



FGIC UK Limited

Solvency and Financial Condition Report (SFCR)

31 December 2019

4 May 2020

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Summary

Amounts in £000's unless otherwise noted.

This document is the Solvency and Financial Condition Report (“SFCR”) for FGIC UK Limited (“FGIC UK” or the “Company”) for the year ended 31 December 2019.

The Company is considered a small Solvency II firm for external audit purposes and has taken advantage of the external audit exemption as stated in the PRA Rulebook: External Audit.

Business Overview

FGIC UK is an insurance company subject to regulation by the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”). FGIC UK is a wholly owned subsidiary of Financial Guaranty Insurance Company, a New York stock insurance corporation (“FGIC”).

FGIC UK is no longer engaged in the business of writing new financial guarantees. FGIC UK’s principal business activity continues to be the run-off of its outstanding financial guarantees.

The Company’s remaining financial guarantees cover the following types of financial obligations:

Private Finance Initiatives (“PFI”) obligations, which are financial obligations issued by certain corporate entities as part of public-private initiatives to finance the construction of public sector hospitals and healthcare facilities in the United Kingdom (“UK”), which are supported by long-term concession arrangements with National Health Service (NHS) trusts.

Transportation obligations, which comprise financial obligations of a single corporate entity that operates toll road concessions in France, which are largely supported by the related toll road revenues.

Utility obligations, which are financial obligations issued by certain government-regulated providers of essential services and commodities, including electric, water and gas utilities.

The following table sets out the par in force of the Company’s financial guarantee (insured) portfolio, by type, as of 31 December 2019.

	Total Par in Force (GBP, MM's)	% of Total
Private Finance Initiatives ("PFI")	1,019	45%
Transportation	86	4%
Utility	1,148	51%
	<hr/> 2,253	<hr/> 100%

The Company reported a profit of £4,338 for the year ended 31 December 2019 (2018: £3,840) which was primarily driven by the premiums earned on financial guarantee contracts and investment income.

The remaining financial guarantees issued by the Company insure the payment of scheduled debt service on the insured obligations when due in the event, and to the extent, the issuer of such obligations fails to make such payments. The Company's obligation to pay claims (should any claim be validly submitted), however, cannot be accelerated without its consent, regardless of whether the insured obligations have been accelerated, although the Company may have the right, at its sole option, to accelerate its payments on defaulted insured obligations. The Company did not pay any claims during 2019, and the Company has not recorded a provision for claims at 31 December 2019, nor to date, based on the information available to, and related estimates, assumptions and judgements by, management.

The Investment Portfolio of FGIC UK as of 31 December 2019 was invested in long-term UK government, other government-related obligations and investment grade corporate bonds with the remainder in short-term money market funds.

System of governance

As of 31 December 2019, FGIC UK's Board of Directors (the "Board") consisted of five directors (three of whom are senior officers of FGIC and two are non-executive directors).

As of 31 December 2019, FGIC UK's Audit Committee consisted of its two non-executive Board members who assist the Board in fulfilling its oversight responsibilities relating to the integrity of FGIC UK's financial statements and reports, the effectiveness of FGIC UK's internal financial controls, the performance of FGIC UK's external auditor and FGIC UK's compliance with laws and regulations.

Section B provides further details of the Company's system of governance.

Valuation for solvency purposes

An analysis of the adjustments made from the Statutory Accounts to the Solvency II assets and other liabilities is provided in sections D.1 and D.3 of this report, respectively.

The valuation of the technical provisions, including the amount of the best estimate and risk margin, are disclosed in section D.2 of this report. Descriptions of the methods and main assumptions and an analysis of the adjustments made from the Statutory Accounts to the Solvency II technical provisions are also discussed there.

Own Funds and Solvency Capital Requirement

Under the European Union's Solvency II Directive (2009/138/EC) ("Solvency II" or "SII"), FGIC UK's Own Funds at 31 December 2019 are £38.4m (2018: £34.5m) in the form of Tier 1 unrestricted capital. Based on the standard formula, FGIC UK's Minimum Capital Requirement ("MCR") is £24.1m (2018: £24.2m) and its Solvency Capital Requirement ("SCR") is £96.2m (2018: £96.8m). FGIC UK therefore has a capital surplus of £14.3m (2018: £10.4m) over the MCR and a capital deficit of £57.8m (2018: £62.2m) against the SCR at 31 December 2019. The ratio of Own Funds to SCR is 39.9% (2018: 35.7%). Section E provides further information on the Company's Own Funds, MCR and SCR.

FGIC UK has notified the PRA of its non-compliance with the SCR and about not having access to incremental capital to remediate this non-compliance.

FGIC UK Limited

Directors' Responsibility Statement in respect of the Solvency and Financial Condition Report

Financial Year Ended 31 December 2019

The Directors acknowledge their responsibility for preparing the SFCR in all material respects in accordance with the PRA Rules and Solvency II Regulations as applicable to the Company.

The Directors are satisfied that, to the best of their knowledge:

- a) throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable to it except for the Company's non-compliance with the SCR; and
- b) it is reasonable to believe that, at the date of publication of the SFCR, the Company has continued so to comply and will continue so to comply in the future except for the Company's continuing non-compliance with the SCR.

On behalf of the Board



T S Travers
Director

4 May 2020

Business and Performance

A.1 Business

General information:

FGIC UK is incorporated in the UK and is a company limited by shares. The address of the registered office of FGIC UK is:

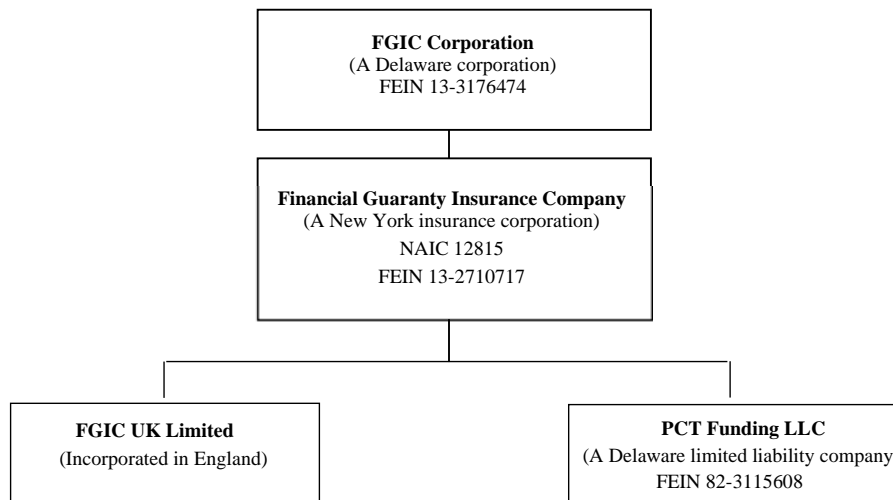
c/o Mazars LLP
Tower Bridge House
St Katharine's Way
London
E1W 1DD

As depicted below in the corporate structure, FGIC UK is a wholly owned subsidiary of FGIC, which in turn is a wholly owned subsidiary of FGIC Corporation ("FGIC Corp."), a privately owned Delaware corporation. FGIC Corp. does not conduct any business other than owning the common shares of FGIC. Lacrosse Financial Products Member, LLC ("Lacrosse") holds 34.5% of FGIC Corp's common stock. Lacrosse is an affiliate of MBIA Inc., a publicly held corporation, which (on behalf of itself and its affiliates) filed for a determination of non-control in accordance with New York Insurance Law. No other shareholder of FGIC Corp. holds 10% or more of such common stock.

FGIC UK, subject to regulation by the PRA and the FCA, was authorised to write financial guarantee business in the UK and had passport rights to write business in other European Economic Area member countries. FGIC UK previously issued financial guarantees covering public finance, structured finance and other obligations. FGIC UK is no longer engaged in the business of writing new financial guarantees and has no present intention to seek permission to recommence writing new financial guarantees. FGIC UK's principal business activity continues to be the run-off of its outstanding financial guarantees.

FGIC UK prepares its financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) including FRS 102 and FRS 103.

The group structure diagram below presents the identities of and legal links between the Company, its parent undertaking and its related entities as at 31 December 2019:



Each entity owns 100% of the common voting securities (or membership interests) of each direct subsidiary.

None of the activities of PCT Funding LLC has any connection with the business of FGIC UK.

The supervisory authority of the Company is the PRA. Contact details of the PRA are:

Prudential Regulation Authority
Bank of England
Threadneedle Street
London
EC2R 8AH

The independent auditors of the Company are:

Ernst & Young LLP
25 Churchill Place
London
E14 5EY

Business overview:

FGIC UK previously wrote financial guarantee business and it ceased writing new business in 2008. FGIC UK's principal business activity continues to be the run-off of its outstanding financial guarantees. For Solvency II purposes the Company's business falls under the Credit and Suretyship insurance line of business.

A.2 Underwriting Performance

The table below shows the Company's premiums, claims and expenses for the years ended 31 December 2019 and 2018. All amounts are in respect of the Solvency II Credit and Suretyship insurance line of business.

	2019	2018
	£'000	£'000
Gross premium written	106	99
Gross premium earned	3,437	5,613
Gross claims recovered/ (paid)	-	(1)
Net operating expenses	(1,206)	(2,054)

Premiums, claims and expenses by country are disclosed within the 'S.05.01 Premiums, claims and expenses by line of business' Quantitative Reporting Template (QRT) in the Appendix hereto.

The Company estimated future instalment premiums at inception of each financial guarantee and then re-estimates the remaining amount of instalment premiums at the end of each reporting period, based on various assumptions and circumstances at the time, which are subject to change. The gross premium written in 2019 and 2018 relate to increases in the estimated remaining amount of instalment premiums on financial guarantees inceptioned in prior years, based on changes in the related assumptions and circumstances for such estimates during the period, including changes in the index to which such premium or the related insured obligation is linked.

The gross premium earned for 2019 were lower than 2018 primarily due to the recognition of earned premiums related to the termination of a financial guarantee in 2018 that did not recur in 2019.

The Company did not pay any claims during 2019, and the Company has not recorded a provision for claims at 31 December 2019, nor to date, based on the information available to, and related estimates, assumptions and judgements by, management. In the event any claims against the Company should arise under its financial guarantees, the Company would pay such claims solely from its own claims paying resources. There is no reinsurance or support from, or recourse to, other persons, including FGIC and FGIC Corp., to pay any such claims. The Company's existing claims paying resources are limited, and if the Company were to incur material claims, it could materially adversely affect the Company's ability to continue its business.

The table below shows the gross premiums written by geographical area for the years ended 31 December 2019 and 2018.

Gross premiums written by geographical area for the year ended 31 December	2019 £'000	2018 £'000
United Kingdom	165	127
Australia	(59)	(28)
Total	106	99

The par in force of the Company's insured portfolio at 31 December 2019 and 2018 is set out below, by type of obligation. Increases associated with inflation index-linked insured obligations in the Utility sector were partially offset by decreases due to normal amortisation of the insured obligations and foreign exchange differences.

	31 December 2019 £'000	31 December 2018 £'000
PFI	1,018,928	1,041,646
Transportation	86,233	87,970
Utility	1,148,383	1,122,798
Total	2,253,544	2,252,414

Net operating expense for 2019 was lower than 2018, primarily due to decreases in the fees charged by FGIC and other outsourced service providers and lower audit fees.

A.3 Investment performance

FGIC UK's current investment strategy provides for investment primarily in UK government bonds, other government-related obligations and investment grade corporate bonds. As of 31 December 2019, 41% of the investments were in UK government bonds (2018: 45%), 13% in other government-related obligations (2018:16%) and 43% in corporate bonds (2018: 36%). Excess cash balances are invested in 'A-1/P-1' rated short-term money market funds, as appropriate in accordance with short-term liquidity requirements. At 31 December 2019, 3% of investments were in short-term money market funds (2018: 3%).

The assets held by FGIC UK on a SII basis fall into the following categories:

	31 December 2019		31 December 2018	
	£'000	%	£'000	%
UK government bonds	34,109	41	34,783	45
Other government-related obligations	10,865	13	12,484	16
Corporate bonds	36,106	43	27,474	36
Short-term money market funds	2,025	3	2,580	3
Total investments	83,106	100.0	77,321	100.0
Cash at bank and in hand	2,104		2,408	
Total investments and cash and cash equivalents	85,210		79,729	

The annualised book yield of the portfolio at year end 2019 was 1.8% (2018: 1.8%).

In 2019, FGIC UK recognised investment income of £2,183 (2018: £2,083), a realised loss of £140 (2018: realised gain of £346) and an unrealised gain of £1,186 (2018: unrealised loss of £2,145). Investment management fees for 2019 were £76 (2018: £72).

There were no gains or losses recognised directly in equity.

There were no investments in securitizations.

A.4 Performance of other activities

There are no other material activities undertaken by FGIC UK other than its insurance-related activities.

A.5 Any other information

There are no other material matters to disclose in respect to the business or performance of the Company.

System of Governance

B.1 General Information on the System of Governance

As of 31 December 2019, the Board consisted of five directors, including three members of senior management of FGIC and two non-executive directors.

As of 31 December 2019, the Audit Committee consisted of its two non-executive Board members. The Audit Committee assists the Board in fulfilling its oversight responsibilities relating to the integrity of FGIC UK's financial statements and reports, the effectiveness of FGIC UK's internal financial controls, the performance of FGIC UK's external auditor and FGIC UK's compliance with laws and regulations.

FGIC UK is managed by its Chief Executive Officer ("CEO"), who has responsibility, under the immediate authority of the Board, for managing the whole of FGIC UK's business. FGIC UK's CEO is also the CEO of FGIC.

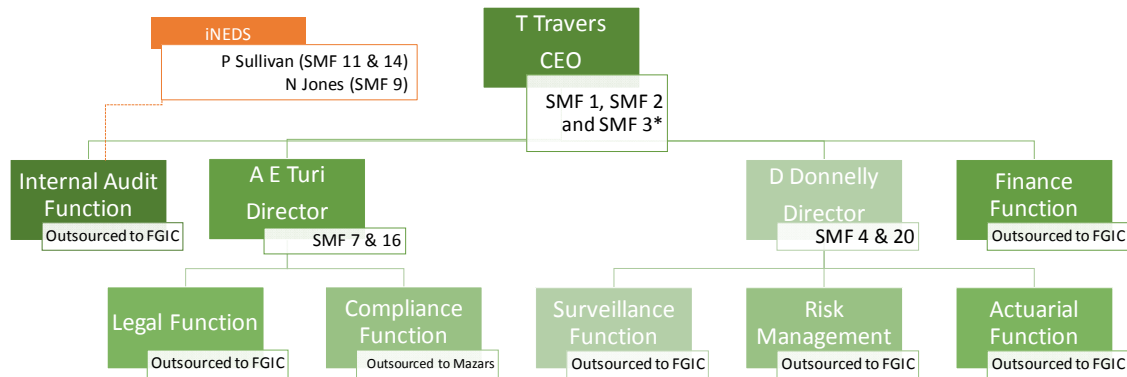
The Company has no direct employees (2018: Nil) hence there is no remuneration, fixed or variable. Instead, it has contracted with FGIC, as an outsourced service provider, to provide it with most management and administrative services. An administration fee is charged to the Company by FGIC. Such administration fee includes a charge of £159 in 2019 (2018: £238) in respect of the allocable costs associated with the time these directors devoted to performing services for FGIC UK. This is a common way for parent and subsidiary insurance companies to operate and FGIC UK obtains benefit from this structure through cost-effective access to experienced personnel resources. These services are provided at FGIC's actual cost pursuant to an agreement between FGIC UK and FGIC, which was approved or not objected to by the PRA and FGIC's primary regulator, the New York State Department of Financial Services (the "NYSDFS"). FGIC UK directly remunerates its two non-executive directors. FGIC UK's three other directors are employees of and paid by FGIC; FGIC UK paid no direct remuneration to these directors in 2019 (2018: Nil). Remuneration of the directors employed by FGIC is set by the FGIC Board of Directors and subject to the remuneration policies in place at FGIC.

The non-executive directors are paid on a fixed salary basis directly by the Company. These payments amounted to £100 in 2019 (2018: £100) and do not include any element of variable remuneration.

No material changes in the system of governance have taken place for the years ended 31 December 2019 and 2018.

FGIC UK's system of governance is considered to be appropriate, taking into account the nature, scale and complexity of the risks inherent in FGIC UK's business.

The overall governance structure of the Company is composed of the functions and senior manager function (“SMF”) holders shown in the chart below:



* SMF 3 function (previously CF1) is retained under SM&CR as T Travers is also responsible for insurance mediation.

Below is a table showing the allocation of the PRA’s prescribed principal responsibilities to the members of the Board.

	Prescribed responsibility	Responsible
A	Performance by the firm of its obligations under the Senior Managers Regime, including implementation and oversight	Timothy Travers
B	Performance by the firm of its obligations under the Certification Regime	A. Edward Turi, III
C	Compliance with the requirements of the regulatory system about the Responsibilities Map	A. Edward Turi, III
F	Induction, training and professional development of all members of the firm’s governing body	Timothy Travers
G	Induction, training and professional development of all persons performing designated senior management functions on behalf of the firm other than members of the governing body and key function holders	Timothy Travers
J-2	Oversight of Internal Audit (IA) at firms that outsource their IA to a third party	Timothy Travers
M	Responsibility for overseeing the development and implementation of the firm’s remuneration policies and practices.	Nicholas Jones
N	Whistleblowing	Nicholas Jones

B-1 (ba)	Responsibility for the firm's performance of its obligations under the Code of Conduct (COCON) (in terms of training and regulatory reporting)	A. Edward Turi, III
D	Overall responsibility for the firm's policies and procedures for countering the risk that the firm might be used to further financial crime	A. Edward Turi, III
Z	Overall responsibility for the firm's compliance with CASS	Not applicable
H	Overseeing the adoption of the firm's culture	Timothy Travers
I	Leading the development of the firm's culture by the governing body as a whole	Timothy Travers
O	Management of the allocation and maintenance of the firm's capital and liquidity	Timothy Travers
Q	Production and integrity of the firm's financials and its regulatory reporting	Timothy Travers
T	Development and maintenance of the firm's business model by the governing body	Timothy Travers
T-2 (tb)	Performance of the firm's Own Risk and Solvency assessment (ORSA)	Timothy Travers
U	Performance of the firm's obligations under Fitness and Propriety in the PRA Rulebook	A. Edward Turi, III
X (ua)	Outsourced operational functions including systems and technology	Timothy Travers

	Other allocated responsibility	Responsible
	Management of financial risks arising from climate change.	Derek Donnelly

The Company is a party to a cost sharing arrangement with FGIC whereby FGIC provides management and support services to the Company as part of the outsourcing arrangement discussed above. Charges in connection with this agreement include amounts allocated in respect of overhead and staff costs incurred by FGIC as well as direct charges paid by FGIC on behalf of the Company. In 2019, the Company was charged £567 (2018: £1,028) in respect of allocated expenses under this arrangement. £36 was due to FGIC in respect of this arrangement at December 2019 (2018: £260). The management charge includes amounts allocated in respect of staff employed by FGIC, including for service of certain such employees as directors of FGIC UK.

B.2 ‘Fit and Proper’ requirements

The SMF holders of FGIC UK have extensive knowledge and experience of the financial guarantee industry to the benefit of the Company.

The following factors are taken into account when deciding whether an individual is fit and proper:

- honesty, integrity and reputation;
- relevant experience;
- competence and capability; and
- financial soundness.

New appointments to the Board are required to be approved by the Board. Extensive checks are carried out prior to approval, including:

- interviews with the candidate;
- assessment of fitness and propriety;
- review of CV;
- professional/regulatory references; and
- criminal records check.

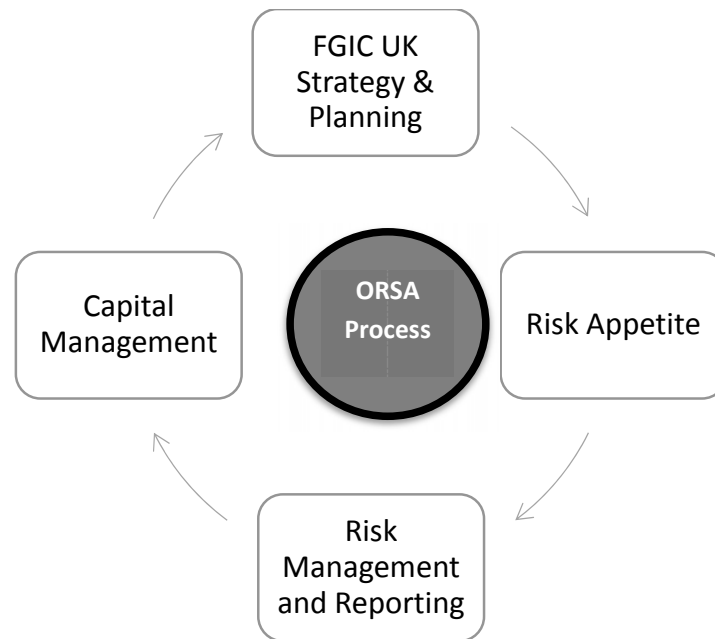
Following appointment by the Board, PRA approval is required before the position is formalised.

B.3 Risk Management System including the Own Risk and Solvency Assessment

The Company’s Own Risk and Solvency Assessment (“ORSA”) process is the mechanism through which the Company ensures that its risk management framework is sufficient and determines management’s own view of risk exposure and associated economic capital needs. The ORSA process is made up of three high level processes:

- Risk Management and Reporting;
- Capital Management; and
- Strategy and Planning.

The following diagram illustrates how these processes interact within the ORSA process:



Further details on the risk management and reporting, capital management, and strategy and planning processes are set out in the sections below.

Risk management and reporting

The Risk Management and Reporting Process sets out how risks are identified, controlled and managed by FGIC UK. It consists of the following three elements:

- Identifying risks and assessing the design and effectiveness of the controls in place to manage risks.
- Measuring and quantifying risks (risk and capital modelling): FGIC UK does this through a combination of modelling techniques, stress and scenario testing and qualitative analysis, using relevant internal and external data.
- Management/monitoring: The information resulting from identifying and assessing risks, and measuring and quantifying risks, is reported to senior management and the Board and used to improve how the business is managed.

Capital management

FGIC UK utilises a capital management tool based upon the SII Standard Formula and also projects Management's Own Economic Capital Assessment ("OECA") over a five-year time horizon. The OECA uses assumptions for Probable Maximum Loss ("PML") and projected incremental SII losses (as defined in section D.2) that are different than the Standard Formula.

Management uses the Standard Formula and the OECA as a basis for capital management. Management performs an annual assessment as part of the ORSA process to determine whether the adjusted PML used in the OECA is appropriate for the Company. Under the OECA assessment the Company has surplus capital over the SCR and MCR of £19.8m and £60.6m, respectively at the year-end 2019.

The capital management tool is overseen for FGIC UK by FGIC's Head of Treasury with support from Mazars LLP ("Mazars").

The Company's Solvency II capital position relative to the SCR and MCR (using the Standard Formula) are reviewed quarterly by the Board.

Strategy and planning

The business strategy of FGIC UK has been set by the Board and will continue in effect, unless and until it is changed by action of the Board. A scheme of operations is prepared annually and reviewed and approved by the Board.

All major decisions affecting the Company are agreed by the Board, including decisions to commute, terminate or amend any material terms of the Company's financial guarantees in a manner that would require the Company to incur any material liability or expense or to amend any material terms of the Company's Board-approved Investment Guidelines (the "Guidelines").

The ORSA is a continuous evolving process carried out by management and the Board in accordance with FGIC UK's ORSA Policy. Many elements follow a quarterly cycle and reports are produced on this basis to ensure that the Board is regularly made aware of any unexpected deviations from the Company's risk profile. The annual ORSA report is provided to the Board for review and approval and it is then submitted to the PRA in accordance with regulatory requirements.

The FGIC UK ORSA process and related ORSA Policy are reflective of the fact that FGIC UK is no longer writing any new business and its business strategy is running off its remaining insured portfolio in an orderly and efficient manner.

The risk assessment process is focused on FGIC UK's Risk Matrix and Heat Map, the integration of appropriate internal controls in the design and implementation of FGIC's and FGIC UK's policies and procedures ("Internal Controls") and the development of FGIC UK's Solvency Capital Adequacy Ratios. These three areas (Risk Matrix, Internal Controls and Solvency Capital Adequacy Ratios) were used in the processes and procedures employed to identify, assess, monitor, manage and report the short and long-term risks FGIC UK faces or may face and the process necessary to determine the capital needs for FGIC UK.

The Company conducts stress and scenario testing and reverse stress testing as part of its ORSA process.

The ORSA process considers key sensitivities of the Company's capital position in relation to relevant industry and market events.

B.4 Internal Control System

Although FGIC UK has ceased writing new business, the Company remains exposed to a number of risks arising from its insured portfolio and other credit, market and operational risks. The Company has implemented Internal Controls, including governance and management oversight structures, that are designed to ensure that the risks facing the Company are appropriately managed.

The Internal Controls, that FGIC UK relies upon generally are based upon or consistent with those used by FGIC. The Internal Controls documentation is reviewed and updated as necessary on a periodic basis.

B.5 Internal Audit Function

The Internal Audit Function for FGIC UK is outsourced to FGIC and overseen by the Audit Committee and FGIC UK's CEO. The Audit Committee approves and oversees the performance of the Company's annual Internal Audit Plan.

B.6 Actuarial Function

The actuarial function is outsourced to FGIC and overseen by a FGIC UK director who is FGIC's Head of Portfolio Risk Management and FGIC UK's SMF holder. FGIC UK uses the services of the actuarial team within Mazars where required, as FGIC UK believes that the FGIC internal staffing and the professional services provided by Mazars are appropriate for the nature, scale, and complexity of the risks to which FGIC UK is exposed.

B.7 Outsourcing

FGIC UK does not directly employ any staff. Instead, it has contracted with FGIC, as an outsourced service provider, to provide it most management and administrative services. This is a common way for parent and subsidiary insurance companies to operate and FGIC UK benefits from this structure through cost-effective access to experienced personnel resources. These services are provided at FGIC's actual or allocated cost pursuant to an agreement between FGIC UK and FGIC, which was approved or not objected to by the PRA and the NYSDFS.

FGIC UK also has contracted to receive certain services from third party providers, including investment management services from Wellington Management International Ltd ("Wellington") and investment accounting services from Clearwater Analytics, LLC ("Clearwater"). FGIC UK also has retained Mazars to provide certain services (e.g., Accounting, Financial and Regulatory Reporting, Tax and Corporate Secretarial).

Reliance on FGIC is not considered a key risk area because (i) FGIC is as a solvent and stable insurance company that is charged with the responsibility of completing the long-term run-off of its insured portfolio in accordance with the terms of its rehabilitation plan and (ii) with respect to the management and other services provided by FGIC to FGIC UK, FGIC and FGIC

UK's interests are aligned because FGIC UK represents a significant investment for FGIC, which, if properly managed, may ultimately yield a significant future benefit for FGIC.

A summary of FGIC UK's outsourcing arrangements is outlined below:

Outsourced Provider	Service Outsourced	Jurisdiction
FGIC	Portfolio Surveillance and Remediation	US
	Financial Reporting	
	Administration	
	Actuarial Services	
Mazars	Information Technology	UK
	Accounting	
	Financial and Regulatory Reporting	
	Tax	
	Actuarial Services	
Wellington	Corporate Secretarial	UK
	Investment Management Services	
Clearwater	Investment Accounting Services	US

The Company has put in place policies and procedures to ensure the outsourced services are monitored and reviewed on a regular basis. Refer to the organisation chart provided in section B.1 above for an overview of key function holders and their responsibilities.

B.8 Any Other Information

There are no other material matters to disclose in respect to the system of governance of the Company.

C. Risk Profile

This section discusses the material risks to which the Company is exposed in executing its business strategy to run-off its remaining financial guarantees.

C.1 Insurance Risk

The remaining financial guarantees issued by the Company insure the payment of scheduled debt service on the insured obligations, in the event and to the extent that the issuers of such insured obligations fail to make such payments when due. The principal risk from the Company's legacy insurance business, therefore, is the risk that the issuers of such insured obligations fail to pay scheduled debt service when due. An issuer's failure to pay scheduled

debt service when due would entitle the beneficiary to make a claim under the applicable financial guarantee issued by the Company for the amount of such unpaid debt service. The Company's obligation to pay claims (should any valid claim be submitted), however, cannot be accelerated without its consent, regardless of whether the insured obligations have been accelerated, although the Company may have the right, at its sole option, to accelerate its payments on defaulted insured obligations.

The Company's financial guarantees are generally not cancelable, and the Company is entitled to receive instalment premiums under certain of its remaining financial guarantees. The Company, therefore, is exposed to the related credit risk that the remaining instalment premiums (or a portion thereof) are not paid to the Company when due.

The Company reviews its insured obligations on a regular basis with the objective of monitoring credit quality and performance, identifying credit deterioration, and avoiding or minimizing losses. Based on these reviews, the Company assigns each insured obligation to one of the following risk categories, to set the extent and frequency of the Company's ongoing surveillance efforts:

Risk Category 1 – Performing – Regular Surveillance: Includes insured obligations that are performing with no expectation of loss in current or anticipated circumstances. Insured obligations assigned to this risk category are reviewed on at least an annual basis.

Risk Category 2 – Performing – Heightened Surveillance: Includes insured obligations that are performing with no expectation of loss in current or anticipated circumstances, but which have been identified as deserving heightened surveillance due to the occurrence of one or more factors that have impacted, or may impact, the credit quality of the insured obligation, such as financial, economic, political, legal, contractual, performance or other issues adversely impacting an issuer/transaction or an entire sector or category of insured obligations, the breach of one or more representations, covenants or deal triggers by the issuer/transaction, or the downgrade of an insured obligation to low or below investment grade. Insured obligations assigned to this risk category are reviewed on at least a semi-annual basis.

Risk Category 3 – Credit Deterioration – Possible Loss: Includes insured obligations that have suffered credit deterioration sufficient to create a significant possibility of payment default in the future, but that are not currently or likely to be in payment default. Insured obligations assigned to this risk category are reviewed on at least a quarterly basis.

Risk Category 4 – Actual or Likely Payment Default: Includes insured obligations that are currently or likely to be in payment default. A provision for claims is established for insured obligations assigned to this category for which future loss is probable and can be reasonably estimated. Insured obligations assigned to this risk category are reviewed on at least a quarterly basis.

Each insured obligation is subject to surveillance by highly experienced members of the FGIC Surveillance team. Each insured obligation is reviewed on a regular basis in accordance with the review process described above. The minimum review period can only be altered with CEO approval. The insured portfolio is discussed at each quarterly Board meeting.

As part of its monitoring process, the FGIC Surveillance team collects and analyses information from various sources for each insured obligation, including trustee reports, financial statements, technical advisor reports, operating reports, general industry or sector news and analyses, rating agency reports and direct contact with issuer representatives. The team also analyses and considers various factors relevant to each insured obligation, including both transaction-specific and broader macroeconomic developments and trends, changes in applicable law or the legal environment, and the potential impact of other material risks relevant to the Company's insured portfolio. This process minimises the risk that credit deterioration is not identified on a timely basis.

The Company's insured obligations generally share common risk and other characteristics based on their particular sector. The FGIC Surveillance team provides reports to the Board on the Company's key insured portfolio sectors (Utilities and PFI), which are designed to identify and assess trends and developments that may adversely affect the Company's insured obligations in those sectors, as well as potential mitigating considerations.

As of 31 December 2019, all insured obligations were assigned to "Performing" Risk Categories 1 or 2. The Company did not pay claims during 2019, and the Company has not recorded a provision for claims at 31 December 2019, nor to date, based on the information available to, and related estimates, assumptions and judgements by, management.

In the event that in the future any insured obligations are, or are likely to be, in payment default and the related future loss is probable and can be reasonably estimated, the Company would establish a provision for claims for the value of the estimated losses on such insured obligations. Any determination by the Company to establish (or not establish) a provision for claims is necessarily based upon estimates, assumptions and judgements by management, including with respect to the probability of default, the severity of loss upon default and the outcome of other future events. These estimates, assumptions and judgements may change materially from time to time, and as a result the Company's provision for claims, and its financial results, may change materially during the relevant period. Any estimates of the Company's provision for claims, therefore, may differ from the ultimate claims required to be paid by the Company, possibly materially.

In the event any claims against the Company should arise under its remaining financial guarantees, the Company would pay such claims solely from its own claims paying resources. There is no reinsurance in place or support from, or recourse to, other persons, including FGIC, to pay any such claims. The Company's existing claims paying resources are limited, and if the Company were to incur material claims, it could materially adversely affect the Company's ability to continue its business.

For the remaining financial guarantees under which instalment premiums are payable, the Company projects future instalment premiums of £52,089. Expected premium receipts are monitored against actual premium receipts on a monthly basis. Any discrepancies are reported and investigated. Credit quality of the obligors is monitored on a regular basis and is reported to the Board on a quarterly basis. If any instalment premium was not paid when due, FGIC UK would pursue its available remedies. FGIC UK's financial guarantees, however, generally are not cancelable as a result of any failure to pay premium. The expected profit in future premiums (SII Gross Best Estimate) is £13,696 at 31 December 2019.

The risk modules comprising the SCR are shown in the second table in section E.2 and were calculated using the Standard Formula. The risk module for insurance risk is shown in that

table as Non-life Underwriting Risk, which comprises the sub-modules for Underwriting Risk and Catastrophe (Cat) Risk shown in that table.

C.2 Market Risk

From a Solvency II perspective, market risk includes FGIC UK's exposure to interest rate risk, spread risk, currency risk and inflation risk (discussed below).

FGIC UK's exposure to market risk is primarily in respect of FGIC UK's investment portfolio, through interest rate risk and spread risk (discussed below). FGIC UK is exposed to limited market risk in its insured portfolio, through currency risk and inflation risk (discussed below).

As of 31 December 2019, FGIC UK's investment portfolio was composed of investments in UK government bonds (41%), other government-related obligations (13%) and investment grade corporate bonds (43%), nearly all of which were fixed rate, and investments in A-1/P-1-rated short-term money market funds (3%). All of these investments were denominated in GBP. As of 31 December 2019, the investment portfolio had an overall average credit quality of AA-/Aa3, a book yield of about 1.8% per annum, and an effective duration of about 5.5 years. FGIC UK's investment portfolio is managed by Wellington pursuant to the Guidelines.

FGIC UK does not invest in equity securities, so it is not exposed to stock market declines or other equity valuation risk. FGIC UK does not employ derivatives, so it is not exposed to any derivative counterparty credit risk. FGIC UK does not invest in securities insured by FGIC UK or FGIC.

The prudent person principle

The Company's investment strategy and the Guidelines are aligned with the "prudent person principle" set out in the Solvency II regulations. Under the Guidelines, FGIC UK's investment objective is to obtain an after-tax total rate of return that exceeds the after-tax total return of the benchmark index selected for measuring investment performance while preserving capital. The Guidelines are designed to minimize credit risk and concentration risk and to ensure sufficient liquidity to pay the Company's financial obligations as they come due. Each quarter the Board reviews an investment performance report prepared by Wellington. The report includes a detailed portfolio review, a market analysis and a compliance report. The Board periodically reviews the Guidelines to determine if changes are necessary or appropriate.

Interest Rate Risk

The Company is exposed to interest rate risk in its investment portfolio, primarily with respect to its investments in fixed rate bonds. As market interest rates rise, the value of the Company's fixed rate investments generally will decrease, which would produce unrealized losses or reduce the amount of unrealized gains. A fixed rate investment's maturity will generally affect how much its value will decrease as a result of increases in market interest rates, with longer maturities generally experiencing larger decreases. This relationship between interest rates and values is known as interest rate risk.

The Company seeks to manage its interest rate risk by maintaining a diversified portfolio of investments with a variety of remaining maturities and setting a target band of duration for the investment portfolio, which effectively requires Wellington to maintain the investment

portfolio's interest rate risk within acceptable risk limits. Interest rate sensitivity analyses are periodically presented to the Board for review.

Spread Risk

The Company is exposed to spread risk in its investment portfolio, particularly with respect to its investments in corporate and other non-government bonds. The Company's investments may suffer credit rating downgrades, credit deterioration, or default, causing the value of the investments to decline. Credit spread generally reflects the risk premium required by investors to own corporate bonds as compared to government debt with an equivalent maturity. Credit spreads may be affected by various factors, including changes in the credit rating or perceived credit quality or default risk of the particular bond or issuer, as well as changes in general market conditions. As credit spreads widen, the value of the Company's corporate bond investments will generally decrease.

The Company seeks to manage this risk by maintaining a high-quality investment portfolio with diversified risk exposures. The Guidelines provide, among other things, that (i) the investment portfolio must maintain a weighted average portfolio rating of A/A2 or better (AA-/Aa3 as of 31 December 2019), (ii) individual securities must be rated BBB-/Baa3 or better at the time of purchase, (iii) the value of the securities rated in the triple-B category must not exceed 30% of the value of the portfolio (17.7% as of 31 December 2019), and (iv) money market funds and other short-term investments must be rated A-1/P-1 at the time of purchase. The Guidelines also impose issuer and sector specific concentration limits. In the event that the investment portfolio or an individual security may fall out of compliance with these requirements, Wellington is required to notify the Company's management and provide an evaluation and a recommended plan of action.

Wellington monitors the credit ratings for, and other developments concerning, the Company's investments on an ongoing basis and reports to the Board and management on such matters on at least a quarterly basis.

Currency Risk

FGIC UK is exposed to currency risk based on adverse movements in the exchange rate between GBP and certain other currencies. FGIC UK's investment assets are denominated in GBP. About 9% of FGIC UK's insured exposure (by principal outstanding) is under financial guarantees denominated in EUR or AUD. FGIC UK is exposed to currency risk in the event and to the extent FGIC UK should incur any claims under such financial guarantees. In the event that FGIC UK ever determines to record a provision for non-GBP claims, FGIC UK would consider mitigating its currency risk through hedging transactions.

In addition, certain remaining instalment premiums or other amounts receivable by FGIC UK are denominated in EUR or AUD, and expenses related to services provided by FGIC and certain other vendors are denominated in USD, which exposes FGIC UK to currency risk.

Inflation Risk

FGIC UK is exposed to inflation risk under financial guarantees covering inflation index-linked obligations. As of 31 December 2019, FGIC UK insured inflation index-linked obligations with an aggregate outstanding principal amount of £1,168,568. The insured principal amount of these obligations will increase if the applicable retail price index increases. Any remaining

instalment premiums on the financial guarantees covering these inflation index-linked obligations will generally be calculated by reference to the outstanding principal amount of these obligations (as adjusted due to changes in the retail price index). Changes in gross par outstanding are reported to the Board on a quarterly basis. Ongoing surveillance of insured inflation index-linked obligations includes monitoring the underlying exposures and any changes in the related indices.

C.3 Credit Risk

FGIC UK is exposed to credit risk under its remaining financial guarantees, including with respect to the collection of the remaining instalment premiums owed to it (discussed above in section C.1), and in connection with the investments held in its investment portfolio (discussed above under Spread Risk in section C.2).

The only other counterparty credit risk to which FGIC UK is exposed is the risk relating to cash on deposit at banks, which totaled £2,104 at 31 December 2019. This risk is shown as Counterparty Risk in the second table in section E.2, and it is not material to FGIC UK.

C.4 Liquidity Risk

FGIC UK manages its liquidity risk by holding cash on deposit at banks and short-term money market fund investments in excess of the aggregate amount of all known financial liabilities coming due within the next twelve months. FGIC UK had cash on deposit at banks and short-term money market fund investments totaling £4,129 at 31 December 2019. FGIC UK had no debt obligations at 31 December 2019 (2018: Nil).

For FGIC UK, liquidity risk relates primarily to how quickly and easily FGIC UK will be able to convert its bonds and other investment securities to cash to pay any unanticipated financial liabilities, including unanticipated claims under financial guarantees, as they come due, in the event any such liabilities or claims arise in the future. FGIC UK manages its liquidity risk by maintaining a high quality, diversified portfolio of liquid investment securities, with a majority of FGIC UK's investments comprising UK government bonds and other government-related obligations. FGIC UK considers its liquidity risk to be low.

C.5 Operational Risk

The Company faces operational risk associated with its business, including risks related to accounting, financial, tax and regulatory reporting, information technology and cybersecurity, and legal and regulatory matters. Operational risk includes the risk that the service providers with whom the Company has contracted fail to perform their respective services in accordance with applicable contracts with the Company. Operational risk includes reputational risk and regulatory risk.

FGIC UK does not employ any staff. Instead, it has contracted with FGIC, as an outsourced service provider, to provide it most management and administrative services. This is a common way for parent and subsidiary insurance companies to operate and FGIC UK benefits from this structure through cost-effective access to experienced personnel resources. FGIC UK also has contracted to receive certain services from third party providers, including investment management, investment accounting, and certain accounting, financial and regulatory reporting, actuarial, tax and corporate secretarial services. To manage this risk, FGIC UK has

implemented policies and procedures to monitor and review the outsourced services and the performance and capabilities of its outsourced service providers on a regular basis.

Operational risk is further mitigated by policies, procedures and controls implemented by FGIC UK (or FGIC and applicable to FGIC UK), including those relating to compliance, business continuity, cybersecurity, and corporate governance. FGIC UK was not named as a defendant in any litigation or regulatory enforcement proceeding as of 31 December 2019. Reputational risk is minimal for FGIC UK as it only conducts the run-off of its business. FGIC UK is not writing, nor does it intend to seek to write, any new insurance business.

Regulatory risk represents the potential for losses or other consequences relating to action or inaction by FGIC UK, which could potentially result in the taking of regulatory action or the imposition of fines by either the PRA or the FCA. FGIC UK mitigates this risk by developing, implementing and enforcing policies and procedures to ensure awareness of and compliance with regulatory obligations.

At 31 December 2019, FGIC UK is compliant with the MCR but not compliant with the SCR. To date, the PRA has shown forbearance with respect to this non-compliance, but there can be no assurance that it will continue to do so. If the PRA were to discontinue this forbearance, it could materially adversely affect the Company's ability to continue its business.

C.6 Other Material Risks

The events and circumstances discussed below could impact the Company's risk profile, including the risks discussed above in this section C.

C.6.1 COVID-19

A coronavirus disease, COVID-19, began to spread globally in early 2020 and has been declared a pandemic by the World Health Organization. Its emergence and reactions to it have already had a profound effect on both the domestic and global economies and financial markets. The short- and long-term impacts of the COVID-19 pandemic, and the true extent of such impacts, are by their very nature uncertain and will be determined by many factors, including the effectiveness of government and other health measures to contain and prevent the spread of the virus and the effectiveness of economic stimulus, emergency relief, and other government programs, initiatives and actions implemented or taken to mitigate the economic, financial and other disruptions caused by the COVID-19 pandemic.

At this time, however, there remains considerable uncertainty as to how long the COVID-19 pandemic will last and as to the extent and duration of the economic, financial and other disruptions caused by the pandemic. Consequently, there remains considerable uncertainty relating to precisely how the COVID-19 pandemic will impact the insurance, market, credit, liquidity and operational risks to which the Company is exposed, including risks relating to the Company's remaining financial guarantees, and whether or to what extent any such impact will be temporary or lasting.

The Company is working with FGIC and its other important service providers to ensure continuity of services during the COVID-19 pandemic, and, to date, the Company's business operations have not been disrupted nor adversely impacted in any material respect. To augment the Company's regular surveillance process for its insured portfolio (discussed above in section C.1), the Company is implementing plans to assess and monitor the impact that the COVID-19 pandemic may have on the obligations insured by each of its remaining financial guarantees,

based on the relevant characteristics of the particular insured obligation and the related issuer and sector. Based on the information available to, and related estimates, assumptions and judgements by, management to date, the Company does not expect the issuer of any obligations insured under any of the Company's remaining financial guarantees to fail to make the scheduled debt service payments on such insured obligations when due. To augment the Company's regular review process for its investment portfolio (discussed above in section C.2), the Company is implementing plans to assess and monitor the impact that the COVID-19 pandemic may have on its investment portfolio. In the first quarter of 2020, the market value of the Company's investment portfolio was not impacted in any material respect, and any lessening of the liquidity of such investments has not affected the Company in any material respect. These activities are subject to supervision and oversight by the Board.

C.6.2 Brexit

The UK exited from the European Union (EU) (i.e., Brexit) on 31 January 2020. During a transition period that is scheduled to last until 31 December 2020, EU law will continue to apply in and to the UK and the UK will continue to trade with the EU as part of the Single Market. During this transition period, the UK and the EU will seek to negotiate and decide on the terms of a UK-EU trade deal and other matters pertaining to their future relationship. Whether a UK-EU trade deal will be negotiated during the transition period is uncertain, and the terms of any such trade deal are not known at this time, but any trade deal (or the failure to reach a trade deal) may result in tariffs on exports and imports. The ultimate impact of Brexit on applicable laws and regulations, the UK economy, and employment rates, interest rates, credit spreads and exchange rates in the UK is currently unknown. From a cross-border perspective, the Company does not expect that Brexit will adversely impact its ability to continue to implement its business strategy of running off its remaining financial guarantees. Outside of the UK, the Company has a small number of financial guarantees for which the Member State of the Risk is Ireland. The Company is engaging with the PRA in relation to these guarantees but does not currently anticipate taking any course of action.

C.6.3 Anticipated LIBOR Cessation

The anticipated cessation of the London Interbank Offered Rate ("LIBOR") at the end of 2021 could impact the financial markets and certain market participants. None of the Company's remaining financial guarantees covers LIBOR-based obligations. As of 31 December 2019, the Company owned only a minimal amount of LIBOR-based bonds. The Company, therefore, believes that it has no meaningful exposure to risks associated with the anticipated cessation of LIBOR at the end of 2021.

C.6.4 Climate Change

The financial risks from climate change could impact the Company's risk profile, including the insurance and market risks to which it is exposed. To comply with a PRA supervisory statement, the Company appointed an SMF for managing financial risks arising from climate change. The SMF will work with management and the Board to establish a process to identify and assess the financial risks arising from climate change that affect the Company, which is proportionate to the size and nature of the Company's run-off business.

C.7 Any Other Information

C.7.1 Stress Tests

The Company conducts stress and scenario testing and reverse stress testing as part of its ORSA process. Stress and scenario testing are designed to provide quantitative and qualitative insight with respect to the impact that plausible, adverse stress scenarios could have on the Company's capital position. Reverse stress testing is designed to identify plausible, but severe stress scenarios that could threaten the Company's continued business viability. Results of this testing are included in the Company's ORSA Report that is presented to and approved by the Company's Board.

D. Valuation for Solvency Purposes

D.1 Assets

The following table provides a comparison of the valuation of assets in FGIC UK's UK GAAP financial statements as of 31 December 2019 (the "Statutory Accounts") compared to the valuation of assets for Solvency II purposes shown on the Solvency II Balance Sheet as of 31 December 2019 (the "Solvency II Balance Sheet").

As at 31 December 2019	Statutory Accounts Valuation £'000	Solvency II Valuation Adjustment £'000	Solvency II Balance Sheet Valuation £'000
Deferred acquisition costs	3,642	(3,642)	-
Investments	82,440	666	83,106
Insurance and intermediaries receivables	53,967	(53,967)	-
Cash at bank and in hand	2,104	-	2,104
Other assets	775	(666)	109
Total Assets	142,928	(57,609)	85,319

As at 31 December 2018	Statutory Accounts Valuation £'000	Solvency II Valuation Adjustment £'000	Solvency II Valuation £'000
Deferred acquisition costs	3,822	(3,822)	-
Investments	76,676	645	77,321
Insurance and intermediaries receivables	58,819	(58,819)	-
Cash at bank and in hand	2,408	-	2,408
Other assets	645	(645)	-
Total Assets	142,370	(62,641)	79,729

An explanation of the adjustments made to arrive at the Solvency II Balance Sheet valuation is provided in the paragraphs below.

Deferred acquisition costs

On a Statutory Accounts basis deferred acquisition costs comprise costs associated with the conclusion of insurance contracts that were incurred in prior reporting periods during which

the Company wrote business, which were deferred and not expensed during those periods, but are amortised over the period in which unearned premiums are earned.

Deferred acquisition costs are not an asset on the Solvency II Balance Sheet and, therefore, are fully eliminated.

Investments

Investments comprise UK government bonds, other government-related obligations, corporate bonds and short-term money market funds. For both the Statutory Accounts and the Solvency II Balance Sheet all financial investments are valued at fair value. All investments are classified as level 2 of the fair value hierarchy, which values investments with quoted prices in active markets for similar assets or other valuation techniques for which all significant inputs are based on either directly or indirectly observable market data.

On a Statutory Accounts basis, accrued income of £666 related to investments is shown in other assets, but is included within investments on the Solvency II Balance Sheet.

Insurance and intermediaries receivables

On a Statutory Accounts basis, insurance and intermediaries receivables consists of all projected future instalment premiums and other receivables of the Company at the balance sheet, including any such amounts that were past due. There were no past due amounts at the balance sheet.

Insurance and intermediaries receivables are not an asset on the Solvency II Balance Sheet (except to the extent any were past due) as amounts receivable are included within the calculation of technical provisions. No amounts were past their due date.

Cash at bank and in hand

Cash at bank and in hand comprises cash on demand deposits with banks which are exchangeable for GBP currency on demand at par and which are directly usable without penalty or restriction.

Cash at bank and in hand is included within both the Statutory Accounts and the Solvency II Balance Sheet.

Other assets

On a Statutory Accounts basis, other assets comprise accrued investment income of £666 and a tax receivable of £109.

Accrued investment income is not a separate asset on the SII Balance Sheet and is included within investments on the Solvency II Balance Sheet.

D.2 Technical Provisions

On a Statutory Accounts basis technical provisions for FGIC UK comprise the provision for unearned premiums, since FGIC UK has not determined it necessary to establish a provision for claims. On the Solvency II Balance Sheet, technical provisions comprise the gross best estimate and a risk margin (each discussed below).

Technical provision calculation methodology under Solvency II

For the Company, the Solvency II technical provisions equal the sum of a gross best estimate and a risk margin valued in accordance with the Solvency II Directive.

Gross Best Estimate

The gross best estimate component of Solvency II technical provisions represents the present value of the Company's projected future cash outflows less the present value of the Company's projected future cash inflows, in each case determined in accordance with SII. For the Company, projected cash outflows include projected future expenses to run-off the Company's remaining financial guarantees and projected future claim payments under the Company's remaining financial guarantees, in each case determined for these purposes in accordance with SII. Even though the Company has not recorded a provision for claims in its Statutory Accounts (having not determined that the likelihood of loss under any financial guarantee is probable), the Gross Best Estimate includes a provision for projected claim payments under every remaining financial guarantee not just those where the likelihood of loss is probable (the "projected incremental SII losses"). To determine the projected incremental SII losses the Company relies on Management's judgement as well as external sources to determine the appropriate probability of default and loss severities to apply to its insured portfolio. For the Company, projected cash inflows include all projected future instalment premiums and other insurance-related amounts payable to the Company. The Company's projected cash inflows exceed its projected cash outflows and therefore the gross best estimate component of Solvency II technical provisions is negative.

Risk Margin

For Solvency II, the risk margin it intended to represent an estimate of the amount that a third party insurer would expect to receive in addition to the gross best estimate to assume liability for the Company's remaining financial guarantees. The Company uses a cost-of-capital approach to determine the risk margin, including an assumption that the Company's remaining insurance obligations run off on a linear basis over time to their respective scheduled maturity dates for purposes of calculating the SCR for each future year to which the assumed cost of capital is applied. The Company's insured portfolio has a much longer run-off period (over 30 years) than other insurers. The risk margin drives the Company's Solvency II technical provisions.

The technical provisions at 31 December 2019 and 31 December 2018 on the Solvency II Balance Sheet are made up as follows:

	<u>2019</u> £'000	<u>2018</u> £'000
Gross Best Estimate	(13,696)	(15,915)
Risk Margin	59,625	59,656
Technical provisions	<u>45,929</u>	<u>43,741</u>

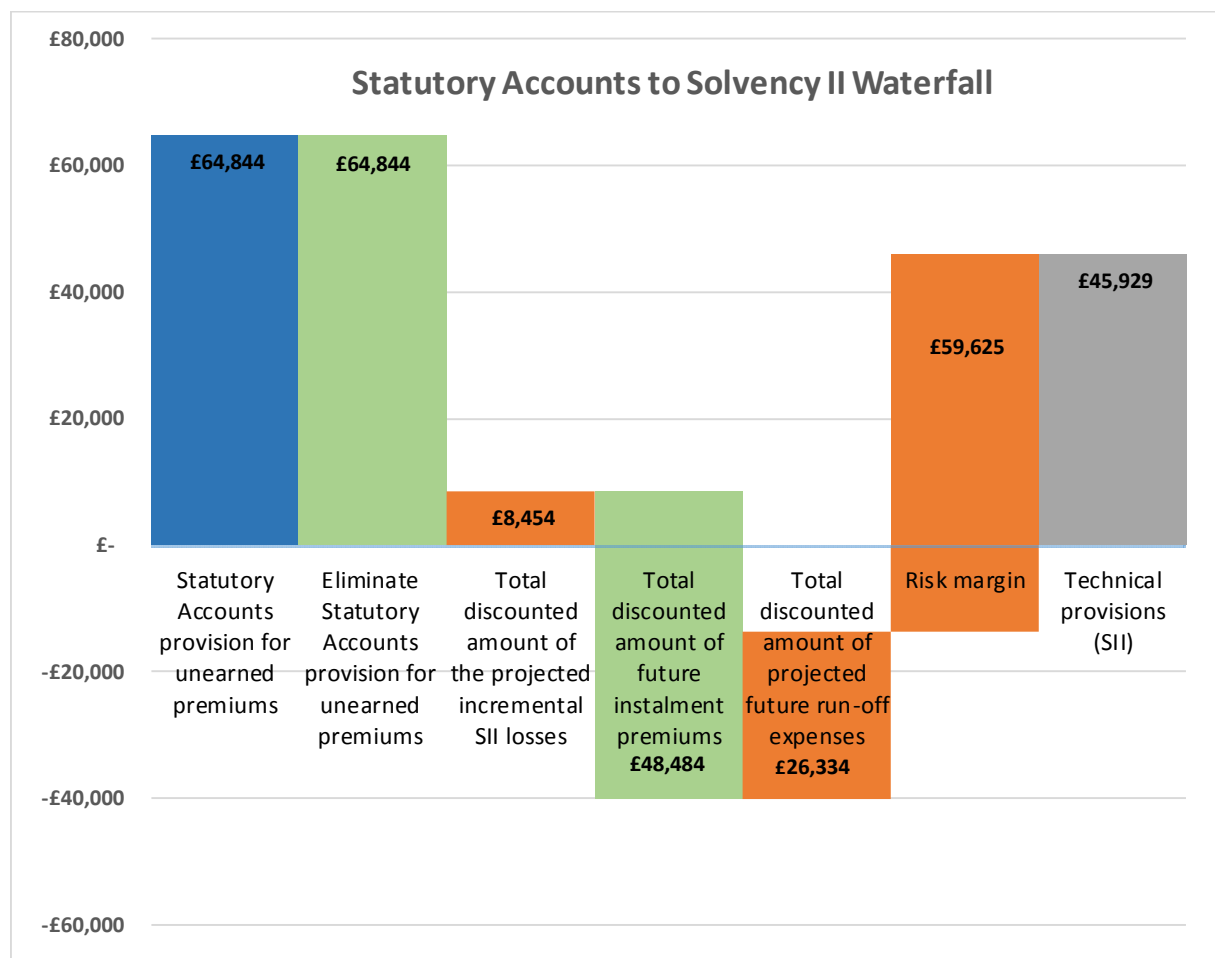
All figures relate to the Credit and Suretyship insurance line of business. As noted earlier there is no reinsurance cover in place for the Company.

Solvency II and Statutory Accounts valuation differences- technical provisions

The table below shows a reconciliation of the Statutory Accounts valuation of technical provisions to the Solvency II Balance Sheet valuation of technical provisions at 31 December 2019 and 31 December 2018.

	<u>2019</u>	<u>2018</u>
	£'000	£'000
Technical provisions - Statutory Accounts valuation	64,844	68,174
Adjustments for Solvency II	(78,540)	(84,089)
Gross Best Estimate	(13,696)	(15,915)
Risk Margin	59,625	59,656
Technical provisions – Solvency II valuation	45,929	43,741

The Solvency II adjustments are further detailed in the waterfall diagram below:



The material differences between the Statutory Accounts valuation of technical provisions and the Solvency II Balance Sheet valuation of technical provision are summarized below:

- The Statutory Accounts provision for unearned premiums is eliminated because an unearned premium reserve is not included in the calculation of the Solvency II technical provisions;
- The total discounted amount of the projected incremental SII losses is included in the calculation of the Solvency II technical provisions;
- The total discounted amount of future instalment premiums expected to be received is included in the calculation of the Solvency II technical provisions as a contra amount;
- The total discounted amount of all projected future run-off expenses is included in the calculation of the Solvency II technical provisions; and
- The risk margin is included in the calculation of the Solvency II technical provisions.

The Company does not have any approvals in place in relation to any Solvency II transitional measures.

Uncertainty

Uncertainty associated with the valuation of technical provisions primarily arises from how future actual experience will differ from the best estimate assumptions used to calculate technical provisions. Future experience may differ materially from the Company's projected technical provisions. The key assumptions driving technical provisions are estimates of future premiums, claims, inflation rates and expenses. Future premiums are based on the premium rate applicable to each financial guarantee and the estimated future par outstanding on FGIC UK's existing exposure. Future expenses reflect costs associated with outsourced service providers, including FGIC. Expense projections reflect the projected run-off of the insured portfolio, partially offset by future inflation. The Company's projection of claim payments utilises probability of default and loss severities which are higher than that experienced by FGIC UK historically.

D.3 Other Liabilities

The table below presents a valuation of the other liabilities in the Statutory Accounts and Solvency II Balance Sheets; no Solvency II valuation adjustments were required.

	Statutory Accounts Valuation £'000	Solvency II Valuation Adjustment £'000	Solvency II Balance Sheet Valuation £'000
As at 31 December 2019			
Payables (trade, not insurance)	800	-	800
Accruals and deferred income	189	-	189
Total Other Liabilities	989	-	989

	Statutory Accounts Valuation £'000	Solvency II Valuation Adjustment £'000	Solvency II Valuation £'000
As at 31 December 2018			
Payables (trade, not insurance)	1,176	-	1,176
Accruals and deferred income	263	-	263
Total Other Liabilities	1,439	-	1,439

Accruals and deferred income are classified under 'any other liabilities, not elsewhere shown' on the Solvency II Balance Sheet.

D.4 Alternative Methods for Valuation

Alternative methods for valuation are not used by the Company. The investments are classified as level 2 of the fair value hierarchy. This is a financial statement classification. Level 2 investments are investments with quoted prices in active markets for similar assets or other valuation techniques for which all significant inputs are based on observable market data.

D.5 Any Other Information

There is no other material information on valuation for Solvency II purposes.

E. Capital Management

E.1 Own Funds

Objective, policies and processes of managing Own Funds

FGIC UK is no longer engaged in the business of writing new financial guarantees and its principal business activity continues to be the run-off of its outstanding guarantees. FGIC UK has no access to new funds and is unable to pay dividends without the prior approval of the PRA. The Company's investment portfolio is managed by Wellington pursuant to the Guidelines (see Section C.2 for further details).

An analysis of Own Funds is shown below:

	Tier	<u>2019</u> £'000	<u>2018</u> £'000
Ordinary share capital	1	175	175
Share premium account	1	17,272	17,272
Reconciliation reserve	1	20,954	17,102
Total Own Funds		38,401	34,549

Reconciliation of the movement in the reconciliation reserve:

	<u>2019</u> £'000
Opening reconciliation reserve	17,102
Profit	4,338
Change in asset valuation	1,252
Change in technical provisions	(2,188)
Change in other liabilities	450
Reconciliation reserve	20,954

The reconciliation reserve represents retained earnings and reconciliation adjustments from the Statutory Accounts balance sheet to the SII Balance Sheet. The volatility in the valuation of assets and liabilities is dependent on various factors discussed in the stress testing section (C.7).

As of 31 December 2019	Statutory Accounts Valuation £'000	Solvency II Valuation Adjustment £'000	Solvency II Valuation £'000
Assets	142,928		
Exclusion of DAC		(3,642)	
Exclusion of insurance receivables		(53,967)	
Total Assets	142,928	(57,609)	85,319
Liabilities			
Technical Provisions	64,844	(18,915)	45,929
Other Liabilities	989	-	989
Total Liabilities	65,833	(18,915)	46,918
Total Own Funds	77,095	(38,694)	38,401

As of 31 December 2018	Statutory Accounts Valuation £'000	Solvency II Valuation Adjustment £'000	Solvency II Valuation £'000
Assets	142,370		
Exclusion of DAC		(3,822)	
Exclusion of insurance receivables		(58,819)	
Total Assets	142,370	(62,641)	79,729
Liabilities			
Technical Provisions	68,174	(24,433)	43,741
Other Liabilities	1,439	-	1,439
Total Liabilities	69,613	(24,433)	45,180
Total Own Funds	72,757	(38,208)	34,549

The ordinary share capital and share premium account are not subordinated and have no restricted duration and are therefore classified as Tier 1 capital for Solvency II purposes. There are no foreseeable dividends nor own shares held and therefore no deductions have been made to Own Funds for these items.

The Company has no Tier 1 restricted Own Funds (per Article 80 of the Delegated Regulations), no Tier 2 Own Funds (per Article 72 of the Delegated Regulations) and no Tier 3 Own Funds (per Article 76 of the Delegated Regulations).

The Company's Own Funds are all unrestricted Tier 1 and may be used towards meeting the SCR and MCR.

The Statutory Accounts Own Funds of FGIC UK at 31 December 2019 were £77,095 (2018: £72,757), compared to Solvency II Own Funds of £38,401 (2018: £34,549). The difference primarily arises due to the difference in valuation of technical provisions as well as the adjustments made in respect of deferred acquisition costs, and insurance receivables discussed in Section D.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The SCR and MCR of the Company at 31 December 2019 and 2018 are as follows:

	<u>2019</u> £'000	<u>2018</u> £'000
SCR	96,215	96,794
MCR	24,054	24,199

The SCR is calculated using the Standard Formula. The final amount of the SCR is subject to supervisory assessment. The ratio of the Company's Own Funds to SCR is 39.9% (2018: 35.7%).

The SCR of the Company is made up of the risk modules as follows:

	2019	2018
	£'000	£'000
Interest Rate Risk	3,969	608
Spread Risk	3,445	1,901
Currency Risk	6,502	8,519
Sub total	13,916	11,028
Less Diversification	(4,221)	(1,626)
Market Risk	9,695	9,402
Counterparty Risk	28	32
Underwriting Risk	20,825	22,157
Catastrophe (Cat) Risk	85,801	85,804
Sub total	106,626	107,961
Less Diversification	(13,412)	(14,132)
Non-life Underwriting Risk	93,215	93,829
Total	102,938	103,263
Less Diversification	(6,826)	(6,637)
BSCR	96,112	96,626
Operational Risk	103	168
SCR	96,215	96,794

Simplified calculations are not used for any of the risk modules or sub-modules in applying the Solvency II standard formula.

Undertaking specific measures have not been used by the Company and the Company does not have a capital add on.

The inputs to calculate the MCR are as follows:

	2019	2018
	£'000	£'000
AMCR (3,700 in Euros)	3,187	3,288
Linear MCR	26	11
SCR	96,215	96,794
Combined MCR	24,054	24,199
MCR	24,054	24,199

The Absolute Minimum Capital Requirement (“AMCR”) of 3,700 EUR is the absolute floor for the MCR which is provided in the technical specifications.

The linear MCR is calculated based on the best estimate technical provisions and the net written premiums of the last 12 months. The combined MCR is the linear MCR subject to a floor of 25% of the SCR and a cap of 45% of the SCR.

The overall MCR is the greater of the combined MCR and the AMCR.

MCR and SCR are consistent with prior year as reductions of insured exposure due to normal amortisation and foreign exchange differences were offset by increases due to index-linked guarantees.

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

This is not applicable to the Company as the PRA has not implemented the member State option set out in Article 304 to use this module in the standard formula.

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

This section is not applicable to the Company as it does not have a PRA approved internal model.

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

Under Solvency II, FGIC UK's Own Funds at 31 December 2019 are £38.4m (2018: £34.5m). Based on the standard formula, FGIC UK's MCR is £24.1m (2018: £24.2m) and its SCR is £96.2m (2018: £96.8m). FGIC UK therefore has a capital surplus of £14.3m (2018: £10.4m) against the MCR and a capital deficit of £57.8m (2018: £62.2m) against the SCR at 31 December 2019.

As of 31 December 2019, FGIC UK is compliant with the MCR but not compliant with the SCR. The primary factors driving non-compliance with the SCR are highlighted below:

- FGIC UK has included a substantial risk margin in its estimated Solvency II Balance Sheet at 31 December 2019. The risk margin is intended to be the premium that another insurer taking on the liabilities at the valuation date would require over and above the best estimate of technical provisions. It is calculated using a cost-of-capital approach. Since FGIC UK's insured portfolio has a very long duration (over 30 years), the risk margin is a material consideration for FGIC UK.
- FGIC UK's SCR includes an amount for catastrophe risk based on its two largest exposures. Since FGIC UK's top two exposures represent about 40% (2018: 40%) by Gross Par in Force of FGIC UK's outstanding insured exposures at 31 December 2019, the catastrophe risk element is a material consideration for FGIC UK. Approximately 89% (2018: 89%) of the SCR at 31 December 2019 relates to catastrophe risk before the impact of diversification.

FGIC UK has notified the PRA about the non-compliance with the SCR and about not having access to incremental capital to remediate this non-compliance.

FGIC UK has already ceased, and has no plans to recommence, writing new business. FGIC UK's overriding business strategy is to run off its remaining insured portfolio in an orderly and efficient manner.

As a potential means to reduce the capital deficit against the SCR, FGIC UK explores ways to reduce its insured exposure through commutations and other methods on appropriate economic and other terms. The ability to meaningfully reduce insured exposure is impacted by many factors beyond the control of FGIC UK, and such opportunities may be limited, given the nature of FGIC UK's insured portfolio.

E.6 Any Other Information

There is no further information to disclose in relation to the Company's capital management.

Appendix

**Annual Quantitative Reporting
Templates (QRTs)**

FGIC UK LIMITED

Solvency and Financial Condition Report

Disclosures

31 December

2019

(Monetary amounts in GBP thousands)

General information

Undertaking name	FGIC UK LIMITED
Undertaking identification code	213800ZVWZNGTY15PP67
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 2019
Currency used for reporting	GBP
Accounting standards	Local GAAP
Method of Calculation of the SCR	Standard formula
Matching adjustment	No use of matching adjustment
Volatility adjustment	No use of volatility adjustment
Transitional measure on the risk-free interest rate	No use of transitional measure on the risk-free interest rate
Transitional measure on technical provisions	No use of transitional measure on technical provisions

List of reported templates

- S.02.01.02 - Balance sheet
- S.05.01.02 - Premiums, claims and expenses by line of business
- S.05.02.01 - Premiums, claims and expenses by country
- S.17.01.02 - Non-Life Technical Provisions
- S.19.01.21 - Non-Life insurance claims
- S.23.01.01 - Own Funds
- S.25.01.21 - Solvency Capital Requirement - for undertakings on Standard Formula
- 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
		C0010
Assets		
R0030	Intangible assets	
R0040	Deferred tax assets	
R0050	Pension benefit surplus	
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	83,106
R0080	<i>Property (other than for own use)</i>	0
R0090	<i>Holdings in related undertakings, including participations</i>	0
R0100	<i>Equities</i>	0
R0110	<i>Equities - listed</i>	
R0120	<i>Equities - unlisted</i>	
R0130	<i>Bonds</i>	81,081
R0140	<i>Government Bonds</i>	38,320
R0150	<i>Corporate Bonds</i>	42,392
R0160	<i>Structured notes</i>	0
R0170	<i>Collateralised securities</i>	369
R0180	<i>Collective Investments Undertakings</i>	2,025
R0190	<i>Derivatives</i>	
R0200	<i>Deposits other than cash equivalents</i>	0
R0210	<i>Other investments</i>	0
R0220	Assets held for index-linked and unit-linked contracts	
R0230	Loans and mortgages	0
R0240	<i>Loans on policies</i>	0
R0250	<i>Loans and mortgages to individuals</i>	
R0260	<i>Other loans and mortgages</i>	
R0270	Reinsurance recoverables from:	0
R0280	<i>Non-life and health similar to non-life</i>	0
R0290	<i>Non-life excluding health</i>	0
R0300	<i>Health similar to non-life</i>	0
R0310	<i>Life and health similar to life, excluding index-linked and unit-linked</i>	0
R0320	<i>Health similar to life</i>	
R0330	<i>Life excluding health and index-linked and unit-linked</i>	
R0340	<i>Life index-linked and unit-linked</i>	
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	
R0370	Reinsurance receivables	
R0380	Receivables (trade, not insurance)	
R0390	Own shares (held directly)	
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	2,104
R0420	Any other assets, not elsewhere shown	109
R0500	Total assets	85,319

S.02.01.02

Balance sheet

Solvency II value		
C0010		
R0510	Technical provisions - non-life	45,929
R0520	<i>Technical provisions - non-life (excluding health)</i>	45,929
R0530	<i>TP calculated as a whole</i>	0
R0540	<i>Best Estimate</i>	-13,696
R0550	<i>Risk margin</i>	59,625
R0560	<i>Technical provisions - health (similar to non-life)</i>	0
R0570	<i>TP calculated as a whole</i>	0
R0580	<i>Best Estimate</i>	0
R0590	<i>Risk margin</i>	0
R0600	Technical provisions - life (excluding index-linked and unit-linked)	0
R0610	<i>Technical provisions - health (similar to life)</i>	0
R0620	<i>TP calculated as a whole</i>	
R0630	<i>Best Estimate</i>	
R0640	<i>Risk margin</i>	
R0650	<i>Technical provisions - life (excluding health and index-linked and unit-linked)</i>	0
R0660	<i>TP calculated as a whole</i>	
R0670	<i>Best Estimate</i>	
R0680	<i>Risk margin</i>	
R0690	Technical provisions - index-linked and unit-linked	0
R0700	<i>TP calculated as a whole</i>	
R0710	<i>Best Estimate</i>	
R0720	<i>Risk margin</i>	
R0740	Contingent liabilities	
R0750	Provisions other than technical provisions	
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	
R0780	Deferred tax liabilities	
R0790	Derivatives	
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	
R0820	Insurance & intermediaries payables	
R0830	Reinsurance payables	
R0840	Payables (trade, not insurance)	800
R0850	Subordinated liabilities	0
R0860	<i>Subordinated liabilities not in BOF</i>	
R0870	<i>Subordinated liabilities in BOF</i>	0
R0880	Any other liabilities, not elsewhere shown	189
R0900	Total liabilities	46,918
R1000	Excess of assets over liabilities	38,401

S.19.01.21

Non-Life insurance claims

Total Non-life business

Z0020

Accident year / underwriting year

Gross Claims Paid (non-cumulative)													
(absolute amount)													
Year	C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0170	C0180
	Development year										In Current year	Sum of years (cumulative)	
	0	1	2	3	4	5	6	7	8	9			10 & +
R0100	Prior										0	0	0
R0160	2010	0	0	0	0	0	0	0	0	0	0	0	0
R0170	2011	0	0	0	0	0	0	0	0	0	0	0	0
R0180	2012	0	0	0	0	0	0	0	0	0	0	0	0
R0190	2013	0	0	0	0	0	0	0	0	0	0	0	0
R0200	2014	0	0	0	0	0	0	0	0	0	0	0	0
R0210	2015	0	0	0	0	0	0	0	0	0	0	0	0
R0220	2016	0	0	0	0	0	0	0	0	0	0	0	0
R0230	2017	0	0	0	0	0	0	0	0	0	0	0	0
R0240	2018	0	0	0	0	0	0	0	0	0	0	0	0
R0250	2019	0	0	0	0	0	0	0	0	0	0	0	0
R0260												Total	0

Gross Undiscounted Best Estimate Claims Provisions													
(absolute amount)													
Year	C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0300	C0360	
	Development year										Year end (discounted data)		
	0	1	2	3	4	5	6	7	8	9		10 & +	
R0100	Prior										0	0	
R0160	2010	0	0	0	0	0	0	0	0	0	0	0	
R0170	2011	0	0	0	0	0	0	0	0	0	0	0	
R0180	2012	0	0	0	0	0	0	0	0	0	0	0	
R0190	2013	0	0	0	0	0	0	0	0	0	0	0	
R0200	2014	0	0	0	0	0	0	0	0	0	0	0	
R0210	2015	0	0	0	0	0	0	0	0	0	0	0	
R0220	2016	0	0	0	0	0	0	0	0	0	0	0	
R0230	2017	0	0	0	0	0	0	0	0	0	0	0	
R0240	2018	0	0	0	0	0	0	0	0	0	0	0	
R0250	2019	0	0	0	0	0	0	0	0	0	0	0	
R0260												Total	0

S.25.01.21

Solvency Capital Requirement - for undertakings on Standard Formula

	Gross solvency capital requirement	USP	Simplifications
	C0110	C0090	C0120
R0010 Market risk	9,695		
R0020 Counterparty default risk	28		
R0030 Life underwriting risk	0		
R0040 Health underwriting risk	0		
R0050 Non-life underwriting risk	93,214		
R0060 Diversification	-6,826		
R0070 Intangible asset risk	0		
R0100 Basic Solvency Capital Requirement	96,112		
Calculation of Solvency Capital Requirement			
R0130 Operational risk	103		
R0140 Loss-absorbing capacity of technical provisions	0		
R0150 Loss-absorbing capacity of deferred taxes	0		
R0160 Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0		
R0200 Solvency Capital Requirement excluding capital add-on	96,215		
R0210 Capital add-ons already set	0		
R0220 Solvency capital requirement	96,215		
Other information on SCR			
R0400 Capital requirement for duration-based equity risk sub-module	0		
R0410 Total amount of Notional Solvency Capital Requirements for remaining part	0		
R0420 Total amount of Notional Solvency Capital Requirements for ring fenced funds	0		
R0430 Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios	0		
R0440 Diversification effects due to RFF nSCR aggregation for article 304	0		
Approach to tax rate			
R0590 Approach based on average tax rate	0		
Calculation of loss absorbing capacity of deferred taxes			
LAC DT			
C0130			
R0640 LAC DT	0		
R0650 LAC DT justified by reversion of deferred tax liabilities	0		
R0660 LAC DT justified by reference to probable future taxable economic profit	0		
R0670 LAC DT justified by carry back, current year	0		
R0680 LAC DT justified by carry back, future years	0		
R0690 Maximum LAC DT	0		

USP Key

For life underwriting risk:

- 1 - Increase in the amount of annuity benefits
- 9 - None

For health underwriting risk:

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

For non-life underwriting risk:

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

