BRITISH GAS INSURANCE LIMITED

SOLVENCY & FINANCIAL CONDITION REPORT

AS AT 31ST DECEMBER 2016

CONTENTS

I. INTRODUCTION

Purpose

Insurers are required annually to prepare and publicly disclose a Solvency and Financial Condition Report (“SFCR”) and Quantitative Reporting Templates (“QRT”) under Solvency II regulations that came into effect from 1st January 2016. Article 51 of the Delegated Act requires the following information to be included:

- Description of the company’s business and performance
- Systems of governance and their adequacy given the firm’s risk profile
- Risk profile by category of risk
- Balance sheet, noting any differences between statutory and regulatory asset and liability valuations
- Capital management including a comparison of own funds with minimum capital requirement (“MCR”) & solvency capital requirement (“SCR”)

Overview

British Gas Insurance Limited (“BGIL”) is a private company limited by shares and is a wholly owned subsidiary of GB Gas Holdings Limited (“GBGH”) forming part of the Centrica group. It is authorised and regulated by the Prudential Regulation Authority (“PRA”) and regulated by the Financial Conduct Authority (“FCA”).

BGIL underwrites general insurance business within the assistance class of business, principally the breakdown of boiler, central heating systems, home electrics, plumbing & drains and kitchen appliances. The company’s products are relatively low risk, short tail insurance policies with intermediation, claims fulfilment and claims handling activities provided by a Centrica group subsidiary, British Gas Services Limited (“BGSL”).

The product range was materially unchanged in 2016 and profits were broadly consistent with the previous year.

In December 2015 the company received approval from the PRA to operate a partial internal model (“PIM”) with insurance risk capital requirements being assessed by an internal model for the purposes of capital determination with the remaining risk types assessed by standard formula and capital add-ons.

Own funds at 31st December 2016 were £190m representing a capital surplus of £116m over the SCR of £74m, representing a solvency ratio of 257%.

II. BUSINESS AND PERFORMANCE

A. BUSINESS

Company Details

The company is incorporated as British Gas Insurance Limited (registration number 06608316) and is a wholly owned subsidiary of GB Gas Holdings Limited forming part of the Centrica Group.

Registered office:

Millstream

Maidenhead Road

Windsor

Berkshire

SL4 5GD

BGIL is the only insurance subsidiary of GBGH and its' position within the group structure is illustrated below. BGSL is the company's sole insurance intermediary and provider of claims fulfilment and handling services and is also shown below. Note there are other companies in the group structure but only BGIL and its intermediary BGSL are shown here below their parent companies.

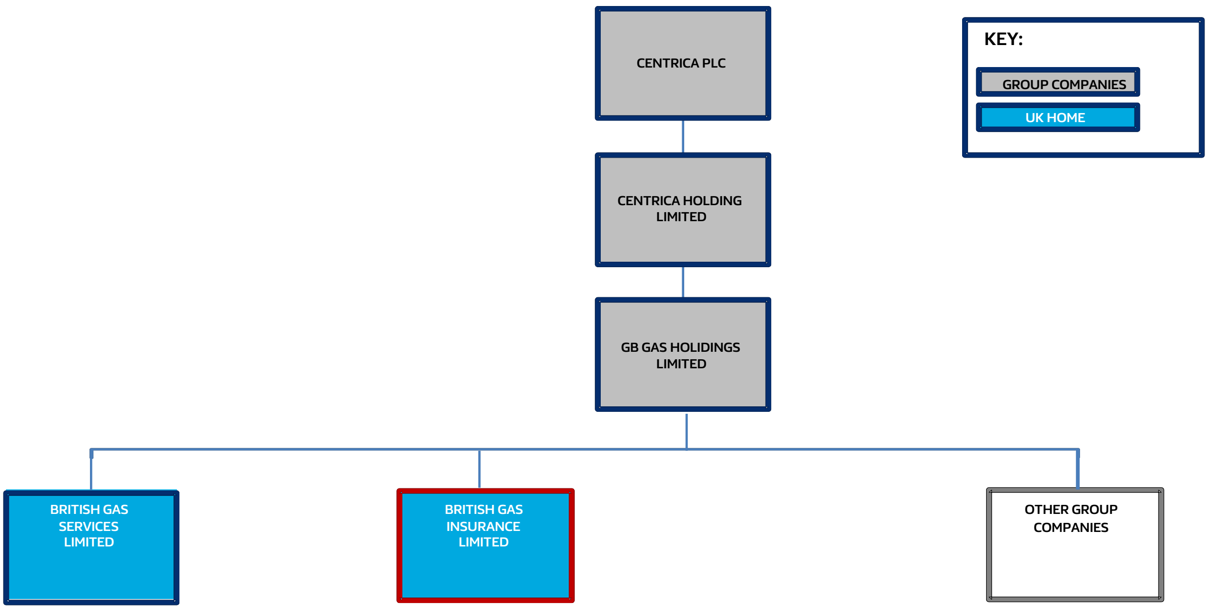


Figure 1: Legal Entity Structure (Centrica plc ultimately owns 100% of BGIL's share capital)

Regulatory Supervision

BGIL's prudential regulator is the PRA. It's supervisor is Shaheena Baig, Supervisor - Non Life & International Composites, Prudential Regulation Authority, Bank of England, 20 Moorgate, London EC2R 6DA.

BGIL's FCA supervisory team is led by Nicola Jarman, Senior Associate, Retail General Insurance, Supervision Division.

External Audit & Assurance

BGIL's 2016 accounts and regulatory returns were audited by PricewaterhouseCoopers LLP, 7 More London Riverside, London SE1 2RT.[1]

Lines and Regions of Business

BGIL underwrites risks in the assistance class of business only.

The company underwrites general insurance risks in the UK covering the breakdown of domestic boilers and central heating systems, plumbing and drains and electrical and gas appliances.

The company had customers of over 3.1m as at December 2016, generating in excess of £1 billion in Gross Written Premium.

Customer Numbers ('000s)	December 2015	December 2016
All in assistance class	3,252	3,172

Table 1: British Gas Insurance Limited Customer Numbers in '000s 2015 vs. 2016

B. UNDERWRITING PERFORMANCE

BGIL reports its financial results on a UK GAAP basis.

A combined operating ratio ("COR") of 92% was achieved in 2016, consistent with recent years and within its risk appetite range of 90% to 95%. Each of its principal lines of business, central heating, home electrical, kitchen appliance and plumbing and drains, was profitable.

Customer numbers decreased slightly over the year. Revenue remained in excess of £1 billion. Claims fulfilment, comprising breakdown repairs and annual service visits, fell slightly over the period whilst commission payable increased slightly. BGIL remunerates BGSL for claims fulfilment and claims handling services on a fixed fee basis set by product.

All business is conducted under the assistance class of business.

Profit after investment income and tax was £62m. The Board have approved a dividend of £86m to be paid to GBGH in June, in line with its risk appetite.

[1] *Note change of external auditors from year end 31st December 2017*

	2015	2016
Customers (‘000s)	3,252	3,172
Gross Earned Premium (£m)	1,019	1,009
Claims (£m)	(512)	(492)
Claims Ratio (%)	50%	49%
Underwriting Profit (£m)	79	78
COR (%)	92%	92%

Table 2: Underwriting Performance 2015-2016

C. INVESTMENT PERFORMANCE

At 31st December 2016 the value of the company’s investment portfolio was £215m (31st December 2015: £301m) comprising £195m of units in several sterling denominated short term money market funds listed on the Irish Stock Exchange (31st December 2015: £266m) and £20m of cash deposits with maturities between two and eight months (31st December 2015: £35m, maturity up to 8 months).

Units in the money market funds have a constant net asset value so there were no investment gains or losses. Investment income of £1.4m was earned in the year with £0.2m of investment fees incurred, representing an average return of 0.5%.

The business continues to adopt a very prudent investment policy prioritising security and liquidity above yield and uses the Centrica treasury team’s experience to assist in managing its investments.

D. PERFORMANCE OF OTHER ACTIVITIES

There are no other activities to note.

E. ANY OTHER INFORMATION

All material and required information has been disclosed in the earlier sections.

III. SYSTEM OF GOVERNANCE

A. GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE

The Board has responsibility for systems of governance and recognises the importance of a strong corporate governance structure to ensure the company meets its business and regulatory obligations. There is a well defined governance framework which includes a governance map which is considered to be appropriate for the company, taking into account the nature, scale and complexity of the risks inherent in the business. The governance framework is illustrated below:

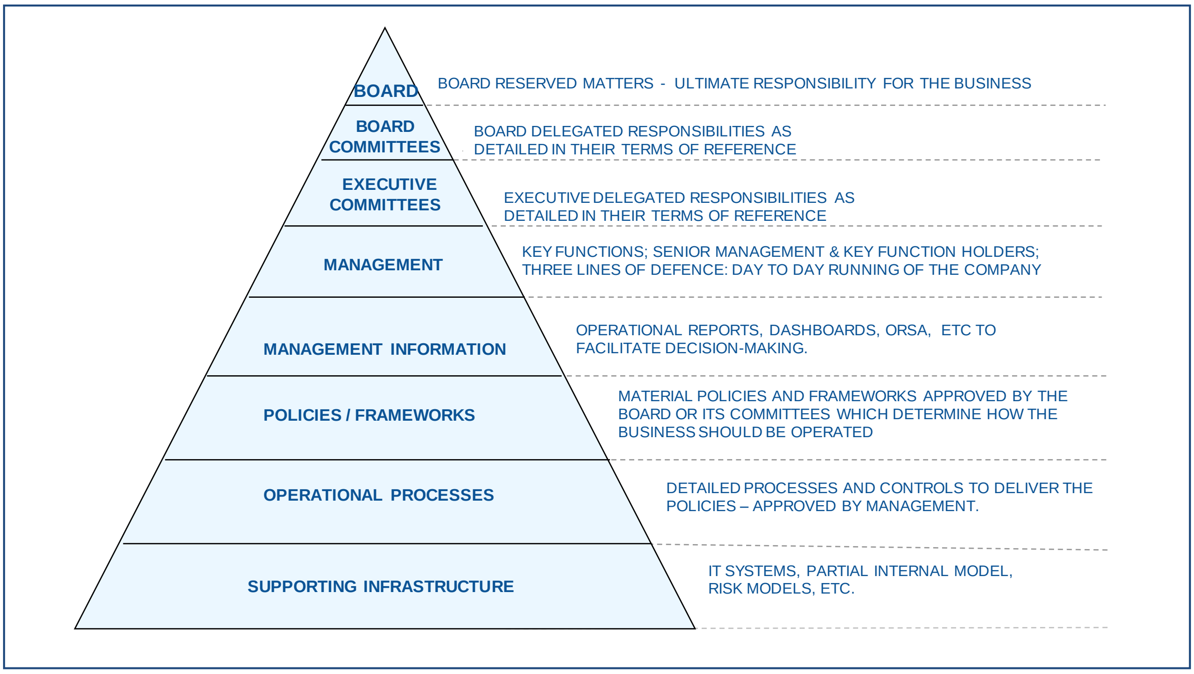


Figure 2: Corporate Governance Framework Overview

Board & Committees

BGIL's management committee is its Board of Directors which is responsible for the long term success of the company, its culture and for compliance with all laws and regulations.

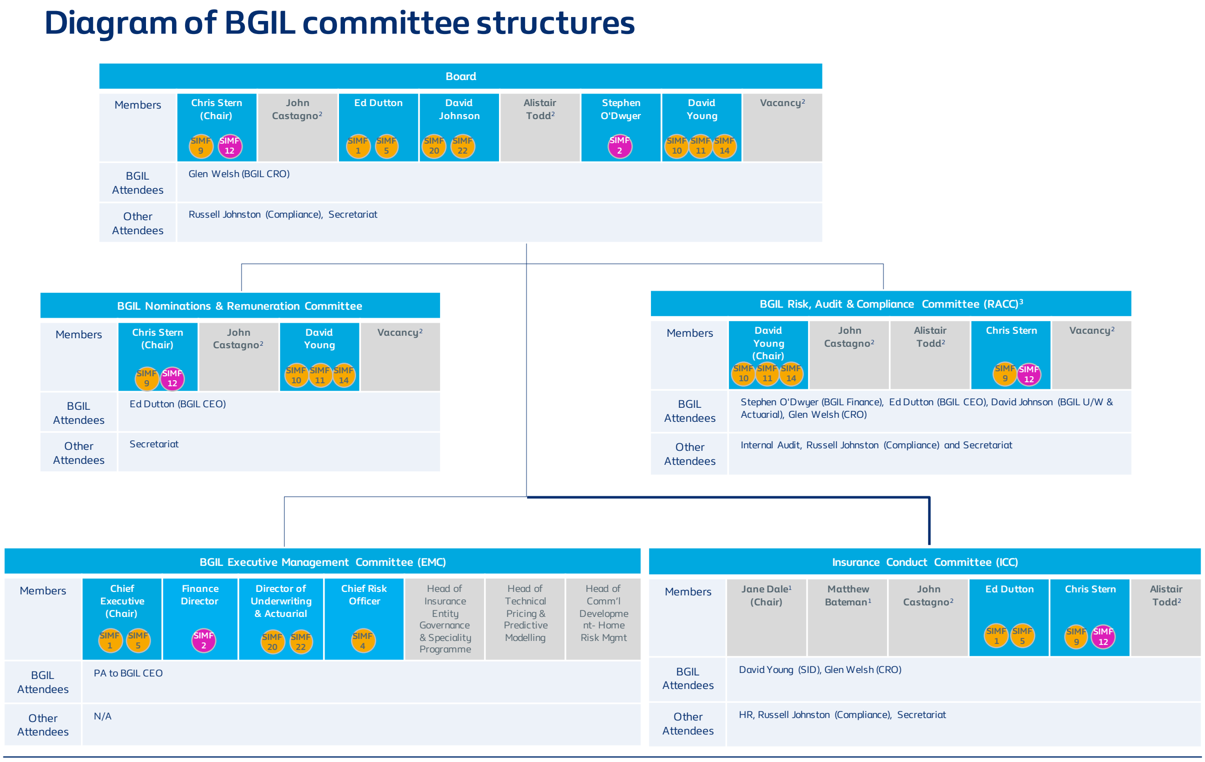
The following responsibilities are reserved for the Board:

- The Company's Annual Report and Accounts.
- Payment of any dividend by the Company.
- Significant changes in accounting policies or practices (such as the basis on which accounts are prepared).
- The Company's Strategic Plan and Operating Plan/Budget.
- Changes in the capital structure of the Company and, in particular, the issue or allotment of shares in the Company. This includes acquiring or disposing of companies or company operations and setting up new companies.
- Appointment and removal of Directors and the Company Secretary.
- Establishment of Board committees, their membership, constitution, terms of reference and any authority delegated to them.
- Recommendations for the appointment and removal of auditors and approval of the remuneration of auditors.
- Significant matters not in the ordinary course of business of a UK General Insurer.

- Moves into areas of insurance business other than Home Services Insurance or expanding an existing business into countries outside the UK, Channel Islands and Isle of Man.
- The acquisition of the share capital of or the assets and liabilities of any business.
- The Company's overall risk appetite, risk strategy and risk management policies.
- The Company's regulatory Annual Returns.
- The Company's corporate governance arrangements.
- Any matter requiring reference to the Board under the Company's conflict of interest policy.
- The Company's internal control arrangements.
- The Own Risk Solvency Assessment (ORSA) and any intervening reports arising from a material change in the reported solvency assessment.
- The Company's Outsourcing Policy and any significant changes to material outsourcing arrangements, see section IIID.

The Board ensures a formal and rigorous process for evaluating the performance of the Board, the Chairman, and its principal committees is conducted periodically, usually on an annual basis.

There are a number of Board committees supported by the Executive Management Committee (the "Executive"). The Board and its committees' responsibilities are detailed in their terms of reference. The committees and memberships are shown in Figure 3. The Senior Insurance Management Functions ("SIMF") are those which have been approved by the PRA.



[1] BGSL Board members
[2] 'Notified' Non-Executive Director'. The PRA does not require advance notification of planned appointments, but must be notified when the appointment is confirmed, for example when a letter of appointment is accepted.
[3] BGIL RACC meets jointly with BGSL RACC a number of times throughout the year.

Figure 3: BGIL Committee Membership

Committees

The **Risk, Audit and Compliance Committee** (**"RACC"**) is responsible for monitoring and reviewing the effectiveness of the company's risk, compliance, actuarial, internal audit, internal controls and financial matters to ensure they are in full compliance with all applicable regulations. Its responsibilities include oversight of the Company's partial internal model as well as all other duties required of a risk and audit committees by the regulations.

The RACC meet at least quarterly. Joint RACC meetings are held with the equivalent BGSL committee twice a year. These joint meetings support the effective oversight of the company's outsourcing arrangements.

The **Nominations & Remuneration Committee** is responsible for the nomination and approval of potential senior management appointments and for the effective operation of the company's remuneration policy. Meeting of the Nominations & Remuneration Committee are organised when business needs arise.

The **Insurance Conduct Committee** (ICC) is a joint committee which consists of Directors of both BGIL and BGSL. The committee is authorised by the Boards to exercise governance and oversight in the area of conduct risk ensuring both companies have an effective culture which delivers fair outcomes for our customers.

The **Executive Management Committee (EMC)** is the main operational committee of the Board and has a responsibility to implement the business strategy and decisions of the Board and keep them properly informed.

In addition to the Board committees there are a number of executive committees and working groups, the key ones of which are:

- **Enterprise Risk Management Committee** ("**ERMC"**) which acts as a sub-committee of the RACC and has second line responsibility for providing challenge to the Executive's risk management and control activity.
- **Insurance Risk Committee ("IRC")** is an executive sub-committee with specific responsibility for coordinating the insurance risk framework activity of the business.
- **Capital Investment Committee ("CIC")** is an executive sub-committee with responsibility for coordinating capital requirements, investment monitoring and solvency reporting activities of the company.

Further information on the ERMC and IRC can be found in risk processes section.

Material Changes to Governance Arrangements

With the introduction of the PRA's Senior Insurance Management Regime in 2016 the following changes were made to governance arrangements:

- Allocation of prescribed and significant responsibilities to the Senior Insurance Management Function-holders **("SIMFH"**) whom have been authorised by the PRA to undertake the duties required by the regulations;
- Identification of key functions, see below;
- Documentation of the organisations structure, SIMFH, key functions, and allocation of responsibilities in a "Governance Map".

Further changes to the governance arrangements were made in January 2017 to improve governance of the company's remuneration arrangements. The responsibilities of the Nominations Committee were extended to include oversight of the remuneration policy and related reward schemes and processes. The committee was renamed the Nominations & Remuneration Committee.

David Johnson was appointed as a director of the Board in January 2017.

Stephen O'Dwyer was appointed as a director of the Board in April 2017.

Key Functions

Key Function	Role-holder	Overview
Risk	Chief Risk Officer	The risk function is part of the Company's second line of defence and maintains its independence by carrying out an oversight role across the material parts of the business and all of the outsourcing arrangements with group companies. The function oversees the Own Risk Solvency Assessment processes and the design and operation of the partial internal model.
Compliance	Chief Risk Officer	A second line function responsible for oversight of the Company's compliance with PRA regulation and the memorandum of understanding in place with the Group Ethics & Compliance Department for the provision of compliance services, which includes responsibility for conduct regulation and all compliance auditing activity. Russell Johnston is authorised by the Financial Conduct Authority (CF29) and is the senior manager responsible within Group Ethics & Compliance for FCA compliance.
Internal Audit	Chief Executive Officer	Internal audit is outsourced to the Group Internal Audit Department which in turn uses external resource from audit firms where in-house skills are not present. The results of internal audit monitoring are reported directly to the RACC by a senior manager from Group Internal Audit who is also responsible for reporting on progress achieved on all audit actions. This ensures no conflicts of interest arise with the Chief Executive's other responsibilities.
Actuarial	Director of Underwriting & Actuarial	Provide actuarial services including risk and capital modelling expertise. Produces an annual actuarial function report confirming its opinion on technical provisions, underwriting and reinsurance policy and other material activity undertaken. There is potential for conflict of interest in respect of the underwriting opinion which is mitigated by an independent third party review, every three years. At all times, the Director of Underwriting and Actuarial has unrestricted access to relevant information and is not constrained, controlled or unduly influenced in respect of relevant actuarial matters.

Figure 4: Key Functions

Information on Remuneration Policies and Practices

The company's remuneration policy sets out the incentive arrangements that apply to the Board, executive and key employees whose professional activities have a material impact on BGIL's risk profile. The policy aims to deliver a remuneration package that promotes sound and effective risk management, does not encourage risk-taking that exceeds our risk tolerance limit, avoids conflicts of interest and ensures fair customer outcomes. Remuneration is managed and structured in line with PRA regulations with the fixed component of an individual's remuneration representing a sufficiently high proportion of total remuneration.

Incentive Plans for senior management

The company's incentive plan is designed to incentivise and reward the achievement of the financial performance of Centrica plc and individual strategically aligned objectives.

The target and maximum incentive payment is typically defined as a percentage of base salary. The maximum award for outstanding performance is 125% for senior executive directors. Dependent on seniority and performance rating, the award is delivered either entirely in cash, or as a combination of cash and deferred Centrica shares. For current executive directors, the minimum deferral where a variable incentive is awarded is 50%.

50% of deferred shares are released after two years with the remainder after three years providing the employee remains employed until the release dates. Claw-back and malus provisions apply to the deferred share awards if the performance, which gave rise to the payment, is subsequently discovered to have been achieved by a breach of PRA Conduct Standards.

Centrica's policy is not to offer defined pension benefit arrangements to new hire employees. A defined contribution with employer contributions is provided. For employees hired before 2009 we continue to honour existing defined benefit pension arrangements. BGIL has no pension scheme of its own with its employees employed under Centrica (or other Group company) contracts.

Requirements for skills, knowledge and expertise

The company's training & competence scheme sets out policies and procedures for ensuring the competency of all its directors and staff. Competency standards are defined for each role in their job description and all are assessed annually, as part of the performance management process.

Adequacy of systems of governance

The Company continually assesses the need for change in its system of governance through its annual review cycle of Board and committee terms of reference and material policies. The Company also keeps abreast of guidance from its industry bodies, regulators and the Financial Reporting Council, implementing these as appropriate to the size and complexity of the business.

In addition, each year Internal Audit prepares a report to the Board which includes an assessment of the adequacy of the Company's systems of governance. There have been no adverse findings in the past 12 months.

B. FIT AND PROPER REQUIREMENTS

The company ensures that all persons who effectively run the company or have other key functions (Solvency II staff) are fit to provide sound and prudent management through their professional qualifications, knowledge and experience and are proper by being of good repute and integrity. The Centrica good repute policy sets out the policy and procedures for ensuring the good repute of our employees and those who act on our behalf and applies across the Group.

The Centrica good repute policy ensures the suitability of responsible staff – covering their honesty, integrity and competence – from staff recruitment to appointment and throughout their length of service.

C. RISK MANAGEMENT SYSTEM INCLUDING THE ORSA

Risk Management System

The company's risk management system is articulated in a number of policies and frameworks, overarched by the Enterprise Risk Management Framework **("ERMF"**), the objectives of which are to:

- Meet the company’s statutory obligations
- Ensure no actions or behaviours develop that could result in poor outcomes or unfair treatment of our customers
- Maximise the efficient deployment of capital
- Ensure the delivery of strategic objectives
- Help ensure effective reporting
- Avoid damage to reputation and associated consequences to protect our brand
- Ensure employee and customer safety

The Board is committed to a proactive approach in managing all of its risks and it aims to ensure that effective risk management practices are a key element of the company’s culture. As a business which is reliant on its solvency capital the board is committed to best practice within the insurance industry on managing risk.

To support the objectives, the framework includes a comprehensive set of risk policies and guidelines to ensure that adequate process and procedures are in place to manage all material types of risk. They include the following risk policies.

- Insurance risk policy (Includes underwriting and reserving risks)
- Operational risk policy
- Financial - investment risk policy (includes market, credit, liquidity)
- Internal model change Policy
- Internal model validation Policy
- ORSA policy

The following principles have been established to inform the operation of the ERMF, deliver the risk objectives and implement the risk strategy:

- The Board owns the ERMF and will not delegate ultimate ownership of risk within the business although individuals across the business have day-to-day responsibility for ensuring that these principles are implemented, monitored and refreshed as required.
- The ERMF is fully aligned with and supports the delivery of the business strategy and management objectives.
- The ERMF is communicated to and understood by all senior management and staff.
- Governance is achieved through the implementation of the “three lines of defence” model that ensures appropriate segregation of risk ownership, oversight and assurance responsibilities.
    - 1st Line - business management is accountable day to day for implementing and using the Framework when it delivers the business plan, all risk taking and embedding a risk culture.
    - 2nd Line - Risk and Compliance functions are accountable for providing an independent and forward looking view of the risk profile to the Board.
    - 3rd Line - Internal Audit is accountable for providing wholly independent assurance on the adequacy and effectiveness of risk management and control.

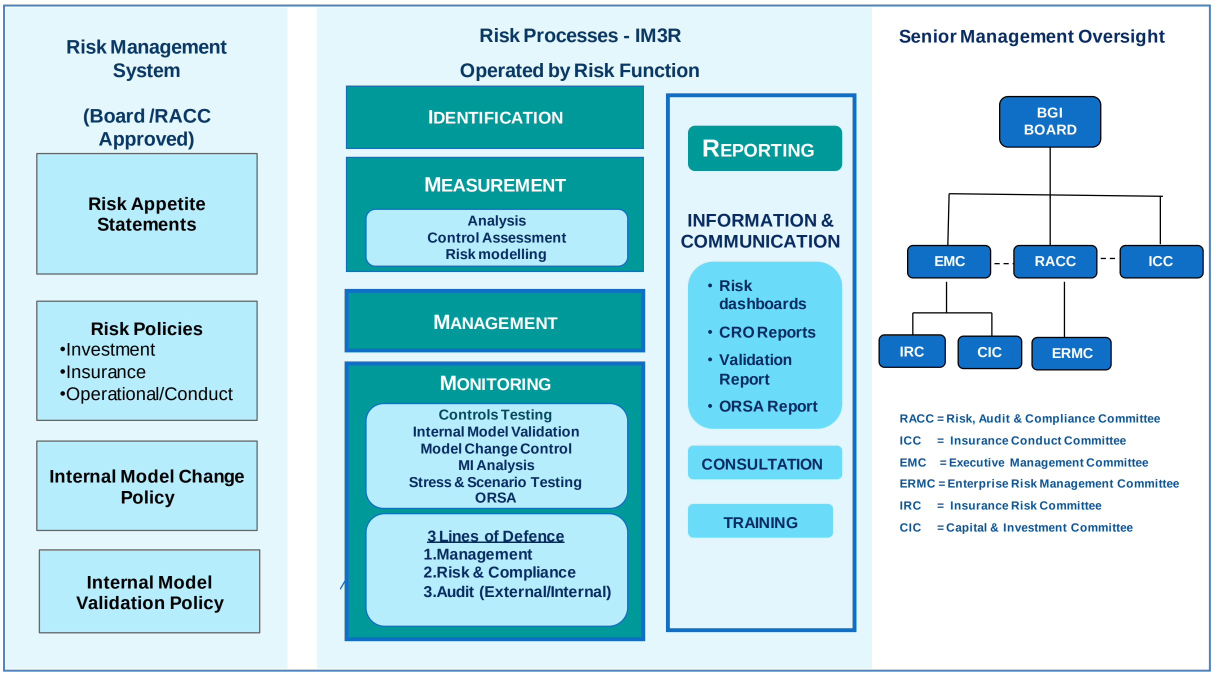


Figure 5: Risk Management Framework

Risk Management Roles and responsibilities

The Chief Risk Officer is responsible for the function and effectiveness of the framework and risk policies, supported by the ERMC (which he chairs) and the RACC on behalf of the Board. The Chief Risk Officer reports to the Chief Executive Officer and has an escalation route to the Chair of the RACC in order that an independent channel is available to escalate matters where it is considered appropriate to do so. The Chair of the RACC has a responsibility to report the output of RACC meetings to the Board but may also escalate matters directly to the Chairman of the Board should this be necessary at any stage.

Chief Risk Officer responsibilities include:

- Maintenance of the risk register which contains all risks which have a material impact on the company's profits, capital or compliance with regulations.
- Collation, analysis and reporting of risks to the ERMC, RACC and Board
- Implementing best practice in risk management and emerging risk identification
- Management of the risk and control review programme, and in particular monitoring risk mitigation plans and the company's risk appetite
- Liaising with the actuarial and modelling teams on the design and performance of the internal model
- Liaising with Centrica Group and other British Gas business divisions to ensure that where appropriate the company's approach to maintaining our risk and controls environment is consistent with other group entities
- Oversight of the risk activities by our outsourced partners, and in particular by BGSL
- Managing the production of the ORSA report

The company will ensure that for each risk identified and recorded on the risk register a senior manager is appointed as the risk owner. The risk owner will ordinarily be a SIMFH or key function-holder and their primary responsibilities are to monitor risk and controls in their area of responsibility and identify emerging risks and where appropriate design appropriate controls to mitigate risks.

Risk Appetite & Tolerances

BGIL's risk appetite is defined in terms of both quantitative metrics and qualitative measures and is used by the risk function to monitor the company's risk profile, identify those instances where risk exposure has exceeded the Board's acceptable limit for a particular risk and report its findings to the Board.

BGIL has risk appetite statements for the following:

- Earnings at risk 'uncontrollable'
- Earnings at risk 'controllable'
- Capital surplus
- Target COR
- Product offering
- Permitted investments (including credit ratings, concentration, asset type)
- Liquidity of investments
- Customer and employee health and safety **("HSE")** incidents
- Conduct with customers

Risk Processes

IM3R is the BGIL abbreviation for the risk management process and is illustrated below:

Identification	There are several methods that have been adopted within BGI to identify and assess risks such as: Meetings, workshops, seminars, media reports, reports from assurance functions
Measurement	BGI measures risks using both a conventional risk matrix approach and scenario analysis
Management	A comprehensive controls framework exists which ensures risks are managed within agreed appetite and tolerance levels
Monitoring	The main components of BGI's risk monitoring process are: Meetings of the Board, RACC, Executive, ERMC and sub committees; risk dashboards; Risk register; Controls dashboard
Reporting	Various risk reports are produced to enable stakeholders to assess the risk profile of BGI. These include: Executive risk dashboards; Board and RACC risk reports; ORSA

Figure 6: Risk Management Process

Partial Internal Model (PIM)

The Company's partial internal model (PIM) is used to model insurance risk capital. Oversight is provided in the first instance by the Insurance Risk Committee (**"IRC"**) which is authorised to approve:

- The insurance risk, risk and control assessment templates and the expert judgement included therein
- The insurance risk capital numbers derived from the PIM
- Minor changes to the PIM as outlined in the model change policy

- The data used in the PIM for calculating insurance risk
- The design, documentation, parameterisation and outputs from the cold weather and pricing models
- The validation output applicable to the PIM and the cold weather model which is material part of the PIM as it drives the parameterisation of the company's most material risk, cold weather.

The ERMC co-ordinates with the IRC to ensure that insurance risks are identified, measured, managed and monitored effectively. It also has a responsibility to ensure the PIM is performing as intended and reflects the risk profile of the business; to include review and challenge of the results of stress & scenario testing, profit & loss attribution, validation report(s), model changes and progress of any actions to improve the model.

The RACC ensures the ongoing appropriateness of the design and operations of the PIM and the suitability of the internal model validation policy in order to make a recommendation to the board as to whether or not model outputs should be used to inform decision-making within the company. The RACC reviews all model changes and PIM validation reports prior to advising the board of the outcomes. Any major model change request is reviewed by the RACC prior to submission to the Board and the PRA.

Validation of the PIM

The Company has an internal model validation policy and supporting procedures which includes detailed testing templates to confirm compliance with the tests and standards required by the regulations. Independent validation has been undertaken by an external firm and the Ethics and Compliance department on behalf of the risk function and is due to be approved at the June Board.

Own Risk Solvency Assessment (ORSA)

BGIL produces an ORSA on an annual basis or more frequently if required in response to material changes in the internal or external environment. Regulatory capital requirements (SCR PIM, standard formula and economic capital) are also refreshed at least annually.

The ORSA is prepared under the direction of the Chief Risk Officer and is reviewed by the ERMC and RACC. The ORSA is used to inform the Board of capital adequacy and solvency coverage, enabling management to adjust capital if required to meet the company's obligations and make informed risk aware decisions by reference to their capital impact and consequences.

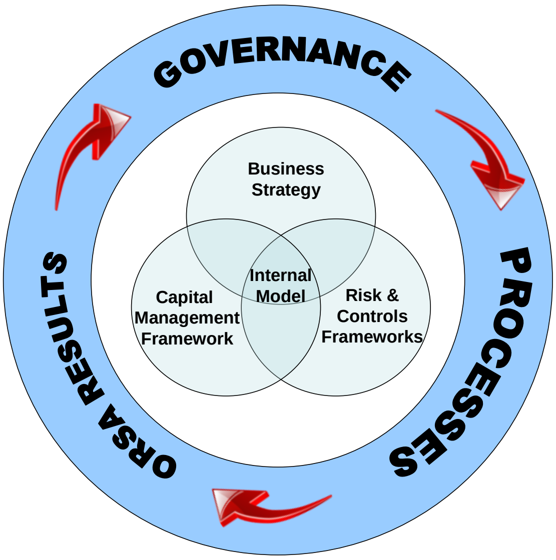


Figure 7: ORSA Process

D. INTERNAL CONTROL SYSTEM

The Board has overall responsibility for ensuring its systems and controls are adequate, appropriate, proportionate and effective in mitigating the risks to which the business is exposed. The Board has delegated responsibility to the RACC and ERMC to oversee the management of the controls framework.

An overview of the controls framework is provided below:

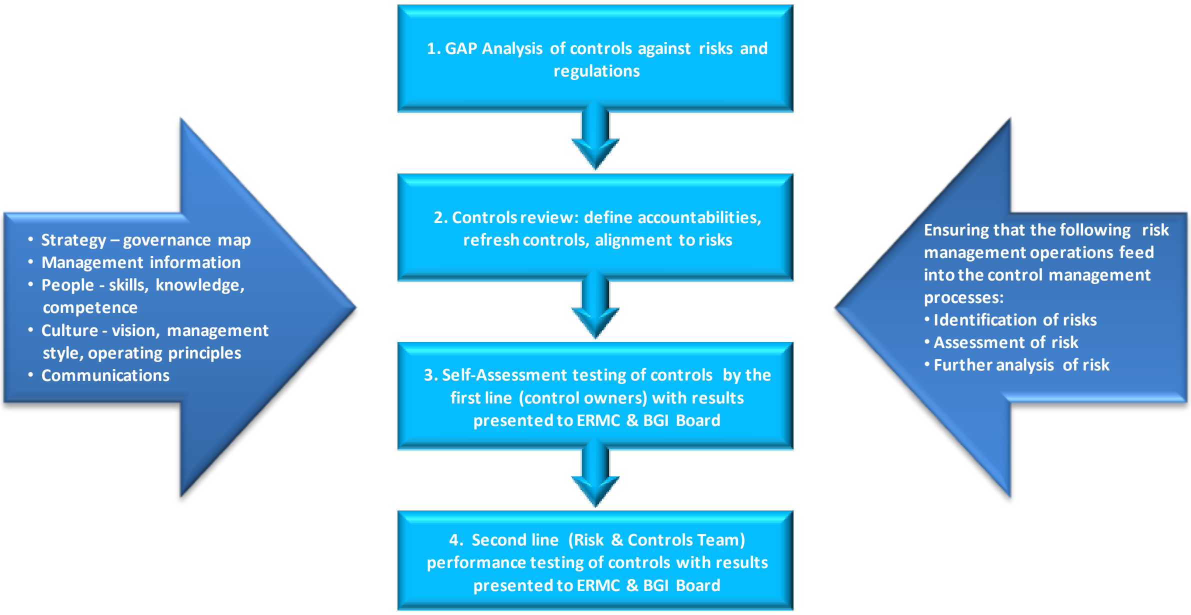


Figure 8: BGIL Controls Framework

The RACC is responsible to the Board for assessing the overall quality and effectiveness of the control systems and seeks input from risk, compliance, and audit teams as required. The ERMC is responsible to the RACC for overseeing the effective implementation of the controls framework and for assessing the effectiveness of controls, monitoring control improvements, ensuring controls are proportionate, and to report financial and non-financial risks. The ERMC provide challenge to management and control owners where controls are not fully effective.

The Executive is responsible for embedding the controls framework and for ensuring effective controls are in place to mitigate all monitored risks. The coordination of control related activities and implementation of the controls framework is delegated to the risk and controls function. The risk and controls function provide a second line of defence by supporting the first line in developing their controls, oversight of controls self assessment by the first line, manage the second line review of controls, and perform gap analyses of all controls against regulatory frameworks. The risk and controls function maintain logs of controls development, analyse control effectiveness to mitigate risk, monitor control performance, develop MI and work with the group (Centrica) to ensure consistency across all systems and controls. The compliance function also provide a monitoring programme, the results of which are fed back into the risk and control assessments.

E. INTERNAL AUDIT FUNCTION

Internal audit is outsourced to the Group Internal Audit Department which in turn uses external resource from audit firms where in-house skills are not present. The results of internal audit monitoring are reported directly to the RACC by a senior manager from Group Internal Audit who is also responsible for reporting on progress achieved on all audit actions.

F. ACTUARIAL FUNCTION

The actuarial function provides actuarial services including risk and capital modelling expertise. It produces an annual actuarial function report confirming its opinion on technical provisions, underwriting and reinsurance policy and other material activity undertaken. There is potential for conflict of interest in respect of the underwriting opinion which is mitigated by an independent third party review, every three years.

At all times, the Director of Underwriting and Actuarial has unrestricted access to relevant information and is not constrained, controlled or unduly influenced in respect of relevant actuarial matters.

G. OUTSOURCING

The Board retains responsibility for discharging all outsourced activities and has approved BGIL's policy under which it may only outsource material services to Centrica group companies. Material services are those which are critical to the business model or are of such importance that weakness, or failure, of the services would cause detriment to customers and/or cast serious doubt upon an ability to meet regulatory requirements. The outsourcing policy and all material outsourcing arrangements are approved by the Board and have been designed to meet all relevant regulations.

BGIL has outsourced the following material services to group companies in the UK:

British Gas Services Ltd	Centrica PLC
• Sales & Marketing	• Ethics & Compliance function
• Product design *	• Finance
• Policy administration including premium collection	• Treasury & investment services
• Claims handling services	• Internal Audit
• Claims fulfilment (engineers)	• Information Systems
• Complaints handling	• Human Resources

Figure 9: BGIL activities outsourced to Group
** Underwriting and the setting of terms and conditions are the responsibility of BGIL*

No customer facing activities are outsourced outside the UK although some support services (e.g. IT support) provided by Centrica are outsourced overseas. The Centrica policy on outsourcing includes meeting the requirements of UK regulators i.e., due diligence, written agreements which maintain confidentiality of information, contingency planning, access to staff, premises and records all of which ensures consistency in the event that our group service providers outsource to third parties. Directors and/or members of the risk function attend the management committees of relevant group companies and analyse relevant management information to enable them to identify operational and other risks arising from outsource arrangements. The Chief Risk Officer reports to each Board meeting on the results of its monitoring of the outsourced arrangements and its assessment of risks arising.

H. ANY OTHER INFORMATION

All material and required information has been disclosed in the earlier sections.

IV. Risk Profile

A. UNDERWRITING RISK

BGIL's underwriting risk is low due to its very short claims development tail, its contractual fixed claims costs relationship with BGSL, low cost base and the inherent nature of the company's insurable risks. Additionally, the claims fulfilment approach (an engineer attends almost every breakdown rather than the settlement of claims in cash) acts as a strong mitigant against fraudulent claims.

Nonetheless, BGIL is exposed to underwriting risk, defined as the risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions. This risk category includes the sub-categories of premium risk, lapse risk and catastrophe risk. EIOPA ("European Insurance & Occupational Pensions Authority") further defines underwriting & reserving risks as fluctuations in the timing, frequency and severity of insured events relative to the expectations of the undertaking at the time of underwriting.

- Premium risk relates to the day to day variability in underwriting performance resulting from ongoing claims reporting and fulfilment, competitor activity and gradual changes in portfolio mix, for example, due to changes in the nature of boilers and appliances insured. BGIL's stable underwriting performance is a good indicator of low levels of premium risk.
- Lapse risk derives from customers' non-renewal or mid-term cancellation of policies. Whilst non-renewal and mid-term cancellation do occur, rates are relatively stable and of limited impact on BGIL due to its low level of fixed expenses.
- Reserve risk refers to uncertainty in the adequacy of technical provisions. The short tail and stable nature of BGIL's insurance activities results in low levels of both absolute reserves and their uncertainty. The actuarial function conducts an independent review of technical provisions including stress testing. The conclusion offered in the 2016 year end actuarial function report was that technical provisions appeared reasonably stated.
- Catastrophe Risk relates to the risk of loss, or of adverse change in the value of insurance liabilities, resulting from an extreme or exceptional event or series of events. In respect of BGIL, the potential for catastrophe losses exists as a result of exposure to extreme cold weather.

BGIL's underwriting risk is managed in accordance with the Enterprise Risk Management Framework (ERMF) and the detailed IM3R procedures. These include an Insurance Risk Committee which typically meets 6 times each year and an insurance risk policy, annually reviewed and approved by the Board.

BGIL's partial internal model, incorporating specific and detailed analysis of extreme cold weather risk, was approved by the PRA in December 2015. Cold weather is the largest driver of insurance risk in BGIL due to the exposure of the company to increased claims numbers when cold temperatures causes increased demand on central heating systems leading to higher than average boiler breakdown rates.

Other less material insurance risks include claims leakage due to inadequate claims validation processes; unexpected insurance exposure caused by ambiguous or vague terms and conditions; and potential mistakes in the calculation or implementation of net rates i.e., the technical price at which BGIL prices products to cover the costs of claims, commission and expenses and provide a modest margin in line with its risk appetite.

B. MARKET RISK

Market risk is defined as the risk of loss resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.

Examples of market risk would include a collapse in equity prices or a significant reduction in interest rates. BGIL's investment strategy, guided by the investment risk policy, aims to mitigate this risk by restricting investments to high quality fixed interest securities and deposit based investments.

C. CREDIT RISK

Credit risk is defined as the risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which BGIL is exposed.

The largest exposure to credit risk comes in the form of counterparty default of BGSL. As BGSL collects insurance premiums from customers on behalf of BGIL, insolvency of BGSL could result in premiums not being passed across to the company. Credit risk is mitigated through use of monthly cash forecasts designed to ensure exposure to BGSL is minimised and via regular monitoring of credit ratings of other counterparties.

Counterparty default risk is currently subject to a capital add-on. An internal model is being developed for this risk, with direction from the Executive Management Committee.

D. LIQUIDITY RISK

Liquidity risk is defined as the risk that BGIL is unable to realise investments and other assets in order to settle its financial obligations when they fall due. Cash flows are forecast regularly and reported against actual experience in the monthly Board pack to ensure appropriate liquidity levels are maintained.

Exposure to liquidity risk would arise for example from a very large and sudden increase in claim volumes, the cost of which could not be covered by premium receipts and cash held on current account, and other investments could not be sold quickly at a reasonable return. The risk is mitigated by the company's investment risk policy which ensures sufficient investments are held in a very liquid form.

E. OPERATIONAL RISK

Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events. Operational risk also includes conduct risks and regulatory risks.

Examples of operational risk include breach of regulations, poor sales practices, complaints handling, theft or loss of customer data, failure of information systems and failure of outsourcing arrangements.

The most significant operational risk for BGIL is outsourcing of administration of policies to BGSL, i.e., sales, claims, complaints handling. The main focus of BGIL's outsourcing risk is conduct with customers. These risks consider poor customer outcomes and include four component risks:

- Complaints handling and root cause analysis
- Claims handling
- Sales
- Products

BGIL's main risk mitigation controls for conduct risks are close oversight of BGSL's activities and managing the outsourcing agreement between the two companies which enables BGIL to recover costs from BGSL for any breaches. This mitigation is supported by close oversight of BGSL at all levels of the organisation including joint meetings at Executive and Board level.

The second largest risk is the insolvency of BGSL which results in the significant loss or deterioration of fulfilment capability of BGIL. In the event of BGSL insolvency, it is likely an administrator would seek to sell BGSL as a going concern given its unique service capability (engineer workforce, national call centres, systems, supply chain, etc). However, it is recognised that increased service costs may result from the appointment of a new outsourced service provider. The probability of insolvency remains extremely remote and although BGSL default is outside the direct control of BGIL, the close relationship between the two companies allows effective monitoring of the BGSL financial position.

Health and safety is a key focus for BGIL and the whole of Centrica. Due to the nature of the home services business, there is a significant inherent risk due to the number of engineer visits carried out on a daily basis. Continuous improvement is made to the monitoring and management of health and safety in order to mitigate this risk. For example, in the last year, tool boxes have been replaced by tool rolls and this has reduced the number of accidents in customer's homes.

In light of a number of high profile corporate incidents, cyber risk is being very closely monitored in the context of risk of loss of key IT systems and the importance of data protection.

Operational risk is currently subject to a capital add-on. An internal model is being developed for this risk, with direction from the Executive Management Committee.

F. OTHER MATERIAL RISKS

As part of the British Gas brand of companies, BGIL is exposed to brand damage contagion caused by other parts of the group or the energy market in general. The principal direct impact of British Gas brand damage to BGIL would be a reduction in business volumes.

The risk associated with Brexit has been the subject of stress testing and is not material to BGIL. It will continue to be monitored as negotiations progress. Any risks are domestic risks; BGIL is not exposed to any currency risk.

G. ANY OTHER INFORMATION

Quantification of risk capital attaching to each risk type is disclosed in section VI.

V. VALUATION FOR SOLVENCY PURPOSES

The company's balance sheets as at 31 December 2016 and 2015 on both a UK GAAP ("UKG") and SII basis are shown below:

£m	31/12/2015 (unaudited)			31/12/2016		
	UKG	*Adj*	SII	UKG	*Adj*	SII
Assets						
Investments & Cash	301		301	215		215
Ins Debtors (DAC/premium receivable)	752	(752)	0	802	(802)	0
Prepayments	1		1	1		1
Liabilities						
Ins Creditors (UPR/accrued commission)	(754)	754	0	(808)	808	0
Other Creditors	(25)		(25)	(30)		(30)
Tax on reconciliation reserve		(8)	(8)	(7)		(7)
Technical Provisions						
Inter-company payable	(4)		(4)	(9)		(9)
O/S Claims & IBNR	(9)		(9)	(11)		(11)
Premium Provision		47	47		37	37
ENID		(1)	(1)		(2)	(2)
Risk Margin		(6)	(6)		(5)	(5)
Net Assets	**262**	**33**	**295**	**160**	**30**	**190**
Funded By						
Share Capital/Contributions	115		115	5		5
Retained Earnings	147		147	155		155
Reconciliation Reserve (net of tax)		33	33		30	30
Shareholder/Own Funds	**262**	**33**	**295**	**160**	**30**	**190**

Table 3: BGIL Balance Sheet at 31/12/15 and 31/12/16

Note: the principal reason for the reduction of £105m in own funds during 2016 was the payment of a dividend of £164m to GBGH in May 2016

Accounting principles

The principal accounting policies and assumptions applied to the Solvency II ("SII") balance sheet and Quantitative Reporting Templates ("QRT") are set out in the sections that follow. They have been consistently applied unless otherwise stated.

The preparation of financial reports to meet Solvency II obligations includes the selection by BGIL of accounting policies from the available range of options within the SII framework. Those areas involving a higher degree of judgement or complexity or areas where key accounting policy decisions have been made are as follows:

Technical provisions:

a. Deterministic rather than stochastic methods are used to determine balance sheet valuations for premium provisions, IBNR and outstanding claims. Deterministic approaches are considered appropriate given the relatively stable characteristics of the business and comprehensive data available. A stochastic approach is adopted in determining the Events Not In Data (“ENID”) balance as a means of modelling multiple scenarios and possible outcomes to create an average (best) estimate. Technical provision estimates are tested by the actuarial team for reasonableness and accuracy at least annually or if there is a significant change in business.
b. The value of technical provisions represents a best estimate plus a risk margin, the latter representing the additional amount an insurer would be obliged to pay for immediate transfer of its obligations under the insurance contracts to another insurer. Best estimate incorporates all future cash inflows and outflows in relation to in-force insurance contracts, discounted at an EIPOA risk free rate to derive present values.
c. The premium provision includes an estimate for insurance policies bound but not incepted (“BBNI”), representing discounted net cash flows relating to contracts not in force at 31 December 2016 but for which the company has contractual obligations.
d. Technical provisions and the risk margin are discounted over 12 months or near 12 months as appropriate using published EIOPA rates, reflecting the run-off periods of policies in force at the balance sheet date. Claims outstanding, IBNR and ENIDs are discounted over much shorter periods reflecting average exposure periods.

Risk margin (unaudited):

SII regulations provide insurers with a number of options to determine a risk margin. The company has adopted method three, a simplified approach which is considered proportionate and appropriate given the low volatility of the company’s historical results and risk profile.

Current year SCR forecasts are derived from the partial internal model for underwriting risk and the standard formula for other risks (with capital add-ons where appropriate).

Future estimated SCR forecasts are derived from a change in future best estimate reserves, as noted in method three for risk margin in SII Guidance.

The SII valuation basis is different to UK GAAP. Table 4 provides further detail on the reconciling items between the two valuation bases.

	£m
Shareholder Funds at 31/12/16	**160**
Remove UK GAAP insurance balances:	
Premium Receivable	(556)
Deferred Acquisition Costs	(246)
Unearned Premium Reserve	560
Accrued Commission	249
	6
Add SII balances:	
Premium Provision	37
ENIDS	(2)
Risk Margin	(5)
Tax on Reconciliation Reserve	(7)
Discounting	0
	23
Own Funds at 31/12/16	**190**
Additional Available Capital	**30**
i.e., the reconciliation reserve	

Table 4: BGIL reconciliation reserve at 31st Dec 2016

Own funds valued on an SII basis as at 31 December 2016 are £30m higher compared to the UK GAAP valuation used for statutory accounting purposes. The reasons for this are:

- Insurance debtors and creditors on a UK GAAP basis are removed in line with the SII requirement to estimate a fair value of all in force policies at the balance sheet date.
- A premium provision is established, representing the best estimate of future net cash-flows relating to future exposure for in-force policies at the balance sheet date.
- A provision is established for events not in data.
- A risk margin is established representing the cost of providing capital equal to the SCR necessary to support the insurance obligations over their lifetime.
- The adjustments above are all discounted over the appropriate time horizon at prescribed rates.
- The sum of the above give rise to a reconciliation reserve. Corporation tax is applied to this at the prevailing rate. In BGIL the net balance is an asset as it reflects future positive cash-flows arising on a stable and profitable book of business only partly offset by the introduction of new provisions. The impact of discounting in BGIL is marginal given the very short tail associated with claims notification and settlement.

A. ASSETS

Investments

The company has an investment risk policy and risk appetite approved by the Board. At 31 December 2016, the company's investments comprised units in short term money market funds (£195m) and bank deposits with terms of less than eight months to maturity (£20m).

All investments are denominated in sterling and in the case of short term money market funds, listed on the Irish stock exchange at unit prices with a constant net asset value so there is no bid and offer spread. Values are the same for UKG and SII balance sheet reporting purposes.

Cash at bank

Cash at bank is reported on the same basis for UKG and SII balance sheet reporting purposes.

Prepayments and accrued income

Comprises prepayments for regulatory fees and levies and accrued interest on investments. Values are the same for UKG and SII balance sheet reporting purposes.

B. TECHNICAL PROVISIONS

SII requires the technical provisions to be a best estimate of the current liabilities relating to insurance contracts, plus a risk margin.

The best estimate liabilities are calculated as i) the discounted best estimate of all future cash flows relating to claim events prior to the valuation date (claims provisions) and ii) the discounted best estimate of all future cash flows relating to future exposure arising from policies that the insurer is obligated to at the valuation date (premium provisions).

The risk margin is the amount that insurers and/or reinsurers would require over and above the best estimate liabilities in order to take over and meet the insurance and reinsurance obligations over the lifetime of the policies (i.e. the amount required to transfer liability to a third party).

All technical provisions relate to one class of business, the assistance class. Refer to table 3 for a full breakdown of technical provisions.

Description of bases, methods and assumptions used and valuation uncertainty

None of the insurance contracts issued by the company meet the requirements for technical provisions to be calculated as a whole. Technical provisions are calculated as the sum of a best estimate and a risk margin. The calculation of technical provisions estimates is undertaken by the Finance function. Oversight, review and sign-off are the responsibility of the BGIL Actuarial function.

Year-end technical provisions have been assessed as at 31st December 2016 as being reasonable (on both a UKG and SII basis) following input and review from the Director of Underwriting & Actuarial and BGIL's capital modelling actuary.

The company has no reinsurance protection of its gross insurance exposures so technical provisions are the same gross and net of reinsurance.

1. Claims provisions

The balance sheet includes provision for the cost of claim events that have occurred up to the balance sheet date regardless of whether the claims arising from the events have been reported to customers by the company or not:

a) Best estimate provisions are made for outstanding claims, IBNR and associated claims handling costs.

b) Quantification incorporates both deterministic and stochastic elements.

c) The provision is discounted to present value using the EIOPA published rates.

For the reasons noted below, the valuation used in the UKG balance sheet represents the best estimate and is an appropriate valuation for SII purposes. Only the requirement to discount is a change from UKG principles:

- BGIL insurance risks are very short tail both in terms of the time between occurrence and notification, and between notification and final settlement. A very small volume of claims remain outstanding for longer but these are not material compared with the total incurred cost.
- Shared systems/processes mean the advice of claims to BGIL’s sole intermediary/claims handler (BGSL) is simultaneous. Uncertainties around reporting delays which might otherwise undermine the completeness and timeliness of reported data are therefore avoided.
- The indemnity and claims handling cost of each claim are charged at contractual rates agreed with BGSL; volatility and uncertainty of the amounts at which claims will settle is avoided. As a consequence, BGIL has no exposure to individual large claims.
- Other than its Assistance class risk concentration, there are no major aggregations of risk. BGIL catastrophe risk relates to extreme cold weather; a risk which forms part of BGIL’s SCR as a separately modelled component, rather than part of BGIL’s best estimate claims provisions.
- Policy terms & conditions do not include the right to a policy surrender value, paid up value or conversion rights of any description.
- Claims cost and claims frequencies are not impacted by inflation, business interruption or similar external events. The company monitors any claims litigation against it; no such litigation has been reported in previous years.
- Other than very rare replacement of kitchen appliances, claims are not settled in cash (an engineer attends every breakdown) so there is little incentive for fraudulent or duplicate claims; best estimate technical provisions do not include any specific allowance, although ENIDs do examine potential claims fraud.

These characteristics limit both the size and volatility of claims provisions. Consequently they are very small in value compared to the company’s other assets, liabilities and premium volumes: at 31 December 2016, claims provisions including claims handling, were £10.6m comprising £6.5m and £4.1m of outstanding claims and IBNR respectively.

2. Premium Provision

The Company has used a simplified method to determine its premium provision (“PP”), proportionate to underlying risks and taking account of Article 56 (Proportionality) of Commission Delegated Regulation (EU) 2015/35 and the technical provisions requirements of PRA Supervisory Statement SS5/14.

The PP is the best estimate of future net cash-flows (premiums less claims, commission and expenses) relating to future exposures arising from policies for which BGIL has an obligation at the balance sheet date. The best estimate is then discounted using EIOPA prescribed interest rates. The key assumptions and methodology used to determine PPs are:

- A deduction is made for mid-term cancellations on in-force policies and renewal lapses on policies invited but not taken up, based on past experience.
- An additional allowance for "bound but not incepted business" ("BBNI") representing policies invited for renewal in the weeks prior to the balance sheet date but not renewed until after that date. Claims ratios are modelled per the business plan which is consistent with recent actual loss experience.

Typically, given the business has been consistently profitable and most customers pay by monthly instalments, future cash in-flows exceed the present value of future cash out-flows, thus creating a PP asset.

This exposure primarily relates to contracts incepting post year end. As these contracts are entirely unearned at the valuation date, there is additional uncertainty attached to this exposure and the estimate for the following underwriting year will be subject to the highest level of uncertainty.

3. Events Not In Data ("ENID")

SII valuation rules require that technical provisions are valued on a best estimate basis and consider the outcomes of all possible scenarios, weighted according to their respective probabilities. This includes consideration of events not included in past experience.

Exposure to additional claims related to past exposure is low, evidenced by the very short and largely predictable tail. However, remote and unobserved scenarios exist and represent possible outcomes in respect of future exposure. The company therefore considers these scenarios, sourced from its risk register and partial internal model.

Five insurance risks or scenarios are used to model the company's ENID and are described below.

1. Claims fraud and leakage: The risk that claims made by customers are not adequately checked, leading to the completion of work which is not underwritten by the insurer.
2. Component default: The risk of a significant increase in the number of customer claims as a result of a major appliance, product or component defect.
3. Flooding: The risk of a significant increase in the number of customer claims as a result of extreme flooding.
4. Pricing of premiums: The risk that customer premiums are over-priced leading to reduced sales and hence lower profits and conversely the risk that customer premiums are under priced, giving rise to reduced profitability
5. Policy wording: The risk that additional claims (and/or compensation) may be paid due to contract law / regulations broken, or conduct issues arising as a result of imperfectly worded policies and/or Terms & Conditions.

The methodology adopted considers the financial impact of these scenarios at various probabilities up to a 1 in 200 return period event and generates a weighted average of all modelled probabilities. It then compares this to the mean/plan modelled in the premium provision with the ENID representing the difference between the mean/plan and the weighted average of all modelled probabilities. An ENID balance of £1.5m has been included within BGIL's technical provisions at 31st December 2016.

4. Risk Margin (unaudited)

BGIL's risk margin represents the cost of providing an amount of capital equal to the SCR, derived from BGIL's PIM, necessary to support the insurance obligations over their lifetime. It is added to the best estimate reserves to form the total technical provisions. This cost is equivalent to the amount a third party would be expected to require in order to take over and meet the insurance obligations.

SII rules prescribe that insurers must use a rate of 6% for the cost of capital when determining the risk margin.

Risk Margin Methodology selected for BGIL

BGIL has elected to use a simplification method (method three) as permitted under Solvency II regulations. This approach requires the approximation of the company's whole SCR for all future years by using a proportional approach without the requirement to assess individual elements of the SCR. This method is considered appropriate and proportionate given the company's stable risk profile for both individual risk elements of the SCR and the firm's overall SCR.

Approach to Risk Margin Calculation

A 6% charge is applied to the current year (year 1) SCR as prescribed by the regulations.

In addition the company is required to consider the run-off of its risks beyond year 1 hence a proportionate SCR is calculated based on a best view of run-off of exposure beyond year 1. BGIL consider that all liabilities will be materially run-off in the second year and the impact on the value of the risk margin beyond year one is extremely small.

Selection of Run-Off Time Horizon

BGIL does not underwrite insurance contracts for more than one year. The time from a typical claim event to its advice and settlement is extremely short; the vast majority of claims are settled in the month of notification or the following month. As a result almost all of BGIL's risk exposure is confined to a one year period.

To the extent there is a year 2 tail, however limited, BGIL elects to use a two year run off period to ensure all exposure is captured. Historical experience confirms run-off is complete by the end of year 2. There are no risks that would give rise to a capital requirement beyond the second year.

C OTHER LIABILITIES

Other Creditors

Other creditors comprise expense accruals and corporation tax payable at 31 December 2016 and have the same carrying amounts as under GAAP.

Insurance Premium Tax liability

Other creditors include a liability of £26m at 31 December 2016 for IPT collected but not due for payment to HMRC until 2017. The amount payable is the same as reported in the GAAP balance sheet.

Deferred tax liability

The reconciliation reserve in the SII balance sheet at 31 December 2016 accounts for £37m of own funds additional to the amount recognised under GAAP. A deferred tax liability of £7m is recognised on this reserve recognising that it will flow through to profits subject to tax deduction; the net reconciliation reserve is £30m.

D ALTERNATIVE METHODS OF VALUATION

The company does not apply alternative methods of valuation permitted under EIOPA Delegated Acts Article 296(4).

E. ANY OTHER INFORMATION

All material and required information has been disclosed in the earlier sections.

VI. CAPITAL MANAGEMENT

A. OWN FUNDS

At 31 December 2016 the company had basic own funds of £190m which includes £5m of ordinary fully paid share capital.

All own funds qualify as unrestricted Tier 1 and none are ring-fenced.

BGIL's basic own funds meet the requirements for classification as tier 1 capital for the purposes of meeting SCR and MCR requirements. The company does not carry any ancillary own funds.

Table 3 highlights the difference in balance sheet valuation on a UKG basis and SII regulatory basis. SII own funds are £30m higher than GAAP. The principal reason for this is SII permits the recognition in 2016 of estimated profits arising from in-force policies at 31 December 2016 that will be earned in 2017 under UKG. There are a number of other smaller adjustments, including the incorporation of two technical provisions not recognised in UKG – ENID and a risk margin – which partly offset this increase and are explained in the Valuation for Solvency Purposes section.

The company adopts a policy of holding capital equivalent to its SCR plus a solvency margin:

- BGIL's (diversified) SCR plus add on stands at £74m, comprising £39m calculated SCR plus a £35m capital add-on approved by the PRA.
- The company has defined a capital buffer ranging from £15m to £30m above its SCR plus add on and aims to hold at all times a capital surplus at least equal to the upper end of this range, currently £30m and representing the difference between the undiversified and diversified SCR. If capital were to fall below the SCR (plus add on) plus £30m, the company would take action as specified in its ladder of intervention principles designed to reinstate this surplus. The ladder of intervention has been approved by the Board. It quantifies the trigger points for management intervention and describes the management actions that would be undertaken in the event of own funds falling below this threshold.

BGIL's strategy is to distribute excess capital to its parent company in line with its capital management and dividend policy whilst ensuring the SCR (plus add on) and agreed surplus of £30m are maintained. In line with that policy, a dividend of £86m was approved by the Board in May 2017 for payment in June, representing:

- Own funds at 31 December 2016: £190m, less
- SCR plus add on at 31 December 2016: £74m, less
- Target surplus i.e., the trigger point for ladder of intervention to be invoked: £30m

Note that in-year unaudited profits are currently not distributed. These profits progressively add to BGIL's solvency surplus as the year progresses.

B. SOLVENCY CAPITAL REQUIREMENT & MINIMUM CAPITAL REQUIREMENT (UNAUDITED)

BGIL calculates its Solvency Capital Requirement using:

- Partial internal model ("PIM") for insurance risk. The PRA approved the company's Internal Model application submitted in December 2015.
- Standard formula for all other risk types, namely market, counterparty and operational risk.

A £35m capital add-on was approved by the PRA for counterparty and operational risk when the company's internal model was approved in December 2015. The same position is retained as at 31 December 2016. The add-on represents the differential between an economic capital view of these risk types and the standard formula. The company is planning to extend its internal model to include counterparty and operational risk during 2017, subject to PRA approval.

The SCR is subject to annual external validation and has most recently been approved by the Board in May 2017. Further supervisory approval by the PRA, over and above the annual validation, is only required in the event of material model change, of which there were no instances in 2016.

The SCR plus add on at the end of 2016 was unchanged in absolute terms from the previous year, reflecting the company's very stable (and low) risk profile:

Risk Type £m	2015 SCR (incl PRA IMAP £35m add-on)	2016 SCR (incl PRA IMAP £35m add-on)	Difference
Market	2.4	1.3	(1.1)
Counterparty	0.0	0.0	0.0
Insurance	29.1	29.5	0.4
Diversification	(1.6)	(1.0)	0.6
Basic SCR	29.9	29.9	(0.1)
Operational	8.9	9.0	0.1
SCR	38.8	38.8	0.0
Counterparty	9.3	9.3	0.0
Operational	29.4	29.4	(0.0)
Diversification	(3.8)	(3.8)	0.0
PRA add-on	35.0	35.0	0.0
SCR (add-on)	73.8	73.8	0.0

Table 5: BGIL 2016 SCR vs. 2015 SCR (including add ons)

The company's economic capital assessment for 2016 was £71m, £3m lower than the SCR plus add-on due to a reduction in the operational risk assessment in 2016. The add on was approved in 2015 at which point operational risk was higher.

The Minimum Capital Requirement ("MCR") is £33m, equivalent to 45% of SCR and unchanged from the previous year.

C. USE OF DURATION BASED EQUITY RISK SUB-MODULE (UNAUDITED)

These are not employed.

D. DIFFERENCES BETWEEN THE STANDARD FORMULA & INTERNAL MODEL (UNAUDITED)

The capital requirement at 31 December 2016 calculated on a standard formula basis is £307m (£246m net of tax), £234m higher than the SCR plus add on using the approved PIM, the difference mainly arising from the lower insurance risk figure produced by the model. Table 6 shows the composition by risk type under both bases.

Risk Type £m	2016 SF	2016 SCRadd-on	Difference
Market	1.3	1.3	0.0
Counterparty	0.0	0.0	0.0
Insurance	276.8	29.5	(247.3)
Diversification	(1.0)	(1.0)	0.0
Basic SCR	277.1	29.9	(247.2)
Operational	30.3	9.0	(21.3)
SCR	307.4	38.8	(268.6)
Counterparty	0.0	9.3	9.3
Operational	0.0	29.4	29.4
Diversification	0.0	(3.8)	(3.8)
PRA add-on	0.0	35.0	35.0
SCR (add-on)	307.4	73.8	(233.6)

Table 6: BGIL SCR plus add on vs. SF

The standard formula for insurance risk produces a capital requirement of £277m compared with an internal model basis of £30m. BGIL's insurance risk profile is exceptionally low due to the short tail nature of the business, the fixed nature of claims costs and provision of claims fulfilment and handling services from within the Group.

The standard formula for operational risk at £30m is £8m lower than BGIL's economic capital assessment. Operational risk standard formula is derived by applying a prescribed factor to the company's revenue. Economic capital considers the principal operational risks facing the Company and the financial cost were these to crystallise at a 1 in 200 probability level which is considered a more appropriate assessment basis.

The standard formula for counterparty risk is almost zero reflecting the very small, cash fund in the 2016 balance sheet. The SCR figure of £9.3m is aligned to the economic capital assessment of counterparty risk and includes a capital add-on of £9.3m to reflect BGIL's broader counterparty exposure and designed to represent an extreme risk impact (1 in 200).

The diversification benefit in the standard formula is relatively small reflecting a high insurance risk capital figure and relatively low counterparty and market risk capital requirements. Under SCR, the counterparty risk capital figure is much higher after inclusion of the add-on, creating a larger diversification benefit of £4m when correlated against insurance and market risk.

The partial internal model is used in day to day management of the business:

- To assess any reinsurance protection requirement (currently no reinsurance is purchased)
- For capital management purposes, the determination of dividends and defining an appropriate solvency capital margin
- To inform the ORSA process and report
- To inform pricing decisions by applying risk based capital allocation
- To develop risk ranking reports and the risk register
- To support new product development e.g., decisions to underwrite new product lines

In respect of the methods used in the internal model to calculate the probability distribution forecast and the SCR, a stochastic, attritional model is employed. Claims frequency is the primary driver of variability. In addition, a cold weather model is utilised, using 10 years of company data and 250 years of simulated winter breakdown history and expert judgement driven assessments of other insurance risks 'not in data'. Industry standard correlation matrices are adopted for aggregation purposes within insurance risk and across risk types.

Integration techniques are employed to combine the internal model, standard formula and add-on components of the SCR. Various integration points exist within the model, for example attritional product performance, the combination of cold weather and insurance risks 'not in data', within market and operational risk across risk types. A standard correlation matrix is adopted throughout.

Data integrity in the internal model is validated through application of a data quality policy and application of data controls. Additional temperature data from the Meteorological Office is incorporated into the cold weather element of the capital modelling process.

E. NON-COMPLIANCE WITH THE MCR AND SCR (UNAUDITED)

No instances of non-compliance with capital requirements have occurred at BGIL since its inception. BGIL holds a capital surplus £114m at 31 December 2016 against its SCR plus add on. Against its MCR, the surplus is £155m.

The company reports available against required capital in monthly Board performance report. BGIL assesses its future available capital against its requirements in periodic planning and forecasting exercises.

Capital is monitored on a monthly basis against the SCR and an agreed capital buffer of £30m. A ladder of intervention has been approved which is triggered if available capital fell below the sum of its SCR plus an agreed capital surplus of £30m. A series of management actions will be triggered if the capital fell below this £104m threshold and escalate in scope and urgency the closer available capital falls towards the SCR of £74m.

F. ANY OTHER INFORMATION

All material and required information has been disclosed in the earlier sections.

British Gas Insurance Limited

Solvency and Financial Condition Report

Disclosures

31 December

2016

(Monetary amounts in GBP thousands)

General information

Undertaking name	British Gas Insurance Limited
Undertaking identification code	213800QKXD83EEO79W25
Type of code of undertaking	LEI
Type of undertaking	Non-life undertakings
Country of authorisation	GB
Language of reporting	en
Reporting reference date	31 December 2016
Currency used for reporting	GBP
Accounting standards	The undertaking is using local GAAP (other than IFRS)
Method of Calculation of the SCR	Partial internal model
Matching adjustment	No use of matching adjustment
Volatility adjustment	No use of volatility adjustment
Transitional measure on the risk-free interest rate	No use of transitional measure on the risk-free interest rate
Transitional measure on technical provisions	No use of transitional measure on technical provisions

List of reported templates

S.02.01.02 - Balance sheet
S.05.01.02 - Premiums, claims and expenses by line of business
S.17.01.02 - Non-Life Technical Provisions
S.19.01.21 - Non-Life insurance claims
S.23.01.01 - Own Funds
S.25.02.21 - Solvency Capital Requirement - for undertakings using the standard formula and partial internal model
S.25.02.21 - Solvency Capital Requirement - for undertakings using the standard formula and partial internal model
S.28.01.01 - Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

S.02.01.02

Balance sheet

		Solvency II value
	Assets	C0010
R0030	Intangible assets	0
R0040	Deferred tax assets	0
R0050	Pension benefit surplus	0
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	215,316
R0080	*Property (other than for own use)*	0
R0090	*Holdings in related undertakings, including participations*	0
R0100	*Equities*	0
R0110	*Equities - listed*	0
R0120	*Equities - unlisted*	0
R0130	*Bonds*	0
R0140	*Government Bonds*	0
R0150	*Corporate Bonds*	0
R0160	*Structured notes*	0
R0170	*Collateralised securities*	0
R0180	*Collective Investments Undertakings*	195,265
R0190	*Derivatives*	0
R0200	*Deposits other than cash equivalents*	20,051
R0210	*Other investments*	0
R0220	Assets held for index-linked and unit-linked contracts	0
R0230	Loans and mortgages	0
R0240	*Loans on policies*	0
R0250	*Loans and mortgages to individuals*	0
R0260	*Other loans and mortgages*	0
R0270	Reinsurance recoverables from:	0
R0280	*Non-life and health similar to non-life*	0
R0290	*Non-life excluding health*	0
R0300	*Health similar to non-life*	0
R0310	*Life and health similar to life, excluding index-linked and unit-linked*	0
R0320	*Health similar to life*	0
R0330	*Life excluding health and index-linked and unit-linked*	0
R0340	*Life index-linked and unit-linked*	0
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	0
R0370	Reinsurance receivables	0
R0380	Receivables (trade, not insurance)	0
R0390	Own shares (held directly)	0
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	212
R0420	Any other assets, not elsewhere shown	706
R0500	**Total assets**	216,235

S.02.01.02

Balance sheet

		Solvency II value
	Liabilities	C0010
R0510	Technical provisions - non-life	-10,438
R0520	*Technical provisions - non-life (excluding health)*	-10,438
R0530	*TP calculated as a whole*	0
R0540	*Best Estimate*	-15,097
R0550	*Risk margin*	4,659
R0560	*Technical provisions - health (similar to non-life)*	0
R0570	*TP calculated as a whole*	0
R0580	*Best Estimate*	0
R0590	*Risk margin*	0
R0600	Technical provisions - life (excluding index-linked and unit-linked)	0
R0610	*Technical provisions - health (similar to life)*	0
R0620	*TP calculated as a whole*	0
R0630	*Best Estimate*	0
R0640	*Risk margin*	0
R0650	*Technical provisions - life (excluding health and index-linked and unit-linked)*	0
R0660	*TP calculated as a whole*	0
R0670	*Best Estimate*	0
R0680	*Risk margin*	0
R0690	Technical provisions - index-linked and unit-linked	0
R0700	*TP calculated as a whole*	0
R0710	*Best Estimate*	0
R0720	*Risk margin*	0
R0740	Contingent liabilities	0
R0750	Provisions other than technical provisions	0
R0760	Pension benefit obligations	0
R0770	Deposits from reinsurers	0
R0780	Deferred tax liabilities	7,078
R0790	Derivatives	0
R0800	Debts owed to credit institutions	0
R0810	Financial liabilities other than debts owed to credit institutions	0
R0820	Insurance & intermediaries payables	0
R0830	Reinsurance payables	0
R0840	Payables (trade, not insurance)	0
R0850	Subordinated liabilities	0
R0860	*Subordinated liabilities not in BOF*	0
R0870	*Subordinated liabilities in BOF*	0
R0880	Any other liabilities, not elsewhere shown	29,798
R0900	**Total liabilities**	26,438
R1000	**Excess of assets over liabilities**	189,797

S.05.01.02

Premiums, claims and expenses by line of business

Non-life

		Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)												Line of business for: accepted non-proportional reinsurance				Total
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Misc. financial loss	Health	Casualty	Marine, aviation and transport	Property	
		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0200
	Premiums written																	
R0110	Gross - Direct Business											1,033,286						1,033,286
R0120	Gross - Proportional reinsurance accepted																	0
R0130	Gross - Non-proportional reinsurance accepted																	0
R0140	Reinsurers' share																	0
R0200	Net											1,033,286						1,033,286
	Premiums earned																	
R0210	Gross - Direct Business											1,008,697						1,008,697
R0220	Gross - Proportional reinsurance accepted																	0
R0230	Gross - Non-proportional reinsurance accepted																	0
R0240	Reinsurers' share																	0
R0300	Net											1,008,697						1,008,697
	Claims incurred																	
R0310	Gross - Direct Business											473,305						473,305
R0320	Gross - Proportional reinsurance accepted																	0
R0330	Gross - Non-proportional reinsurance accepted																	0
R0340	Reinsurers' share																	0
R0400	Net											473,305						473,305
	Changes in other technical provisions																	
R0410	Gross - Direct Business																	0
R0420	Gross - Proportional reinsurance accepted																	0
R0430	Gross - Non-proportional reinsurance accepted																	0
R0440	Reinsurers' share																	0
R0500	Net											0						0
R0550	**Expenses incurred**											443,825						443,825
R1200	**Other expenses**																	14,891
R1300	**Total expenses**																	458,715

S.17.01.02

Non-Life Technical Provisions

		Direct business and accepted proportional reinsurance												Accepted non-proportional reinsurance				
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance	Non-proportional property reinsurance	Total Non-Life obligation
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0170	C0180
R0010	**Technical provisions calculated as a whole**											0						0
R0050	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole																	0
	Technical provisions calculated as a sum of BE and RM																	
	Best estimate																	
	Premium provisions																	
R0060	Gross											-35,194						-35,194
R0140	Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default																	0
R0150	**Net Best Estimate of Premium Provisions**											-35,194						-35,194
	Claims provisions																	
R0160	Gross											20,096						20,096
R0240	Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default																	0
R0250	**Net Best Estimate of Claims Provisions**											20,096						20,096
R0260	**Total best estimate - gross**											-15,097						-15,097
R0270	**Total best estimate - net**											-15,097						-15,097
R0280	**Risk margin**											4,659						4,659
	Amount of the transitional on Technical Provisions																	
R0290	Technical Provisions calculated as a whole																	0
R0300	Best estimate																	0
R0310	Risk margin																	0
R0320	**Technical provisions - total**											-10,438						-10,438
R0330	**Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total**											0						0
R0340	**Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total**											-10,438						-10,438

S.19.01.21

Non-Life insurance claims

Total Non-life business

	Accident year / underwriting year	Accident Year
Z0010		

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

	Year	C0010 0	C0020 1	C0030 2	C0040 3	C0050 4	C0060 5	C0070 6	C0080 7	C0090 8	C0100 9	C0110 10 & +	C0170 In Current year	C0180 Sum of years (cumulative)
R0100	Prior											0	0	0
R0160	N-9	0	0	0	0	0	0	0	0	0	0		0	0
R0170	N-8	0	0	0	0	0	0	0	0	0			0	0
R0180	N-7	2,153	102	0	0	0	0	0	0				0	2,255
R0190	N-6	192,373	5,153	0	0	0	0	0					0	197,526
R0200	N-5	525,073	4,585	0	0	0	0						0	529,658
R0210	N-4	544,973	6,819	0	0	0							0	551,792
R0220	N-3	561,863	6,777	0	0								0	568,640
R0230	N-2	523,184	7,715	0									0	530,898
R0240	N-1	506,000	4,495										4,495	510,495
R0250	N	485,542											485,542	485,542
R0260												Total	490,037	3,376,806

Gross Undiscounted Best Estimate Claims Provisions
(absolute amount)

	Year	C0200 0	C0210 1	C0220 2	C0230 3	C0240 4	C0250 5	C0260 6	C0270 7	C0280 8	C0290 9	C0300 10 & +	C0360 Year end (discounted data)
R0100	Prior											0	0
R0160	N-9	0	0	0	0	0	0	0	0	0	0		0
R0170	N-8	0	0	0	0	0	0	0	0	0			0
R0180	N-7	0	0	0	0	0	0	0	0				0
R0190	N-6	0	0	0	0	0	0	0					0
R0200	N-5	0	0	0	0	0	0						0
R0210	N-4	0	0	0	0	0							0
R0220	N-3	0	0	0	0								0
R0230	N-2	0	0	0									0
R0240	N-1	0	0										0
R0250	N	20,098											20,096
R0260												Total	20,096

S.23.01.01

Own Funds

	Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35	Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
R0010	Ordinary share capital (gross of own shares)	5,000	5,000		0	
R0030	Share premium account related to ordinary share capital	0	0		0	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
R0050	Subordinated mutual member accounts	0		0	0	0
R0070	Surplus funds	0	0			
R0090	Preference shares	0		0	0	0
R0110	Share premium account related to preference shares	0		0	0	0
R0130	Reconciliation reserve	98,796	98,796			
R0140	Subordinated liabilities	0		0	0	0
R0160	An amount equal to the value of net deferred tax assets	0				0
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	0	0	0	0	0
R0220	**Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds**	0				
R0230	**Deductions for participations in financial and credit institutions**	0				
R0290	**Total basic own funds after deductions**	103,797	103,797	0	0	0
	Ancillary own funds					
R0300	Unpaid and uncalled ordinary share capital callable on demand	0				
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0				
R0320	Unpaid and uncalled preference shares callable on demand	0				
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0390	Other ancillary own funds	0				
R0400	**Total ancillary own funds**	0			0	0
	Available and eligible own funds					
R0500	Total available own funds to meet the SCR	103,797	103,797	0	0	0
R0510	Total available own funds to meet the MCR	103,797	103,797	0	0	
R0540	Total eligible own funds to meet the SCR	103,797	103,797	0	0	0
R0550	Total eligible own funds to meet the MCR	103,797	103,797	0	0	
R0580	**SCR**	73,802				
R0600	**MCR**	33,211				
R0620	**Ratio of Eligible own funds to SCR**	140.64%				
R0640	**Ratio of Eligible own funds to MCR**	312.54%				

	Reconcilliation reserve	C0060
R0700	Excess of assets over liabilities	189,797
R0710	Own shares (held directly and indirectly)	0
R0720	Foreseeable dividends, distributions and charges	86,000
R0730	Other basic own fund items	5,000
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0
R0760	**Reconciliation reserve**	98,796
	Expected profits	
R0770	Expected profits included in future premiums (EPIFP) - Life business	
R0780	Expected profits included in future premiums (EPIFP) - Non- life business	-37,850
R0790	**Total Expected profits included in future premiums (EPIFP)**	-37,850

S.25.02.21

Solvency Capital Requirement - for undertakings using the standard formula and partial internal model

Row	Unique number of component	Component description	Calculation of the Solvency Capital Requirement	Amount modelled	USP	Simplifications
	C0010	C0020	C0030	C0070	C0080	C0090
1	50100I	Premium risk	5,496	5,496		
2	50300I	non-life catastrophe risk	31,839	31,839		
3	50500I	Other non-life uw risk	4,194	4,194		
4	55900I	non-life uw diversification	-12,049	-12,049		
5	10200I	Interest rate risk	462			
6	10700I	Spread risk	56			
7	10800I	Concentration risk	1,246			
8	19900I	Market risk - Diversification	-434			
9	20100I	Counterparty default risk	6			
10	70100I	Operational risk	8,959			

S.25.02.21

Solvency Capital Requirement - for undertakings using the standard formula and partial internal model

		C0100
	Calculation of Solvency Capital Requirement	
R0110	Total undiversified components	39,775
R0060	Diversification	-973
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	
R0200	**Solvency capital requirement excluding capital add-on**	38,802
R0210	Capital add-ons already set	35,000
R0220	**Solvency capital requirement**	73,802
	Other information on SCR	
R0300	Amount/estimate of the overall loss-absorbing capacity of technical provisions	
R0310	Amount/estimate of the overall loss-absorbing capacity ot deferred taxes	
R0400	Capital requirement for duration-based equity risk sub-module	
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	
R0420	Total amount of Notional Solvency Capital Requirement for ring fenced funds	
R0430	Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	
R0440	Diversification effects due to RFF nSCR aggregation for article 304	

S.28.01.01

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

	Linear formula component for non-life insurance and reinsurance obligations	C0010
R0010	MCR_{NL} Result	86,003

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
		C0020	C0030
R0020	Medical expense insurance and proportional reinsurance	0	
R0030	Income protection insurance and proportional reinsurance	0	
R0040	Workers' compensation insurance and proportional reinsurance	0	
R0050	Motor vehicle liability insurance and proportional reinsurance	0	
R0060	Other motor insurance and proportional reinsurance	0	
R0070	Marine, aviation and transport insurance and proportional reinsurance	0	
R0080	Fire and other damage to property insurance and proportional reinsurance	0	
R0090	General liability insurance and proportional reinsurance	0	
R0100	Credit and suretyship insurance and proportional reinsurance	0	
R0110	Legal expenses insurance and proportional reinsurance	0	
R0120	Assistance and proportional reinsurance	0	1,011,797
R0130	Miscellaneous financial loss insurance and proportional reinsurance	0	
R0140	Non-proportional health reinsurance	0	
R0150	Non-proportional casualty reinsurance	0	
R0160	Non-proportional marine, aviation and transport reinsurance	0	
R0170	Non-proportional property reinsurance	0	

	Linear formula component for life insurance and reinsurance obligations	C0040
R0200	MCR_{L} Result	0

		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0050	C0060
R0210	Obligations with profit participation - guaranteed benefits		
R0220	Obligations with profit participation - future discretionary benefits		
R0230	Index-linked and unit-linked insurance obligations		
R0240	Other life (re)insurance and health (re)insurance obligations		
R0250	Total capital at risk for all life (re)insurance obligations		

	Overall MCR calculation	C0070
R0300	Linear MCR	86,003
R0310	SCR	73,802
R0320	MCR cap	33,211
R0330	MCR floor	18,450
R0340	Combined MCR	33,211
R0350	Absolute floor of the MCR	3,332
R0400	**Minimum Capital Requirement**	33,211

DIRECTORS' STATEMENT

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

We are satisfied that:

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

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

Date

17th May, 2017

Signed on behalf of the Board of Directors:

....

Steve O'Dwyer

Finance Director, British Gas Insurance Limited

Report of the external independent auditors to the Directors of British Gas Insurance Limited ('the Company') pursuant to Rule 4.1 (2) of the External Audit Part of the PRA Rulebook applicable to Solvency II firms

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

Opinion

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

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2016, (**'the Narrative Disclosures subject to audit'**); and

- Company templates S.02.01.02, S.17.01.02, S.23.01.01 and S.28.01.01 (**'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:

- Information contained within the relevant elements of the Solvency and Financial Condition Report set out above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report;

- The 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;

- Company templates S05.01.02, S.19.01.21 and S.25.02.21;

- 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 the Company as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as supplemented by supervisory approvals and determinations.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & I)), International Standard on Auditing (UK) 800 and International Standard on Auditing (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditors'*

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Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report section of our report.

Emphasis of Matter - Basis of Accounting

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

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, which have been supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed at below:

Approvals

- Approval to use a partial internal model

Determinations

- Determination of any capital add-on to the SCR

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.

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

It is our responsibility to form an independent opinion, in accordance with applicable law, ISAs (UK & I) and ISAs (UK) 800 and 805 as to whether the information subject to audit in the relevant elements of the Solvency and Financial Condition Report 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. ISAs (UK & I) require us to comply with the Auditing Practices Board's Ethical Standard for Auditors

An audit involves obtaining evidence about the amounts and disclosures in the relevant elements of the Solvency and Financial Condition Report sufficient to give reasonable assurance that the relevant elements of the Solvency and Financial Condition Report are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the relevant elements of the Solvency and Financial Condition Report. In addition, we read all the financial and non-financial information in the Solvency and Financial Condition Report to identify material inconsistencies with the audited relevant elements of the Solvency and Financial

Condition Report. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

This report, including the opinion, has been prepared for the Directors of the Company to comply with their obligations under External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose save where expressly agreed by our prior consent in writing.

Other Matter

The Company has authority to calculate its Solvency Capital Requirement using a partial internal model ('the Model') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

Report on Other Legal and Regulatory Requirements

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

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Accountants

7 More London Riverside, London SE1 2RT

17 May 2017

- The maintenance and integrity of the Centrica Plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Solvency and Financial Condition Report since it was initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of Solvency and Financial Condition Reports may differ from legislation in other jurisdictions.

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

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

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions - non-life (excluding health) - risk margin
  - Row R0590: Technical provisions - health (similar to non-life) - risk margin
  - Row R0640: Technical provisions - health (similar to life) - risk margin
  - Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
  - Row R0720: Technical provisions - Index-linked and unit-linked - risk margin

- The following elements of template S.17.01.02
  - Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin

- The following elements of template S.23.01.01
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

- The following elements of Company template S.28.01.01
  - Row R0310: SCR

- Elements of the Narrative Disclosures subject to audit identified as 'unaudited':
  - Risk Margin,
  - All prior year comparatives disclosed,
  - Solvency Capital Requirement and Minimum Capital Requirement,
  - Differences between the Standard Formula and Internal Model; and
  - Non-compliance with the MCR and SCR.