal and external audit arrangements and for managing and monitoring the capital position. The ACC also oversees regulatory and compliance matters, including ensuring that public money is handled and reported in line with Governmental requirements for the prudent stewardship of financial resources. The Audit and Compliance Committee Chair is the whistleblowers' champion for Flood Re. During the year, the Committee has undertaken a number of deep dive reviews into the treatment of Flood Re specific technical accounting issues including International Financial Reporting Standards 9, 15, 16 and 17 alongside establishing the ongoing internal audit programme.

Executive Committee ("ExCo")

The Executive Team is responsible for the day-to-day running of the Company. The Executive Team oversees the running of the Reinsurance Sub-Committee, Internal Model Steering Group, Operations Sub-Committee and Transition Sub-Committee (formed in March 2018).

B.1.2 Changes in the System of Governance

The Company was authorised by the Prudential Regulatory Authority and the Financial Conduct Authority on 1 April 2016 and commenced underwriting from 4 April 2016. With the exception of the Transition Sub-Committee, which was formed in March 2018, the governance structure of the Company has operated throughout the year.

Andy Bord assumed the role of interim Chief Executive Officer on 11 February 2017. On 13 April 2017, Andy Bord was appointed Chief Executive Officer on a permanent basis.

Michael Bartholomeusz resigned as Chief Risk Officer effective 31 May 2017. Daniel Byrne assumed the role of Chief Risk Officer from 1 June 2017.

B.1.3 Remuneration policy

The Remuneration Committee meets twice a year: in November, to set policy decisions and approve the renewal of staff benefits schemes, and May, to accept or amend recommendations for pay and bonuses from the CEO.

Flood Re's Remuneration Policy and practices reflect its objectives of good corporate governance and sustained, long-term value to industry participants and the need to attract and retain talent with suitable experience. The Remuneration Policy and practices also aim to promote robust and effective risk management. Flood Re's Remuneration Policy applies to all employees.

The Remuneration Policy is owned by the Remuneration Committee. It is reviewed by the Remuneration Committee at least annually and sent to the Board for approval. This helps ensure it remains appropriate and relevant. The general principles of the Remuneration Policy are as follows:

- Flood Re provides total remuneration packages delivered through fixed and variable pay components. Fixed remuneration is determined based on the role and position of the individual employee and reflects the need to meet the Threshold conditions set by Regulators and to attract individuals with the requisite experience and expertise to operate in a highly regulated environment. Factors affecting this will include professional experience, responsibility, job complexity, and local market conditions.
- The Performance-based bonuses are in place and are intended to motivate and reward high performers who significantly contribute to the Company's achievements and results, and out-perform according to objectives set for the individual in question and the Company as a whole. The performance-based bonus is in the form of a cash settlement capped at a maximum of 30% of base salary (dependent on the role and seniority of the employee within the organisation). There are no shares or share options included in the performance-based bonus.
- Flood Re offers all employees access to a Defined Contribution Pension Plan.
- The Company aims to provide total remuneration packages that reward superior performance in a way that is consistent with the Company's values and culture.

The Remuneration Committee determines the performance-based remuneration of the Executive Team; along with the performance-based remuneration pool available for allocation, by the CEO, to all other staff.

Fees for the Chair and other Independent Non-Executive Directors are determined annually by the Remuneration Committee and approved by the Board.

The Chair and other Independent Non-Executive Directors are not eligible to participate in annual bonus plans, the employee benefit schemes or the pension scheme. Their pay rates are determined annually by the Remuneration Committee and approved by the Board after taking advice from the CEO. The Remuneration Committee takes into account the time commitment, the responsibilities and complexities of their roles, as well as the rates paid by other comparable organisations within the insurance industry and wider financial services sector.

B.1.4 Directors' Remuneration disclosures

The table below shows the total compensation of Directors and Non-Executive Directors for the years ended 31 March 2018 and 2017.

	2018 £000	2017 £000
Short-term employee benefits	1,113	985
Pension allowance	34	0
Post-employment pension and medical benefits	34	62
Termination benefits	0	0
Total Directors' emoluments	**1,181**	**1,047**

Pension contributions represent 12% of base salary. Executive Directors were eligible to join the pension scheme from 1 January 2016.

The Directors and Officers of the Company have the benefit of insurance which provides suitable cover in respect of legal actions brought against them.

B.1.5 Other related party transactions

Directors and Officers

Andy Bord, Chief Executive Officer of Flood Re, previously held the position of CEO at Capita Insurance Services. Andy Bord held a small number of shares and share options in Capita Plc all of which have been sold or matured during the year ended 31 March 2018. Flood Re has contracted with Capita Plc to provide managing agency outsourcing services. For the year ended 31 March 2018 and 2017, the Company incurred Capita managing agency fees of £6.1m (2017: £6.0m) and as at 31 March 2018 has a receivable due from Capita Plc of £nil (2017: £0.5m).

Department of Environment, Food and Rural Affairs

In accordance with the Government Resources and Accounts Act 2000 (Estimates and Accruals) (Amendment) Order 2015, Flood Re is consolidated into the DEFRA annual report and accounts. Flood Re is yet to be classified as a non-departmental Public Body by the Office for National Statistics.

B.1.6 Ordinary members

Through its normal course of business a number of transactions are by necessity undertaken by Flood Re with its Ordinary Members.

- Levy income: Underwriters of UK household insurance business are required to contribute to the Flood Re annual Levy in proportion to their relevant underwriting profiles;
- Gross written premium and associated claims: if signed up to Flood Re's standard inwards reinsurance treaty, underwriters of UK household insurance business may cede the associated flood peril in relation to their inwards policies to Flood Re;
- Outwards reinsurance ceded premium (and associated technical balances): through a public procurement process subject to the Official Journal of the European Union requirements, Flood Re places its outwards reinsurance programme on the global reinsurance market;
- Commercial insurance: Ordinary Members participate on the commercial insurance coverage purchased by the Company.

All transactions are entered into on arm's length terms and are considered by management to be market sensitive.

For the year ended 31 March 2018 and 2017, the following four Ordinary Members individually account for 10% or more of the voting rights of Ordinary Members.

- Aviva Insurance Limited;
- Lloyds Bank General Insurance Holdings Limited;
- Royal and Sun Alliance Insurance Plc;
- UK Insurance Limited.

The above Ordinary Members write UK household insurance business and contribute to the Levy I income and gross written premium assumed by Flood Re and may also provide commercial insurance services.

B.1.7 Directors and Officers shared with other entities

In the normal course of its operations, the Company has entered into transactions with companies whose Directors and Officers include Directors or Non-Executive Directors of Flood Re. All such transactions entered into were completed on market terms.

David Hindley, an Independent Non-Executive Director is currently a Non-Executive Director with The Channel Managing Agency Limited (where he is Chair of the Audit Committee). Syndicate 2015, managed by The Channel Managing Agency Limited, writes a portfolio of UK business that includes household exposures.

Claire Ighodaro, an Independent Non-Executive Director, is currently a Board member and Audit Committee Chair of XL Catlin Unitary Board. XL Catlin write UK household insurance business in the United Kingdom and provide flood related reinsurance protection.

Until December 2016, Claire Ighodaro was also a Franchise Board member and the Audit Committee Chair of the Society of Lloyd's. Lloyd's syndicates write UK household insurance business in the United Kingdom and provide flood-related reinsurance protection.

Huw Evans, Senior Independent Non-Executive Director and Chair of the Remuneration Committee is currently Director General of the Association of British Insurers (ABI). For the year ended 31 March 2018, the Company incurred £60k (2017: 15k) of ABI Associate membership fees.

Michael Bartholomeusz who resigned as Chief Risk Officer of Flood Re effective 31 May 2017 was also a Director of ORIC International. For the year ended 31 March 2018, the Company incurred £26k (2017: £26k) of ORIC corporate membership fees.

B.2 FIT AND PROPER REQUIREMENTS

The Company ensures that individuals performing a role requiring PRA approval meet the Fit and Proper requirements at all times to ensure that they have the appropriate competence, expertise, and propriety to carry out their roles.

The Company assesses Fit and Proper requirements initially during the recruitment process and subsequently throughout the period of employment. A more granular and role specific analysis is conducted prior to the appointment of an approved person due to the critical nature of the role in terms of the ongoing soundness of the Company and protection of policyholders.

During the recruitment phase the Company will:

- Use specialist and experienced recruitment agencies;
- Assess applicant competence against job descriptions and key functional requirements;
- Involve ExCo members, Directors and Non-Executive Directors in the interview process as appropriate;
- Perform regulatory reference checking covering six years;
- Verify professional and educational qualifications;
- Conduct criminal record checks;
- Complete identity and address verification checks;
- Search FCA/PRA registers;
- Undertake financial sanctions and anti-money laundering checks.

During the period of employment the Company will:

- Complete an induction programme;
- Conduct annual performance appraisals;
- Review job descriptions and delegated authorities;
- Maintain a governance map with clearly defined roles;
- Monitor actual performance against specific targets, objectives and quality outputs;
- Conduct role specific training to ensure technical and non-technical competence;
- Conduct compulsory compliance training for all staff;
- Fully investigate any breaches or incidents;
- Maintain an appropriate Board and Committee structure.

All staff are made aware of and are expected to comply with their specific regulatory obligations. All staff are expected to notify the Company of any change in circumstances impacting on their fitness and propriety.

The Senior Insurance Managers Regimes ("SIMR") came into force on 7 March 2016, replacing the previous Approved Persons Regime. A requirement of the SIMR is for firms to have "governance maps" in place for regulatory inspection. Flood Re has prepared a suite of documents which together present the required "governance map", comprising an organisational chart, a Committee structure (showing membership and terms of reference) and job descriptions for all SIMF, Key Function holders and individuals with Prescribed Responsibilities.

B.3 RISK MANAGEMENT SYSTEM INCLUDING THE OWN RISK AND SOLVENCY ASSESSMENT

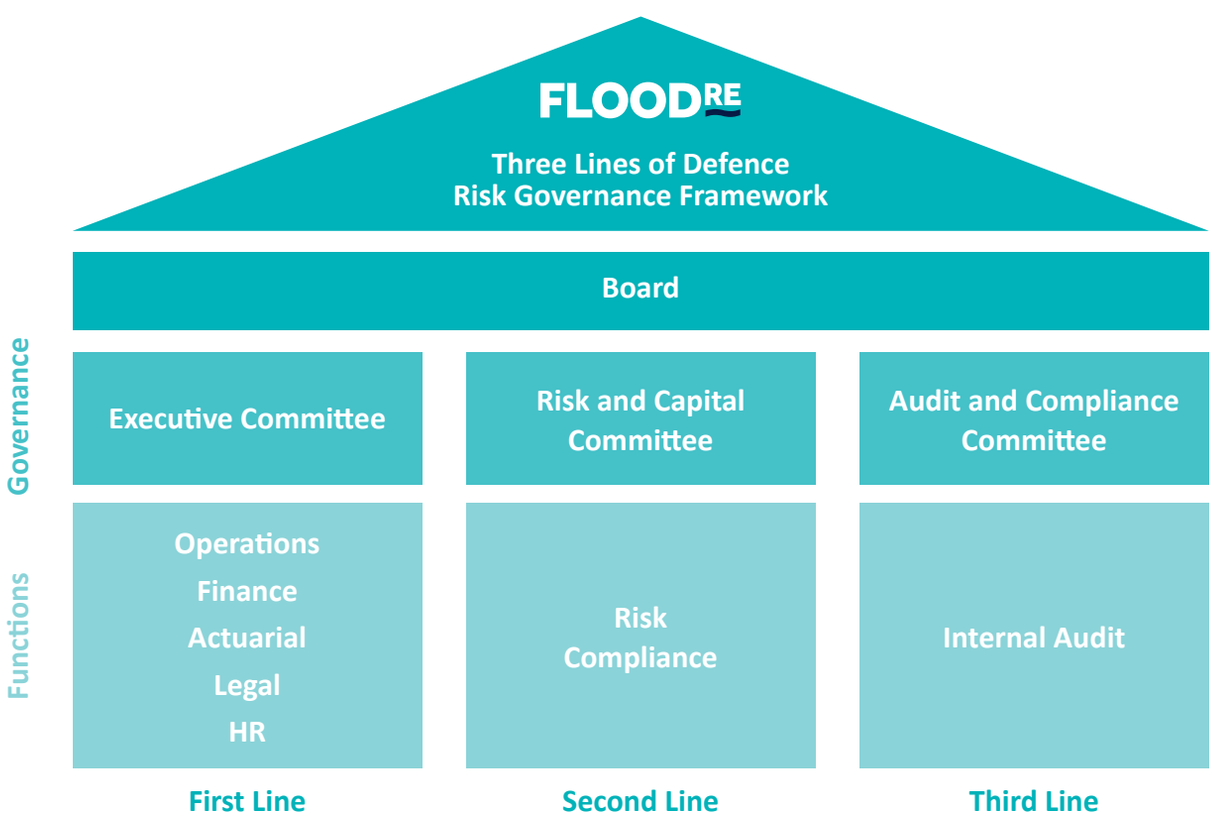
Overview of Risk

Flood Re defines risk as the possibility of incurring misfortune or loss. In principle, a risk is expressed by the combination of the probability (likelihood) of an event and its impact. Uncertainty occurs where it is not possible to assess the probability and/or impact with sufficiently reliable accuracy. Flood Re classifies risks into six key areas (Strategic Risk, Insurance Risk, Credit Risk, Market Risk, Liquidity Risk and Operational Risk).

Risk Governance and Culture

Ultimate responsibility for risk management and control within Flood Re lies with the Board. Critical to this is the tone it sets with respect to Risk Culture. The Board's responsibility for risk management is discharged through Flood Re Committee structure (see section B.1.1 above).

Flood Re uses the UK financial industry standard three lines of defence approach to managing risks:



The first line of defence is undertaken by the Executive Team and staff of Flood Re. Its responsibility is to identify and manage risks (mainly through operating mitigating controls), generate and review risk information, and to take appropriate actions to maintain Flood Re's risk exposure within risk appetite. The first line of defence reports to the Executive Committee and the Risk Function on its management of current and forward-looking risk exposures.

The second line of defence is carried out by the Risk Function, led by the CRO and the Compliance Function led by the General Counsel.

The Risk function is responsible for providing risk advice, facilitating and co-ordinating first line risk activity, monitoring of risks and providing independent commentary, oversight and challenge of the management of risks and Internal Model validation. The Risk Function reports to the RCC.

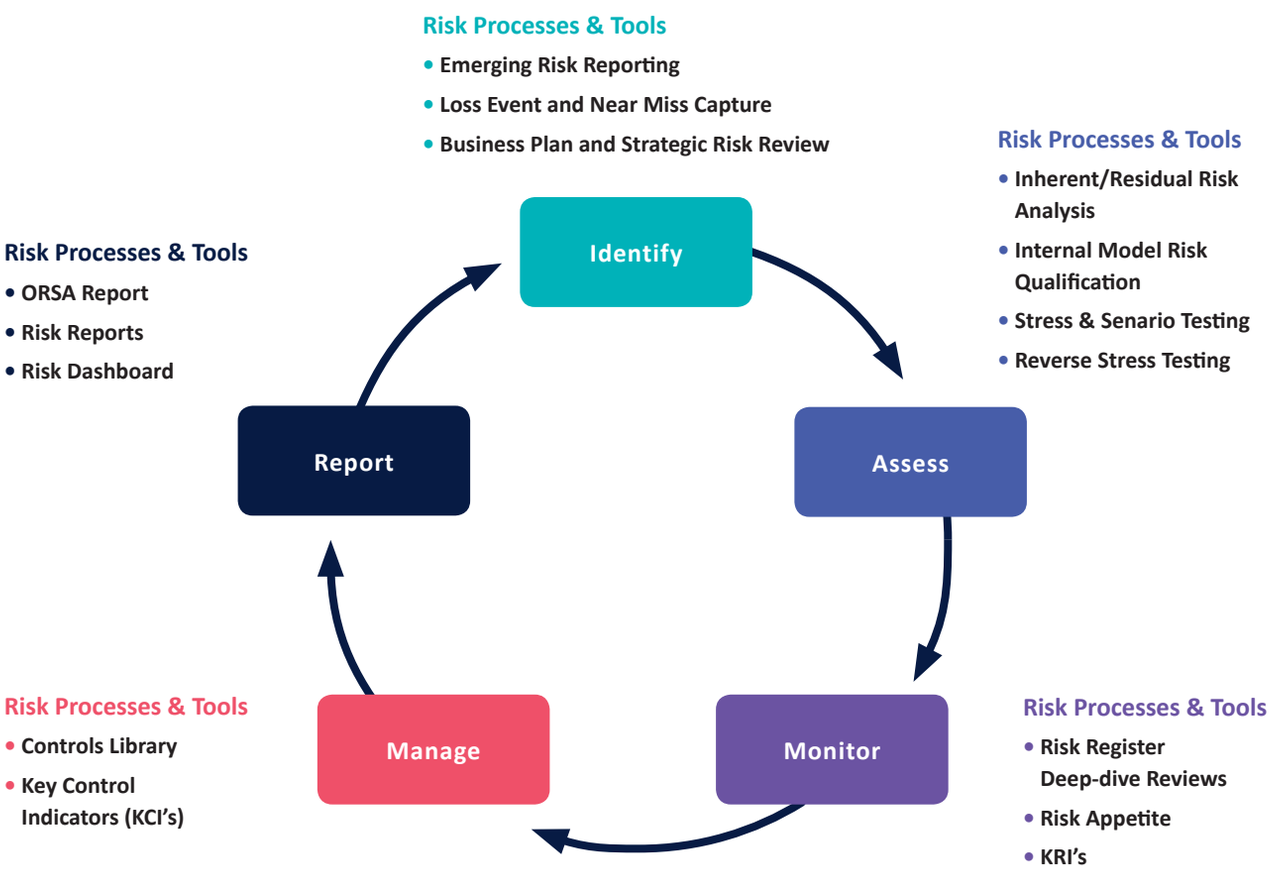
The Compliance Function forms an independent part of the second line of defence and is responsible for implementing a governance framework across the Company, compliance monitoring, regulatory disclosure and monitoring potential compliance risk arising from activities of Flood Re's outsourced service providers. The Compliance Function reports to the ACC.

The third line of defence is performed by the Internal Audit Function which evaluates the effectiveness of the design and operation of Flood Re's control environment and reports to the ACC. Its responsibility is to evaluate whether the controls and risk information are adequate and effective in mitigating risk to the Board -greed risk appetite levels.

It is the responsibility of each of the three lines of defence to ensure the delivery of Flood Re's complete risk management system.

Risk Management System

The following diagram sets out the major risk management tools and procedures that make up Flood Re's risk management system. Each of the processes and tools utilised in the Risk Management System, in particular the internal model, risk appetite framework and stress and scenario testing, feed into Flood Re's wider business strategy and decision-making processes.



Flood Re operates a live risk register containing all identified and emerging risks at a given date. Each risk on the register is subject to an assessment of both its Likelihood (of occurrence) and Impact (given occurrence). Flood Re monitors changes in its risk profile against a set of key risk indicators and Board approved risk appetite metrics on an ongoing basis. Each risk is allocated to a risk owner. Risk owners ensure risks are managed in accordance with the risk management policy and within the risk appetite metrics. The management of each risk is aligned to one or more of the following types of actions: Transfer, Avoid, Reduce or Accept. Key control indicators are used to monitor the effectiveness of risk controls. Regular risk management information (e.g. position versus appetite, KRI's) is reported to each risk owner to ensure that risks are being monitored and a CRO report is delivered to the RCC.

ORSA Policy

The ongoing delivery of the risk cycle, and its associated processes and procedures, ultimately culminates in the completion of the Own Risk and Solvency Assessment (ORSA) Report.

The ORSA Report seeks to draw together Flood Re's risk and capital management processes to facilitate understanding of its current and forward looking risk profile and ultimately inform strategic decision-making. The ORSA report sets out both Flood Re's regulatory capital requirement (SF-SCR) and the entity's internal view of capital (the Partial Internal Model SCR).

The ORSA report is delivered by the risk team with considerable involvement from actuarial, operations and finance. Its ultimate audience is the Board, Executive Committee, Employees and Regulators.

The ORSA report is owned by the CRO. The ORSA report is delivered at least annually, reviewed by the RCC and approved by the Board.

A material change in the risk profile of the Company would trigger an ORSA process outside of the annual cycle.

The ExCo, advised by the CRO, would be required to make a judgement on materiality. Examples of a material change include

- Change in SCR or risk component commensurate with the major model change threshold
- Significant change to the business plan e.g. new perils, change in reinsurance strategy, corporate actions, changes in operating model such as outsourcing arrangements.

B.4.1 Internal control system

Compliance Risk is defined as the risk of legal or regulatory sanctions, material financial loss or reputational loss to Flood Re as a result of not complying with laws, regulations and administrative provisions.

The Board has ultimate responsibility for compliance and ensuring that an appropriate internal control system is in place and operating effectively throughout the organisation. The internal control system of the Company broadly comprises

- An appropriate Board and Committee structure for the size and scale of the Company (see Section B.1 above);
- Enterprise risk management framework (see section B3 above);
- Key function holders including a Compliance function holder responsible for Compliance Risk (see B.4.2 below);
- Committee terms of reference;
- Clearly defined roles and responsibilities for all staff members;
- Ongoing training for all staff;
- Policies and Procedures covering all significant areas of applicable law and regulation;
- Annual Board and Committee Effectiveness Review.

Terms of Reference

The Board approves terms of reference for each Committee and Sub-Committee of the Company, subject to annual review and approval. Terms of reference outline the Committee structure and composition, roles and responsibilities of individuals, monitoring and oversight responsibility of the Committee or Sub-Committee, the overarching operating principles guiding the Committee, the required frequency of meetings, monitoring requirements and governance requirements (e.g. quorums and voting rights).

Roles and responsibilities (See also section B.2 above)

All employees have clearly defined job descriptions and delegated authorities. These are reviewed annually for appropriateness. All staff must adhere to the requirements of the Flood Re Compliance Manual. An annual compliance attestation is required from all staff. Directors and Key Function Holders are responsible for the enforcement of compliance procedures in each of their respective areas of activity.

Training and competence

Flood Re has a formal performance monitoring and assessment framework to ensure that all staff are competent and appropriately supervised. All staff are assessed against Company, department and role specific objectives as part of the annual appraisal process. The appraisal process identifies training and development needs.

Annual regulatory, compliance and anti-financial crime training is provided to all staff on a compulsory basis to ensure that they are aware of their regulatory responsibilities.

Employees attend relevant industry training and undergo continuing professional development, where appropriate, to keep them abreast of industry developments.

Policies and Procedures

The Company maintains policy and procedure documents for all significant areas of legal and regulatory risk and operations. All Level 1 Policy documents are subject to final review and approval by the Board on an annual basis. All activities of the Company are managed in accordance with the documented policies and procedures. Policy documents are available to all staff on an intranet website.

B.4.2 Compliance Function

Flood Re has a Compliance Function headed by the General Counsel who reports directly into the CEO and the ACC. The Compliance Function forms an independent part of the second line of defence (see section B.3). The General Counsel has rights of access to all records, documents and procedures of the Company. All employees must co-operate to the best of their ability with the Compliance Function.

The Compliance Function has responsibility for the following:

- Providing guidance and training on the proper application and interpretation of law, regulatory principles, rules, guidance, internal policies and codes of practice;
- Maintenance of the Compliance Manual issued to all staff including establishing procedures around anti-financial crime, data protection, conflicts of interest, treating customers fairly, whistleblowing and complaints handling;
- Ensuring each business area documents their Policies and Procedures to a common compliant standard with appropriate annual review and approval;
- Conducting risk-based compliance monitoring in accordance with a plan approved by the ACC;
- Monitoring compliance risk arising from activities of outsourced service providers through regular client meetings and reviews of Risk and Compliance processes and manuals at the service provider (see section B.7 below);
- Maintenance of an incident and near miss log;
- Disclosing to the Regulatory Authorities anything relating to the firm which the regulator would reasonably expect notice of (e.g. Breaches, Solvency adequacy);
- Ensuring that Flood Re acts within the Official Journal of the European Union ("OJEU") Procurement Process requirements when awarding all major contracts;
- Overseeing the governance of Board and Committee meetings (minutes, voting rights, attendance records, notice periods, terms of reference etc.).

Responsible Officer

The Company's Responsible Officer has direct accountability to Parliament for the achievement of the policy objectives set out in the Regulations and must pay due regard to the need to act in the public interest. The Chief Executive Officer is the designated Responsible Officer, supported by the Flood Re Board.

B.5 INTERNAL AUDIT FUNCTION

Flood Re has an Internal Audit function headed by a Chief Internal Auditor. In addition to internal resources, the function utilises external service providers for some of the audit work, especially in cases where specialist skills are required.

The Internal Audit function holder has a documented standard procedure that is aligned to the Internal Audit Standards set out by the Chartered Institute of Internal Auditors ("IIA").

The Internal Audit function carries out a risk based annual planning process, which ensures that areas of high risk are given more priority compared to low risk areas. The audit planning is structured to ensure that each area is audited at least once every three years. The appropriateness of the plan is regularly reviewed and where necessary, changes are proposed and presented to the ACC for approval.

All audit actions identified through audits are tracked to ensure appropriate and timely resolution of issues. A quarterly Internal Audit Report is presented to the ACC. This report includes a summary of the results of audits carried out in that quarter, progress in resolving outstanding issues and an overall view on the control environment.

B.5.1 Independence and objectivity

The Flood Re Internal Audit function ensures independence and objectivity in a number of ways:

Reporting Lines: The Chief Internal Auditor reports to the Chair of the ACC to ensure independence. Administratively, the Chief Internal Auditor works with the CEO to ensure that all key areas of the business are given adequate attention.

Responsibility: The Chief Internal Auditor does not have management responsibility over any areas that are subject to internal audits.

Scope of Work: The work of Internal Audit is governed by an Internal Audit Charter which specifies that Internal Audit should have unlimited access to all areas of the business.

Approach: All audits are conducted in line with a standard internal Audit methodology that is aligned to the IIA standards. These standards require Internal Audits to be carried out objectively and where necessary, additional measures to be in place to avoid any conflict of interest.

B.6 ACTUARIAL FUNCTION

The Actuarial Function forms part of Flood's Re System of Governance working alongside the Risk Management Function, the Compliance Function and the Internal Audit Function.

The Actuarial Function delivers consistent and reliable analysis and recommendations for all areas of the business on both a regular and ad-hoc basis. The Actuarial Function is responsible for the following:

- calculating and recommending quarterly IFRS best estimate reserves;
- calculating and recommending quarterly Solvency II Technical Provisions;
- calculation of the Solvency Capital Requirement;
- parameterisation and operating of the capital model;
- flood intelligence and assessment of Levy and inwards tariff appropriateness;
- production of analysis from the capital model that facilitate "model use" as detailed within the Flood Re Model Use Policy, including reinsurance analysis; and
- provision of the Actuarial Function Report including the opinions on the adequacy of the Technical Provisions, underwriting policy and reinsurance arrangements.

The Actuarial Function is led by the Chief Actuary, who is a qualified actuary and holder of the Institute and Faculty of Actuaries Chief Actuary Certificate. The Chief Actuary reports directly to the Chief Executive Officer, the ExCo, RCC and the ACC.

Potential conflicts of interest are mitigated by the following:

- Clear segregation of responsibilities where the Actuarial Function is independent from the Risk Management Function.
- The Chief Actuary reports directly to the CEO which allows key messages of the Actuarial Function to be communicated directly to the Board.
- The review process ensures appropriate checking and peer review are in place, with clear reporting lines within the Actuarial Function.

Actuarial processes are carried out in accordance with regulatory expectations and Technical Actuarial Standards ("TAS"). The TAS standards allow for a proportionate approach when addressing these standards depending on the nature of the work and significance of the areas concerned for the business. "Reserved work" such as recommending reserve levels, assessing capital requirements or establishing frameworks for regular work are carried out under full TAS standards.

B.7 OUTSOURCING

Flood Re's design and business strategy requires a number of operational outsourcing arrangements, some of which are critical or important to the running of the business, as opposed to developing the functionality in-house.

The table below provides an overview of the critical and important outsourcing contracts the Company has entered into.

Contract	Description	Jurisdiction	Responsibility
Capita Plc -Managing agents	General reinsurance management services including underwriting, claims management and IT Infrastructure	UK	Director of Operations
Guy Carpenter	Support in relation to catastrophe modelling, geo-coding and capital modelling.	UK	Chief Actuary

The Outsourcing Policy is owned by the Director of Operations. It is reviewed by the Director of Operations and the Operations Sub-Committee at least annually and sent to the Board for approval. This helps ensure it remains appropriate and relevant. Additional reviews may be performed as required and as detailed in the Documentation Policy.

The key components and principles of the Outsourcing Policy, which forms part of the overall risk management strategy, are as follows:

Risk Appetite

Board approved risk appetite statements define the level of Operational Risk the Company is willing to accept through outsourcing. The risk appetite is used to ensure outsourcing is managed in line with acceptable risk thresholds.

Governance and oversight

Each outsourced activity is assigned to a contract owner who has responsibility for monitoring the day-to-day activities of the outsourced arrangement.

The Director of Operations is primarily accountable for the oversight of the outsource providers and their performance in line with service level agreements and key performance indicators. The General Counsel retains responsibility for all compliance matters in relation to the outsource providers, and works with the Director of Operations to ensure that outsourced service providers comply with Flood Re's policies and procedures.

The Operations Sub-Committee is responsible for overseeing outsourcing performance. This Sub-Committee is chaired by the Director of Operations and reports into the ExCo.

Define business needs and develop outsourcing strategy

Prior to entering into an outsourcing arrangement the contract owner must define the scope of Flood Re's outsourced needs and identify all of the stakeholders within the Company that will need to be engaged through the entire process. A risk and impact assessment on the overall business strategy is completed.

Perform Due Diligence

Due diligence is performed prior to entering into outsourcing arrangements and at regular intervals thereafter (at least every three years). Due diligence includes, but is not limited to, consideration of strategic fit of the service provider with Flood Re, experience and technical expertise, financial strength, business reputation, internal control environment including confidentiality provisions, business continuity, reliance on sub-contractors, ability to provide services over the longer term and degree of insurance coverage.

Procurement

The Company complies with EU public procurement rules. The legal framework for public procurement ensures that contracts are awarded fairly, transparently and without discrimination. The Company is required to advertise the contract at EU level (in the Official Journal of the European Union ("OJEU") and follow specified procedures for selecting candidates and assessing tenders.

Contractual arrangements

All contracts are reviewed by the legal and compliance team prior to being signed to ensure that the minimum required terms and clauses are included. To ensure that all regulatory and legal requirements are met, an outsourcing contract review checklist must be completed prior to binding the Company to any contract.

All contracts are recorded in a Contracts Log, maintained by the General Counsel.

Monitoring and review

The performance of the third party service providers is monitored on an on-going basis through the provision of contractually required management information and regular review meetings by the Operations Sub-Committee and the Executive Committee.

Retained capability

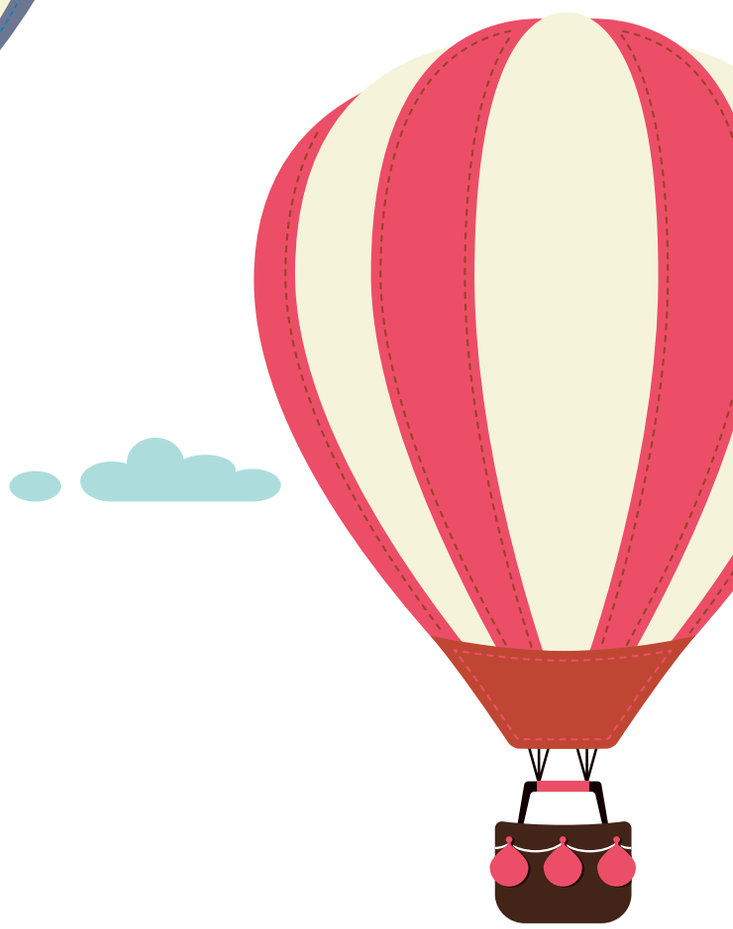
Where a business activity is outsourced, the Company remains responsible for all of its regulatory obligations, as these cannot be contracted out. Flood Re must retain the necessary expertise to supervise the outsourced service effectively and to manage the risks associated with the outsourcing, and must supervise those functions and manage those risks.

Termination

The Company is required to have exit plans in place for all critical outsourced functions. Exit plans form part of the Company's resilience arrangements and must be developed and maintained in consultation with the service provider and reviewed annually.

B.8 ANY OTHER INFORMATION

Not applicable



C. RISK PROFILE

The following section sets out the major elements of the Flood Re Risk Profile, which are managed through the risk cycle and ultimately presented in the ORSA report.

The Company uses the Standard Formula to calculate its SCR. Changes in the risk profile of the Company are monitored on at least a quarterly basis and assessed against the Standard Formula parameters to ensure the continuing appropriateness of the Standard Formula as a means for calculating the regulatory capital requirements.

C.1 UNDERWRITING RISK

Non-Life Premium Risk

As at 31 March 2018, the undiversified non–life Premium Risk capital charge is £nil (2017: £nil).

Premium Risk is defined as the risk of loss or of adverse change in the value of insurance liabilities due to inadequate pricing assumptions.

The premium that Flood Re charges is not reflective of the underlying risk that the Company assumes. Flood Re's principal objective is to enable the continued availability of affordable flood cover for households at risk of flooding and to manage a transition to a market with risk-reflective pricing over a 25-year period. Accordingly, the Company's Premium Risk strategy is to charge insurers a subsidised fixed rate that is set according to the Council Tax Band associated with the insured property.

The premium thresholds have been set at a level that:

- Is below the level that would be charged for properties with the highest risk if prices fully reflected those risks. This provides a subsidy for those properties judged to be at risk and improves affordability; and
- Is still sufficiently high to ensure that insurers only cede those properties at high risk. This ensures that the industry retains a significant portion of household flood risk that can affordably and profitably be covered in the open market.

The Company expects that assumed premium will not be sufficient to cover the estimated mean cost of claims. The cost of the subsidy provided through the premium thresholds is met by a Levy raised from all insurers writing Home Insurance in the UK. The Levy is set at £180m per annum.

The Standard Formula uses net premium income as the volume measure to calculate the Premium Risk capital charge. As net premium income during the past 12 months and the forthcoming 12 months is negative, the Standard Formula results in a zero Premium Risk charge.

Non-Life Reserving Risk

As at 31 March 2018, the undiversified non –life Reserve Risk capital charge is £1.5m (2017: £0.9m).

Reserving Risk is defined as the risk of loss or of adverse change in the value of insurance liabilities due to inadequate reserving assumptions. This is influenced by the frequency of claims, the severity of claims, the timing of actual claims payments and the development of the claims over a period of time.

The volume measure for Reserve Risk is equal to the best estimate of the provisions for claims outstanding after deduction of the amounts recoverable from reinsurance contracts. Flood Re commenced underwriting in April 2016. During the current and prior financial year, the Company has experienced relatively benign loss activity. Net reserves remain small in absolute terms so the capital charge for non-life Reserve Risk is not a material contributor to the overall Standard Formula SCR.

Lapse Risk

As at 31 March 2018, the undiversified non –life Lapse Risk capital charge is £nil (2017: £nil). Lapse Risk is defined as the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level or volatility of the rates of policy lapses, terminations, renewals and surrenders.

The Standard Formula quantifies non-life Lapse Risk in terms of the loss in basic own funds arising from lapse event scenarios. The Company expects that assumed premium will not be sufficient to cover the estimated mean cost of claims (see non-life premium risk above). Policy lapse would be accretive to basic own funds due to the loss making nature of the business written and the subsidised policy premium thresholds.

Catastrophe risk

As at 31 March 2018, the undiversified non –life Catastrophe Risk capital charge is £19.5m (2017: £15.2m).

The Company's most significant Insurance Risk exposure is to losses arising from low frequency, high severity, catastrophe flood events. A catastrophe flood event is defined by the Company as a UK flood that

- impacts more than 250 properties ceded to the Company or
- is expected to have claims costs in excess of £5m.

Catastrophe loss events result in a high level of volatility in the financial results of the Company.

The Catastrophe Risk charge under the Standard Formula comprises several possible catastrophe scenarios, of which the only one relevant to Flood Re is the UK flood scenario. The scenario cost is calculated based on a forecasted policy count and the estimated Total Rebuild Values of Flood Re's anticipated portfolio.

Underwriting Risk mitigation

The Company purchases reinsurance as part of its overall risk mitigation programme. Reinsurance ceded is placed on both a proportional and non-proportional basis and is the Company's primary mechanism for managing and mitigating Insurance Risk.

The Flood Re Scheme Document establishes the requirement for the Company to set an annual aggregate loss amount ("Liability Limit"). The Liability Limit for the year ended 31 March 2018 is £2.133bn (2017: £2.100bn). The amount of the Liability Limit is adjusted annually for the percentage increase or decrease in the Consumer Price Index in the prior calendar year. Subject to these adjustments, the Liability Limit is set for a period of five years. Should claims exceed the Liability Limit, then relevant insurers will continue to be liable to policyholders in accordance with the terms of the insurance policy sold.

Flood Re requires that the outwards reinsurance protections purchased match the full Liability Limit. Furthermore, HM Government requires that Flood Re protect itself from an annual accounting loss above £100m in any one accounting period. To provide for both of these requirements Flood Re has purchased an extensive reinsurance programme.

The reinsurance programme is reviewed and approved by the Board in line with the business strategy and risk appetite. The Company uses both its own and commercially available proprietary risk management software to assess catastrophe exposure.

Monthly aggregate exposure monitoring involving catastrophe analysis by Guy Carpenter and review by the Actuarial Function, combined with quarterly reserve reviews are used to monitor the ongoing appropriateness of the reinsurance programme and the sufficiency of the reserves, premium and Levy income.

C.2 MARKET RISK

Prudent Person Principle

The Company adheres to the Prudent Person Principle through the application of a conservative Market Risk strategy that prioritises capital preservation over investment return. The investment mandate agreed between the Company, Government and the Insurance Industry restricts the type, duration and amount of holdings that may be invested in. Flood Re only invests in UK Government backed securities (gilts, treasury notes and UK Government backed liquidity funds). Through its anticipated status as a Public Body, Flood Re has access to the UK Debt Management Office ("DMO") for investment purposes. Short-term deposits with the DMO vary for periods between one day and three months, depending on the immediate cash requirements of the Company.

Interest rate risk

As at 31 March 2018, the undiversified Interest Rate Risk capital charge is £0.1m (2017: £0.1m).

Interest Rate Risk is the risk that the fair market value or future cash flows of a financial instrument will fluctuate because of changes in interest rates. An increase in interest rates will result in a decrease in the market value of debt securities and vice versa.

Interest Rate Risk measures the potential change in the value of assets and liabilities arising from a shock to the yield curve. The Company has very limited exposure to Interest Rate Risk due to the short-term nature of its assets and liabilities. Invested assets are currently held as cash or as short-term deposits with the DMO, so are considered risk free and not subject to Interest Rate Risk.

The Interest Rate Risk charge arises from the possible change in the value of Technical Provisions in a shock scenario. Given the size of reserves, the overall charge is currently very low.

Market Concentration risk

As at 31 March 2018, the undiversified Market Concentration Risk capital charge is £nil (2017: £nil).

Concentration Risk is the risk of a financial loss arising from a lack of diversification in the investment portfolio or from a large exposure to any single issuer or sector.

The Company has a risk appetite for, and accepts Market Risk concentration arising from, exposure to the UK Government and from exposure to the financial services sector.

As at 31 March 2018, the Company has £247m (2017: £154) of short-term deposits invested with the DMO representing 96% (2017: 98%) of the total invested assets.

Equity Risk, Property Risk, Corporate Credit Spread Risk and Foreign Currency Risk.

As at 31 March 2018, the undiversified risk capital charge is £nil (2017: £nil).

The company does not have any risk appetite or exposure to Equity Risk, Property Risk, Corporate Credit Spread Risk or Foreign Currency Risk. All transactions are settled in pounds sterling.

C.2 MARKET RISK (cont.)

Market Risk mitigation

Flood Re's investment strategy is largely conservative with a focus on preservation of capital. The investment portfolio is managed in accordance with the Board-approved risk appetite statements.

Flood Re's key liabilities derive from short tail, natural flood catastrophe events. It is anticipated that most claims will settle within one year of the date of loss. The Company ensures appropriate consideration of asset and liability duration matching to ensure policyholder protection.

Given the short tail nature of Flood Re's assets and liabilities coupled with the asset and liability matching policy, the mismatch between assets and liabilities cash flows is limited and Interest Rate Risk is of low materiality.

C.3 CREDIT RISK

As at 31 March 2018, the undiversified Credit Counterparty Risk capital charge is £1.7m (2017: £0.6m).

Flood Re defines Counterparty Credit Risk as the risk of not recovering money owed to Flood Re by third parties. At any one point in time, the Company's maximum exposure to Credit Risk is the gross carrying value of its Levy receivables, reinsurance premium receivables, reinsurance recoveries, trade and other receivables and cash and short-term deposits.

Credit Risk mitigation

The Company uses issuer credit ratings provided by external credit rating agencies to monitor the ongoing creditworthiness of its counterparties together with other publicly available data and market information such as Solvency ratios.

Ceded reinsurance arrangements do not relieve the Company from its obligations to policyholders. Reinsurance is only placed with counterparties that have a minimum credit rating of A (S&P equivalent) or provide alternative collateralisation as a Credit Risk mitigant. No single reinsurer can exceed the maximum credit counterparty exposure thresholds established by the Board.

Cedants submit premium bordereaux on a monthly basis and settlement is due 30 days thereafter. Levy income has a statutory basis and is due quarterly. The level of aged debtor balances is monitored on a monthly basis.

C.4 LIQUIDITY RISK

As at 31 March 2018, the Liquidity Risk capital charge is £nil (2017: £nil).

Flood Re defines Liquidity Risk as the risk of not being able to meet current and future financial obligations as and when they fall due, or only being able to do so at excessive cost.

The Company must maintain sufficient liquidity at all times to support it cedants by settling claims in line with terms. The Company generates cash inflows primarily from Levy I, premium and investment income and is exposed to significant cash outflows arising from reinsurance claims costs, reinsurance ceded premiums and operating expenses.

Liquidity Risk mitigation

The Company monitors its liquidity and future cash flow requirements on a regular basis and maintains a high quality, well balanced and liquid investment portfolio. There is uncertainty around the timing and severity of claims costs. The maturity profile of the Company's invested assets is aligned to the short-term nature of the business underwritten whereby insurance contract liabilities are generally incurred and settled within one year. The Company ensures appropriate consideration of asset and liability duration matching to ensure policyholder protection.

In the period ending March 31, 2019, the Company anticipates generating positive cashflows, absent a series of large flood events.

As at 31 March 2018 the Company had liquid assets of £256.9m (2017: £157.2m) representing 83% (2017: 78%) of the equity and liabilities and 520% (2017: 371%) of the SCR. Liquid assets comprise amounts included in the cash and short-term deposits.

The Company expects that assumed premium will not be sufficient to cover the estimated mean cost of claims. A gross premium deficiency provision of £6.4m (2017: £2.9m) has been established to recognise the overall excess of expected claims over unearned premium. As at 31 March 2018, the Expected Profit Included in Future Premium (EPIFP) is £nil (2017: £nil).

C.5 OPERATIONAL RISK

As at 31 March 2018, the Operational Risk capital charge is £6.3m (2017: £4.7m).

Flood Re defines Operational Risk as the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events.

When controls fail to perform, Operational Risks can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. Flood Re manages Operational Risks to minimise financial losses, and risks to its reputation and industry standing.

The Flood Re risk register has identified a number of Operational Risks split into three risk levels. The Operational Risks classified into the top risk category include failure in underwriting, claims and IT processes.

Operational Risk mitigation

The Company's operating model makes significant use of outsourced service providers (see Section B.6) to deliver a number of key operational elements. The relationship with, and management of, the outsourced service providers is a key component of the Operational Risk profile.

The Company's operational policies and procedures set out how various Operational Risks are managed throughout the Company. See section B.4 for a discussion of risk mitigating factors arising from the operation of the Internal Control system.

C.6.1 Strategic Risk

Flood Re defines Strategic Risk as the risk of non-achievement of the Company's strategic objectives due to the failed implementation of a strategic plan, a flawed strategic plan or a lack of appropriate responses to a changed environment.

Risk mitigation

The CEO is responsible for the execution of the overall business strategy. The business strategy and operational plans are reviewed and approved by the Board on an annual basis. Performance against plan is monitored on an ongoing basis. The Board includes Independent Non-Executive Directors with Parliamentary experience and background to engage with political stakeholders. The Company has an extensive ongoing engagement process with the insurance industry and DEFRA.

The Company has a statutory duty to publish a transition plan, updated on a regular basis, that sets out how the market will return to risk-reflective pricing. The first transition plan was published in February 2016, an update will be published in July 2018.

C.6.2 Sensitivity, Stress and scenario testing

Sensitivity, Stress and Scenario Tests are key risk management tools that allow the Company to assess the consequences of future events and determine whether risk-mitigating actions should be taken to manage their associated impacts.

Sensitivity and Stress Tests – Simple shocks focused on changing one key variable or parameter (e.g. expected volumes, loss ratios, investment income, operational expenses) to assess the impact on the Company's financial strength.

Scenario Tests – More complex sequences of shocks that can be based on historic events or created to assess the impacts of potential events that have not yet occurred.

Reverse stress tests – Stress tests that require Flood Re to assess scenarios and circumstances that would render its business model unviable.

It is essential that Flood Re's Board, Committees and management are able to understand the effect of changing market and business conditions on Flood Re's business plan, risk profile, solvency and liquidity. This will ensure they are able to proactively manage risks and the Company's capital position.

Flood Re has broadly split Sensitivity, Stress and Scenario Testing into the following areas and uses:

Model Validation

Sensitivity, Stress and Scenario Testing can provide an alternative (independent) quantitative lens through which to assess specific risks to Flood Re and compare these against equivalent model outputs.

- Flood Re designs and delivers a series of Realistic Disaster Scenarios ("RDS") for flood events based on historic events (e.g. 2007 UK floods) and potential events (e.g. Lloyds flood RDS/Flood Re's own designed scenarios) and compare these to equivalent model output (e.g. 1 in 200 gross flood loss).
- The Company undertakes internal model validation exercises and delivers a suite of Sensitivity and Stress Tests (across each of its risk areas), focused in particular on assessing the most material assumptions and expert judgements within the Internal Model.

Sensitivity, Stress & Scenario Testing of the Business / Strategic Plans

- The assumptions underpinning the business plan and financial forecasts are subject to a range of sensitivity, stress and scenario testing to determine the robustness of the business model and to identify potential management actions following a major event.

Model Calibration

- Flood Re uses a scenario-based approach to model Operational Risk in the Internal Model. Operational Risk workshops assist in the identification of the scenarios and facilitate risk quantification.

Reverse Stress Testing (RST)

- Annual RST exercises seek to identify and assess events and scenarios that could lead to the business model becoming unviable and consider key points of strategic dependencies and consequences of severe reputational damage.

Risks not captured in SCR

- Risks not explicitly captured within the Standard Formula are subject to Stress Tests and documented in the ORSA report e.g. Liquidity Risk strains.

Regulatory Sensitivity, Stress and Scenario Testing

- The Company performs Sensitivity, Stress and Scenario testing in response to annual industry stress testing exercises requested by the UK (PRA) and European (EIOPA) Regulators.

Emerging Risk Sensitivity, Stress and Scenario Testing

- Emerging Risks are subject to Sensitivity, Stress and Scenario Testing on an ad-hoc basis to assess the impact and identify the appropriate management actions to control or mitigate the risks.

C.6.3 Sensitivity, Stress and scenario outcomes

The major items of note from the sensitivity, stress and scenario testing performed during the year ended 31 March 2018 are as follows:

Scenario analysis is helping to inform the strategic decision-making ahead of the quinquennial review in relation to scheme parameterisation. These scenarios also helped refine the Solvency risk appetite statements and Transition planning arrangements.

A series of scenarios were run to consider the future structure, retention and limits of the outwards reinsurance programme. The outputs from this testing will help inform decision making around the re-procurement of the outwards reinsurance programme in 2018.

Adverse Stress and Scenario testing identified that a 1 in 200 year flood loss delivers the largest shock to Flood Re's solvency in the year the stress takes place. The stress delivers a considerable reduction in Tier 1 Own Funds due to claims payments and increased loss reserves. The counterparty default risk increases due to the higher level of reinsurance recoverables.

Sensitivity testing highlighted that the 2018/19 operational business plan was not overly sensitive to changes in operating costs or gross written premium, more sensitive to loss ratio movements and outwards reinsurance costs and most sensitive to changes in Levy 1 income.

C.7 ANY OTHER INFORMATION

See section E.2 for a discussion of the standard formula appropriateness and PRA capital add-on.

D. VALUATION FOR SOLVENCY PURPOSES

The statutory financial statements of Flood Re Limited are prepared in accordance with IFRS. For Solvency II valuation purposes, assets and liabilities are valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction (Article 75 EU DIRECTIVE 2009/138/EC). The table below shows a reconciliation between excess assets and liabilities valued on an IFRS GAAP basis and a Solvency II basis as at 31 March 2018.

Flood Re is engaged in the provision of reinsurance cover for a single risk (property), a single peril (flood), single currency (pounds sterling) within a single territory (United Kingdom).

Under Solvency II, all underwriting transactions are classified and recorded under the Proportional Reinsurance – Fire and other damage to property line of business.

The bases, methods and main assumptions have been in place throughout the years ended 31 March 2018 and 2017.

		IFRS £000	SII £000	Difference £000
Assets				
Deferred tax assets	D.1a	0	4,244	4,244
Cash and short term deposits	D.1b	256,920	256,995	75
Reinsurers' share of unearned premium	D.2a	26,709	0	(26,709)
Reinsurers' share of loss reserves	D.2d	7,852	0	(7,852)
Recoveries due on paid losses	D.1c	367	0	(367)
Claims provision recoverable	D.2d	0	9,325	9,325
Premium provision recoverable	D.2d	0	(8,406)	(8,406)
Insurance and intermediaries receivables	D.1c	5,129	31	(5,098)
Reinsurance receivables	D.1c	11,930	0	(11,930)
Receivables (trade, not insurance)		499	436	(63)
Total Assets		**309,406**	**262,626**	**(46,780)**
Liabilities				
Unearned premium	D.2a	16,706	0	(16,706)
Loss reserves	D.2b	16,108	0	(16,108)
Best estimate claims provision	D.2b	0	10,182	10,182
Best estimate premium provision	D.2b	0	12,858	12,858
Risk margin	D.2c	0	5,829	5,829
Insurance and intermediaries payables	D.3a	195	53	(142)
Reinsurance payables	D.3a	24,612	0	(24,612)
Payables (trade, not insurance)	D.3b	44,009	44,023	14
Total Liabilities		**101,630**	**72,945**	**(28,685)**
Excess assets over liabilities		**207,776**	**189,681**	**(18,095)**
Analysis of movement				
Decrease in other assets	D.1			(13,138)
Increase in net technical provisions	D.2			(29,697)
Decrease in other liabilities	D.3			24,740
Total				**(18,095)**

D.1 ASSETS

The material differences between the bases, methods and main assumptions used to value assets for solvency purposes compared to the IFRS statutory financial statements are outlined below:

a. Deferred tax assets

Deferred tax is provided using the liability method in respect of temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

A net deferred tax asset is recognised as recoverable only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred tax assets are measured at the tax rates that are expected to apply to the year when the asset is realised, based on the rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

The company expects growth in deferred tax assets and forecasted taxable profits over the remaining business planning horizon. Accordingly, the Company has determined the Solvency II deferred tax asset by applying a corporation tax rate of 19% to the Solvency II asset and liability valuation adjustments compared to the IFRS values. Flood Re did not have any unused tax losses as at 31 March 2018 and 2017.

b. Cash and cash equivalents

Cash and short-term deposits comprise cash at banks and on hand and short-term deposits with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

For Solvency II valuation purposes, cash and short-term deposits are valued in conformity with IFRS and are inclusive of accrued interest. As highlighted in the previous section, Flood Re's investment management approach focuses on capital preservation and Liquidity Risk management over investment return, hence the material level of Flood Re's invested assets held in cash and cash equivalents.

c. Insurance and reinsurance receivables

Reinsurance receivables consist primarily of assumed reinsurance premiums due from policyholders and commission income due from reinsurers.

For Solvency II valuation purposes, reinsurance and commission receivables are valued in conformity with IFRS. Amounts due but not yet received are included in the SII balance sheet as receivables. Amounts not yet due are included in the cashflows used to calculate Technical Provisions (see D2).

D.2 TECHNICAL PROVISIONS

The material differences between the bases, methods and main assumptions used to value Technical Provisions for solvency purposes compared to the IFRS statutory financial statements are outlined below. All items are shown net of reinsurance:

	2018 £000	2017 £000
Unearned premium	10,003	10,664
Insurance claims liabilities	(8,256)	(5,415)
IFRS technical provisions	**1,747**	**5,249**
Less: Unearned premium	(10,003)	(10,664)
Less: Reserve margins and premium deficiency	3,984	2,329
Add: Future claims liabilities	(11,524)	(9,373)
Add: Future claims expenses	(1,028)	(3,730)
Reclassify: receivables/payable not yet due	581	(7,143)
Add: Future premium and commission cashflows	(5,940)	(5,714)
Add: Risk margin	(5,829)	(3,765)
Less: Allowance for reinsurer default	(72)	(44)
Discounting	134	84
Total adjustments	**(29,697)**	**(38,020)**
Total SII Technical Provisions	**(27,950)**	**(32,771)**
Best estimate claims provision	(857)	(19,591)
Best estimate premium provision	(21,264)	(9,415)
Risk Margin	(5,829)	(3,765)
Total	**(27,950)**	**(32,771)**

a. Unearned premium

Solvency II dispenses with the concept of unearned premium and instead requires reinsurers to hold reserves based upon best estimate cashflows (premiums, claims and expenses) in respect of the unearned element of all business written or legally obligated to be written at the valuation date.

b. Best estimate provisions

Solvency II Technical Provisions are calculated applying a probability-weighted average of future cashflows, taking account of the time value of money using the relevant risk free interest rate term structure. Exposure relating to legal obligations is included.

IFRS premium deficiency provisions and loss reserve margins are excluded from the best estimate under Solvency II.

The cashflow in respect of the component of the technical provisions related to the earned element is termed "claim provisions" and the unearned element is termed "premium provisions" and includes reinsurance receivable and payable cashflows not yet due (see section D.1 and D.3).

The Solvency II best estimate includes cashflows from expenses incurred servicing existing policies during their lifetime and are allocated between premium and claims provisions.

All future cashflows are discounted using market consistent risk free rates of interest.

Future cashflows are adjusted to allow for expected default, whether from insolvency, dispute or other reason. This requires a consideration of the probability of default and the average loss following default over the whole run-off period. This approach is applied to premium and claims provisions.

c. Risk margin

An explicit risk margin is added to Technical Provisions. The risk margin is based on a market consistent cost of capital approach of transferring the liabilities to a third party. The current cost of capital rate is 6%.

d. Provisions recoverable

Technical Provisions are calculated applying a probability-weighted average of future cash-flows, taking account of the time value of money using the relevant risk free interest rate term structure and based on the reinsurance programme in place.

Cash flows include reinsurance receivables and payables not yet due (see section D.1 and D.3).

Material cashflow assumptions used in the calculation of Technical Provisions

Lines of business

The Company provides reinsurance protection for a single risk (property damage) and a single peril (Flood) within the United Kingdom. All transactions are in Pounds Sterling.

Premiums

Insurance companies select the policies they wish to cede to Flood Re and report these via the submission of a monthly bordereaux. Settlement is due 30 days after submission. Insurance companies have up to 120 days from the inception date of the policy to notify Flood Re.

Claims

Flood Re is only required to pay a claim when the underlying claim has been settled by the direct insurer. Insurance companies submit claims bordereaux on a monthly basis. Flood Re has up to one month to pay a claim from receipt of the claims bordereaux. Claims normally settle within one year from the date of loss, and hence Flood Re's Investment Policy sets out an Asset Liability Management approach which aligns to this Interest Rate Risk profile (short term, low risk investments). The maximum loss payable by Flood Re is limited to the sum insured less a £250 policy deductible, or end consumer policy deductible, if larger. Claims will generally fall in the band of £20,000-£100,000 with relatively few small (less than £1,000) or large (greater than £400,000) losses.

Levy I Income

Levy I Income is payable quarterly in advance commencing on 1 April of each year. The Levy is not considered to be insurance income. However, as the cost of the subsidy provided through the Premium Thresholds is met through the £180m annual market Levy, the outwards reinsurance pricing references the Levy I income for the purposes of calculating an estimated fair risk premium.

Ceded reinsurance

For Excess of Loss contracts, a minimum and deposit premium is payable quarterly in arrears with a final adjustment premium due 120 days after the contract end date.

For Quota Share contracts, Flood Re is required to prepare a bordereaux 60 days after the quarter end with settlement due 30 days thereafter. The Company receives a sliding scale profit commission. Commission income is received via net settlement in the quarterly bordereaux.

Reinsurance recoveries

Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contracts. The Company does not have any reinsurance contracts with or recoveries due from Special Purpose Vehicles.

Changes in assumptions

The above cashflow assumptions have been in place throughout the years ended 31 March 2018 and 2017. They are reviewed on at least a quarterly basis.

Assumptions and uncertainty

The principal assumption underlying the liability estimates is that the Company's future claims development will follow a similar pattern to past claims development experience. This includes assumptions in respect of average claim costs, claim handling costs, claim inflation factors and claim numbers for each accident year. The Company only commenced underwriting in April 2016 and is therefore partly reliant on historical industry claims data rather than the Company's specific claims data.

Qualitative judgements are used to assess the extent to which past trends may not apply in the future. There will be uncertainty around:

- the number of flood affected properties ceded to the Company;
- the portfolio mix of business impacting average premium and average claims cost assumptions;
- split of business by Council Tax band;
- type of policy (covering buildings only, contents only or combined cover);
- variability in the actual claims pay-out patterns;
- delays in notification of claims to the Company;
- assessment of the level of claims costs, including aspects such as additional living expenses;
- recoverability of amounts due under the outwards reinsurance programme.

The Company monitors flood risk exposure on a per risk and on an aggregate sum insured basis and performs exposure modelling on at least a quarterly basis or on the occurrence of an event.

Given the relatively high cost of flood claims compared with the size of typical Household Insurance claims, most flood claims will have been assessed by a loss adjuster before being notified to Flood Re. Furthermore, strict claim review policies to assess new and ongoing claims, regular detailed review of claims handling procedures and frequent investigation of possible fraudulent claims are established to reduce the risk exposure of the Company. The Company enforces a policy of actively managing and promptly pursuing claims, in order to reduce its exposure to unpredictable future developments that can negatively impact the Company.

In setting claims provisions the Company considers the probability and magnitude of future experience being more adverse than assumed and exercises a degree of caution in setting reserves where there is considerable uncertainty. In general, the uncertainty associated with the ultimate claims experience in an accident year is greatest when the accident year is at an early stage of development and the margin necessary to provide the necessary confidence in the provisions adequacy is relatively at its highest. As claims develop, and the ultimate cost of claims becomes more certain, the relative level of margin maintained should decrease. However, due to the uncertainty inherent in the estimation process, the actual overall claim provision may not always be in surplus.

The Company estimates cash flow payment patterns for premium, claims and recoveries based on data gathered from a range of sources (e.g. cedants, reinsurers and the Association of British Insurers).

The pipeline premium assessment will be informed by the latest reforecasted plan. During the start-up phase of Flood Re, a degree of volatility is expected in the pattern of written premium.

Flood Re pays its claims only once the underlying claim has settled and therefore has a longer claims payment pattern compared to cedants. There is uncertainty as to the extent to which cedants might accelerate claim settlements in order to trigger a payment from Flood Re. Payment patterns may vary between attritional and flood event losses and between different flood events.

Management actions

For the purposes of calculating the Solvency II best estimate and risk margin, Flood Re only recognises obligations within the boundary of the assumed or ceded reinsurance contracts.

Flood Re is able to cancel Inwards Reinsurance Treaties with 30 days' notice. Underlying policies that are incepted before the termination date, assumed to be one-month worth of policies, need to be taken into account as obligated contracts at any balance sheet date.

All outwards reinsurance contracts include a clause giving Flood Re the option to either continue or terminate the contract. The Company is required to provide between one to three months advance notice if it wishes to terminate its outwards reinsurance contracts mid-term.

The assumed management action would be to terminate the contracts and invoke the notice period.

A further management action looks to protect the remaining exposure over the run-off period through the purchase of equivalent outwards reinsurance. These revised cash flows are included on an estimated pro rata cost basis.

D.3 OTHER LIABILITIES

The material differences between the bases, methods and main assumptions used to value other liabilities for solvency purposes compared to the IFRS statutory financial statements are outlined below:

a. Insurance and Reinsurance payables

Reinsurance payables consist primarily of claims payable to insurers, premiums payable for ceded reinsurance contracts and deferred commission income.

For Solvency II valuation purposes, claims and premiums payable are valued in conformity with IFRS. Amounts due but not yet paid are included in the Solvency II balance sheet as payables. Amounts not yet payable are included in the cashflows used to calculate technical provisions (see D2).

For Solvency II valuation purposes, deferred commission income is non-admitted. Future commission income cash flows are included in the calculation of the Solvency II Technical Provisions (see D2).

b. Trade and other payables

Trade and other payables consist primarily of Levy I receipts in advance, corporation tax liability, accrued expenses and staff costs.

For Solvency II valuation purposes, Levy I receipts in advance, accrued expenses and staff costs are valued in conformity with IFRS. Current and deferred IFRS tax assets and liabilities are adjusted by applying a corporation tax rate of 19% (2017: 19%) to the SII asset and liability valuation adjustments.

Timing and uncertainty

For Insurance and Reinsurance payables and Levy 1 receipts see section D.2 above. Current income tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted, or substantively enacted, by the reporting date. Current income tax assets and liabilities also include adjustments for tax expected to be payable or recoverable in respect of previous periods.

Contractual commitments and operating leases

	2018 £000	2017 £000
Service contracts	6,363	6,385
Staff contractual commitments	1,799	1,505
Operating lease commitments	854	829
Other financial lease commitments	724	312
Total commitments	**9,740**	**9,031**

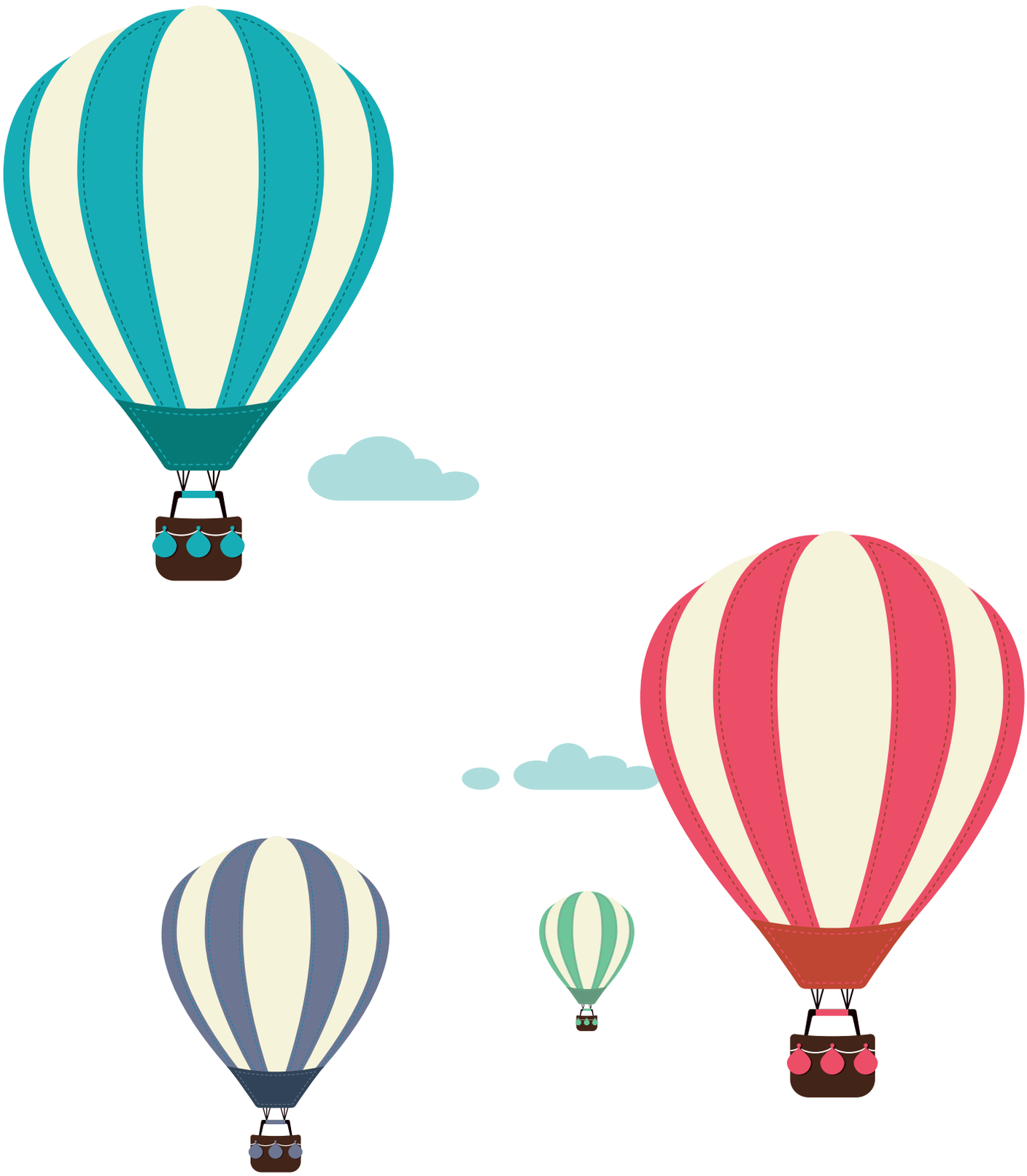
All contractual commitments and operating leases have cancellation clauses of one year or less.

D.4 ALTERNATIVE METHODS FOR VALUATION

Not applicable.

D.5 ANY OTHER INFORMATION

The Company does not make use of any matching adjustment (Article 77b), volatility adjustment (Article 77d), transitional risk free interest rate term structures (Article 308b) or transitional deductions (Article 308d) referred to in the Solvency II Directive.



E. CAPITAL MANAGEMENT

E.1 OWN FUNDS

Capital objectives

The principal objectives of the Flood Re capital management framework are:

- Preservation of capital to ensure the long-term financial stability of the Company;
- Policyholder protection through maintenance of capital margins in excess of regulatory capital requirements; and
- Maintenance of an appropriate Standard and Poor's financial strength credit rating of at least A-.

Sources of capital

Flood Re is a Company limited by guarantee and has no issued share capital. For the purpose of the Company's capital management, capital includes

- Retained profits (Tier I basic own funds);
- Mutual members accounts (Tier 1 restricted basic own funds);
- Uncalled Levy II income (Tier 2 ancillary own funds); and
- Deferred tax assets (Tier 3 basic own funds)

Flood Re charges cedants subsidised fixed-rate premiums. To meet the costs of this subsidy, Levy I income of £180 million per annum is raised from all insurers writing Home Insurance in the United Kingdom. The Levy has a statutory basis and provides the Company with a guaranteed income stream. This income stream allows the Company to protect its capital base by purchasing reinsurance protection and to build up a surplus of funds during low loss occurrence years so that it can withstand large catastrophic loss events.

Capital Modelling

The Company models its economic capital requirements over a five-year business-planning horizon utilising risk and economic capital modelling software. The economic capital model informs decision making around the optimisation of the reinsurance strategy, premium threshold levels, Levy I income, regulatory capital requirements, the Levy II mechanism, risk appetite statements and financial business planning.

Capital management balances the need to build up adequate reserves, largely through the annual Levy process, against the overall cost to the industry of funding the Scheme.

Flood Re's objective is to enable the continued availability of affordable flood cover for households at risk of flooding and manage a transition to a market with risk-reflective pricing over a 25-year period. The Company published its first transition plan in February 2016; and an update will be published in July 2018.

Uncalled Levy II income - Ancillary own funds

Flood Re has the ability to issue a compulsory call for additional funding from the industry through a Levy II top up mechanism.

- Levy II contributions received from the Ordinary Members of Flood Re are recognised in a mutual member account ("MMA") within equity.
- Levy II contributions received from non-members are treated as income in accordance with Levy I.

Both methods result in an increase in Tier 1 basic own funds.

Ordinary Members of Flood Re are potentially eligible for their Levy II contributions to be returned, subject to Board and Prudential Regulatory Authority approval.

The PRA has approved Flood Re to use up to 50% of the SCR, capped at a monetary amount of £75m, as a method by which uncalled Levy II may be recognised as ancillary own-fund items for the period 1 April 2016 to 31 March 2019. The minimum frequency of recalculation of the amount of ancillary own funds item using this method is every three months.

Capital Adequacy

The table below shows the Company's available capital for the year ending 31 March 2018 and 2017.

The Company has complied at all times with the regulatory Minimum Capital Requirements and the Solvency Capital equirements.

Solvency Capital Ratios		2018 £000	2017 £000	Difference £000
Basic Own Funds (Tier 1 Unrestricted)	A	185,438	75,215	110,223
Deferred tax assets (Tier 3)		4,244	3,881	363
Total basic own funds		**189,682**	**79,096**	**110,586**
Ancillary own funds (Tier 2) – 50% of SCR	B	24,713	21,185	3,528
Available own funds	C	**214,395**	**100,281**	**114,114**
Eligible own funds	A+C	**210,151**	**96,400**	**113,751**
Solvency Capital Requirement (SCR)	E	49,427	42,370	6,224
Minimum Capital Requirement (MCR)	F	12,357	10,592	1,557
Ratio of available own funds to meet the SCR	C/E	434%	237%	204%
Ratio of eligible own funds to meet the SCR	(A+B)/E	425%	228%	204%
Ratio of eligible own funds to meet the MCR	A/F	1501%	710%	816%

Reconciliation of equity to available own funds		2018 £000	2017 £000
Total equity on an IFRS basis		**207,776**	**98,046**
Adjustment in respect of:			
Decrease in valuation of assets	D.1	(13,138)	(8,719)
Increase in valuation of technical provisions	D.2	(29,697)	(38,020)
Decrease in the valuation of other liabilities	D.3	24,741	27,789
Basic Own Funds		**189,682**	**79,096**

Reconciliation reserve		2018 £000	2017 £000
Basic Own Funds - Excess of assets over liabilities		**189,682**	**79,096**
Foreseeable dividends		-	-
Other basic own fund items		-	-
Deferred tax assets		(4,244)	(3,881)
Reconciliation reserve (Tier 1 Unrestricted)		**185,438**	**75,215**

The increase in available own funds is due to:

- Basic own funds: an after tax profit for the year ended 31 March 2018 of £109.7m (2017: £104.1m). See section "A.2 Underwriting performance", "A.3 Investment performance" and "A.4 Performance of other activities" for a discussion of the items contributing to the increase in retained earnings.
- Ancillary own funds: Calculated as 50% of the SCR, capped at a monetary amount of £75m.
- Deferred tax assets: The Solvency II deferred tax asset is calculated by applying the corporation tax rate to the valuation differences between Solvency II and IFRS. See section D for a discussion of the material differences between shareholders equity on an IFRS basis and Excess of assets over liabilities on a Solvency II basis.

Tier 1 own funds only consist of the reconciliation reserve (see section A.2 – A.4 for the potential volatility of the reconciliation reserve).

As at 31 March 2018 and 2017, there are no restrictions impacting on the availability and transferability of own funds and no items have been deducted from own funds.

No basic own fund items are subject to transitional arrangements.

See section D for a discussion of the material differences between shareholders equity on an IFRS basis and Excess of assets over liabilities on a Solvency II basis.

Eligibility and limits applicable to own funds

The Company must ensure that it has enough capital of sufficient quality to meet the SCR and MCR eligibility requirements.

The Company must be able to meet at least 50% of its SCR with tier 1 own funds, of which only 20% can be restricted. A maximum of 15% of the SCR may be met by Tier 3 Capital. A maximum of 50% of the SCR may be met by Tier 2 and Tier 3 capital.

The Company's Minimum Capital Requirements must be met with a minimum of:

- 80% of basic Tier 1 own funds
- 20% of basic Tier 2 own funds

Ancillary Own Funds are not eligible to meet the MCR.

As at 31 March 2018 and 2017, 100% of the SCR and MCR requirements are met with unrestricted Tier 1 own funds.

Dividend distributions

There is no requirement for the Company to redistribute, to its Ordinary Members, the accumulated surplus held in the MMA. The Company may repay mutual members balances that relate to previous Levy II calls from the industry provided that

- The accumulated surplus capital is in excess of the SCR requirements
- A period of five years has elapsed since the original Levy II call was made; and
- The PRA approves the distribution to Ordinary Members.

The Company has not received any Levy II contributions during the years ended 31 March 2018 and 2017. The accumulated mutual members account as at 31 March 2018 is £nil (2017: £nil) and there are no foreseeable dividend distributions.

E.2 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENTS

The table below shows the Solvency Capital Requirements by Standard Formula risk module as at 31 March 2018 and 2017.

SCR - Standard formula	2018 £000	2017 £000	Difference £000
Non-life underwriting risk	19,916	15,389	4,527
Market interest rate risk	150	90	60
Credit Counterparty default risk	1,716	647	1,069
Diversification	(915)	(380)	(535)
Basic Solvency Capital Requirement ("BSCR")	**20,867**	**15,746**	**5,121**
Operational Risk	6,260	4,724	1,536
SCR excluding capital add-on	**27,127**	**20,470**	**6,657**
Capital add-ons already set	22,300	21,900	400
Solvency capital requirement	**49,427**	**42,370**	**7,057**

The Company does not use any undertaking specific parameters or simplified calculations when calculating its Solvency Capital Requirements using the Standard Formula.

As at 31 March 2018, the SCR is subject to supervisory assessment by the PRA.

Movements in the SCR

The increase in the Catastrophe Risk capital charge is primarily due to the scenario cost which is calculated based on a forecasted policy count and the estimated Total Rebuild Values of Flood Re's anticipated portfolio.

The increase in Credit Counterparty Risk capital charge is due to changes in the gross carrying value of Levy receivables, reinsurance premium receivables, reinsurance recoveries, trade and other receivables and cash and short-term deposits. In particular, Flood Re Cash balances of £9.9m as at 31 March 2018 have increased from £3.2m as at 31 March 2017.

The increase in the Operational Risk capital charge corresponds to an increase in the BSCR. Flood Re's Operational Risk capital charge under the standard formula is calculated as 30% of the BSCR.

Capital add-on

The Company currently uses the Standard Formula to calculate its regulatory Solvency Capital Requirements.

The Standard Formula is a regulatory prescribed solvency calculation that has been set to reflect an average European insurance or reinsurance undertaking. Given Flood Re's unique structure, the Standard Formula does not fully capture the Company's risk profile. As a result, two actions have been taken:

- The Company has developed a Partial Internal Model ("PIM") which more appropriately captures its risk profile. In order to utilise the PIM to calculate the SCR, it must first be approved by the PRA through an internal model approval process. The Company is currently working through this process with the PRA.
- In the interim period, the PRA has set a capital add-on in line with Article 37.1.a.ii of the Solvency II Directive (risk profile deviates significantly from the assumptions underlying the standard formula). As at 31 March 2018, the SCR of £49.4m (2017: £42.4m) includes a capital add-on of £22.3m (2017: £21.9m).

The capital add-on and its application to Flood Re is subject to an annual review with the PRA until the Company has developed an approved PIM. The Company has identified four areas where the Standard Formula may not be appropriate, given the risk profile of the Company.

Non-life Premium and Catastrophe Risk

The probability of a financial loss is lower than suggested by the Standard Formula due to the Levy income the Company receives.

The Company expects properties at highest risk of flooding to be included in its book of business and has a higher UK catastrophe Flood Risk exposure than the average European insurer writing a diversified portfolio.

The Standard Formula catastrophe risk module does not adequately assess the prospective benefit from the non-proportional reinsurance protection the Company has purchased as the risk scenarios are not severe enough to reach the Flood Re retentions.

Reserve Risk

Under normal conditions, Reserve Risk should be relatively small compared to Premium and Catastrophe Risk given the:

- Short-tail nature of flood claims.
- Reinsurance limiting the potential deterioration of reserves.
- The subsequent small size of the Technical Provisions.

However, under stressed conditions (where claims arising from large flood events are being settled) it is highly sensitive to where the claim amounts lie relative to the retention on the reinsurance. For loss amounts under the reinsurance retention, there will be Settlement Risk but for loss amounts in excess of the reinsurance retention, the net Reserve Risk will be zero. As such, the relationship between reserves and their potential volatility is not appropriately reflected in the flat factor used by the Standard Formula.

E.2 SOLVENCY CAPITAL REQUIREMENT AND MINIMUM CAPITAL REQUIREMENTS (cont.)

Counterparty Credit Risk

The Standard Formula does not adequately assess the credit risk associated with the prospective benefit from non-proportional risk mitigation.

Operational Risk

The Standard Formula uses premium and technical provision volume measures to calculate the Operational Risk charge. This is deemed inappropriate to Flood Re due to the start-up nature of the business and also due to the high dependency on outsourced service providers.

Minimum Capital Requirement

The table below shows the calculation of the Minimum Capital Requirement as at 31 March 2018 and 2017.

Minimum Capital Requirement calculation	2018 £000	2017 £000	Difference £000
Linear SCR	2,079	2,727	(648)
MCR Cap (45% of the SCR)	22,242	19,067	3,175
MCR Floor (25% of the SCR)	12,357	10,593	1,764
Combined MCR	12,357	10,593	1,764
Absolute floor of the MCR	3,163	3,242	(79)
Minimum Capital Requirement	**12,357**	**10,593**	**1,764**

The linear SCR is calculated by applying an EIOPA prescribed line fo business loading of 9.4% to the net of reinsurance best estimate and Technical Provision value of £22.1m (2017: £29.0m).

The Combined MCR is the minimum of the MCR Cap compared to the maximum of the Linear SCR and the MCR Floor.

The absolute floor is €3.6m converted at a closing rate of €0.88/£1 (2017: €0.90/£1).

Analysis of changes in the Solvency Capital Requirement and Minimum Capital Requirement

The Company commenced underwriting in April 2016. For a discussion and analysis of the Solvency Capital Requirement by risk module and sub-module in the first year of operation, see sectionm C - Risk Profile.

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 in the calculation of its regulatory Solvency Capital Requirements.

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

The Company uses the Standard Formula to calculate its Solvency Capital Requirement.

As at 31 March 2018, the Company had not applied to the PRA for permission to use an internal model or partial internal model.

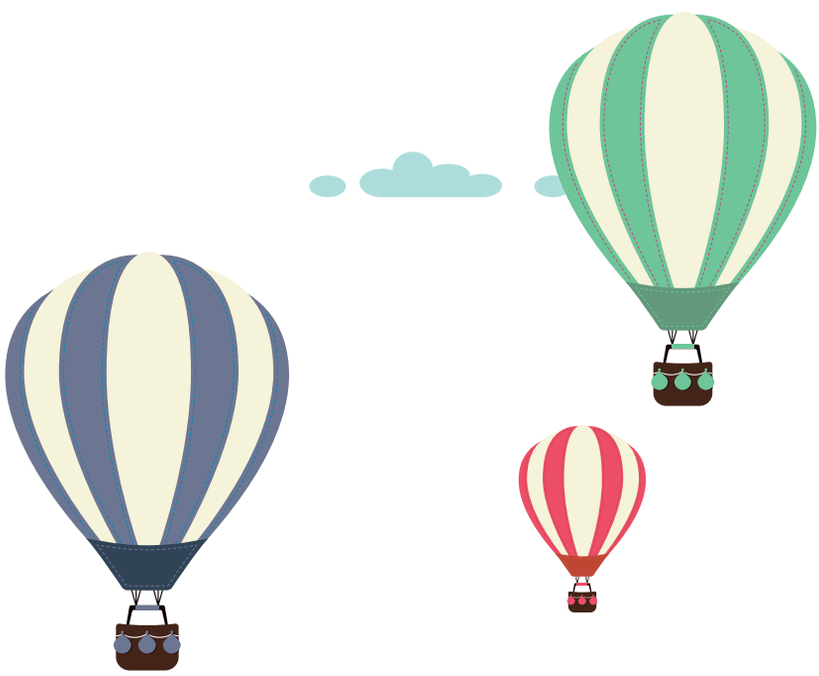
E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement

For the years ending 31 March 2018 and 2017, the Company has complied at all times with the regulatory Minimum Capital Requirement and Solvency Capital Requirement.

There is no reasonably foreseeable risk of non-compliance with the Minimum Capital Requirement or Solvency Capital Requirement.

E.6 Any other information

Not applicable



F. APPENDICES – PUBLIC QRTS

FLOOD RE