MAPFRE | MIDDLESEA

MAPFRE Middlesea P.L.C

Solvency and Financial Condition Report
31st December 2017

MAPFRE | MIDDLESEA

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Executive Summary

The Solvency and Financial Condition report is aligned with the requirements of Directive 2009/138/EC (Solvency II Directive) and the Commission Delegated Regulation (EU) 2015/35.

A. Business and Performance

MAPFRE Middlesea plc (hereinafter the Company, MAPFRE Middlesea or MMS) is a composite insurance company with primary activities being underwriting of non-life and group life risk. It accepts risks on the following Solvency II lines of business:

- Medical expense insurance
- Income protection insurance
- Motor vehicle liability insurance
- Other Motor insurance
- Marine, Aviation and Transport insurance
- Fire and other damage to property insurance
- General liability insurance
- Assistance
- Miscellaneous Financial loss
- Other life insurance

MAPFRE Middlesea is a subsidiary of MAPFRE S.A and forms part of the MAPFRE GROUP, and other companies with activity in insurance, financial, real estate and service sectors.

The company closed the year with written premiums amounting to €61.94 million, experiencing an increase of 3.2 percent over 2016. Total claims incurred have increased by 8.3 percent over 2016 and amounted to €35.56 million. Profitability has also improved, with a net profit after tax of €10.31 million.

MMS’s combined ratio also improved by 9.3 percentage points over the last year and now reads 92.3%. This is mainly attributed to the improvement in the motor line of business following the adjustment in tariffs and a number of other internal initiatives undertaken.

Total net investment income during the year amounted to €9.02 million compared with the €4.81 million registered in 2016. This increase is mainly derived from higher dividends received from group companies.

B. System of Governance

MMS's Governing Bodies at 31st December 2017 are set out below:

- Shareholder’s Annual General Meeting
- Board of Directors
- Audit Committee
- Risk and Compliance Committee
- Investment Committee
- Remuneration Committee
- Management Committee

All of the governing bodies allow for adequate strategic and operational management and allow MMS to provide an adequate and timely response to any event that may arise at any level within the organization, and within its business and corporate environment.

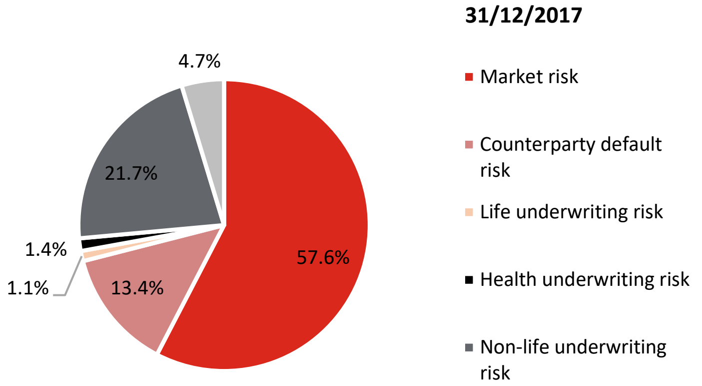
In order to ensure that MMS's systems of governance has an adequate structure, the Company has a series of policies that govern the essential functions (Risk Management, Compliance, Internal Audit and Actuarial) to ensure that these functions follow the regulatory requirements and are compliant with the lines of governance established by MMS and by MAPFRE Group.

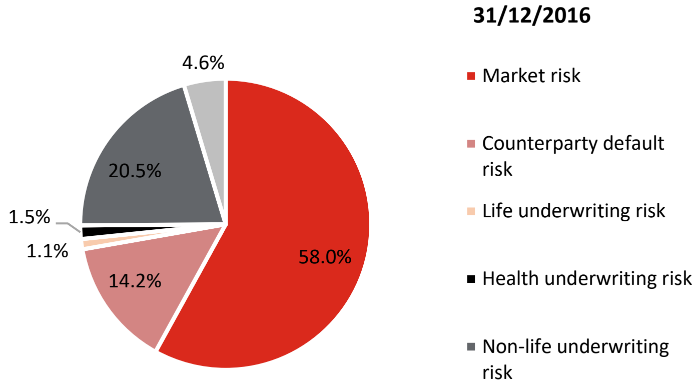
The MMS's Board of Directors determines the policies and strategies regarding the Risk Management System which are aligned with the policies and strategies defined by the Board of Directors of MAPFRE S.A.

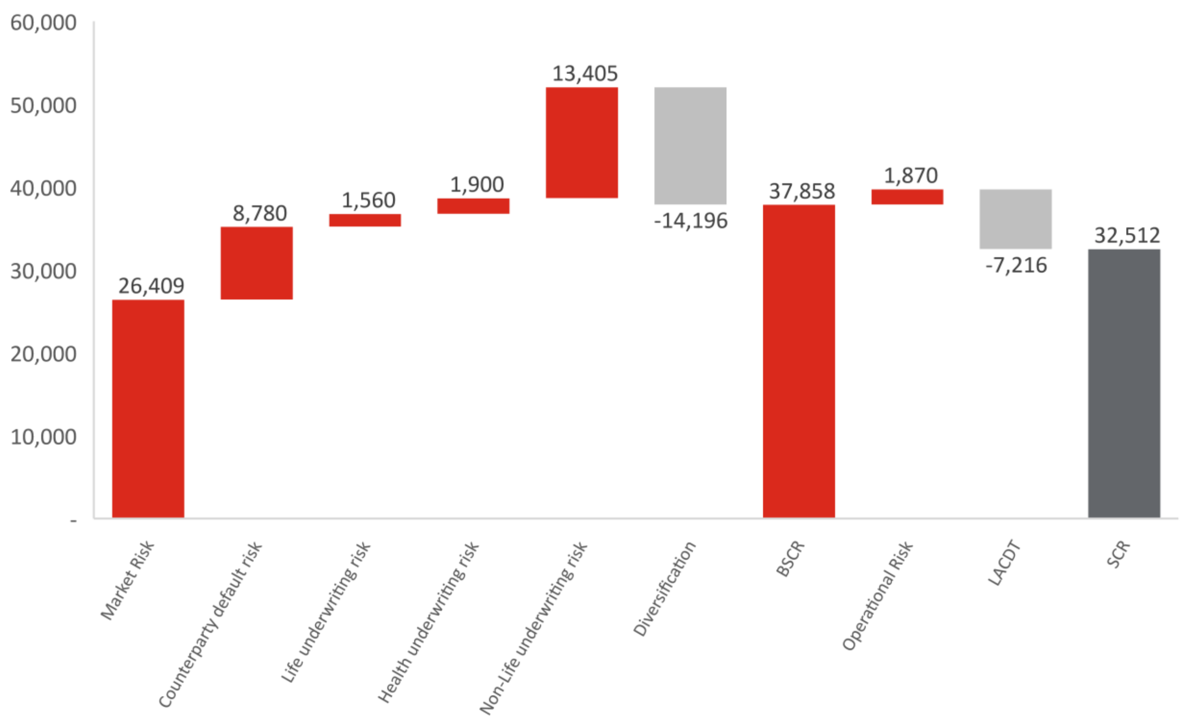
C. Risk profile

MMS calculates its Solvency Capital Requirement (SCR) using the standard formula.

The following reflects the composition of MMS's risk profile based on the risks included under the standard formula methodology as well as the regulatory capital necessary for each.







Figures in thousand euros

MMS's risk profile mainly comprises of Market Risk, due to MMS's strategic investment in MAPFRE MSV Life plc. This risk is followed by Non-Life Underwriting Risk and Counterparty Default Risk.

Other risks to which MMS is exposed to are liquidity, non-compliance, legal, cybersecurity and risk of new distribution channels. As a result of the mitigation measures in place, these risks are not considered to materially affect MMS's solvency.

MMS also considered a number of stress tests and scenarios to assess its resilience and strength of its business model when facing adverse events during the projected period. The results from these analyses indicate that MMS will continue to have eligible own funds to comply with the SCR even in stressed scenarios.

D. Valuation for solvency purposes

The Solvency II value of assets amounts to €179.76 million, while the Accounting value (IFRS value) is equal to €153.87 million. The differences between the Solvency II value and the IFRS value arose due to the different valuation criteria used for deferred acquisition costs, intangible assets, investments and reinsurance recoverables.

The Solvency II value of liabilities amounts to €76.40 million, while the IFRS value is equal to €85.03 million. The main difference between the Solvency II value and the IFRS value arose from the different valuation criteria used for technical provisions. Section D.2 provides an explanation on the actuarial methodology and assumptions used in the calculation of the technical provisions (best estimate and risk margin).

The excess of assets over liabilities for Solvency II purposes amounted to €103.36 million under Solvency II, which represents a 50.2% increase over the IFRS value of equity. As at 31st December 2017, the excess of assets over liabilities increased by €7.70 million when compared to 2016.

E. Capital Management

MMS has the appropriate structure and processes necessary to manage and oversee its own funds, and has a policy and medium-term capital management plan to maintain solvency levels within the limits established by the legislation and by MMS's own risk appetite.

The following table shows details of MMS's Solvency Ratio:

	31/12/2017	31/12/2016
Solvency Capital Requirement (SCR)	**€32,512**	**€31,420**
Eligible own funds to meet the SCR	**€93,663**	**€92,146**
Solvency ratio (SCR coverage)	**288.1%**	**293.3%**

Figures in thousand euros

MMS's Solvency Capital Requirement amounted to €32.51 million. The SCR corresponds to the own funds that MMS must hold to limit the probability of bankruptcy to one case per 200, or that MMS is still 99.5% able to meet its commitments to insurance beneficiaries or policyholders during the following year.

Eligible own funds to cover MMS's SCR represent €93.66 million, of which €92.43 million were classified as unrestricted Tier 1 and €1.23 million were classified as Tier 3. Tier 1 capital has the characteristics set out in Article 93 (1)(a) and (b) of the Solvency II Directive, fully paid up and available to absorb losses.

To calculate the solvency ratio, MMS does not make use of matching and volatility adjustments, or transitional measures for technical provisions.

The Solvency II regulation also establishes a Minimum Capital Requirement (MCR), which is the minimum level of security under which financial resources should never fall. MMS's MCR amounted to €9.00 million. Eligible own funds to cover the MCR amount to €92.43 million and the ratio of eligible own funds to cover the MCR stood at 1026.7%.

A. Business and Performance

A.1. Business

A.1.1. Company Business

MAPFRE Middlesea plc is a composite insurance company specialising in underwriting of non-life and group life business.

MMS underwrites risks, which are exclusively located in the Maltese territory. Legacy business, which originated from the MMS's previous branches outside the Maltese territory is now in run off.

The registered address is: MAPFRE Middlesea P.L.C
Middlesea House,
Floriana, Malta

MMS is a subsidiary of MAPFRE S.A with registered address:

MAPFRE S.A
Carretera de Pozuelo-Majadahonda s/n 28222
Majadahonda,Spain

MMS forms part of the MAPFRE GROUP, composed of MAPFRE S.A. and various companies operating in the insurance, financial, property, and service industries.

The ultimate controlling party within the Group is FUNDACIÓN MAPFRE, a non-profit institution located in Madrid at Paseo de Recoletos 23.

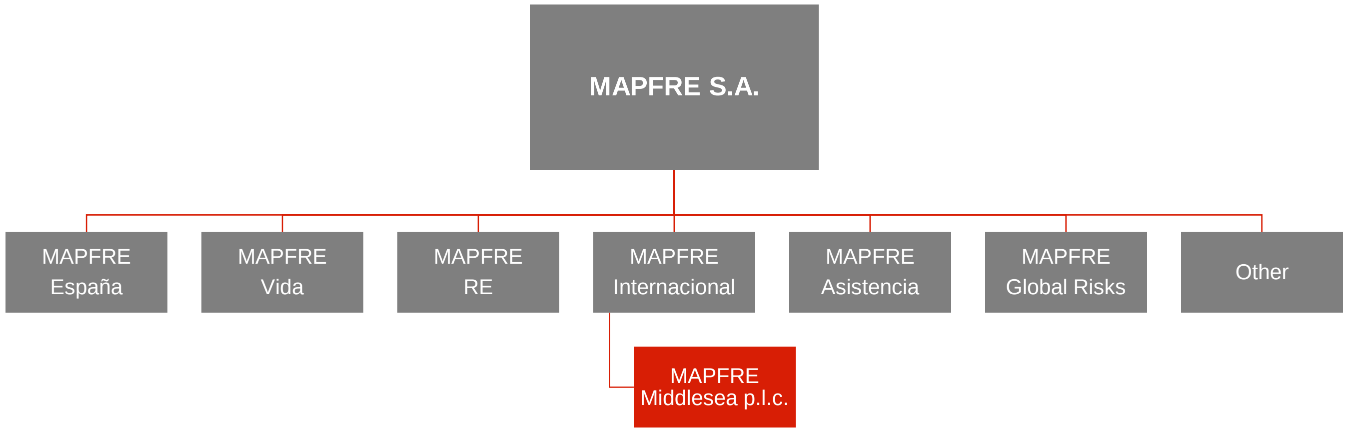
The following table reflects the companies, which hold qualified investments in MMS:

Name	Legal Status	Location	Percentage of ownership (*)
MAPFRE Internacional	Limited Liability	Spain	54.56%
Bank of Valletta	Limited Liability	Malta	31.08%

(*) The ownership interest and voting rights are the same

Two directors hold an equity interest in the Company. Mr Joseph F.X. Zarha has a direct interest of below 1% in the company's share capital. Mr Paul Testaferrata Moroni Viani has an indirect shareholding in the company's shares through his shareholding in other companies.

The following is MMS's position within the Group's legal structure:



MAPFRE Group presents a consolidated report for the Group and individual reports for the insurance and reinsurance companies belonging to the Group.

MMS is also the parent company of a number of subsidiaries with main activities being insurance, financial and assistance services. Annex I to this report provides details of these companies.

Supervision of the Company

The Malta Financial Services Authority (hereinafter MFSA) is responsible for the financial supervision of MMS since it established in Malta.

The MFSA Is located at Notabile Road, Attard, Malta, and its website is http://www.mfsa.com.mt.

External Audit

On 8th March 2018, KPMG Malta, issued an unqualified audit opinion in its audit report on the individual and consolidated financial statements as at 31st December 2017. KPMG Malta is formed as a Civil Partnership with a registered address: KPMG Portico Buildings, Marina Street Pieta', Malta.

Lines of business

Though a composite insurer, MMS is primarily a general insurer and accepts risks on the following lines of business:

- Medical expense insurance
- Income protection insurance
- Motor vehicle liability insurance
- Other motor insurance
- Marine, Aviation, and Transport insurance
- Fire and other damage to property insurance
- General liability insurance
- Assistance
- Miscellaneous Financial Loss
- Other life insurance

Geographic areas

MMS does not underwrite any risks, which are situated outside Malta, unless there is a specific Maltese interest. Previous business underwritten by the company branches outside Malta is now in run off.

A.1.2. Businesses and/or events with material repercussions on the Company.

Events relating to the Business & Market Regulatory Matters

Throughout 2017, MMS maintained its position as the market leader in the non-life sector, with an increase in the written business. MMS's combined ratio also improved by 9.3 percentage points over the last year and now reads 92.3%. This is mainly attributed to the improvement in the motor line of business following the adjustment in tariffs and also some other internal initiatives undertaken.

MMS's Solvency ratio stands at 288.1%.This shows that MMS holds sufficient capital to meet its long-term strategy and a good resilience to face challenging business scenarios.

A.2. Underwriting Performance

Below is a comparison of the quantitative information regarding the activity and underlying results for 2017 and 2016 by line of business.

S.05.01.02 – Premiums, claims and expenses by line of business

	Non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)																		Accepted non-proportional reinsurance		Total	
	Medical expense insurance		Income Protection insurance		Motor vehicle liability		Other motor insurance		Marine, aviation and transport insurance		Fire and other damage to property insurance		General liability		Assistance		Miscellaneous financial loss		Property			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Premiums Written																						
Gross - Direct Business	9,361	8,128	839	932	15,193	13,644	17,541	16,735	1,773	1,908	11,035	10,829	3,649	3,657	946	2,005	56	62	-	-	60,395	57,899
Gross - Proportional reinsurance accepted	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted																			1	-	1	-
Reinsurers' share	20	27	-	-	482	534	557	655	81	168	8,581	8,524	260	317	-	2	25	27	-	-	10,008	10,255
Net	9,341	8,102	839	932	14,711	13,109	16,985	16,080	1,692	1,740	2,454	2,305	3,389	3,340	946	2,003	31	34	1	-	50,388	47,644

	Non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)																		Accepted non-proportional reinsurance		Total	
	Medical expense insurance		Income Protection insurance		Motor vehicle liability		Other motor insurance		Marine, aviation and transport insurance		Fire and other damage to property insurance		General liability		Assistance		Miscellaneous financial loss		Property			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Premiums earned																						
Gross - Direct Business	8,812	7,919	900	962	14,939	12,182	17,248	14,942	1,795	1,772	10,964	9,974	3,621	3,519	1,812	1,728	62	51	-	-	60,152	53,049
Gross - Proportional reinsurance accepted	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted																			1	-	1	-
Reinsurers' share	20	27	0	24	477	488	551	599	81	196	8,530	7,883	331	512	-	2	29	23	-	-	10,020	9,754
Net	8,792	7,893	900	938	14,462	11,693	16,697	14,343	1,714	1,576	2,433	2,090	3,290	3,007	1,812	1,726	33	27	1	-	50,133	43,295

	Non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)																		Accepted non-proportional reinsurance		Total	
	Medical expense insurance		Income Protection insurance		Motor vehicle liability		Other motor insurance		Marine, aviation and transport insurance		Fire and other damage to property insurance		General liability		Assistance		Miscellaneous financial loss		Property			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Claims incurred																						
Gross - Direct Business	4,287	4,309	272	272	12,496	11,594	8,466	7,918	983	1,440	4,824	4,190	2,152	559	1,517	889	-	-	-	-	34,997	31,171
Gross - Proportional reinsurance accepted	-	-	-	-	-	7	-	-	-	22	(142)	-	-	-	-	-	-	-	-	-	(142)	30
Gross - Non-proportional reinsurance accepted																			(231)	-	(231)	-
Reinsurers' share	(48)	173	1	(14)	(163)	(33)	(110)	66	144	559	4,333	3,268	1,757	(11)	256	13	-	-	-	-	6,171	4,021
Net	4,335	4,136	271	286	12,658	11,634	8,576	7,852	839	904	349	922	394	570	1,261	876	-	-	-231	-	28,453	27,179

	Non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)																		Accepted non-proportional reinsurance		Total	
	Medical expense insurance		Income Protection insurance		Motor vehicle liability		Other motor insurance		Marine, aviation and transport insurance		Fire and other damage to property insurance		General liability		Assistance		Miscellaneous financial loss		Property			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Changes in other technical provisions																						
Gross - Direct Business	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross - Proportional reinsurance accepted	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gross - Non-proportional reinsurance accepted																						
Reinsurers' share	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Expenses incurred	3,046	2,663	510	376	5,324	4,801	5,708	5,371	609	579	861	1,052	1,264	1,048	726	862	49	42	-	-	18,097	16,795
Other																						

	Non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)																		Accepted non-proportional reinsurance		Total	
	Medical expense insurance		Income Protection insurance		Motor vehicle liability		Other motor insurance		Marine, aviation and transport insurance		Fire and other damage to property insurance		General liability		Assistance		Miscellaneous financial loss		Property			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
expenses																						
Total expenses																					18,097	16,795

Figures in thousand euros

	Line of Business for: Life insurance obligations												Total	
	Health insurance		Insurance with profit-participation		Index-linked and unit-linked insurance		Other life insurance		Annuities stemming from non-life insurance contracts and relating to health insurance obligations		Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Premiums written														
Gross	-	-	-	-	-	-	1,542	2,110	-	-	-	-	1,542	2,110
Reinsurers' share	-	-	-	-	-	-	118	181	-	-	-	-	118	181
Net	-	-	-	-	-	-	1,424	1,930	-	-	-	-	1,424	1,930
Premiums earned														
Gross	-	-	-	-	-	-	1,542	2,110	-	-	-	-	1,542	2,110
Reinsurers' share	-	-	-	-	-	-	118	181	-	-	-	-	118	181
Net	-	-	-	-	-	-	1,424	1,930	-	-	-	-	1,424	1,930
Claims incurred														
Gross	-	-	-	-	-	-	560	1,668	-	-	-	-	560	1,668
Reinsurers' share	-	-	-	-	-	-	(15)	659	-	-	-	-	(15)	659
Net	-	-	-	-	-	-	574	1,008	-	-	-	-	574	1,008
Changes in other technical provisions														
Gross	-	-	-	-	-	-	(457)	337	-	-	-	-	(457)	337
Reinsurers' share	-	-	-	-	-	-	0	(241)	-	-	-	-	0	(241)
Net	-	-	-	-	-	-	(457)	578	-	-	-	-	(457)	578
Expenses incurred	-	-	-	-	-	-	379	334	-	-	-	-	379	334
Other expenses													0	0
Total expenses													379	334

Figures in thousand euros

As can be seen from the aforementioned tables, MMS closed the year with written premiums amounting to €61.94 million, experiencing an increase of 3.2 percent over 2016. Total claims incurred have increased by 8.3 percent over 2016 and amounted to €35.56 million. Profitability has also improved, with a net profit after tax of €10.31 million.

A.3. Investment performance

A.3.1. Information on investment income and expenses by asset class

The following tables present quantitative information regarding income and expenses deriving from investment properties, the held-to-maturity portfolio, the available-for-sale portfolio and the fair value through profit or loss portfolio and net realised and unrealised gains and losses:

Interest, dividend and similar income	2017	2016
INVESTMENT INCOME		
Investment properties	672	399
Income from the held-to-maturity portfolio	-	-
Income from the available-for-sale portfolio	257	266
Income from the fair value through profit or loss portfolio	213	283
Dividend income from Group Companies	7,083	2,672
Other financial yields	3	1
TOTAL INVESTMENT INCOME	**8,228**	**3,621**
REALISED AND UNREALISED GAINS		
Net realised gains		
Investment properties	-	-
Held-to-maturity investment portfolio	-	-
Available-for-sale investment portfolio	235	-
Fair value through profit or loss portfolio investments	-	-
Other	-	-
Net unrealised gains		
Increase in the fair value of the trading portfolio and profits from derivatives	873	1,394
Other	-	-
TOTAL GAINS	**1,108**	**1,394**
OTHER FINANCIAL INCOME FROM THE INSURANCE BUSINESS		
OTHER FINANCIAL TRANSACTIONS IN THE INSURANCE BUSINESS		
Gains on investments on behalf of policyholders bearing the investment risk	-	-
Gains on exchange	-	-
Other	49	-
TOTAL OTHER FINANCIAL INCOME FROM THE INSURANCE BUSINESS	**49**	**-**
TOTAL INCOME FROM THE INSURANCE BUSINESS	**9,385**	**5,015**
FINANCIAL INCOME FROM OTHER BUSINESSES	**-**	**-**
TOTAL FINANCIAL INCOME	**9,385**	**5,015**

Figures in thousand euros

Financial Expenses	2017	2016
INVESTMENT EXPENSES		
Investment properties	58	34
Expenses from the held-to-maturity portfolio:	-	-
Expenses from the available-for-sale portfolio:	8	9
Expenses from the fair value through profit or loss portfolio:	-	-
Other financial expenses	-	-
TOTAL INVESTMENT EXPENSES	**66**	**43**

Financial Expenses	2017	2016
REALISED AND UNREALISED LOSSES		
Realised losses		
Property investment	-	-
Held-to-maturity investment portfolio	-	-
Available-for-sale investment portfolio	6	84
Fair value through profit or loss portfolio investments	4	-
Other	-	-
Unrealised losses		
Decrease in the fair value of the fair value through profit or loss portfolio and losses on derivatives	258	24
Other	-	-
TOTAL LOSSES	**268**	**108**
OTHER FINANCIAL EXPENSES FROM THE INSURANCE BUSINESS		
OTHER FINANCIAL EXPENSES FROM THE INSURANCE BUSINESS		
Losses on investments on behalf of policyholders bearing the investment risk	-	-
Losses on exchange	21	41
Other	14	18
TOTAL OTHER FINANCIAL EXPENSES FROM THE INSURANCE BUSINESS	**35**	**59**
TOTAL EXPENSES FROM THE INSURANCE BUSINESS	**369**	**210**
FINANCIAL EXPENSES FROM OTHER BUSINESSES	**-**	**-**
TOTAL FINANCIAL EXPENSES	**369**	**210**

TOTAL INCOME FROM THE INSURANCE BUSINESS	**9,385**	**5,015**
TOTAL EXPENSES FROM THE INSURANCE BUSINESS	**369**	**210**
FINANCIAL RESULT FROM THE INSURANCE BUSINESS	**9,016**	**4,805**
TOTAL INCOME FROM OTHER BUSINESSES	**-**	**-**
TOTAL EXPENSES FROM OTHER BUSINESSES	**-**	**-**
TOTAL FINANCIAL RESULT FROM OTHER BUSINESSES	**-**	**-**
TOTAL FINANCIAL RESULT	**9,016**	**4,805**

Figures in thousand euros

Total net investment income during the year amounted to €9.02 million (2016: €4.81 million). The increase is primarily resulting from higher dividends received from Group companies. A higher rental income derived from the main investment property (higher occupancy rate) had also a positive impact. Realised gains were registered on the sale of equities within the available for sale portfolio. In terms of unrealised gains or loss, whilst investment property registered a €0.87 unrealised gain, the financial investments within the fair value through profit and loss portfolio registered losses.

A.3.2. Information regarding losses and gains recognised under equity

The following is the quantitative information regarding gains and losses arising from investments broken down by type of asset, and recognised directly in equity in thousands of euros during 2017:

Investments	Income recognised in equity		Losses recognised in equity		Net difference	
	2017	2016	2017	2016	2017	2016
I. Investments properties	**-**	**-**	**-**	**-**	**-**	**-**
II. Financial investments	**139**	**125**	**386**	**-**	**(247)**	**125**
Available for sale portfolio						
Equity instruments	139	83	250	-	-111	83
Debt securities	-	42	137	-	-137	42
Unit-linked						
III. Investments in associates accounting for using the equity method	72	-	-	-	71	-
IV. Deposits established for accepted reinsurance	**-**	**-**	**-**	**-**	**-**	**-**
V. Other investments	**-**	**-**	**-**	**-**	**-**	**-**
Overall performance	**211**	**125**	**386**	**-**	**(176)**	**125**

Figures in thousand euros

Available for sale investments registered a net loss of €0.25 million as compared to a gain of €0.13 million in 2016. The negative movement in equities is derived from the reclassification of gains to profit or loss upon the disposal of equities during the year. On the other hand, bonds registered a negative movement of €0.14 million as securities approach their maturity dates. A gain of €0.07 million was recorded directly in equity representing the share of profits of an associate company.

A.3.3. Information about asset securitisation

MMS did not have any securitisation investments in this or the comparative year.

A.4. Performance of other activities

A.4.1 Other income and expenses in the non-technical account

During this year, the company incurred the following "other" income and expenses other than those arising from the underwriting activity and from the return on investment, including:

	2017	2016
Other income	-	-
Other expenses	1,705	1,655

Figures in thousand euros

Expenses

Other expenses relate to administrative expenses which are allocated to shareholders and therefore to the non-technical account.

A.4.2 Lease Agreements

Finance leases

MMS has no financial leases in which it is the lessor.

Operating Leases

MMS is the lessee/lessor under operating leases involving property and lease of vehicles.

MMS leases out commercial property to a number of tenants with leases ranging from 2 year to 33 year leases with *di fermo* periods never exceeding 5 years. Contracts have renewal and cancellation options with fixed notification periods.

On the other hand, MMS leases from third parties the premises from which it operates and company cars used by Management.

A.5. Any other information

There is no additional information that has not been included in the preceding sections.

B. System of Governance

B.1. General Information on the system of governance

MAPFRE Middlesea's governing bodies ensure that the company follows the Institutional Business and Organizational Principles approved by Board of Directors. Further to this, the Board of Directors delegates to management the strategic, operational and day-to-day business activities.

This governance structure ensures an adequate and timely response to events which may arise within the organization and within its business and corporate environment.

B.1.1 MMS's System of Governance

The following outlines the main functions and responsibilities of MMS's governing bodies:

- **Shareholder's Annual General Meeting**: Is the highest governing body, in that its decisions bind all shareholders. Both ordinary and extraordinary Annual General Meetings are called by the Board of Directors.

- **Board of Directors:** Is the body in charge of managing, administering, and representing the company. It acts as the maximum decision-making and supervisory body at MMS. It establishes the roles of the Management Committee and its Delegated Committees, designating its members, where necessary.

- **Audit Committee:** The main role of this committee is to protect the interest of the shareholders and assist the Board of Directors to effectively take informed decisions based on accurate, reliable and timely reported financial statements.

- **Risk and Compliance Committee:** The purpose of this committee is to assist the company through its oversight role in fulfilling its responsibility relating to the effective identification, measuring, monitoring and management of risk, compliance, prevention of money laundering and other aspects associated with its business.

- **Investment Committee:** The investment committee advises the Board of Directors on Investment Management policies to be adopted by the company so as to secure the safety, marketability and return of the investment portfolio. Furthermore, the committee is also responsible to oversee the management of the investment portfolio in order to ensure compliance with the Investment policy.

- **Remuneration Committee:** This committee is responsible in ensuring a coherent remuneration policy and practices, which enable MMS to attract and retain executives and directors who create good value for the shareholders whilst supporting MMS's mission statement. Further to this, it is also under the committee's responsibility to reward executives in the context of the company's performance and the general pay environment.

- **Management committee.** This is the governing body delegated by the Board of Directors to coordinate and supervise the company's top-level actions, covering operational and management aspects, as well as making the necessary decisions to ensure its appropriate functioning, using the powers delegated at any given time.

The MAPFRE GROUP has a management model centered on rigorous control and supervision at all levels: local, regional, and global. It ensures widespread delegation of the execution and performance of the tasks assigned to the teams, as well as their heads, fostering the deep analysis by the management teams at all levels related to the decision-making process, prior and after their execution.

Apart from the abovementioned administration and supervisory bodies, MMS is supervised by the EURASIA Regional Management Committee within MAPFRE GROUP, which directly supervises the management of regional Business Units.

B.1.2. Key functions

The Board of Directors approved the Actuarial, Compliance, Risk Management, and Internal Audit policies. These policies ensure the operational independence of the key functions and direct access to the governing body. The Board of Directors and/or the relevant delegated Board Committee receive reports at least annually from the responsible areas at the company. The names of the parties responsible for the key functions were communicated to the Malta Financial Services Authority.

The key functions have the resources that are necessary to perform the functions assigned to them under their respective policies.

These functions, inter alias, have the following responsibilities:

- Risk Management Function: in charge of establishing an effective risk management system, which ensures the identification, quantification, monitoring, controlling and reporting on the risks faced by MMS

- Regulatory Compliance Function: ensures that MMS meets present and future obligations as defined in its regulations.

- Internal Audit Function: in charge of control and verification that the MMS's internal control and systems of governance are adequately managed.

- Actuarial Function: performs mathematical and actuarial calculations to determine the Solvency II technical provisions and prices.

More information on the key functions may be found in Sections B.3, B.4, B.5, and B.6.

B.1.3. Relevant resolutions adopted by shareholders at a General Meeting and the Board of Directors

During 2017, there were no changes to MMS's governance structure.

B.1.4. Balances with and remuneration to directors

Remuneration paid to the MMS management and employees is determined in accordance with prevailing regulations as well as its remuneration policy, approved by the Board of Directors on 18th October 2017. The remuneration Policy endeavors to establish adequate remuneration based on the post or position, as well as performance, to thereby foster sufficient and effective risk management, making it unattractive to assume risks which exceed MMS's tolerance level and avoids conflicts of interest. Its main principles are as follows:

- Based on each job/function, it includes measures designed to avoid any conflicts of interest which might arise.
- Consider merit, technical know-how, professional knowledge, and performance.
- Ensure equality, without discrimination based on criteria related to gender, race, or ideology.
- Transparency, as they are shared.

- Flexibility in structure, adaptable to the different market groups and circumstances.
- Aligned with strategy as well as its risk profiles, objectives, risk-management practices, and long-term interests.
- Market competitiveness.

Based on the aforementioned policy, personnel remuneration may be comprised of five items:

a) Fixed remuneration: established in all cases in accordance with the position and professional profile, paid in previously agreed-upon instalments.

b) Variable compensation/incentives: remuneration the exact amount of which may not be known in advance: it may be annual (short-term), or pluri-annual (medium- and long-term). The weight of variable compensation is determined by rank in the organization, as well as evaluations; it increases in line with the hierarchical level

c) Recognition programs: Devoted to formally recognize employee contributions to implementing strategies, while also awarding quality contributions, the dissemination of MAPFRE corporate culture, and innovation.

d) Social benefits: Products, services, or assistance which MMS offers its employees, based on collective agreements or individual arrangements with employees.

e) Salary complements: Economic assistance granted to employees based on the position held (i.e. corporate vehicle, housing, etc.).

The remuneration system for Directors has the following characteristics:

- Transparency in reporting the remuneration paid to Directors.
- It provides an incentive to reward dedication, qualifications and responsibility, without constituting an obstacle to the duty of loyalty.
- It consists of a fixed amount for membership on the Board of Directors and, as appropriate, the Committee, which may be higher for people with positions on the Board or that, hold the position of Chairman of the Committee. This remuneration may be supplemented by other non-monetary remuneration (life or health insurance, discounts on products sold by companies in the MAPFRE Group, etc.) that have been established for the company's staff in general.
- It does not include variable components or those linked to share value.
- Directors are reimbursed for traveling expenses and other costs undertaken in order to attend company meetings or in the performance of their responsibilities.

B.1.5 Additional information

In the normal course of business operations, a number of transactions took place between MMS and its parent company. These transactions related to sales of insurance contracts and other services (e.g. commissions received and claims recovered) and purchases of products and services (e.g. Reinsurance premium, staff training, computer maintenance and software development).

B.2. Fit and proper requirements

MMS has a Fit and Proper Policy approved by the Board of Directors. The Policy defines the requirements of the Relevant Personnel[1] and the Outsourced Personnel[2].

The Fit & Proper policy specifies that the relevant Personnel and outsourced Personnel, should have the appropriate qualifications, know-how, and expertise to ensure that MMS is professionally managed and supervised.

The expertise and experience of Relevant Personnel will include academically-acquired knowledge and the experience necessary to carry out the respective individual responsibilities assigned.

MMS's Board members and directors must have:

Collectively: the appropriate qualifications, experience, and knowledge in at least the following areas:

a) Insurance and financial markets
b) Strategy and business Models
c) System of governance
d) Financial and actuarial analysis
e) Regulatory framework.

Individually: training and experience appropriate to the professional profile, specifically in the insurance and financial services area, with practical experience obtained from prior positions held during a sufficient period of time.

Relevant personnel and, where applicable, outsourced personnel must have proven personal, professional and business integrity based on trustworthy information about their personal and professional conduct and reputation, including any criminal, financial and supervisory issue which is relevant for this purpose.

To this effect, Relevant Personnel and Outsourced Personnel, where applicable must meet the following requirements:

1. Personal, professional and business integrity:

    a) A personal career reflecting the highest respect for company and other laws governing economic activity and business operations, as well as good sales, financial, and insurance practice.

    b) No criminal records related to crimes against heritage, money laundering, against the social/economic order and against the tax authorities and social security, and fines related to offences related to infringement against the insurance industry, securities market or consumer protection.

    c) Based on research a lack of relevant and solid results in both the criminal and administrative areas on some of the matters mentioned in above section b).

    d) They must not be prevented from exercising representation in public or management positions in insurance or financial entities.

    e) They must not be disqualified based on the prevailing regulations.

[1] Relevant Personnel: The Directors and Officers, Senior Executives (all those persons in senior management positions who directly report to the administrative body, executive committee or CEO) and Key Function Holder, as well as all other persons who are required to meet the fit and proper requirements at every moment in accordance whit applicable laws.
[2] Outsourced Personnel: should any of the key functions be outsourced, parties employed by the services provider to this end.

2. Eligibility and compatibility:

    a) Shall not to be subject to incompatibility, disqualification or prohibition pursuant to the laws and internal regulations in force.

    b) Shall not find themselves in an unavoidable conflict of interest pursuant to the laws and internal regulations in force

    c) Shall not hold substantial shareholdings in, or provide professional services to, competitors of the company or of any GROUP company, or to be employees, executives or officers thereof, unless they are expressly authorised by the Board of Directors

    d) Shall not be involved in circumstances which may cause their appointment to or participation in the MMS' Board of Directors to place the company's interest at risk.

<u>Appointment procedures</u>

The persons whose designation is proposed to hold the Relevant Positions subject to notification requirements to the Supervisory Authority or, where required, external personnel, shall make a truthful and complete statement of their personal, family, professional or business circumstances, with particular mention of the following:

a) The persons who, or entities which, are deemed to be linked to them in accordance with the applicable legislation.

b) Those circumstances that may result in incompatibilities pursuant to the law, the company's bylaws and the provisions set out in the internal corporate governance rules, or in conflicts of interests.

c) Any other professional duties they discharge, in case they interfere with the dedication that the office requires.

d) Any Criminal proceedings in which they appear as the accused or the defendant.

e) Any other relevant matters or situations, which may affect performance.

This statement must be made using the forms established by the company for this purpose.

The aforementioned persons shall be obliged to keep the content of their prior statement up to date at all times, and accordingly they must report any relevant change in their circumstance with respect to said statement, periodically updating it when required by MMS's Board of Directors.

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

B.3.1 Governance structure

The Board of Directors of MMS is ultimately responsible for ensuring the Risk Management System's effectiveness and for determining the company's Risk profile and tolerance limits. Further to this, the Board of Directors is also responsible for approving the Risk Management Strategies and policies within the Risk Management Framework. In performing these functions, the company's Board of Directors is supported by the Risk & Compliance Committee.

MMS's Risk Management System is based on the three lines of defense model, which is explained in Section B.4.1.

MMS's Risk Management Function facilitates the application of the Risk Management System. Its functions include the coordination of the strategies, processes and procedures that are necessary to continually identify, measure, monitor, manage and report all the risks to which MMS is exposed to, or may be exposed to.

The Risk Management Function reports to the Board of Directors through the Risk and Compliance Committee any risk exposures, taking into account their interdependencies, and compliance with established limits, including the Own Risk and Solvency Assessment.

B.3.2 Risk management objectives, policies, and processes

MMS's Risk Management System has the following main objectives:

- To promote a solid culture and an effective system of risk management.
- To ensure that risk analysis is part of the decision-making process.
- To preserve MMS's financial solvency and strength

The Risk Management System is based on integrated management of each and every business process, and on the adaptation of risk levels in the established strategic objectives. Thus, in order to ensure its effectiveness, MMS's Board of Directors has approved the Risk Management policy, which defines the framework to be used for an efficient Risk Management practice. The objectives of the said policy are:

- To set general guidelines, basic principles and a general framework for risk management that guarantee a coherent application in the group.
- To promote a solid culture and an effective risk management system.
- To ensure that risk analysis is part of the decision-making process.
- To preserve the solvency and financial soundness of the GROUP and MAPFRE Middlesea, helping to position the GROUP as the most trusted global insurance group.

Capital is generally estimated in line with the budget for the following year, and is periodically reviewed throughout the year according to risk development, to ensure compliance with the established Risk Appetite limits.

The Governing Bodies of MMS receive information regarding the quantification of the main risks to which the company is exposed and the capital resources available to absorb them, as well as information regarding compliance with Risk Appetite limits.

In any event, the actions to be taken with respect to identified risks are decided on by the Board of Directors, which is immediately informed of any risks which:

- Exceed the established risk limits, due to its development;
- Could lead to losses that are equal to or higher than the established risk limits; or
- May put compliance with the solvency requirements or continuity of operation of MMS at risk.

The Own Risk and Solvency Assessment is another process through which MMS monitors and identifies any material risks the company may face. Section B.3.3. of this report provides further insight regarding the Own Risk and Solvency Assessment. A breakdown of the processes for the identification, measurement, management, monitoring, and notification of risks, by type, is set out below.

Type of Risk	Measurement and management	Monitoring and reporting
Underwriting risk - Premium risk - Reserve risk - Catastrophic risk - Reinsurance Mitigation	Standard formula	Annual
Market risk - Interest rate - Equity - Property - Spread - Concentration - Currency	Standard formula	Annual
Credit Risk Reflects any possible losses arising from unexpected non-compliance by counterparties and debtors over the subsequent twelve months	Standard formula	Annual
Operational risk Risk of possible losses deriving from the inadequacy or malfunction of internal processes, personnel or systems, or from external events (excluding the risks deriving from strategic decisions and reputation risks)	Standard Formula Dynamic qualitative analysis of the risks using processes (RiskM@p) Recognition and monitoring of operational risk events	Annual Annual Continuous
Liquidity Risk Risk that the company might not be able to realize its investments and other assets in order to meet its financial commitments at maturity	Liquidity position Liquidity indicators	Continuous

Type of Risk	Measurement and management	Monitoring and reporting
Compliance Risk Risk of losses due to legal/regulatory penalties or reputation losses arising from the failure to comply with laws and regulations, or with applicable administrative requirements.	Monitoring and recognition of significant events	Annual
Strategic and Corporate Governance Risk Includes the following risks: - Business ethics and good corporate governance - Organizational structure - Alliances, mergers and acquisitions - Market competition	Through the corporate policies aligned with MAPFRE Group's Institutional, Business, and Organizational Principles.	Continuous

All of the calculations deriving from the standard formula are updated when there is a material change in the risk profile. The Board of Directors is regularly informed of the risks to which MMS is exposed.

B.3.3 Own Risk and Solvency Assessment (ORSA)

The Own Risk and Solvency Assessment (hereinafter ORSA) is an integrated process in MMS's Risk Management System. The ORSA is a mechanism, which identifies, measures, monitors, manages, and reports any short or long-term risks. Further, to ensure a relationship between the business strategy and the overall solvency capital level, the ORSA process is synchronised with MMS's strategic plan. Thus, the ORSA includes all the significant and potential risk that MMS might face and the measures required to mitigate them.

The Risk Management Function is in charge with the coordination and preparation of the ORSA draft report. The report is reviewed, discussed and approved by the Board of Directors. Save for extraordinary events, the ORSA is prepared annually.

Further to the above, the Risk Management function also carries out capital management activities that verify the following:

- The eligibility of capital in line with the current legislation.
- The compatibility of distributable dividends for continuous compliance with the Solvency Capital Requirement.
- Continuous compliance with future solvency capital requirements
- Amounts and quality of the various eligible capital items capable of absorbing losses.

In addition to this, the Risk Management Function is also responsible for the preparation, submission, and approval by MMS's Board of Directors of the medium-term Capital Management Plan, encompassing the results from forecasts included in the ORSA

MMS has built validation mechanisms to ensure that the data used is complete, accurate and appropriate.

Section E.1.1. of this report includes more detailed information on capital management.

B.4. Internal control system

B.4.1. Internal Control

MMS's Internal Control policy, as approved by the Board of Directors, establishes the actions, which must be developed in order to maintain an optimal and effective internal control system.

Due to its nature, Internal Control involves all people, irrespective of their hierarchical level within the organization, who collectively contribute to providing reasonable assurance on the achievement of the objectives mainly regarding to:

• Operations objectives: Effectiveness and efficiency of operations, differentiating the insurance operations (mainly underwriting, claims, reinsurance and investment) as support operations and functions (Human Resources, Administration, Commercial, Legal, IT, etc.).

• Information objectives: Trustworthiness of information (financial and non-financial, both internal and external) regarding its reliability, timeliness or transparency, among others.

• Compliance objectives: Compliance with applicable laws and regulations.

For its development in the organization, the MAPFRE Internal Control System is based on the three lines of defense model as described below:

1. The First line of defense is made up of the employees, the management and operations, business and support departments, which are responsible of maintaining an effective control on a day- to-day basis. Thus, they are those who take on the risks and who are responsible for designing and applying the control mechanisms needed to mitigate the risks associated to the developed processes. Furthermore, they are also responsible for assuring that the risks do not exceed the set limits.

2. The Second line of defense is made up of the key functions such as Risk management, Actuarial Function, Compliance and others assurance functions, which ensure the internal control functioning.

3. The Third line of defense made up of Internal Audit, which provides independent assessment of the adequacy, appropriateness and effectiveness of the Internal Control System and communicates eventual weaknesses timely to whom is responsible for taking the corrective measures, including Top Management and Governing Bodies, as appropriate.

Thus, MMS's Internal Control System consists of tasks and actions that are present in all the activities of the organization and as such is fully integrated into the organizational structure of the company.

B.4.2. Compliance Function

The role of the Compliance function is to advise the Board of Directors on the laws, regulations and administrative provisions that effect MMS's compliance with the established regulations. Further to this, the compliance function also conducts an impact assessment of the changes in the legal environment.

MMS's Compliance Function is based on the specific applicable regulatory requirements, as well as the principle of proportionality based on its business volume and the nature and complexity of the risks assumed by MMS.

MMS employs its own strategy for implementing and carrying out the function, in accordance with the reference criteria shared by the group's Compliance Area Management.

MMS's Compliance Function Policy was last updated and approved by the Board of Directors in October 2017. The policy defines the structure and responsibilities of the Compliance Function.

B.5. Internal audit function

The Internal Audit function is the third line of defence in MMS's risk management system. It provides an objective, independent, and value added overview of the company's system of governance.

To ensure the principle of independence, MMS's Internal Audit function reports to the Audit committee, a board delegated committee. This guarantees the Internal Audit function independence from the company's management.

The mission, function, attributes and obligations of the Internal Audit function are outlined in the Internal Audit Policy and Charter. These have been approved by MMS's Board of Directors in December 2017.

Furthermore, the Internal Audit Policy also defines the relationship framework between the company's Internal Audit Function and the Audit Committee, its chairman, senior management, business units, corporate areas, assurance functions and external auditors.

Moreover, the policy also includes the rights and obligations of MMS's internal auditors, as well as their code of ethics. The primary objective is to communicate knowledge and Internal audit aspects, classification of audit work, recommendations and deadlines, treatment of audit reports, and any other circumstance related to internal audit activities.

In addition to the aforementioned rights and obligations, MMS's internal auditors avail themselves of the code of ethics as spelled out in the Internal Audit charter. The code of ethics embodies the following four main requirements for internal auditors: Fit and proper, Objectivity, Confidentiality and Proficiency.

B.6. Actuarial function

MMS's Actuarial function is outsourced to MAPFRE S.A. which is the parent company of MMS. This agreement fully respects the company's outsourcing policy as described in section B.7. Although the Actuarial Function Holder is situated in Spain, MMS has established an internal Actuarial team to act as the local reference point.

B.7. Outsourcing

MMS's Outsourcing Policy was last updated and approved by the Board of Directors on the 18th October 2017. The Outsourcing policy establishes the general principles, tasks, processes and responsibilities in the event of outsourcing of a critical and/or important business function.

The basic principle upon which MMS's Outsourcing Policy is based, establishes that it will continue with full responsibility for meeting all obligations arising from the functions or activities susceptible to being outsourced, in the same manner as if they were to be performed internally.

In accordance with the aforementioned policy, as from 1st January 2016, the Board of Directors resolved to outsource the company's actuarial function to the parent company MAPFRE S.A. a Spanish global insurance company. This outsourcing function took place within the terms set forth in the Outsourcing policy and was duly communicated to the Malta Financial Services Authority.

The existing governance structure ensures that MMS has sufficient control over the critical functions and/or activities that have been outsourced, in the terms established in the Solvency II Directive and the enabling local legislation.

B.8. Any other information

MMS's system of governance reflects the requirements established in the Solvency II Directive on managing inherent business risks. MMS employs its own strategy for implementing and carrying out the MAPFRE Group Risk Management Area Function, which involves defining the reference criteria and establishing/validating its organizational structure.

MMS considers that the organizational and functional structure of its system of governance is adequate based on the nature, complexity and scale of the risks inherent to its business.

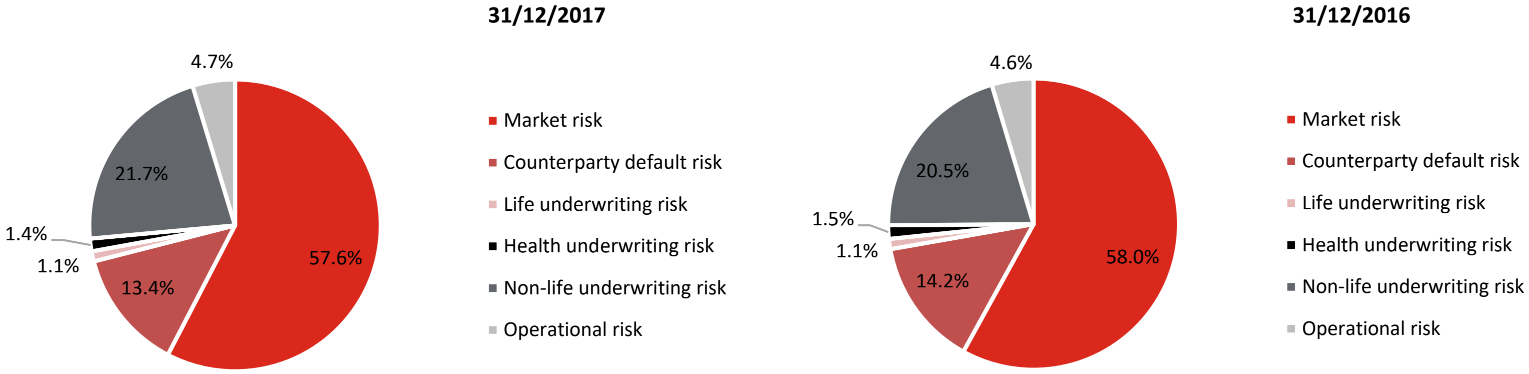
In addition to the above, MMS's Internal Audit function performs a review of the Internal Control Environment on a yearly basis. Through this review, Internal Audit consider and evaluate the company's system of governance, in line with the internal control policy.

C. Risk profile

MMS calculates its Solvency Capital Requirement (SCR) using the standard formula. For the main risk categories, the standard formula is considered an appropriate risk measurement tool for determining the company's risk exposure, as it recognises the capital charge corresponding to key risks (such as underwriting, market, counterparty and operational risk).

As explained in Sections C.4 and C.6, MMS's exposure to other risks not included in the Standard Formula SCR (such as liquidity risk) is not considered significant, as MMS has effective measures in place for the management and mitigation of such risks.

The following reflects the composition of MMS's risk profile based on the risks included under the standard formula methodology as at 31st December 2017 and 2016. Further information on the SCR calculation can be found in Section E.2.



From above, it can be observed that MMS's risk profile mainly comprises of Market Risk, (due to MMS's strategic investment in MAPFRE MSV Life p.l.c), representing 57.6 percent of the total SCR. This risk is followed by Non-Life Underwriting risk and Counterparty Default Risk (21.7 percent and 13.4 percent of the total SCR respectively).

In 2017, the relative share of the Market and Non-life underwriting risks increased, while the relative share of the counterparty default risk decreased. Further information is available in section E.2.1.

In 2017 there have been no significant changes with respect to the measures used to assess the MMS's main risks.

MMS considers that there have been no material changes in the significant risks to which it is exposed, which are described in section C.6.

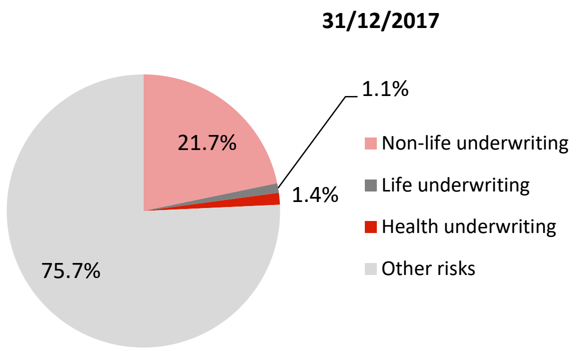
This Section provides detail on the breakdown of the capital requirement under Solvency II by risk module and risk sub-module. It also includes a description of the reduction and mitigation techniques used by MMS to minimise its risks. Any possible concentrations are also indicated.

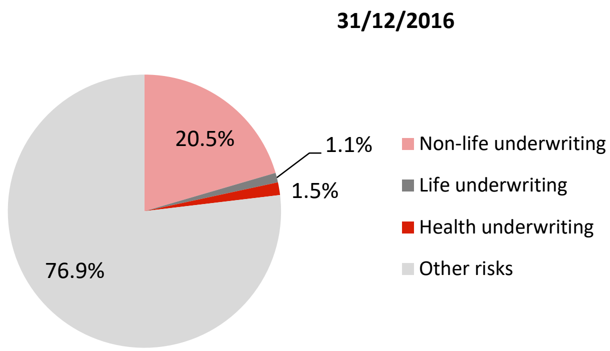
C.1. Underwriting risk

Underwriting Risk is the risk of loss or of adverse change in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions.

Exposure

As at 31st December 2017, underwriting risk represented 24.3 percent of all of the risk modules included in the SCR standard formula calculation. The following charts present details by module and changes when compared to the previous year.





Management and mitigation techniques

MMS minimises underwriting risk through the implementation of the following measures:

- **Establishing policies, limits, and exclusions in underwriting risk:**
  The various insurance products sold by MMS outline the cover provided but are all subject to terms, conditions, limitations and exclusions. These are generally subject to domestic and international market standards and practices and also reflect the reinsurance treaty arrangements entered into. Notwithstanding, MMS's Underwriting Policy establishes the insurance products that can be sold or written by the company and the lines of business that cannot be entertained. Furthermore, the internal Underwriting Guidelines provide further detail in assisting the underwriting and commercial teams on the prudent acceptance or otherwise of a risk, thus controlling and reducing undesired Underwriting Risk.

- **Setting of a sufficient premium:**
  MMS gives importance to premium sufficiency, which is supported by actuarial calculations.

- **Adequate allocation of the technical provisions:**

  Claims handling and the sufficiency of technical provisions, are basic principles of insurance management. Technical provisions are calculated by MMS's Finance Department with the involvement of the Actuarial Unit and their amounts are validated by actuaries forming part of the Company's independent auditors. The establishment of technical provisions is regulated by a specific Group Policy, adapted by MMS. When it comes to establishing Best estimate liabilities calculations, these are performed by the Actuarial Unit and validated by the Corporate Actuarial Area not involved in the establishment of such BELs.

- **Use of Reinsurance**

  The Reinsurance and Underwriting Departments of MMS are responsible for correctly identifying the appropriate level of risk transfer for its previously-defined risk limits, and for defining/designing the types of reinsurance agreements based on its risk profile and appetite, with help from the MAPFRE RE technical advisers.

  Once its reinsurance needs have been defined, MMS communicates them to MAPFRE RE to jointly plan the optimal structure and conditions for ceding contracts.

  At 31st December 2017, MMS ceded 16.3 percent of its premiums and 21.1 percent of its technical provisions to reinsurance.

  The appropriateness of the reinsurance management procedures are revised and updated at least annually.

  The Actuarial Area issues an annual report expressing its opinion on the underwriting policy, the sufficiency of the premium rates and the technical provisions, as well as on the adequacy of reinsurance arrangements.

Concentration

MMS's insurance risk is highly diversified through the different products offered. MMS is currently writing insurance business in Malta but it also has passporting rights to provide services in several countries outside Malta. However, MMS does not actively write insurance business outside of Malta. It merely provides cover to Maltese customers with overseas interests.

MMS applies acceptance limits, which allow it to control the degree of concentration of insurance risk. MMS employs reinsurance contracts to reduce insurance risk arising from the concentration or accumulation of guarantees exceeding maximum acceptance limits. This is also facilitated by the purchase of facultative reinsurance on a risk-by-risk basis.

The highest exposures to underwriting risk arise from natural or man-made catastrophes. To mitigate catastrophic risk, specific reinsurance coverage is purchased to protect MMS's net retained exposure. This is at least reviewed on an annual basis and the level of cover purchased is based on a technical analysis of possible different scenarios, carried out by MAPFRE RE, the Group's reinsurance business unit.

Transfer of risk to special-purpose entities

MMS does not transfer underwriting risk to special-purpose entities.

C.2. Market risk

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

Exposure

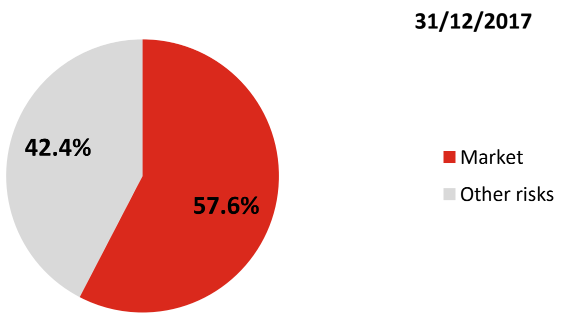
The following is a breakdown of the MMS's investments by asset category:

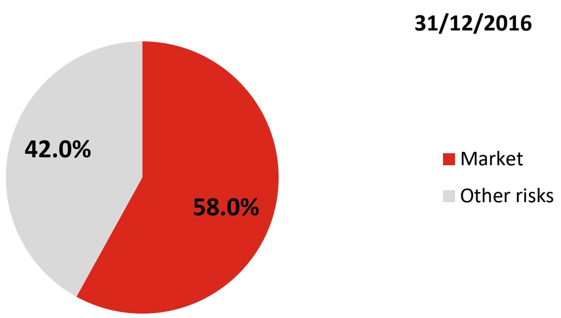
Investments	Investments at 31/12/2017	(%) Investments	Investments at 31/12/2016	(%) Investments
Investment properties	14,822	11.1%	13,713	10.3%
Financial investments	**118,308**	**88.9%**	**119,328**	**89.7%**
Strategic participations	97,889	73.5%	97,003	72.9%
Fixed income	16,999	12.8%	17,860	13.4%
Equities	3,420	2.6%	4,465	3.4%
Mutual funds	-	-	-	-
Other	-	-	-	-
Deposits established for accepted reinsurance	-	-	-	-
Hedging derivatives	-	-	-	-
Other investments	-	-	-	-
Total	**133,130**	**100%**	**133,041**	**100%**

Figures in thousand euros

At 31st December 2017, 12.8% of the total investments were Fixed-income securities. Of these, 45.3% correspond to Government of Malta debt exposures.

At 31st December 2017, market risk represents 57.6% of all of the risk modules included in the SCR standard formula calculation. The following charts present details by module and changes when compared to the previous year.





Management and mitigation techniques

MMS mitigates its exposure to market risk through a prudent investment policy, characterised by investment-grade fixed-income securities, and the establishment of general and specific exposure limits.

These limits are established in the Investment Plan which is approved by the Board of Directors and are reviewed at least on an annual basis.

The management of the investment portfolio is considered as a semi-active management, with internal risk limits in place.

MMS's investment portfolio assumes a degree of Market Risk, in accordance with the following:

- Modified duration is the variable aspect of the management of interest rate risk, and is conditioned by the limits established in MMS's Investment Plan approved by the Board of Directors.
- Spread and concentration risks are mitigated by the high proportion of fixed income securities with investment grade ratings and through issuer diversification.
- Equity investments are subject to a maximum limit of the investment portfolio, and issuer limits.
- Currency risk is minimised through currency matching with respect to the currencies in which the assets and liabilities are denominated.
- Property risk is monitored and it is ensured that the risks lie within the Investment Policy for property investment.

Concentration

For Market Risk, MMS applies the limits established in the Investment Plan, which ensures sufficient diversification by issuer, country and activity sectors.

Maltese Government bonds represent 37.7% of the total financial investments (excluding real estate and strategic investments). MAPFRE MSV Life p.l.c is the most important strategic investment held by MMS whilst MMS's property investment allocation is mainly concentrated in a single exposure.

C.3. Credit risk

Credit Risk is the risk of loss or of adverse change in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties, and any debtors to which insurance and reinsurance undertakings are exposed, in the form of counterparty default risk, spread risk, or market risk concentrations risk.

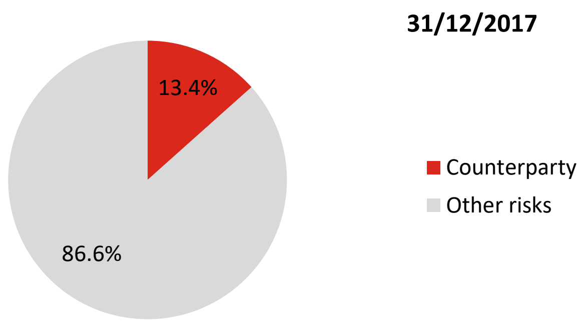
Credit Risk is included under the SCR Standard Formula calculation as spread and concentration risk under the Market Risk module (Section C.2. of this Report) and as counterparty default risk under the Counterparty Default Risk Module.

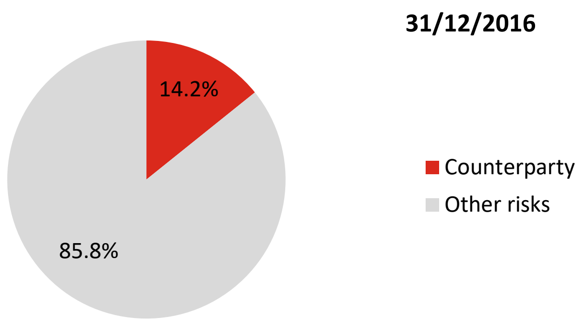
The Counterparty Default risk module distinguishes between two types of exposure:

- Type 1 exposures which include reinsurance contracts, derivatives and cash at bank where a credit rating is usually available for the counterparty.
- Type 2 exposures which include intermediaries' receivables, and policyholder debtors, among others.

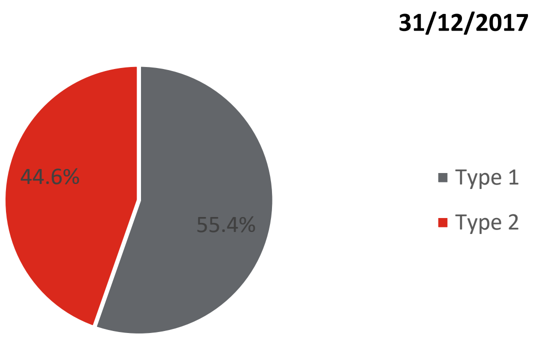
Exposure

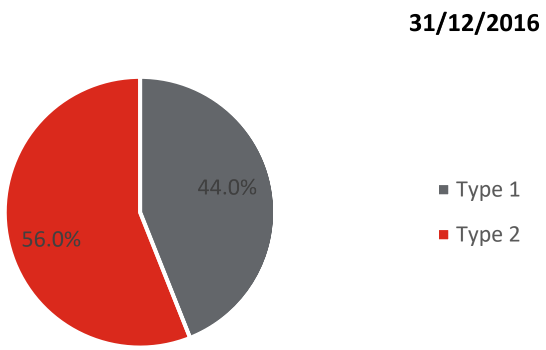
As at 31st December 2017, the counterparty default risk represents 13.4% percent of all of the risk modules included in the SCR standard formula calculation. The following charts present details by module and changes when compared to the previous year.





The following charts show the solvency capital requirement results for the two types of exposures:





Management and mitigation techniques

MMS's Credit Risk Management Policy establishes exposure limits according to the counterparty's credit rating. A risk exposure monitoring and notification system is also set up.

MMS's Credit risk management policy with regards to reinsurance is to cede business to reinsurers of proven financial capacity. Generally, MMS reinsures with entities with a credit rating of at least A, which is equivalent to a credit quality step of 02 and which have been accepted by the Security Committee of the MAPFRE Group. Business can also be ceded to other reinsurers, following an internal analysis that demonstrates that they have a solvency level equivalent to the aforementioned classification or provide appropriate guarantees and which have also been accepted by the Security Committee of the MAPFRE Group.

The main principles which are taken into consideration when purchasing reinsurance and/or implementing other risk mitigation techniques within MMS are:

- Optimisation of capital consumption.
- Optimisation of conditions.
- Solvency of the counterparties.
- The effective transferability of risk.
- Suitability of the risk transfer.

Concentration

The highest concentration in relation to reinsurance is to entities within the MAPFRE Group which has a broad list of diversified stable reinsurers.

C.4. Liquidity risk

Liquidity risk is the risk that insurance and reinsurance undertakings are unable to realise investments and other assets in order to settle their financial obligations when they fall due.

Exposure

Liquidity risk is not included in the SCR Standard Formula calculation. Exposure to liquidity risk is considered to be low, taking into account the prudent investment strategy established in the Investment policy, which is characterised by a relatively high proportion of Government of Malta debt exposures.

In extreme events, liquidity risk is minimised through the use of reinsurance as a risk mitigation technique to reduce the concentration of underwriting risk and also through the selection of highly rated reinsurers.

Management and mitigation techniques

MMS has a Liquidity Risk Management Policy and an Asset and Liability Management Policy, which together form the framework of reference for handling Liquidity Risk. The Liquidity Risk Management Policy is based on maintaining sufficient cash balances and other high-quality assets to comfortably cover commitments arising from MMS's obligations towards its policyholders and creditors at maturity.

As at 31st December 2017, the balance of cash and cash equivalents amounted to €15.06 million (2016: €7.19 million), equivalent to 42.5 percent of total financial investments and cash balances[3].

The majority of fixed-income investments have investment grade ratings and are traded on organised financial markets, which provides comfort to cover any commitments arising from MMS's obligations.

MMS's Liquidity Risk Management Policy requires on a continuous basis, a sufficient volume of high-quality liquid assets, available credit facilities and estimated cash inflows to cover its expected cash outflows.

Concentration

No liquidity risk concentrations have been identified.

Expected profits included in future premiums

The calculation of the best estimate of technical provisions considers the expected profits from future premiums (as a reduction in the best estimate value when positive, or a higher value in the case of expected losses). As at 31st December 2017, the amount of the expected profits totalled €0.72 million.

[3] Excluding strategic investments

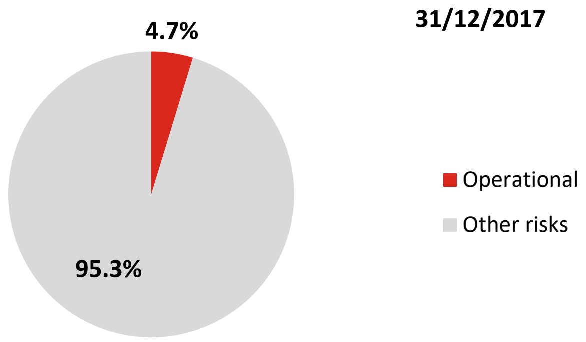
C.5. Operational risk

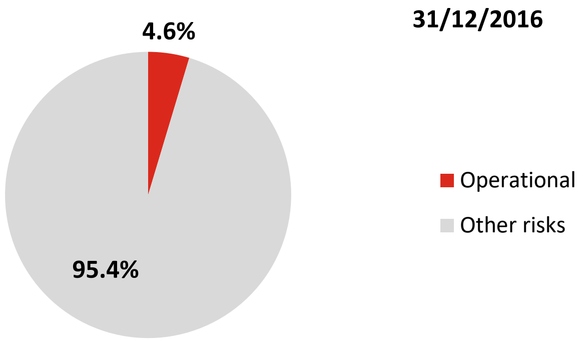
MMS defines Operational Risk as the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events, including legal risks, but excluding risks arising from strategic decisions, as well as reputational risks.

As implied in the aforementioned definition, operational risks are both quantitative and qualitative in nature. In this regard, MMS measures the quantitative aspect through the standard formula calculation. On the other hand, the qualitative aspect is assessed through various risk assessments as described further below.

Quantitative Exposure of Operational Risk

As at 31st December 2017, operational risk represents 4.7 percent of all of the risk modules included in the SCR standard formula calculation. The following charts present details by module and changes when compared to the previous year.





Management and mitigation techniques

Operational Risks are identified and evaluated with Riskm@p, a software application developed in-house by MAPFRE to control risks, notably operational risk.

Risk control is the mechanism through which risk self-assessment questionnaires are managed, along with internal control manuals, inventory controls associated with risks, assessments of their effectiveness and management of the corrective measures in place to mitigate or reduce the risks and/or improve the control environment.

The foregoing operational risk management model consists of a process-based dynamic qualitative analysis of MMS, which enables the managers of each area or department to identify and assess the potential risks and the effectiveness of the related controls affecting the business and support processes: Product Development, Underwriting, Claims / Benefits, Administrative Management, Sales Activities, Human Resources, Committees, Coinsurance / Reinsurance, Technical Provisions, Investments, IT Systems, and Customer Service.

Furthermore, MMS has implemented the recognition of operational loss events for categorization and monitoring, as well as business continuity scenario analyses.

Concentration

MMS relies on its IT systems for the management of insurance policies. A prolonged unavailability of these systems could have a negative impact on the operations of the company. However, MMS has a business continuity plan which mitigates this risk.

C.6. Other material risks

C.6.1. Non-compliance risk

Non-compliance risk is defined as the risk of incurring losses as a consequence of legal or regulatory penalties, or loss to reputation that may affect MMS as a result of not complying with laws, regulations, rules, internal and external standards or administrative requirements which should be applied to its activities.

This risk is primarily mitigated through the valuation, identification, monitoring, and mitigation tasks performed by MMS's Compliance Area through its Compliance Risk Management Process.

C.6.2. Legal risk

Legal risk is defined as the event arising from a change in regulations, law or administrative procedures that may adversely affect MMS.

Over the last years, the regulatory framework to which the insurance industry is subject is being extended with new regulations both at the international and the local level. Additionally, it must be borne in mind that MMS operates in a complex environment under increasing regulatory pressures, not only in the insurance sector but also in the technological, corporate governance or criminal corporate responsibility fields, among others.

This risk is primarily mitigated through the valuation, identification, monitoring, and mitigation tasks performed by MMS's Compliance Area through its Legal Risk Management Process.

C.6.3. Cybersecurity risk

Cyber risks are those risks related to security in the use of information and communication technologies, cyberspace and the transfer, processing and storage of electronic data. These cyber risks can compromise:

- The confidentiality, integrity and availability of information handled by MMS, as well as that of the systems which store, process and/or transmit it.
- The continuity of MMS's business activity and the services it provides to the clients.
- In extreme cases, the physical security both of the facilities and of the people.

MMS has a Security and Environmental Unit which is responsible for analysing and managing cyber security risks that could cause damage to MMS.

C.6.4. Risk of new distribution channels

The risk of new distribution channels is the risk deriving from the failure to adapt MMS's product distribution and services channels quickly enough in response to changes in client preferences, the Internet, mobile devices and digitalisation in general, giving rise to a severe decline in demand.

MAPFRE Group strategic initiatives relating to Digital Transformation and Client Orientation ensures that this risk is minimised.

C.7. Any other information

C.7.1. Sensitivity analysis of significant risks

MMS performs sensitivity analyses of the solvency position involving macroeconomic variables such as:

- An increase/decrease in interest rates.
- Appreciation/depreciation of the euro.
- Decrease in the valuation of equities.
- Increase in the spread of corporate and sovereign exposures.

The table below shows the sensitivity of the solvency ratio to changes in these variables:

	31/12/2017	% Change
Solvency Ratio (SR)	288.1%	
SR In the event of a 100 basis point increase in the interest rate	288.2%	0.12 p.p
SR In the event of a 100 basis point decrease in the interest rate	286.1%	-1.94 p.p
SR in the event of a 10% appreciation of the euro	288.1%	0.02 p.p
SR in the event of a 10% depreciation of the euro	288.1%	-0.02 p.p
SR In the event of a 25% decrease in equities	249.0%	-39.12 p.p
SR In the event of a 50 basis point increase in corporate spreads	287.5%	-0.61 p.p
SR In the event of a 50 basis point increase in corporate and sovereign spreads	287.1%	-0.96 p.p

To analyse the sensitivity of its risks, MMS applies the following method:

- Establish a benchmark based on the actual economic balance sheet, SCR and solvency position at a determined date.
- Based on this cut-off point, select the initial variables that would be affected by the application of the stress assumptions that have been defined for the various tests or scenarios.
- Determine the effect on MMS's solvency when applying the new assumptions for the affected variables.

Based on the outcome of the stress tests and sensitivity analyses performed, MMS will continue to comply with the solvency capital requirement in the analysed situations.

C.7.2. Other matters

<u>Off-balance-sheet positions</u>

There are no significant exposures to the above risks arising from off balance sheet positions.

D. Valuation for solvency purposes

D.1. Assets

Following are the main differences between the measurement of assets under Solvency II ("Solvency II Value") and IFRS ("Accounting value") as at 31st December 2017.

It is important to note that the balance sheet presented is in-line with the Solvency II regulations, and therefore it was necessary to re-classify data included under certain headings in the financial statements to different headings as presented under "Accounting value" in the table below.

Assets	Solvency II Value 2017	Accounting Value 2017
Goodwill	-	-
Deferred Acquisition costs	-	6,174
Intangible assets	-	5,871
Deferred tax assets	1,234	-
Pension benefit surplus	-	-
Property, plant & equipment held for own use	1,933	1,933
Investments (other than assets held for index-linked and unit-linked contracts)	133,130	92,631
Property (other than for own use)	14,822	14,822
Holdings in related undertakings, including participations	97,889	57,580
Equities	3,110	3,110
Equities - listed	3,110	3,110
Equities - not listed	-	0
Bonds	16,887	16,697
Government Bonds	13,815	13,644
Corporate Bonds	3,072	3,053
Structured notes	-	-
Collateralised securities	-	-
Collective Investment Undertakings	422	422
Derivatives	-	-
Deposits other than cash equivalents	-	-
Other investments	-	-
Assets held for index-linked and unit-linked contracts	-	-
Loans and mortgages	-	-
Loans on policies	-	-
Loans and mortgages to individuals	-	-
Other loans and mortgages	-	-
Reinsurance recoverables from:	14,005	17,607
Non-life and health similar to non-life	13,928	17,530
Non-Life excluding health	13,921	17,518
Health similar to non-life	7	12
Life and health similar to life, excluding health and index-	77	77

Assets	Solvency II Value 2017	Accounting Value 2017
linked and unit-linked		
Health similar to life	-	-
Life excluding health and index-linked and unit-linked	77	77
Life index-linked and unit-linked	-	-
Deposits to cedants	-	-
Insurance and intermediaries receivables	12,372	12,372
Reinsurance receivables	575	575
Receivables (trade, not insurance)	379	379
Own shares (held directly)	-	-
Amounts due in respect of own fund items or initial fund called up but not yet paid in	-	-
Cash and cash equivalents	15,064	15,064
Any other assets, not elsewhere shown	1,069	1,259
TOTAL ASSETS	**179,761**	**153,865**

Figures in thousand euros

Below are the explanations of the key asset valuation differences in the table above:

Deferred acquisition costs

Under IFRS, acquisition costs can be deferred whilst for Solvency II, reserving expenses are not deferred but are taken into account fully in the technical provisions.

Intangible assets

Under IFRS, intangible assets are measured at cost less their accumulated amortisation and where applicable, possible impairment. MMS mainly recognises value of business acquired (VOBA) and computer software as intangible assets.

The VOBA is amortised using the straight-line method over a period not exceeding five years. The carrying value is assessed yearly for impairment by projecting the profitability of the portfolio acquired over the life of the asset having considered projected combined ratios and retention patterns.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised using the straight-line method over their useful lives, not exceeding a period of seven years.

Under Solvency II, an intangible asset other than goodwill is only recognised at a value not equal to zero if it can be sold separately and the undertaking can demonstrate the existence of a market value for the same or similar assets. MMS considers that both the VOBA and computer software do not meet the conditions established in the Solvency II regulations for market value recognition, and therefore are reported at a zero value.

Deferred tax assets

Deferred taxes are measured under Solvency II as the amounts reported in the audited financial statements as adjusted by the tax impact (at different applicable rates) on the difference between the values assigned to assets and liabilities for solvency purposes and their carrying values as recognised in the financial statements and valued for tax purposes.

Under IFRS, deferred taxes are calculated on all temporary differences using a principal tax rate of 35% with the exception of investment property and freehold and other property for which deferred income taxes may be calculated using a principal tax rate of 8% or 10% of the carrying amount. MMS recognised a net deferred tax liability on its closing IFRS balance sheet at a carrying amount of €0.50 million. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off a current tax asset against a current tax liability.

As at 31st December 2017, MMS has recognised a net deferred tax asset on the Solvency II balance sheet of €1.23 million. The differences between the Solvency II and IFRS value of the deferred tax assets arose due to the different valuation criteria used for the following:

- Deferred acquisition costs
- Intangible assets
- Participations
- Reinsurance recoverables
- Technical provisions

Due to the nature of the deferred tax assets held by MMS, there are no specific expiration dates for them.

Property, plant & equipment held for own use

In accordance with Solvency II criteria, property, plant & equipment must be measured at fair value.

Under IFRS, property, plant, and equipment for own use is stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. This value has been considered as its fair value under Solvency II and therefore no adjustment to the valuation was needed.

Investments (other than assets held for index-linked and unit-linked contracts)

All investments must be measured at fair value on the Solvency II balance sheet, regardless of the accounting portfolio under which they are classified. The determination of fair value is performed by following the same procedures and methodology used for determining fair value based on IFRS 13.

IFRS 13 defines fair value as the price received in exchange for an asset or paid for transferring a liability during an orderly transaction between market participants at the valuation date. In a fair value valuation, the transaction should take place in the main asset or liability's market, and where this does not exist, in the most advantageous market. Valuation techniques appropriate to the circumstances for which there is sufficient data to conduct a fair value measurement must be used, maximizing the use of relevant observable variables while minimizing the use of variables which cannot be observed.

In order to increase the coherence and comparability of the fair value measurements, IFRS 13 establishes a fair value hierarchy making it possible to classify the valuation technique variables used to determine fair value in three different levels.

Level 1 corresponds to unadjusted quoted prices on active markets. Level 2 uses observable data, or listed prices for instruments which are similar to those being appraised, or other valuation techniques in which all the significant variables are based on observable market data; Level 3 uses specific variables for each case.

Although not all assets and liabilities may have available observable market transactions or information, in any case the purpose of a fair value appraisal is always the same: estimate the price for an orderly transaction for selling or transferring the liability between market participants at the valuation date in present market conditions.

Under "Investments", based on the Solvency II balance sheet, the following investments are included:

- ***Property (other than for own use)***

In accordance with Solvency II criteria, properties which are not considered for own use and are used to earn payments, capital gains or both must be measured at fair value.

Under IFRS, such properties are valued at its appraisal value, determined by an external, independent and qualified architect.

An independent valuation of the investment property of MMS comprising mainly of office buildings was performed by an independent architect to determine the fair value of the land and buildings as at 31st December 2017.

The appraisal value has been considered as its fair value under Solvency II and therefore no adjustment to the valuation was needed.

- ***Holdings in related companies***

In accordance with Article 212 of the Solvency II Directive 2009/138/EC, related parties and subsidiaries are companies in which there is an investment or over which there is a dominant or significant influence.

Wherever possible, investments in related companies are measured at their listed prices on active markets as regards the Solvency II balance sheet. However, due to the absence of quoted prices on active markets, the assets were valued using the adjusted equity method, considering the solvency valuation specifics indicated for each investment or subsidiary.

Under IFRS, and in accordance with the accounting policies of MMS, investments in subsidiaries are valued at cost less impairment, which differs from Solvency II criteria.

Due to the difference in valuation criteria, an increase of €40.3 million was recorded for these investments on the Solvency II balance sheet when compared to the IFRS balance sheet.

- ***Equities, bonds and collective investment undertaking***

Equities and collective investment undertakings

Equities and collective investment undertakings are recognised at fair value on the financial statements and therefore do not reflect valuation differences in comparison with the Solvency II values.

Bonds

Under IFRS, accrued interest for bonds is accounted for as "Any other assets, not elsewhere shown", whilst the Solvency II value of the bonds is equal to the market value.

Reinsurance recoverables

The calculation of the reinsurance recoverables is in line with that for technical provisions for direct insurance and accepted reinsurance, which means that these amounts must be recognised at their best estimate, also considering the cash flow patterns as well as the expected losses from the counterparty's default.

When determining the recoverable value of the amounts of reinsurance arising from amounts considered in technical provisions, MMS takes into account the expected value of potential reinsurance default based on creditworthiness and the time horizon of expected payment patterns.

The classification along the different lines of businesses and the development of reinsurance claims are based on the assumptions made for gross technical provisions. Under IFRS, technical reserves for cessions to reinsurers are calculated in accordance with the reinsurance contracts entered into as applied to the gross technical provisions as explained in Section D.2.

Insurance and intermediaries receivables

For purposes of the Solvency II balance sheet, when determining the value of loans with insurance companies and intermediaries (including accepted reinsurance), the time effect implicit in the loans is irrelevant. The obligatory estimates of possible loan default with insurers related to bills pending payment are considered to correctly reflect their economic value and therefore no adjustment to the valuation was required.

Reinsurance receivables

This heading includes loans arising as a result of ceded reinsurance transactions.

For purposes of the Solvency II balance sheet, when determining the value of amounts receivable from ceded reinsurance transactions, the expected value of potential default by the reinsurer is considered, based on its creditworthiness and the time horizon of the recoveries.

The value of potential reinsurance collections is directly linked to estimates and projections for future cash flows, which might be subject to a number of uncertain factors, which mainly relate to the possibility of the counterparty failing to meet its future payment commitments. Hence, no adjustment to the IFRS valuation was required.

Receivables (trade, not insurance)

This heading includes operational receivables, which are not involved in insurance transactions, and therefore are not reflected in the above two sections.

For the purposes of the Solvency II balance sheet, these were valued in accordance with IFRS, based on their face value.

Cash and cash equivalents

Cash includes cash in hand and demand deposits, while cash equivalents correspond to highly liquid short-term investments that can be easily converted to fixed amounts of cash and have an insignificant risk of changes in value.

For the purposes of the Solvency II balance sheet, Cash and cash equivalents have been valued in accordance with IFRS.

Any other assets, not elsewhere shown

The difference between the IFRS value and the Solvency II value of €190k relates to the accrued interest of bonds, which under IFRS is accounted for under “Any other assets, not elsewhere shown”.

D.2. Technical provisions

Following are the main differences between the valuation of technical provisions under Solvency II and IFRS:

Technical provisions	Solvency II Value 2017	Accounting Value 2017
Technical provisions - Non-Life	65,701	71,992
Technical provisions - Non-Life (excluding health)	61,728	67,131
Technical provisions calculated as a whole	-	
Best Estimate (BE)	58,548	
Risk margin (RM)	3,180	
Technical provisions - health (similar to Non-Life)	3,973	4,860
Technical provisions calculated as a whole	-	
Best Estimate (BE)	3,677	
Risk margin (RM)	296	
Technical provisions - Life (excluding index-linked and unit-linked)	723	1,018
Technical provisions - health (similar to Life)	-	-
Technical provisions calculated as a whole	-	
Best Estimate (BE)	-	
Risk margin (RM)	-	
Technical provisions - Life (excluding health and index-linked and unit-linked)	723	1,018
Technical provisions calculated as a whole	-	
Best Estimate (BE)	627	
Risk margin (RM)	96	
Technical provisions - index-linked and unit-linked	-	-
Technical provisions calculated as a whole	-	
Best Estimate (BE)	-	
Risk margin (RM)	-	
Other technical provisions		-
TOTAL TECHNICAL PROVISIONS	**66,425**	**73,010**

Figures in thousand euros

As has been previously mentioned, MMS is an insurance entity specialising in the Non-Life segment, which covers the legally-assigned risks in this segment, although it also operates in the Life segment with a fairly insignificant portfolio (1.1 percent of the total technical provisions).

Following are the qualitative explanations of the key technical provision valuation differences using Solvency II criteria and those used during the preparation of the financial statements. In general terms, the main difference between the two valuation methods is the criteria framework under which each regulation falls. While under Solvency II, technical provisions are measured using market economic criteria, for financial statements, technical provisions are calculated based on accounting standards.

The Solvency II Directive 2009/138/EC stipulates that the value of technical provisions shall be equal to the sum of a best estimate and a risk margin.

D.2.1. Best estimate and risk margin

Best estimate

The Best Estimate Liabilities (BEL) of the Non-life and Health similar to Non-Life businesses are calculated separately as provisions for claims outstanding and premium provisions.

a) Best estimate of the provision for claims outstanding

The "best estimate" for the provision for claims outstanding is based on the following principles:

- Taking into account all claims which have been incurred prior to the valuation date, regardless of whether they have been reported or not.

- It is calculated as the present value of expected future cash flows associated with the incurred claim. Projected cash flows will include payments for benefits and related expenses.

- Should there be any liabilities transferred to a counterparty, the recoverable amounts are adjusted to factor in the expected losses due to default of the counterparty.

- The best estimate considers the time value of money based on the consideration of the claim inflows and outflows.

From a methodological point of view, it is determined as the ultimate claim cost less payments made. The calculation of the ultimate cost takes place using proven deterministic statistical methods outlined in the Section *Actuarial methods and assumptions used when calculating technical provisions*.

The Claim provisions in the financial statements include: the provision for outstanding claims and the provision for claim settlement expenses. The provision of outstanding claims consists of the individual case-by-case valuation of claims with the exception of Motor claims relating to 2016-2017 accident years which have been determined on an ultimate cost basis. Certain losses involving fatalities or serious bodily injury have been reserved on a case-by-case reserve basis.

The Claim provisions calculated based on Solvency II criteria present the following differences with respect to those calculated based on financial statement requirements:

- The elimination of prudence margins. Using accounting standards, a certain prudence margin is generally applied to provisions to cover possible unfavourable deviations of outstanding claims. However, under Solvency II, the calculation of the claims provision must be made without including any prudence margins.

- The consideration of all cash flow sources.

- The counterparty default risk adjustment to reinsurance recoverable amounts.

- The financial discount of cash flows.

b) Best estimate of the provision for premiums

The "best estimate" for the premium provision is based on the following principles:

- It relates to future claims, or those which take place subsequent to the valuation date, within the remaining claim coverage period.

- It is calculated as the present value of expected cash flows associated with the current portfolio, in accordance with contract boundaries.

- Projected cash flows will include payments for benefits and related expenses: administration, acquisition, claim management, and investment management.

- Should there be any liabilities transferred to a counterparty, the recoverable amounts are adjusted to consider the expected losses due to default of the counterparty.

- The best estimate takes into account the time value of money based on an analysis of claim inflows and outflows.

As indicated previously, the calculation of this provision is comprised of the cash flows corresponding to two portfolios:

- Current portfolio which includes the following:

  - Expected claims. Two different methods may be used to calculate the present value of benefit payments:

    - ✓ The frequency and average cost method: claims are calculated as the result of exposure based on frequency assumptions and final average costs.

    - ✓ Loss ratio method: the expected claims arising from applying the ultimate loss ratio to Unearned Premium Reserve (UPR), gross of acquisition expenses.

  - Expenses attributable to the current portfolio: acquisition (no commissions), administration, chargeable to benefits, investment expenses, as well as other technical expenses.

- Future business which includes the following

  - Premiums for policies, which have not yet been renewed but include company commitments to renew. This calculation includes the future behaviour of the policyholders based on the application of an estimated lapse ratio.

  - Expected loss ratio relating to future premiums. The same methods indicated for the current portfolio may be used.

  - Expenses attributable to future premiums (charged expense-to-premium ratio applied to future premiums): acquisition expenses (including commissions), administration, chargeable to benefits, investment expenses, as well as other technical expenses.

Under IFRS, this provision is recognised under the unearned premium reserve, which is calculated on a policy-by-policy basis, reflecting the premium rate on a pro-rata temporary basis for the unearned period of such policies and complemented by the unexpired risk provision calculated segment-by-segment where applicable. The provision supplements the unearned premium reserve with an amount by which the future contractual cash flows arising from such reserve exceed the same reserve.

Contract boundaries

As outlined in the Solvency II Directive, when calculating the best estimate, the contract boundaries must be taken into account. In certain cases, this implies the inclusion of future premiums arising from commitments in force. If the contracts are profitable, cash inflows corresponding to these premiums will be higher than the outflows (payments and expenses); thereby generating a negative BEL. Depending on the product's profitability, the inclusion of contractual limits generates a decrease in the best estimate (if the contracts are profitable) or an increase (if they are not).

Contractual limits must meet a series of requirements. The obligations arising from the contract, including those which relate to the company's unilateral right to renew or increase its limits and the corresponding premiums, will be included in its text, except for:

- Obligations provided by the Company after the date on which:
  - The Company has the unilateral right to cancel the contract.
  - The Company has the unilateral right to reject premiums payable under the contract.
  - The Company has the unilateral right to modify the premiums or benefits to which it is bound by virtue of the contract, so that the premiums clearly reflect the risks.
- All obligations that do not correspond to premiums which have already been already paid, unless the policyholder may be forced to pay future premiums, provided the following conditions are met:
  - The contract does not establish an indemnity for a specified uncertain event which may adversely affect the reinsured party.
  - The contract does not include a financial guarantee for the benefits.

We conclude that claim provisions calculated based on Solvency II criteria present the following differences with respect to those calculated based on IFRS requirements:

- The application of the concept of contractual limits, which involves the consideration of future business. Conversely, under IFRS, future premiums must be taken into account only if included in the corresponding technical note.
- The consideration of all cash flow sources. In general, under Solvency II, the premium provision for profitable products included in a portfolio in force is less than the UPR reflected in the financial statements. In cases of premium insufficiency, the premium provision is comparable to the UPR plus the unexpired risk provision (without taking the discount effect into account). For future business, the Solvency II premium provision for profitable products will be negative.
- The credit risk adjustment to reinsurance recoverable amounts.
- The financial discount of cash flows.

The Group Life technical provisions are calculated similarly to the Non-Life technical provisions due to the nature of the business written by MMS. MMS does not consider future business in the calculation of the life provision as there is no commitment in the annual renewal.

Risk margin

The Risk Margin is conceptually equivalent to the cost of supplying eligible own funds, and the Solvency Capital Requirement (SCR) necessary to support insurance commitments during their entire period of validity and until they are definitively settled. The interest rate used in determining cost of supplying the amount of eligible own funds is known as the cost-of-capital rate. MMS uses the 6% rate set by Commission Delegated Regulation (EU) 2015/25.

The method for calculating risk margin may be expressed as follows:

$$RM = CoC * \sum \frac{SCR_t}{(1 + r_{t+1})^{t+1}}$$

Where:

- CoC: the cost-of-capital rate which is taken as 6%
- SCR_t: Solvency Capital Requirement after t years.
- r_{t+1}: basic risk-free interest rate for the maturity of t+1 years.

There are a number of simplified methods to calculate risk margin:

- Level 1: explains how to approximate underwriting, counterparty default, and market risks.
- Level 2: this is based on the assumption that the future solvency capital requirement will be proportional to the "best estimate" of technical provisions during the year in question.
- Level 3: this consists of using the modified duration of liabilities to calculate the current and future solvency capital requirement in a single step.
- Level 4: calculates the risk margin as a percentage of the best estimate of technical provisions net of reinsurance.

MMS calculates the risk margin using the Level 2 simplification method.

<u>Actuarial methods and assumptions used when calculating technical provisions</u>

The following are the main actuarial techniques used by MMS when calculating the technical provisions under Solvency II:

For Non-Life insurance:

- A combination of generally-accepted deterministic methods used for calculating ultimate claims based on Development Factors on paid and incurred triangles. MMS considers the methodologies used to be appropriate.

The following two key assumptions were used during the calculation of the technical provisions:

- <u>Economic assumptions</u>, which are compared to available financial and macroeconomic indicators and mainly include:
  - Interest rate structure split by the currencies in which the commitments are denominated.
  - Exchange rates.
  - Market trends and financial variables.

- Non-economic assumptions, which are mainly obtained from generally-available data based on the MMS's and/or the MAPFRE Group's past experience, or external sector/market sources:

  - Realistic administration, investment, acquisition, etc. expenses that will be incurred throughout the duration of the contracts.
  - Portfolio losses and lapse rates.
  - The frequency and severity of claims based on past data.
  - Legislative changes.

Also, it is worth noting that under IFRS, management actions and policyholder behaviour are not included when calculating technical provisions, while under Solvency II, as indicated in the Directive, companies may establish a comprehensive plan covering future decisions considering the necessary time frame to calculate their best estimates, including a probability analysis of when policyholders might exercise certain rights included in their insurance policies.

MMS employs an effective actuarial method which guarantees the appropriateness and consistency of the underlying methods and models used, as well as the assumptions used in these calculations.

For Life insurance:

The following two key assumptions were used during the calculation of the technical provisions:

- Economic assumptions, which are compared to available financial and macroeconomic indicators which mainly include:

  - Interest rate structure split by the currencies in which the commitments are denominated.
  - Exchange rates.
  - Market trends and financial variables.

- Non-economic assumptions, which are mainly obtained from generally-available data based on MMS's and/or the MAPFRE Group's past experience, or external sector/market sources:

  - Realistic administration, investment, acquisition, etc. expenses that will be incurred throughout the duration of the contracts in the portfolio.
  - Portfolio losses and policy surrenders.
  - Legislative changes

Also, it is worth noting that under IFRS, management actions and policyholder behaviour are not included when calculating technical provisions, while under Solvency II, as indicated in the Directive, companies may establish a comprehensive plan covering future decisions considering the necessary time frame to calculate their best estimates, including a probability analysis of when policyholders might exercise certain rights included in their insurance policies.

MMS employs an effective actuarial method, which guarantees the appropriateness and consistency of the underlying methods and models used, as well as the assumptions used in these calculations.

Degree of uncertainty associated with the amount of technical provisions

The value of the technical provisions is directly linked to estimates and projections for future cash flows, which might be subject to a number of factors of uncertainly, which are mainly the following:

- The probability that the obligation will materialise with regard to future cash flows.

- The timing of the claim.
- Potential amount of the future cash flows.
- The risk-free interest rate.

These factors are generally estimated based on expert opinions within the area, or using market data.

D.2.2. Measures designed for managing long-term guarantees

MMS does not make use of any long-term guarantee measures.

D.2.2.a. Matching adjustment

MMS does not make use of any matching adjustments.

D.2.2.b. Volatility adjustment

MMS does not make use of any volatility adjustments.

D.2.2.c. Transitional measure on the risk-free interest rates

MMS does not make use of any transitional measures on the risk-free interest rates.

D.2.2.d. Transitional measure on technical provisions

MMS does not make use of any transitional measures on technical provisions.

D.2.3. Reinsurance recoveries and special purpose entities

MMS does not make use of any special purpose entities.

D.2.4. Significant changes in the assumptions used when calculating technical provisions

MMS did not make any changes with respect to the assumptions used in the calculation of the technical provisions, as a result of the implementation of the Solvency II rules.

D.3. Other Liabilities

Following are the main differences between the measurement of other liabilities under Solvency II and IFRS:

Other Liabilities	Solvency II Value 2017	Accounting Value 2017
Total technical provisions	**66,425**	**73,010**
Contingent liabilities	-	-
Provisions other than technical provision	-	-
Pension benefit obligations	1,100	1,100
Deposits from reinsurers	-	-
Deferred tax liabilities	-	503
Derivatives	-	-
Debts owed to credit institutions	-	-
Financial liabilities other than debts owed to credit institutions	-	-
Insurance & intermediaries payables	205	205
Reinsurance payables	1,547	1,547
Payables (trade, not insurance)	2,988	2,988
Subordinated liabilities	-	-
Subordinated liabilities not in BOF	-	-
Subordinated liabilities included in BOF	-	-
Any other liabilities, not elsewhere shown	4,133	5,674
TOTAL LIABILITIES	**76,400**	**85,027**
EXCESS OF ASSETS OVER LIABILITIES	**103,363**	**68,838**

Figures in thousand euros

Pension benefit obligations

MMS operates a defined benefit plan in favour of a former Executive Chairman. The pension plan defines an amount of pension benefit that he receives on retirement. The valuation of the obligation is the same under IFRS and Solvency II and is equal to the present value of the obligation determined by discounting estimated future cash outflows.

Deferred tax liabilities

As mentioned earlier, MMS recognised a net deferred tax liability on its closing IFRS balance sheet at a carrying amount of €0.50 million. MMS recognised a net deferred tax asset on the Solvency II balance sheet at €1.23 million, resulting from the offsetting of deferred tax assets and liabilities since taxes are paid to the same tax authority.

Insurance & intermediaries payables

This heading includes borrowings arranged as a result of transactions performed with insurers other than those related to claims pending settlement, as well as those related to cash balances with Company intermediaries arising from transactions performed.

For the purposes of the Solvency II balance sheet, the valuation is considered consistent with that under IFRS, valued at the amount at which they may be transferred or settled between duly-informed interested parties carrying out transactions under mutually-independent conditions.

Reinsurance payables

This includes reinsurance payables on the current account established with reinsurers for ceded and retroceded reinsurance transactions.

For the purposes of the Solvency II balance sheet, the valuation is considered consistent with that under IFRS, valued at the amount at which they may be transferred or settled between duly-informed interested parties carrying out transactions under mutually-independent conditions.

Payables (trade, not insurance)

This section includes other payables unrelated to the insurance business. For the purposes of the Solvency II balance sheet, the valuation is considered consistent with that under IFRS, valued at the amount at which they may be transferred or settled between duly-informed interested parties carrying out transactions under mutually-independent conditions.

Any other liabilities, not elsewhere shown

“Accounting value” mainly includes deferred reinsurance commissions together with other accruals with an accounting value of €5.67 million. For Solvency II purposes, deferred reinsurance commissions are taken into consideration during the valuation of technical provisions, as they include the entirety of the associated expenses, and therefore do not appear under this heading.

D.3.1. Additional information

Finance and operating leases

Finance and operating leases are described in Section A of the report.

D.4. Alternative methods for valuation

MMS's Investment property is valued at its appraisal value, determined by an external, independent and qualified architect.

D.5. Any other information

There is no other significant information regarding the valuation of assets and liabilities that has not been included in the preceding sections.

D.6. Annexes

A) Assets

Template **S.02.01.02** detailing quantitative asset disclosures at 31st December 2017:

Assets	Solvency II value
Intangible assets	-
Deferred tax assets	1,234
Pension benefit surplus	-
Property, plant & equipment held for own use	1,933
Investments (other than assets held for index-linked and unit-linked contracts)	133,130
Property (other than for own use)	14,822
Holdings in related undertakings, including participations	97,889
Equities	3,110
Equities – listed	3,110
Equities – unlisted	-
Bonds	16,887
Government Bonds	13,815
Corporate Bonds	3,072
Structured notes	-
Collateralised securities	-
Collective Investments Undertakings	422
Derivatives	-
Deposits other than cash equivalents	-
Other investments	-
Assets held for index-linked and unit-linked contracts	-
Loans and mortgages	-
Loans on policies	-
Loans and mortgages to individuals	-
Other loans and mortgages	-
Reinsurance recoverables from:	14,005
Non-life and health similar to non-life	13,928
Non-life excluding health	13,921
Health similar to non-life	7
Life and health similar to life, excluding health and index-linked and unit-linked	77
Health similar to life	-
Life excluding health and index-linked and unit-linked	77
Life index-linked and unit-linked	-
Deposits to cedants	-
Insurance and intermediaries receivables	12,372
Reinsurance receivables	575
Receivables (trade, not insurance)	379
Own shares (held directly)	-

Assets	Solvency II value
Amounts due in respect of own fund items or initial fund called up but not yet paid in	-
Cash and cash equivalents	15,064
Any other assets, not elsewhere shown	1,069
Total assets	179,761

Figures in thousand euros

B) Technical provisions

B.1 Template **S.02.01.02** detailing quantitative technical provisions disclosures at 31st December 2017:

Liabilities	Solvency II Value
Technical provisions — Non-Life	**65,701**
Technical provisions — Non-Life (excluding health)	61,728
Technical provisions calculated as a whole	-
Best estimate	58,548
Risk margin	3,180
Technical provisions — health (similar to Non-Life)	3,973
Technical provisions calculated as a whole	-
Best estimate	3,677
Risk margin	296
Technical provisions — Life (excluding index-linked and unit-linked)	**723**
Technical provisions — health (similar to Life)	-
Technical provisions calculated as a whole	-
Best estimate	-
Risk margin	-
Technical provisions — Life (excluding health and index-linked and unit-linked)	723
Technical provisions calculated as a whole	-
Best estimate	627
Risk margin	96
Technical provisions — index-linked and unit-linked	**-**
Technical provisions calculated as a whole	-
Best estimate	-
Risk margin	-

Figures in thousand euros

B.2.1 Template **S.12.01.02** – Life and Health SLT Technical Provisions as at 31st December 2017

	Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
			Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
Technical provisions calculated as a whole	-	-			-			-	-	-	-			-	-	-
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	-	-			-			-	-	-	-			-	-	-
Technical provisions calculated as a sum of BE and RM																
Best Estimate																
Gross Best Estimate	-		-	-		627	-	-	-	627		-	-	-	-	-
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to	-		-	-		77	-	-	-	77		-	-	-	-	-

	Insurance with profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
			Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
counterparty default																
Best estimate minus recoverables from reinsurance/SPV and Finite Re - total	-		-	-		550	-	-	-	550		-	-	-	-	-
Risk Margin	-	-			96			-	-	96	-			-	-	-
Amount of the transitional on Technical Provisions																
Technical Provisions calculated as a whole	-	-			-			-	-	-	-			-	-	-
Best estimate	-		-	-		-	-	-	-	-		-	-	-	-	-
Risk margin	-	-			-			-	-	-	-			-	-	-
Technical provisions - total	-	-			723			-	-	723	-			-	-	-

Figures in thousand euros

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B.2.2 Template **S.17.01.02** – Non-Life Technical Provisions as at 31st December 2017

	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
Technical provisions calculated as a whole	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Technical provisions calculated as a sum of BE and RM																	
Best estimate																	
Premium provisions																	
Gross	2,297	342	-	6,569	7,630	529	4,686	201	-	-	145	163	-	-	-	-	22,562
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	-	-	-	-	-5	-	2,444	-16	-	-	-	9	-	-	-	-	2,432
Net Best Estimate of Premium Provisions	2,297	342	-	6,569	7,635	529	2,242	218	-	-	145	153	-	-	-	-	20,130
Claims provisions																	
Gross	610	428	-	15,598	5,713	1,350	6,821	7,820	-	-	1,107	-	-	-	-	216	39,663
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	-1	8	-	1,947	11	756	5,369	3,014	-	-	365	-	-	-	-	28	11,496
Net Best Estimate of Claims Provisions	612	419	-	13,651	5,702	594	1,452	4,806	-	-	742	-	-	-	-	188	28,167
Total Best estimate - gross	2,908	769	-	22,167	13,343	1,879	11,507	8,021	-	-	1,252	163	-	-	-	216	62,225
Total Best estimate - net	2,909	761	-	20,220	13,337	1,123	3,694	5,024	-	-	887	153	-	-	-	188	48,297

	Direct business and accepted proportional reinsurance												Accepted non-proportional reinsurance				Total Non-Life obligation
	Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance	Non-proportional property reinsurance	
Risk margin	243	52	-	995	745	159	663	471	-	-	127	3	-	-	-	16	3,476
Amount of the transitional on Technical Provisions																	
Technical Provisions calculated as a whole	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Best estimate	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Risk margin	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Technical provisions - total																	
Technical provisions - total	3,151	822	-	23,162	14,088	2,038	12,170	8,493	-	-	1,380	166	-	-	-	232	65,701
Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total	-1	8	-	1,947	6	756	7,812	2,998	-	-	365	9	-	-	-	28	13,928
Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total	3,152	814	-	21,216	14,082	1,282	4,357	5,495	-	-	1,014	156	-	-	-	205	51,773

Figures in thousand euros

B.3 Template **S.19.01.21** – Non-Life insurance claims

The following templates reflect the estimate made by the insurer of the cost of claims (those paid and provisions for claims in accordance with Solvency II valuation principles), as well as how the estimate evolves over time.

Gross Claims Paid (non-cumulative)

	Development year										
Year	0	1	2	3	4	5	6	7	8	9	10 & +
Prior											137
N - 9	9,503	4,432	972	301	251	184	617	79	-	33	
N - 8	9,609	4,736	630	539	423	96	977	145	283		
N - 7	10,321	4,092	410	336	164	22	49	49			
N - 6	9,768	4,476	985	563	363	53	38				
N - 5	10,012	4,265	816	357	129	69					
N - 4	10,611	4,397	620	269	550						
N - 3	10,293	4,465	1,062	85							
N - 2	11,611	8,232	178								
N - 1	15,121	10,030									
N	17,885										

	In current year	Sum of years (cumulative)
Prior	137	91,542
N-9	33	16,373
N-8	283	17,437
N-7	49	15,442
N-6	38	16,247
N-5	69	15,647
N-4	550	16,447
N-3	85	15,905
N-2	178	20,021
N-1	10,030	25,151
N	17,885	17,885
Total	29,337	268,097

Figures in thousand euros

The above table reflects payments made each year for claims arising during non-accumulated years of occurrence.

Gross undiscounted best estimate claims provisions											
Year	0	1	2	3	4	5	6	7	8	9	10 & +
Prior											3,638
N - 9	-	-	-	-	-	-	-	-	702	607	
N - 8	-	-	-	-	-	-	-	892	314		
N - 7	-	-	-	-	-	-	1,503	973			
N - 6	-	-	-	-	-	506	410				
N - 5	-	-	-	-	2,459	1,398					
N - 4	-	-	-	2,268	1,141						
N - 3	-	-	1,464	1,478							
N - 2	-	3,656	4,957								
N - 1	17,270	6,218									
N	18,926										

	Year end (discounted data)
Prior	3,620
N-9	605
N-8	310
N-7	967
N-6	400
N-5	1,380
N-4	1,116
N-3	1,446
N-2	4,866
N-1	6,128
N	18,824
Total	39,663

Figures in thousand euros

C) Other Liabilities

Template **S.02.01.02** detailing quantitative disclosures of other liabilities as at 31st December 2017:

Liabilities	Solvency II Value
Contingent liabilities	-
Provisions other than technical provisions	-
Pension benefit obligations	1,100
Deposits from reinsurers	-
Deferred tax liabilities	-
Derivatives	-
Debts owed to credit institutions	-
Financial liabilities other than debts owed to credit institutions	-
Insurance & intermediaries payables	205
Reinsurance payables	1,547
Payables (trade, not insurance)	2,988
Subordinated liabilities	-
Subordinated liabilities not in Basic Own Funds	-
Subordinated liabilities in Basic Own Funds	-
Any other liabilities, not elsewhere shown	4,133
Total liabilities	**76,400**
Excess of assets over liabilities	**103,363**

Figures in thousand euros

E. Capital Management

E.1. Own funds

E.1.1. Equity objectives, policies and management processes

To manage and monitor its own funds and capital, MMS has approved a Capital Management Policy covering the following objectives:

- Provide the GROUP and MMS with a procedure to verify that MMS has a sufficient amount of eligible capital to cover the Solvency Capital Requirement as well as the levels established in the Risk Appetite on a continuous basis.
- Ensure that the projected eligible capital continuously meets the applicable requirements throughout the period covered.
- Ensure that MMS has a Medium-Term Capital Management Plan in place.
- Capital management shall take into account the results of the Own Fund Risk and Solvency Assessment (ORSA), as well as the conclusions drawn during that process.
- Within the framework of the medium and long-term capital management plan, should the need for new resources be anticipated, it will be necessary to verify that the new capital instruments issued meet the requirements to be included in the desired level of quality for eligible capital.

Should the eligible capital be insufficient at any time during the period covered in the three-year projections, the Risk Management Area should propose future management measures to remedy said insufficiency and maintain the solvency levels within the levels established in the applicable regulations and the Risk Appetite.

The medium-term Capital Management Plan prepared by the Risk Management Area must at least take into account the following:

a) Compliance with the Solvency II regulations must be applied throughout the projection period, taking into consideration any known future regulatory changes, while maintaining solvency levels aligned with the provisions in the Risk Appetite.

b) Every expected issuing of eligible capital instruments.

c) Reimbursements, both contractual at maturity and those which are discretionary before maturity, in relation to eligible capital instruments.

d) The results of the projections in the ORSA.

e) Foreseeable dividends and their impact on eligible capital.

The Risk Management Area must submit the medium-term Capital Management Plan to the Board of Directors for approval. The plan is part of the ORSA report.

During 2017, there were no significant changes to the objectives, policies and processes used to manage the MMS's own funds.

E.1.2 Structure, amount, and quality of own funds

The following reflects the structure, amount and quality of own funds, as well as MMS's coverage ratios i.e. the ratio of eligible own funds to SCR and MCR.

	Total		Tier 1–unrestricted		Tier 1 – restricted		Tier 2		Tier 3	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35										
Ordinary share capital (gross of own shares)	19,320	19,320	19,320	19,320			-	-		
Share premium account related to ordinary share capital	688	688	688	688			-	-		
Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings	-	-	-	-			-	-		
Subordinated mutual member accounts	-	-			-	-	-	-	-	-
Surplus funds	-	-	-	-						
Preference shares	-	-			-	-	-	-	-	-
Share premium account related to preference shares	-	-			-	-	-	-	-	-
Reconciliation reserve	72,421	72,082	72,421	72,082	-					
Subordinated liabilities		-			-	-	-	-	-	-
An amount equal to the value of net deferred tax assets	1,234	57							1,234	57
Other own fund items approved by the supervisory authority as basic own funds not specified above	-	-	-	-	-	-	-	-	-	-
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										
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	-	-								
Deductions	-	-								
Deductions for participations in financial and credit institutions	-	-	-	-	-	-	-	-	-	-

	Total		Tier 1–unrestricted		Tier 1 – restricted		Tier 2		Tier 3	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Total basic own funds after deductions	**93,663**	**92,146**	**92,429**	**92,089**	**-**	**-**	**-**	**-**	**1,234**	**57**
Ancillary own funds										
Unpaid and uncalled ordinary share capital callable on demand	-	-					-	-		
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	-	-					-	-		
Unpaid and uncalled preference shares callable on demand	-	-					-	-	-	-
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	-	-					-	-	-	-
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	-	-					-	-		
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	-	-					-	-	-	-
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	-	-					-	-		
Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	-	-					-	-	-	-
Other ancillary own funds	-	-					-	-	-	-
Total ancillary own funds	-	-					-	-	-	-
Available and eligible own funds										
Total available own funds to meet the SCR	93,663	92,146	92,429	92,089	-	-	-	-	1,234	57
Total available own funds to meet the MCR	92,429	92,089	92,429	92,089	-	-	-	-		
Total eligible own funds to meet the SCR	93,663	92,146	92,429	92,089	-	-	-	-	1,234	57
Total eligible own funds to meet the MCR	92,429	92,089	92,429	92,089	-	-	-	-		
SCR	32,512	31,420								
MCR	9,003	8,751								
Ratio of Eligible own funds to SCR	2.8809	2.9327								
Ratio of Eligible own funds to MCR	10.2670	10.5232								

	Amount	
	2017	2016
Reconciliation reserve		
Excess of assets over liabilities	103,363	95,666
Own shares (held directly and indirectly)	-	-
Foreseeable dividends, distributions and charges	9,700	3,520
Other basic own fund items	21,242	20,065
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	-	-
Reconciliation reserve	**72,421**	**72,082**
Expected profits		
Expected profits included in future premiums (EPIFP) - Life business	-	-
Expected profits included in future premiums (EPIFP) - Non- life business	720	469
Total Expected profits included in future premiums (EPIFP)	**720**	**469**

Figures in thousand euros

As stipulated in the Solvency II regulations, own funds are classified as either basic or ancillary. They are also classified by Tiers (1, 2, or 3) depending on the characteristics determining their availability to absorb losses.

As at 31st December 2017, the unrestricted basic Tier 1 own funds of MMS totalled €92.43 million (2016: €92.09 million).

MMS's Tier 1 own funds consist of:

- Ordinary share capital
- Share premium account related to ordinary share capital
- Reconciliation reserve

In addition, MMS also has basic Tier 3 own funds, totalling €1.23 million as at 31st December 2017 (2016: €0.06 million), corresponding to the net deferred tax asset.

All of the own funds of MMS are basic own funds. There are no limitations on their eligibility to cover the Solvency Capital Requirements and Minimum Capital Requirements and have the maximum availability for absorbing losses.

None of the Own Fund Items required supervisory approval.

The tables included at the beginning of the section indicate the structure, amount and quality of own funds and includes the items considered to determine the Reconciliation Reserve based on the excess of assets over liabilities for Solvency II purposes.

The excess of assets over liabilities amounted to €103.36 million. To determine the reconciliation reserve the following were deducted:

- Foreseeable dividends distributions, and charges amounting to €9.70 million.
- Oher basic own funds items totalling €21.24 million that are considered to be independent own fund items (*Ordinary share capital, Share premium account related to ordinary share capital* and *An amount equal to the value of net deferred tax assets*).

Solvency Capital Requirement (SCR)

The SCR corresponds to the own funds that MMS must hold to limit the probability of bankruptcy to one case per 200, or that MMS is still 99.5% able to meet its commitments to insurance beneficiaries or policyholders during the following year.

As stipulated in the Solvency II directive, all the unrestricted basic Tier 1 own funds and Tier 3 own funds are eligible to cover the SCR.

MMS's SCR Ratio is equal to 288.1%. The solvency ratio measures the relationship between the eligible own funds and the solvency capital requirements, and was calculated using the standard formula. The ratio shows MMS's significant capital buffer to absorb extraordinary losses deriving from a 1-in-200 year adverse scenario. This ratio falls within the Risk Appetite established for MMS and approved by the Board of Directors.

Minimum Capital Requirement (MCR)

The MCR is the minimum level of security under which financial resources should never fall. When the amount of eligible basic own funds falls below the MCR, the policyholders and beneficiaries are exposed to an unacceptable level of risk, should MMS continue with its business.

All the basic unrestricted Tier 1 own funds are eligible to cover the MCR. Since Tier 3 own funds do not have adequate availability in order to absorb losses in case it is necessary, these are not available and eligible to cover the MCR. MMS therefore has €1.23 million in available own funds that are not eligible to cover the MCR.

The ratio of eligible own funds to MCR is equal to 1026.7%.

Difference between the equity in the financial statements and the excess of assets over liabilities for Solvency II purposes

When valuing assets and liabilities for the purposes of Solvency II, different criteria are used from those used for the preparation of the financial statements. These criteria differences lead to differences between the equity in the financial statements and the excess of assets over liabilities for Solvency II purposes.

As at 31st December 2017, the excess of assets over liabilities for Solvency II purposes amounted to €103.36 million, while equity in the financial statements totalled €68.84 million.

The main adjustments that arise from the reconciliation of equity in the financial statements and own funds under Solvency II may be observed below:

	2017	2016
Equity (IFRS value)	68,838	62,097
Difference in valuation of assets	**29,804**	**30,430**
Deferred acquisition costs (DAC)	(4,635)	(4,748)
Intangible assets	(5,871)	(4,319)
Participations	40,309	39,497
Difference in valuation of liabilities	**4,721**	**3,140**

	2017	2016
Technical provisions	2,984	3,277
Deferred Tax	1,737	-137
Excess of assets over liabilities	**103,363**	**95,667**

Figures in thousands of euros

The quantitative and qualitative explanations are provided in Sections D.1 Assets, D.2 Technical Provisions and D.3 Other liabilities in this report.

E.1.3. Other information

Items deducted from own funds

MMS did not deduct any items from own funds.

Own Funds issued and instruments surrendered

MMS did not issue or surrender any own fund instruments during 2017.

Transitional measures

MMS did not consider any basic own-fund items subject to the transitional arrangements referred to in Article 308b(9) and 308b(10) of Directive 2009/138/EC to be applicable.

E.2. Solvency Capital Requirement and Minimum Capital Requirement

E.2.1. Amount of the Solvency Capital Requirement

SCR and MCR amounts

The Solvency Capital Requirement (SCR) at risk module level and calculated using the Standard Formula is set out below:

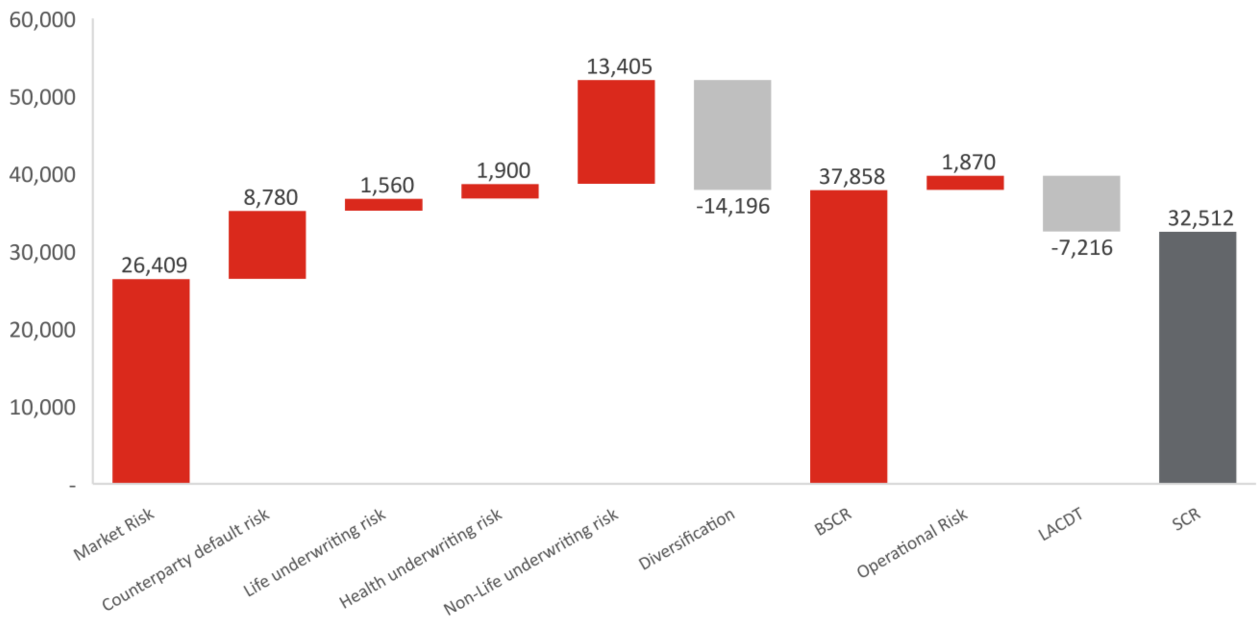
	Gross solvency capital requirement	Undertaking-specific parameters	Simplifications
Market risk	26,409		
Counterparty default risk	8,780		
Life underwriting risk	1,560		Life mortality risk, Life expense risk, Life catastrophe risk
Health underwriting risk	1,900		
Non-Life underwriting risk	13,405		
Diversification	(14,196)		
Intangible asset risk	-		
Basic Solvency Capital Requirement	**37,858**		

Figures in thousand euros

Calculation of the solvency capital requirement	Amount
Operational Risk	1,870
Loss-absorbing capacity of technical provisions	-
Loss-absorbing capacity of deferred taxes	(7,216)
Capital requirement for businesses operated in accordance with Article 4 of Directive 2003/41/EC	-
Solvency Capital Requirement excluding additional capital	32,512
Additional capital already set	-
Solvency capital requirement	**32,512**

Figures in thousand euros

The composition of the SCR is set out below and descriptive information can be found in Section C of this report:



Figures in thousand euros

As at 31st December 2017, MMS's total SCR amount was €32.51 million. At 31st December 2016, it was €31.42 million and the increase is mainly due to Market and Non-Life underwriting risk.

As at 31st December 2017, MMS's total MCR amount was €9.00 million. At 31st December 2016, it was €8.75 million and the increase is mainly due to an overall increase in business.

To calculate its SCR, MMS used the following simplifications:

For Life Underwriting Risk, MMS makes use of the simplified calculation for the solvency capital requirement for its life business for life mortality risk, life expense risk and life catastrophe risk in accordance with Articles 91, 94 and 96 of the Commission Delegated Regulation 2015/35 respectively.

For Counterparty Default Risk, to calculate the risk-mitigating effect on underwriting risk of a reinsurance arrangement, MMS makes use of the simplified calculation of the risk mitigating effect in accordance with Article 107 of the Commission Delegated Regulation 2015/35.

These simplifications are considered appropriate to the nature, volume, and complexity of the associated risks.

There is no capacity to absorb losses through technical provisions. The loss-absorbing capacity of deferred taxes totalled €7.22 million as at 31st December 2017.

MMS does not make use of capital add-ons or undertaking specific parameters.

The following table shows MMS's MCR, and the different components of its calculation, which include:

- Net (of reinsurance/SPV) best estimate
- Net (of reinsurance) written premiums in the last 12 months
- Total capital at risk, net of (reinsurance/SPV) for life insurance obligations

Linear formula component for non-life insurance and reinsurance obligations	8,280

	Net (of reinsurance/ SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
Medical expenses insurance and proportional reinsurance	2,909	9,341
Income protection insurance and proportional reinsurance	761	839
Workers' compensation insurance and proportional reinsurance	-	-
Motor vehicle liability insurance and proportional reinsurance	20,220	14,711
Other motor insurance and proportional reinsurance	13,337	16,985
Marine, aviation and transport insurance and proportional reinsurance	1,123	1,692
Fire and other damage to property insurance and proportional reinsurance	3,694	2,455
General liability insurance and proportional reinsurance	5,024	3,389
Credit and suretyship insurance and proportional reinsurance	-	-
Legal expenses insurance and proportional reinsurance	-	-
Assistance and proportional reinsurance	887	946
Miscellaneous financial loss insurance and proportional reinsurance	153	31
Non-proportional health reinsurance	-	-
Non-proportional casualty reinsurance	-	-
Non-proportional marine, aviation and transport reinsurance	-	-
Non-proportional property reinsurance	188	-

Linear formula component for life insurance and reinsurance obligations	722

	Net (of reinsurance/SPV) best estimate and TP calculated as a whole provisions	Net (of reinsurance/SPV) total capital at risk
Obligations with profit participation - guaranteed benefits	-	
Obligations with profit participation - future discretionary benefits	-	
Index-linked and unit-linked insurance obligations	-	
Other life (re)insurance and health (re)insurance obligations	550	
Total capital at risk for all life (re)insurance obligations	-	1,015,183

Overall MCR calculation	
Linear MCR	9,003
SCR	32,512
MCR cap	14,630
MCR floor	8,128
Combined MCR	9,003
Absolute minimum MCR	7,400
Minimum capital requirement	**9,003**

Notional non-life and life MCR calculation	Non-life activities	Life activities
Notional linear MCR	8,280	722
Notional SCR excluding add-on (annual or latest calculation)	29,904	2,608
Notional MCR cap	13,457	1,174
Notional MCR floor	7,476	652
Notional Combined MCR	8,280	722
Absolute floor of the notional MCR	3,700	3,700
Notional MCR	8,280	3,700

Figures in thousand euros

The MCR is the level of capital that guarantees a minimum level of security below which the amount of financial resources should never fall and has a value of €9.00 million. The notional linear MCR is equal to €8.28 million for non-life activities and €0.72 million for life activities. The linear MCR was obtained by applying the factors relating to the data used in the calculation, which are included in the above tables. The combined MCR is equal to €9.00 million and is the result of applying maximum and minimum limits to the linear MCR.

Since the combined MCR is higher than the MCR's absolute limit, the amount of the combined MCR is considered to be the Minimum Capital Requirement, i.e. the amount of €9.00 million.

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

MMS did not use the duration-based equity risk sub-module set out in Article 304 of the Directive 2009/138/EC for the calculation of its Solvency Capital Requirement.

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

MMS does not make use of internal models in its Solvency calculations, but follows the Solvency II Standard formula.

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

As at 31st December 2017, MMS had a good solvency position and therefore, it was considered unnecessary to adopt any other action or corrective measure.

E.6. Any other information

There is no other information regarding the management of capital that has not been included in the preceding sections.

Annex I

The below chart portrays MAPFRE Middlesea's shareholding in its subsidiaries