Foresters Friendly Society

Solvency and Financial Condition Report (SFCR) as at 31 December 2016

V1.3 18 May 2017

Contents

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Summary

This Solvency and Financial Condition Report (SFCR) has been prepared to enable members of Foresters Friendly Society ('the Society') and other stakeholders to assess the financial position of the Society at 31 December 2016.

This SFCR includes:

- a description of the Society's business;
- analysis of the business performance;
- information regarding the system of governance;
- details of the Society's risk profile;
- a valuation of the Society's assets and liabilities; and
- a summary of the solvency position of the Society as at 31 December 2016.

There have been no material changes to the Society's business or systems of governance in 2016. Management actions to reduce risk were taken in 2016 including a reduction in the level of equity holdings and an increase in the reinsurance coverage for Group Schemes.

The Society's Board of Directors regularly determines the appropriate level of capital to be maintained and monitors the actual capital position against this target.

The 2016 year-end valuation shows that the Society is solvent with Own Funds of £45.8m (2015: £20.5m). For the 2016 year-end the Society has consolidated the Court and Guernsey funds following the approach adopted in its financial statements. Previous results were based on the UK Insurance funds only, which is the primary reason for the significant increase in Own Funds. The inclusion of the Court and Guernsey funds has led to a similar increase in the SCR and MCR, leaving the Society's solvency position largely unchanged. The Own Funds for the UK Insurance Funds are 200% of the regulatory capital requirement of £12.5m for the insurance business, which comfortably exceeds the current target solvency ratio for these funds. In aggregate (UK Insurance Funds, Court and Guernsey Funds) the Society's own funds are 134% of the regulatory Solvency Capital Requirement (SCR). This demonstrates a high level of security for our members and their insurance policies.

The Board is responsible for all information contained within this Solvency and Financial Condition Report and is satisfied that:

(a) throughout 2016, the Society has complied in all material respects with the requirements of the PRA rules and Solvency II Regulations applicable to the Society; and

(b) it is reasonable to believe that, at the date of publication of this report, the Society has continued to comply, and will continue to comply in future.

This 2016 Solvency and Financial Condition Report was approved by the Board on 18 May 2017 and authorised for issue.

On behalf of the Board:

John Instance	**Paul Osborn**	**Lisa Russell**
Chairman	**Chief Executive**	**Company Secretary**

REPORT OF THE EXTERNAL INDEPENDENT AUDITOR TO THE DIRECTORS OF THE ANCIENT ORDER OF FORESTERS FRIENDLY SOCIETY LIMITED ('THE SOCIETY') PURSUANT TO RULE 4.1 (2) OF THE EXTERNAL AUDIT CHAPTER OF THE PRA RULEBOOK APPLICABLE TO SOLVENCY II FIRMS

Report on the Audit of the relevant elements of the Solvency and Financial Condition Report ("SFCR")

Opinion

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

- the 'Valuation for Solvency Purposes' and 'Capital Management' sections of the SFCR of the Society as at 31 December 2016, ('the Narrative Disclosures subject to audit'); and
- Society templates S.02.01.01, S.12.01.01, S.17.01.01, S.23.01.01, S.25.01.01, S.28.02.01 ('the Templates subject to audit').

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the 'relevant elements of the SFCR'.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the Other Information which comprises:
- the 'Executive summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the SFCR;
- Society templates S.05.01.02, S.05.02.01, S.19.01.21;
- the written acknowledgement by management of their responsibilities, including for the preparation of the SFCR ('the Responsibility Statement').

In our opinion, the information subject to audit in the relevant elements of the SFCR of the Society as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK and Ireland)), and ISA (UK) 800 and ISA (UK) 805. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report* section of our report. We are independent of the Society in accordance with the ethical requirements that are relevant to our audit of the SFCR in the UK, including the APB's Ethical Standards, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

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

We have nothing to report in relation to these matters.

Emphasis of Matter – Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' sections of the SFCR, which describe the basis of accounting. The SFCR is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The SFCR is required to be published, and intended users include but are not limited to the PRA. As a result, the SFCR may not be suitable for another purpose. Our opinion is not modified in respect of these matters.

Other Information

The Directors are responsible for the Other Information.

Our opinion on the relevant elements of the SFCR does not cover the Other Information and, we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the SFCR, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the relevant elements of the SFCR, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the relevant elements of the SFCR or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of Directors for the Solvency and Financial Condition Report

The Directors are responsible for the preparation of the SFCR in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations.

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

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

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

Our objectives are to obtain reasonable assurance about whether the relevant elements of the SFCR are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK and Ireland) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the SFCR.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: https://www.frc.org.uk/auditorsresponsibilities. The same responsibilities apply to the audit of the SFCR.

This report is made solely to the Directors of The Ancient Order of Foresters Friendly Society Limited in accordance with Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook for Solvency II firms. We acknowledge that our report will be provided to the PRA for the use of the PRA solely for the purposes set down by statute and the PRA's rules. Our audit work has been undertaken so that we might state to the insurer's Directors those matters we are required to state to them in an auditor's report on the relevant elements of the SFCR and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the PRA, for our audit work, for this report or for the opinions we have formed.

Report on Other Legal and Regulatory Requirements.

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of The Ancient Order of Foresters Friendly Society Limited's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Elanor Gill FCA (Senior statutory audit)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
18 May 2017

Appendix – Relevant Elements of the Solvency and Financial Condition Report that are not Subject to Audit

Solo standard formula

The relevant elements of the SFCR that are not subject to audit comprise:

- Elements of the Narrative Disclosures subject to audit identified as ‘unaudited’.

A. Business and Performance (unaudited)

A.1 Business

Foresters Friendly Society ('the Society') is the trading name of The Ancient Order of Foresters Friendly Society Limited which is an Incorporated Friendly Society (Registration No. 511F). The Society's registered office is 29 – 33 Shirley Road, Southampton, SO15 3EW. The Society is wholly owned by its members, who are all assigned to a local branch ('Court').

Financial Regulator

The Society is authorised by the Prudential Regulation Authority (PRA) and regulated by the Prudential Regulation Authority and the Financial Conduct Authority (FCA) under Registration No. 110029.

PRA
Telephone: 020 3461 7000
Address: Firms Enquiries Team (MG1-SE)
Prudential Regulation Authority
20 Moorgate
London, EC2R 6DA

FCA
Telephone 0300 500 0597
Address FCA Head office
25 The North Colonnade
London, E14 5HS

External Auditor

The Society's auditor is Deloitte LLP.

Telephone: 020 7936 3000
Address: Deloitte LLP
Hill House
1 Little New Street
London
EC4A 3TR

Lines of business

The Society consists of its Insurance and Court operations including the Guernsey Court's general insurance business. The consolidated (i.e. 'Group') results include the results of the Leeds Investment Association (a Specially Authorised Friendly Society registered under the Friendly Societies Act). Foresters General Insurance Services Limited is a wholly owned subsidiary and in view of the immaterial amounts involved, rather than fully consolidating it in the financial statements, the balance sheet includes the cost of £10k for all shares.

The Insurance business is divided into two distinct parts:

- products available to individuals, either directly from the Society or via the network of Introducers and Financial Adviser intermediaries in the UK and Guernsey; and
- products provided to organisations as Group Schemes, which cover a range of organisations including police federations and agencies of charity workers.

The Society offers a range of financial products that are simple and affordable and are backed by excellent customer service. The main products are:

Product	Description
Tax Exempt Savings Plan (TESP)	A long-term regular tax exempt savings plan with a guaranteed tax-free cash sum at the end of the chosen term and the potential for bonuses to increase the policy value.
Guaranteed Savings Plan (GSP)	A long-term regular savings plan with a guaranteed cash sum at the end of the chosen term and the potential for bonuses to increase the policy value.
With-Profit (Stocks & Shares) ISA	A flexible medium to long-term tax-free savings plan which can accept regular investments or one-off lump sum investments up to the maximum annual ISA limit. There is the potential for bonuses to increase the policy value.
Bond	A single lump sum investment with the potential for bonuses to be added over the medium to long-term.
50+ Life Cover	A with-profit whole of life insurance policy for the over 50s, providing a guaranteed tax-free cash sum on death which has the potential to grow with bonuses over time. The monthly premiums are fixed at outset and guaranteed not to change.
Unit-Linked Savings and Investment Plan	A long-term regular savings plan of which the premium is used to allocate units in the POIS Savings Fund. The fund invests mainly in UK stocks and shares for a potential for growth over the longer term.
Unit-Linked Tax Exempt Savings Plan	A long-term regular tax exempt savings plan of which the premium is used to allocate units in the POIS Flexible Growth Fund. The fund invests in a range of investments such as gilts, corporate bonds and equities, both UK and overseas, for the potential of long-term growth.
Medical Expense Insurance	Individual medical expense insurance covering primary healthcare costs of residents of Guernsey and Alderney. This business is regulated by the Guernsey Financial Services Commission.
Group Life & Sickness Schemes	These are set up by trustees, employers or employee groups to provide life assurance, critical illness and/or income protection benefits for participants. The participants have the option of joining the scheme and paying the appropriate premiums for the selected benefits. A range of different benefit types is available and these are tailored to the individual scheme.

The current channels to market for individual sales are:

- online advertising and social media (Facebook, Twitter, LinkedIn and others);
- direct mail and an internal telemarketing team;
- introducers (Courts and POIS);
- Independent Financial Advisers (IFA) or Professional Introducers; and
- newspaper and radio advertising for the Guernsey business.

The distribution of Group Schemes is carried out through specialist brokers.

Significant events in the reporting period

Throughout 2016 there was a downward movement in interest rates and bond yields exaggerated by the result of the Brexit referendum in June and the subsequent actions of the Bank of England.

In response to the adverse impact that these downward movements had on the Society's solvency position, the Board agreed management actions to reduce the level of risk being taken:

- the market risk taken in both the with-profits and non-profit insurance funds was decreased through a reduction in the proportion of assets held in equities and property; and
- the coverage provided by the existing reinsurance arrangement for Group business was extended to provide cover against catastrophic events which might lead to a one-off spike in claims.

These actions had the benefit of both reducing the SCR and the amount of insurance provisions.

The Society also chose to change its accounting policy on measuring its liabilities for long-term insurance policies in its Financial Statements to be consistent with Solvency II rules.

A.2 Underwriting Performance

2016 Underwriting Performance

The following table shows the underwriting performance by line of business over the reporting period for the Society's insurance business.

In £'000	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Guernsey medical expense insurance	2016 Total	2015 Total
Premiums written							
Gross	2,603	7,737	5,410	4,772	2,267	22,788	21,078
Reinsurers' share	19			97		116	122
Net	2,583	7,737	5,410	4,675	2,267	22,672	20,956
Premiums earned							
Gross	2,603	7,737	5,410	4,772	2,267	22,788	21,078
Reinsurers' share	19			97		116	122
Net	2,583	7,737	5,410	4,675	2,267	22,672	20,956
Claims incurred							
Gross	(2,268)	(11,909)	(6,529)	(3,657)	(1,923)	(26,286)	(27,279)
Reinsurers' share		3		58		61	51
Net	(2,268)	(11,906)	(6,529)	(3,599)	(1,923)	(26,224)	(27,228)
Expenses incurred	(342)	(1,578)	(1,104)	(705)	(256)	(3,985)	(3,584)
Other expenses						0	0
Total expenses	(342)	(1,578)	(1,104)	(705)	(256)	(3,985)	(3,584)
Underwriting Performance	27	(5,747)	(2,223)	371	88	(7,537)	(9,856)

Claims incurred were higher than premiums written reflecting known run-off of the Society's maturing pure endowments particularly in the OIF and POIS funds.

A.3 Investment Performance

Investment income and expenses

The table below shows the Society's investment income and expenses earned on the assets supporting the Society's UK long-term insurance business and the medical expense insurance business written by the Guernsey Court.

'Other investments' comprises of cash, units in authorised unit trusts, loans, mortgages, deposits with credit institutions and deposits with Investment Associations. The Society does not invest in derivative investments.

Technical Account (£000s)	2016	2015
UK long-term insurance business		
Investment income		
Income from property investments	526	628
Income from listed investments	4,604	4,497
Income from other investments	52	372
Gains/(Losses) on realisation of property investments	4	0
Gains/(Losses) on realisation of listed investments	2,110	5,812
Total investment income	**7,296**	**11,309**
Unrealised gains/(losses) on investments		
Unrealised gains/(losses) from property investments	192	1,355
Unrealised gains/(losses) from listed and other investments	8,968	(7,434)
Total unrealised gains/(losses)	**9,160**	**(6,079)**
Total UK investment returns	**16,456**	**5,230**
Investment management expenses and charges	**429**	**471**
Guernsey medical expense insurance business		
Income from investments	**116**	**110**
Gains/(Losses) from investments	**-**	**-**
Unrealised gains/(losses) from investments	**-**	**-**
Total Guernsey investment returns	**116**	**110**

Securitisations

The Society does not hold any investments in securitisations.

A.4 Performance of other activities

Courts

The Society has 190 branches ('Courts') which are the local point of contact for members. The Courts have assets amounting to £79.0m. £61.0m is invested in a fund managed by the Society, the Court Investment Fund, £14.7m is invested in deposits with two Investment Associations, £3.0m is invested in directly owned properties with the remainder in cash. The Society also manages a number of Discretionary Benefit Funds amounting to £12.9m which provide non-insurance benefits to members and Courts at the discretion of the Board of Directors of the Society.

The Courts are geographical groups of members who manage their own funds and support social, fraternal, educational and benevolent activities. Each Court elects its own officers and delegates who represent the Court's members at the High Court (Annual General Meeting) of the Society. The delegates attending High Court elect a High Chief Ranger each year to represent all Courts at internal and external events. This approach provides a governance structure for members to have their say in an organisation which they own.

Court assets and the Discretionary Benefit Funds are not available to support the UK insurance business of the Society. Their assets and activities are shown within the Non-Technical Account in the Society's financial statements.

Investment Associations

21 Courts hold deposits totalling £7.5m in two Investment Associations. These Investment Association deposits are investments made by the Courts and Discretionary Benefit funds and consequently have no impact on the insurance results shown in the Technical Account.

Investment Associations are registered as Specially Authorised Societies under the Friendly Society Act. The Investment Associations have their own constitutions or rules and are governed by Committees of Management that are independent to the Society's Board of Directors. The objective of these Investment Associations is to receive deposits of registered friendly societies and their branches and to invest the same for their benefit. Investment Associations are unincorporated associations registered in England and Wales, have no issued share capital and their principal area of operation is Great Britain.

The Society is in a position where it can exert control over the Leeds Investment Association. The Leeds Investment Association's assets and liabilities and its income and expenses are therefore included in the consolidated financial statements, and the Leeds Investment Association assets and liabilities are recognised in the Solvency II balance sheet.

The rules of the Derby and Derbyshire Foresters' Investment Association state that the members of the Association are individuals who are members of the depositing courts and not the Courts themselves and this Association is not consolidated in the Society's financial statements.

Group Capital Fund (GCF)

The Society's Group Capital Fund (GCF) comprises those assets not allocated to any other fund and is available to support all other funds as the Board shall decide after taking advice from the Chief Actuary. The GCF holds technical provisions which are included within the Technical Account of the Society's financial statements. The remainder of the fund is treated as part of the Non-Technical Account, and this is where the fund's expenses and investment income are shown. The GCF supports solvency or capital requirements and is also used to meet business risks as determined by the Board.

Non-Technical Investment Returns

The investment returns below relate to the assets held by the Society's Courts, the Discretionary Benefit Funds and the GCF. The 'Society' column below consists of GCF and the Court operations including Guernsey Court's general insurance business. The 'Group' (i.e. consolidated) column also includes the results of the Leeds Investment Association.

£000s	2016		2015	
	Grou	Society	Group	Society
Investment income				
Income from property investments	2,879	2,609	2,627	2,384
Income from listed investments	911	632	1,022	815
Income from other investments	237	35	343	114
Sub-total income	**4,027**	**3,276**	**3,992**	**3,313**
Gains/(losses) on the realisation of listed investments	413	413	1,052	1,052
Gains/(losses) on the realisation of property investments	326	380	326	331
Sub-total realised gains/(losses)	**739**	**793**	**1,378**	**1,383**
Court held assets:				
Income from property investments	130	130	103	103
Income from mainland Court investments	422	1,199	181	1,044
Other income – Courts	394	394	563	563
Gains/(losses) on realisation of investments	-	-	202	202
Sub-total Court-related investment income	**946**	**1,723**	**1,049**	**1,912**
Total Non-Technical investment income	**5,71**	**5,792**	**6,419**	**6,608**
Unrealised gains/(losses) on investments				
Unrealised gains/(losses) on investments	2,284	1,201	5,474	5,464
Reversal of previously recognised unrealised (gains)/losses on listed investments	188	188	(805)	(805)
Reversal of previously recognised unrealised (gains)/losses on property investments	(668)	(668)	(681)	(681)
Total Non-Technical unrealised gains/(losses)	**1,80**	**721**	**3,988**	**3,978**
Unrealised gains/(losses) on Court investments	**3,18**	**3,185**	**183**	**183**
Total Non-Technical investment returns	**10,7**	**9,698**	**10,590**	**10,769**
Non-Technical Investment management expenses and charges	**439**	**439**	**492**	**492**

Non-Technical Expenses

Non-Technical Account expenses of £2,370k (2015: £1,840k) consist of the allocation of central expenses which are not directly related to individual insurance funds or Courts. They represent the indirect costs of running the business of the Society and include strategy and project costs. Court operating expenses of £3,357k (2015:£ 3,169k) include both the allocated expenses from Head Office and the expenses borne directly by the Courts.

A.5 Any other information

There is no other material information to disclose regarding the business and performance of the Society.

B. System of Governance (unaudited)

B.1 General Information on the System of Governance

The Board of Directors

The Board of Directors is the governing body of the whole of the Society's activities. The Board is responsible for the direction and management of the business of the Society in the fulfilment of its mission and strategic objectives, and in compliance with the Society's Memorandum, Rules and any applicable legislation and regulation and the Society's policies, principles and values.

In pursuance of its strategic objectives, the Board maintains a schedule of matters specifically reserved for the Board and exercises all those powers that are not by regulation, legislation, or by the Rules, required to be exercised by the Society at the Annual General Meeting or a Special General Meeting.

The composition of the Board at the end of 2016 was a mix of five Non-Executive Professional Directors, two Non-Executive Member Directors and two Executive Directors (the Chief Executive and the Membership Director). A 'Professional Director' is identified as having recent insurance industry knowledge and experience, and a 'Member Director' is one drawn directly from the membership, having knowledge of the Society's fraternal activities.

The Board delegates certain parts of its responsibilities to Sub-Committees and to Advisory Arrangements which operate within defined Terms of Reference. The Terms of Reference are available on the Society's website at www.forestersfriendlysociety.co.uk/governance.

Chairman and Chief Executive

The roles of the Chairman and Chief Executive are held by different people and the division of responsibilities between the two is clearly established, set out in writing and agreed by the Board of Directors.

The Chairman is a non-executive and responsible for leadership of the Board and ensuring the Board acts effectively and within its Terms of Reference.

The Chief Executive has overall responsibility for managing the Society and for implementing the strategies and policies agreed by the Board.

Non-Executive Directors

The Non-Executive Directors are responsible for bringing independent judgement and challenge to the Board debate and its decisions.

Copies of the letters of appointment of the Non-Executive Directors are available at the Society's Head Office.

Executive Directors

Two Executive Directors were in post at the end of 2016: Paul Osborn (Chief Executive) and Myles Edwards (Membership Director).

Senior Independent Director

The UK Corporate Governance Code: An Annotated Version for Mutual Insurers ('the Code') recommends that mutual insurers maintain a dialogue with their members and appoint a Senior Independent Director to handle issues and concerns raised by members. The Senior Independent Director acts as the Society's Whistleblowing Champion, provides counsel for the Chairman and serves as an intermediary for the other Directors when necessary.

Appointments to the Board and Re-election

Following co-option to the Board, a Director is subject to election by members at the next Annual General Meeting. Thereafter, in accordance with the Society's Rules, each Director must retire at the Annual General Meeting three years after the meeting at which they were last elected or re-elected as a Director.

Appraisal and Evaluation

The Board undertakes a formal annual evaluation of its own performance and that of its Committees and individual Directors, and an externally facilitated evaluation every three years.

Sub-Committees of the Board

Audit Committee

The Audit Committee considers matters in relation to internal and external audit and is provided with reports on significant findings and recommendations, together with management's responses. It also considers and recommends the methodology and assumptions for the Solvency II technical provisions.

The Chief Executive, Chief Finance Officer (CFO), internal auditors and external auditors attend meetings of the Audit Committee by invitation. The Committee also invites other departmental managers as necessary to provide a deeper insight into key issues.

The Audit Committee, in accordance with the Code, considers whether the annual Report and Accounts, taken as a whole, are fair, balanced and understandable, providing the information necessary for members to assess the Society's performance, business model and strategy.

Reserving Committee

As a Sub-Committee of the Audit Committee, the Reserving Committee considers matters in relation to the methodology and assumptions in the calculation of Solvency II Technical Provisions and any assumptions or methodology requiring major technical input and judgement. The Committee reports to the Audit Committee and on occasions, directly to the Board of the Society.

Investment Committee

The Investment Committee considers matters in relation to investment of funds managed by the Society.

The performance of the various asset classes and funds is reviewed on a quarterly basis to ensure that they are in line with expectations and risk appetite.

Membership Committee

The Membership Committee considers matters in relation to the membership of the Society and the Society's non-regulated activities.

The main function of the Membership Committee is to promote active Forestry, as well as act as a conduit between the Board of Directors and the total membership, and to ensure the Society's non-regulated activities are relevant to members' needs and that they add value to the membership of the Society.

Nominations Committee

The Nominations Committee recommends to the Board suitable candidates for positions on the Board and the roles of Senior Independent Director, High Chief Ranger and High Sub-Chief Ranger. It also makes recommendations to the Risk and Capital Committee in respect of the appointment and termination of the Chief Risk Officer.

The Committee considers key person dependency and succession planning for the Board, role of Chief Executive and other senior management positions. It also considers the composition of the Sub-Committees reviewing the balance of skills, experience, independence and training of the Board.

Remuneration Committee

The Remuneration Committee considers matters in relation to remuneration and expenses.

The Committee supports the Board in the design and content of the Society's overall Remuneration Policy and reviews it regularly, in line with market conditions and applicable legislation.

The Committee determines and advises the Board on the policy for remuneration of the Executive Directors and Company Secretary.

It also makes recommendations to the Board on Propositions to be proposed at the AGM, as well as the framework for remuneration of the Chairman, Non-Executive Directors, High Chief Ranger and High Sub-Chief Ranger.

Risk and Capital Committee

The Committee provides advice to the Board on risk strategy and risk appetite, including the oversight of current risk exposures of the business. It develops proposals for the Board in respect of overall risk appetite and tolerance, as well as the metrics used to monitor the firm's risk management.

Meetings may be held jointly with the Audit Committee to address risk related audit issues and to provide input into Internal Audit priorities and planning.

Individuals such as the Risk Manager and the Compliance Manager may be invited to attend meetings as appropriate.

With-Profits Advisory Arrangements

The With-Profits Advisory Arrangements (WPAAs) provides independent judgment to the Board including consideration of the rights and interests of with-profits policyholders and other policyholders, stakeholders and members of the Society, in a way that is consistent with the fair treatment of customers.

The Society has one open with-profits fund – the Order Insurance Fund (OIF) – and four closed with-profits funds – the Pure Endowment Fund (PEF), the Tunstall Fund (TF), the Leek Fund (LF) and the Post Office Insurance Society Fund (POIS Fund). Although each fund is considered individually, the main terms of reference are the same for all funds.

The WPAAs, taking the advice of the With-Profits Actuary, consider the areas where management is able to exercise discretion in complying with the Principles and Practices of Financial Management (PPFM) set out for each of the five with-profits funds in all material respects.

The PPFMs are available on the Society's website at www.forestersfriendlysociety.co.uk/about-us/reports-and-governance.

Unit-Linked Advisory Arrangement

The role of the Unit-Linked Advisory Arrangement (ULAA) is to provide independent judgment to the Board including consideration of whether the management of the Society's unit-linked funds is consistent with the fair treatment of customers.

The Society has three unit-linked funds in operation – the POIS Flexible Growth Fund, the POIS Money Bond Fund and the POIS Savings Fund. The POIS Money Bond Fund is a closed fund.

The Unit-Linked Advisory Arrangement reviews and recommends to the Board any changes to the public document entitled 'How we manage our unit-linked funds' (available on the Society's website at www.pois.co.uk/funds). This document helps explain to customers how the funds will be operated and how the exercise of discretion may occur in relation to deriving unit-linked fund prices for use in working out policyholder benefits.

The WPAAs and ULAA are advisory in nature; they are not decision making bodies.

Key Functions

The following section provides a summary of the authority, resources and operational independence of the key functions.

Chief Actuary

The role of Chief Actuary is currently outsourced to Mr Trevor Fannin of Willis Towers Watson, with internal oversight provided by the CFO. The Chief Actuary is a Fellow of the Institute of Actuaries, holds a practising certificate and is approved under the SIMF regime. The Chief Actuary is responsible for the work of the Actuarial Function, particularly in respect of the calculation of technical provisions and solvency capital requirements. Key actuarial reports are presented to the Reserving Committee which is chaired by an independent Non-Executive Director.

The Chief Actuary is invited to attend relevant Board and Committee meetings. An annual report is produced for the Board, setting out all tasks that have been undertaken by the Actuarial Function and their results, with clear identification of any deficiencies and recommendations as to how these should be remedied.

Compliance Manager

The Compliance Manager is appropriately skilled in respect of the regulatory environment, data protection, financial crime, and monitoring and compliance advice. To ensure independence and authority the Compliance Manager reports directly to the Chief Executive and the Chair of the Audit Committee and is a member of the internal Business Risk and Compliance Committee (BRCC). The Compliance Manager is also not involved in the day to day running of operations of the Society. External resource is used to provide expertise in such areas as Financial Promotions as required. The Compliance Function has access to all information and staff necessary to carry out its responsibilities. The Compliance Manager has direct access to the Audit Committee Chair.

The Compliance Manager is invited to attend Board and Committee meetings where relevant and provides reports to the Audit Committee. The Compliance Plan sets out the planned activities of the Compliance Function taking into account the activities of the Society and its exposure to compliance risk.

Chief Risk Officer

The Risk Function is led by the Chief Risk Officer (CRO) who is supported by the Risk Manager. The CRO is a senior role within the Society and reports directly to the Chief Executive and the Chair of the Risk and Capital Committee, and is a member of the Risk and Capital Committee and the BRCC. Independence is maintained by carrying out an oversight role enabling the ability to challenge key decisions and processes across the Society. The role has responsibility for oversight of the Risk Management Framework and performance of the Society's Own Risk and Solvency Assessment (ORSA) which is delegated to the Risk Manager.

The Chief Risk Officer provides oversight and challenge of the Society's systems and controls in respect of risk management and ensures the adequacy of risk information, risk analysis and risk training provided to the Board.

Head of Internal Audit

The Head of Internal Audit oversight role is held by the Company Secretary who reports directly to the Chief Executive and the Audit Committee, to whom all significant concerns relating to the adequacy and effectiveness of risk management activities, internal control and governance are reported. The Head of Internal Audit is a member of the BRCC.

The Internal Audit Function is currently outsourced to Mazars LLP. The Head of Internal Audit has access to a wide skill set through the use of Mazars. The Head of Internal Audit maintains independence as the internal audits are conducted by an outsourced external company who are removed from the day to day operations of the Society. The annual internal audit plan is developed on a risk-based approach taking into account the resources and skills required to carry out the plan.

The Head of Internal Audit role has responsibility for the establishment, implementation and maintenance of the internal audit plan, taking into account all of the Society's activities and the complete system of governance. Written recommendations are presented to the Audit Committee based on the results of the audit findings.

Changes to the system of governance in the reporting period

There have been no material changes to the system of governance in 2016.

Assessment of adequacy of the system of governance

The Board consider that the system of governance is appropriate for the Society based on consideration of the nature, scale and complexity of the risks inherent in its business.

Remuneration Policy

The Society's Remuneration Policy aims to attract, motivate, support and retain high quality individuals with the necessary skills to achieve the Society's strategic objectives, meet regulatory requirements and support the short, medium and long-term interests of members.

The scope of the Policy covers all elements of the remuneration package for staff, Executive and Non-Executive Directors (including the Chairman, Deputy Chairman and Senior Independent Director), members of Board Sub-Committees and roles within the Society which are of a presidential nature such as the High Chief Ranger.

The Policy forms part of a risk framework supporting the Board and management in discharging their responsibilities to ensure that:

- remuneration awards do not threaten the Society's ability to maintain an adequate capital base;
- remuneration arrangements with service providers do not encourage risk taking that is excessive in view of the Society's risk management strategy; and
- failure is not rewarded.

The Board and Remuneration Committee are primarily responsible for determining the Policy and reviewing it annually to ensure it remains appropriate. The Board retains the discretion to make changes in response to market conditions and in exceptional circumstances, where it is in the interest of the Society and its members to do so.

The outcome of any assessment by the Remuneration Committee will be reported ultimately to the Board with any actual and potential risks being reported to the Chief Risk Officer as part of the management of risks across the whole Society.

The Society operates a defined contribution group stakeholder pension scheme which employees are eligible to join after a probationary period with auto-enrolment. Prior to 2003, employees were eligible to join one of the Society's defined benefit pension schemes. There are no supplementary pension benefits or early retirement schemes for members of the Board or other key function holders.

The remuneration budget is usually aligned with price inflationary indices as published by the Office of National Statistics and with reference to the living wage rate published from time to time.

Executive remuneration comprises of basic salary, a contributory pension and other benefits.

The remuneration of all Non-Executive Directors, including the Chairman, is reviewed on an annual basis using expert advice and guidance from both internal and external sources. Non-Executives are only entitled to fees and expenses, and do not participate in any performance-related pay schemes or receive any pension arrangements or other benefits.

Post holders to the roles of High Chief Ranger and High Sub-Chief Ranger are only entitled to fees and expenses during their term of office, and do not participate in any performance related pay schemes or receive any pension arrangements or other benefits.

Any proposed change in fees for Non-Executive Directors, the High Chief Ranger or High Sub-Chief Ranger is determined by the Board and presented as a Proposition for approval by the delegates at the next Annual General Meeting.

The Society defines substantial variable pay as 25% to 30% of base salary. The majority of bonus payments made by the Society to employees are below 25% of base pay and the maximum potential bonus payment is 50% of base pay.

Where the Society considers making the payment of a substantial bonus, the following points are considered:

- is the person to whom the bonus applies at or above Level 2 management;
- a substantial variable pay scheme needs to be linked/referenced to risk tolerance and business strategy i.e. no reward should be given for risk taking outside the stated risk tolerance of the Society;
- there needs to be the possibility of a nil payout;
- a substantial portion would be deferred for a period of not less than three years;
- application of malus; and
- compliance with stated risk tolerance.

The Compliance Manager, Risk Manager, Head of Internal Audit and Actuarial Manager do not participate in a substantial bonus scheme based on quantitative performance.

Material transactions

There have been no material transactions conducted during 2016 between the Society and members of the Board or key function holders.

B.2 Fit and Proper requirements

Members of the Board and Senior Management provide strategic leadership that influences the financial position and future direction of the Society. As such, persons in these positions are required to possess certain qualities including integrity, credibility and relevant competencies. Annual reviews are undertaken to ensure this standard is met.

The Society has a Fit and Proper Policy which sets out how it meets the regulatory requirements for persons who have key functions to be Fit and Proper.

The scope of the Policy covers the assessment of the fitness and propriety of the persons who effectively run the Society or have other key functions, both when being considered for the specific position and on an ongoing basis. The assessment covers the honesty and financial soundness based on relevant evidence regarding their character, personal behaviour and business conduct including any criminal, financial and supervisory aspects regardless of jurisdiction. The period of limitation of the committed offence is judged based on national law or practice.

An assessment is carried out using a Fit and Proper questionnaire prescribed by the Society's regulator on initial appointment and where appropriate, submitted to the said regulator as part of the approval process.

The Chief Executive is responsible for ensuring the Society meets its Fit and Proper requirements in accordance with the Society's Governance Map. The Chief Executive may choose to delegate the undertaking of the Fit and Proper assessments to the Company Secretary but will have overall responsibility.

The Society determines whether any other employee who is not subject to the regulatory approval process, should also be assessed against the Fit and Proper requirements laid down by the Society, on a case-by-case basis.

Failure to meet one element of the Fit and Proper questionnaire does not necessarily mean failure to meet the requirements and considerations of the specific surroundings, including the lapse of time, potential risks posed to the Society, degree of influence the specific role will attract or new conflicts that could impair the individual's performance in the position.

The Fit and Proper assessments are supported by relevant information. Where significant reliance is placed on information that is obtained from the person being assessed, and that information is material to the determination of the person's fitness and propriety, the Society takes reasonable steps within permissible written laws to verify the information against independent sources.

Where the Society outsources a key function, it ensures that the service provider applies the Fit and Proper assessment of persons employed by them to perform the specific role. The Society designates a person with overall responsibility for the outsourced key function that is Fit and Proper and possesses sufficient knowledge and experience regarding the outsourced key function to be able to challenge the performance and results of the service provider.

An assessment is also carried out at regular intervals, at least annually, or whenever any key responsible person's fitness and propriety is or might be materially compromised. Situations which if they arise would lead to a reassessment of the Fit and Proper status include:

- if the approved person breaches any of the regulatory principles and practices which approved persons are required to follow, or
- if the approved person commits an act of gross misconduct under the Society's Internal Policies and Procedures

The outcome of any assessment would be reported to the Board with any actual and potential risks being reported to the CRO as part of the management of risks across the whole Society.

B.3 Risk management system

The Society's governance model is designed to promote transparency, accountability and consistency through the clear identification of roles, the separation of Society management and governance and control structures. Oversight of the Society's operation is provided using the ''three lines of defence'' approach. Details on roles and responsibilities by risk type are documented in the Society's Risk Management Policy.

Risk Management Function

The Society's Risk Management Function is headed by the CRO and supported by the Risk Manager.

The CRO reports directly to the Chief Executive and also to the Chair of the Risk and Capital Committee (R&CC), of which the CRO is a member. The role has responsibility for oversight and challenge of the Society's systems and controls in respect of risk management and ensures the adequacy of risk information, risk analysis and risk training across the Society.

Business Risk and Compliance Committee (BRCC)

The BRCC is a management committee that oversees and monitors risk management across the Society. It is responsible for all risk types and monitors key risk indicators, risk appetite and risk limits on a regular basis in line with the Society's Risk Policies.

The membership of the BRCC comprises the CRO, Risk Manager, Compliance Manager, Chief Executive, Head of Internal Audit and Membership Director.

The BRCC meets monthly and reports to the R&CC quarterly on an exceptions basis.

Risk Management Framework

The Society's Risk Management Framework is owned by the CRO and is reviewed annually. Changes to the framework are approved by the BRCC.

The objectives of the framework are to:

- align strategy, capital, processes, people, technology and knowledge to enable the management of opportunities, uncertainties and threats in a structured manner;
- establish a common view of risk across the Society and an understanding of the risks inherent within the business;
- ensure the Society's view of risk is current and in line with risk appetite;
- improve decision making;
- provide relevant and accurate management information;
- ensure adequate and appropriate resources are available to facilitate effective governance and challenge;
- ensure clear accountability; and
- promote and embed a risk-aware culture.

Risk Identification

Risks are identified both on a top-down basis and a bottom-up basis. Under the top-down basis, risks are identified from the business strategy and how they might impact on business objectives. Using the bottom-up basis, managers identify risks in their own areas and how these might impact business objectives. A risk categorisation model is used to ensure completeness and coverage of all relevant risks.

Other risks are identified through stress testing for financial risks, business risks and insurance risks.

Individual risks are assigned to and owned by a specified individual within the Society.

Risk and Control Self-Assessment (RCSA) Process

The RCSA process is normally undertaken twice within an annual ORSA reporting period. Internal risk events are considered when assessing risks, where actual events have indicated a trend or a heightening of risk. Internal audit findings are also considered as part of the RCSA review to ensure that risk exposures or control deficiencies are reassessed.

Emerging Risks

Emerging risks are assessed as part of the business planning process and monitored via an emerging risk register. Emerging risks are considered by the BRCC monthly and reported to the R&CC on a quarterly basis.

Risk Reporting and Monitoring

Risk information is reported monthly as part of the Society's monthly Management Information Report. The R&CC receive a Risk Management Information pack each quarter which is also presented to the Board to ensure changes to risks are escalated appropriately.

Own Risk and Solvency Assessment (ORSA)

The ORSA process is the set of processes and procedures in place to identify, assess, monitor, manage and report on the short and long-term risks that the Society faces, or may face in the future, and to determine the own funds necessary to ensure that overall solvency needs are met at all times.

The ORSA report is owned by the Board and supported by the ORSA Policy and ORSA processes. It details the main risks faced by the Society and the governance and processes in place to enable the Board to understand and manage them. The Society's Business Plan is used as a feed into the ORSA process to support future decision making from a risk and capital management perspective.

The Society's ORSA Policy sets out the overall aim and approach to be taken for the ORSA, together with the standards and parameters which have to be adhered to, the escalation procedures, reporting requirements, responsibilities and frequency.

The Policy is designed to be appropriate and proportionate for the Society and compliant with regulation. The ORSA processes are designed to be auditable, repeatable and subject to the appropriate levels of documentation appropriate to meet the objectives of Solvency II.

The ORSA report identifies and assesses both the risks included in the calculation of the Solvency II SCR and the non-quantifiable risks which are part of the risk profile.

The objectives are to:

- define established principles for the ORSA process to comply with Solvency II regulations and embed effective risk management throughout the Society;
- ensure the ORSA process is aligned to both the Business Planning process and the Strategic Planning process;
- allocate roles, responsibilities and ownership to the Board, Committees, Senior Management, Management and Staff;
- promote a consistent and effective use of the ORSA framework across the Society;
- define and communicate ORSA processes and procedures to the Board of Directors and the wider company;
- produce effective ORSA documentation to be used by management in decision-making processes and for external disclosure;
- define requirements for evidence and reporting to demonstrate the methods applied; and
- conduct a consistent prospective assessment of the Society's risk and capital requirements, both in normal and stressed environments, throughout the business plan period.

The Board has ownership and the ultimate responsibility for the ORSA process and report, including the appropriateness and completeness of the processes and procedures, and approval of the disclosures. The Board has an active role in:

- reviewing and approving the ORSA Policy;
- providing a steer on the design and content of the ORSA process;
- challenging risk identification and mitigation; and
- approval and communication of the ORSA report.

The schedule of Board meetings across the year allows sufficient time for discussion of the different elements of the ORSA process.

The ORSA process considers strategy and risk over the business plan period. This includes:

- significant changes in risk profile;
- external factors and/or future changes in economic and political conditions;
- change in the legal or regulatory environment;
- any significant management action;
- new product development and design; and
- other qualitative assessment on a longer-term horizon

Stress and scenario testing, including reverse stress testing, is carried out annually alongside the best estimate projections to understand the potential impact of certain events over the business plan period. The results are used as part of the broader risk assessment framework, to incorporate relevant management or mitigating actions and to help develop contingency planning.

The conclusions of the ORSA process are communicated through circulation of the ORSA report to selected staff, a summary update to the management team as part of monthly management meetings and, as appropriate, through quarterly staff briefings.

In approving the annual ORSA report, the Board acknowledge the need to give due consideration to the outputs and conclusions of the continuous ORSA processes when making risk-based decisions over the coming year.

Frequency of the ORSA

The ORSA process is undertaken on an annual basis.

The full ORSA process will also be undertaken if there are any significant events that could have an impact on the ability of the Society to achieve its business plan. As set out in the ORSA Policy, a significant change would be:

- potential acquisition/merger;
- major strategic changes in distribution and/or product offerings; or
- collapse of financial markets.

Basis of the ORSA capital assessment

The assessment of the appropriateness of the Solvency II Standard Formula is reviewed and updated annually given the Society's specific risk profile and features. The most recent review, which was approved by the Board in February 2017, demonstrated that the Standard Formula continues to be an appropriate basis for the calculation of the Society's regulatory SCR.

The approach and assumptions for the economic capital assessment in the ORSA report therefore only deviate from the Standard Formula approach in the following areas:

- use of the full equity stress test allowing for symmetric adjustments, instead of the less onerous transitional stress test;
- the longevity stress being applied to the Society's defined benefit pension schemes;
- an internal operational risk assessment replacing the Standard Formula calculation; and
- the EIOPA 'Low-for-Long' interest rate stress being used instead of the Standard Formula interest rate down stress test (due to the actual low interest environment being experienced).

The Capital Management Policy outlines the overall aim and approach to be taken for capital management within the Society and forms part of the Society's Risk Management Framework. The objective of the Capital Management Policy is to provide principles and standards for capital management to ensure that the Society has sufficient capital resources to remain solvent on both a statutory (regulatory) basis and an economic basis.

The Capital Management Policy is maintained by the R&CC which is responsible for monitoring its effectiveness in maintaining an appropriate level of capital resources.

B.4 Internal control system

Internal control system

The Society has in place standards, processes and structures as a basis for carrying out internal controls across the company. The Board has overall responsibility for ensuring that an adequate and effective control system exists. Internal Control forms part of the Risk Management Framework. All key risks are identified and documented, controls both manual and automated are put in place to address these risks and they are designed as preventative or detective.

The Audit Committee reviews the effectiveness of the Society's internal controls and is responsible for understanding the extent of both internal and external auditors' review of internal control over financial reporting disclosures. On an annual basis the Audit Committee will review the adequacy of the Risk Management and Internal Controls system.

The Society has a number of control policies in place that cover Risk, Compliance, Human Resources and Information Technology. The policy review process ensures that there is a robust framework for the documentation and oversight of annual and periodic policy reviews.

The Society has no appetite for regulatory risk. Compliance monitoring provides assurance that the business is managing its regulatory risk exposure appropriately and that controls are effective. It is a key mechanism in confirming that the business is complying with agreed policies and meeting regulatory responsibilities.

Compliance function

The Compliance function seeks to be a trusted advisor to the business, supporting the strategies set out by the Board whilst ensuring that regulatory obligations are met. It helps to ensure that the Society's behaviours and activities are in the members' interests and that the Society acts with integrity in areas such as product launches, marketing and strategic initiatives.

The Society employs a Compliance Manager who also performs the roles of the Money Laundering Reporting Officer and Data Protection Officer. The Compliance Manager reports directly to the Chief Executive and the Chair of the Audit Committee.

External resource is used to provide expertise in such areas as Financial Promotions as required. The Compliance Manager is invited to attend Board Sub-Committee meetings where relevant and provides reports to the Audit Committee.

The annual Compliance Plan is approved by the Audit Committee and involves a programme of reviews targeted on the business areas and issues which give rise to the highest potential risk of customer detriment, regulatory censure or reputational damage. Particular focus is given in response to regulatory thematic reviews.

The main roles of the Compliance function are to:

- ensure there is a good understanding of the regulatory requirements and the regulatory environment in which the Society operates;
- help identify and evaluate regulatory risk and advise on ways to manage and mitigate risk to protect the Society and its members;
- track, assess and communicate the impact of new regulation in a way that is tailored to the business of the Society;
- advise on the design and implementation of controls; and
- monitor and challenge the behaviours and controls in place to promote the compliance culture

The Compliance function is responsible for managing regulatory requests and onsite visits, ensuring there is a central point of contact with a clear understanding of the regulators' approaches and the standards to which the Society is held to account. The Compliance Manager maintains awareness of all issues and communications with the various regulatory bodies.

Financial crime risk is also the responsibility of the Compliance function, covering fraud, bribery and corruption, money laundering, terrorist financing and sanction breaches. Advisory and monitoring tasks are carried out in relation to the financial crime risks both within the business and in relation to third parties on whom reliance is placed or to whom activities are outsourced.

B.5 Internal audit function

The Internal Audit Function is a key part of the assurance cycle for the Society in informing and updating the risk profile of the organisation. Internal Audit provides the Board and management with assurance on whether the Society's risk management, control and governance processes are adequate and operating effectively to protect the assets, reputation and sustainability of the Society.

The Internal Audit Function is able to maintain its independence and objectivity from the activities it reviews as the external staff from Mazars that carry out the audits are independent from the Society staff that work in the areas under review.

In addition, the Head of Internal Audit, an employee of the Society, reports into the Chair of the Audit Committee. This reporting structure ensures the independence of the Internal Audit Function.

B.6 Actuarial function

The Society has an in-house actuarial team headed by the Actuarial Manager who reports to the CFO. The team works under the guidance of the external Chief Actuary, with internal oversight provided by the CFO.

The Chief Actuary is responsible for the work of the Actuarial Function, particularly in respect of the calculation of technical provisions and SCR, and is required to express an opinion on the underwriting policy and reinsurance arrangements of the Society.

The Actuarial Function submits reports to the Board setting out the tasks that have been undertaken, the results and any relevant recommendations.

B.7 Outsourcing

The Society recognises that outsourcing is a key element of its business model and that there are associated risks. The Outsourcing Risk Policy covers the Society's approach and processes for outsourcing from the inception to the end of the contract.

This Policy defines:

- the criteria for determining whether a function is a Key Outsourced Function;
- the criteria for selecting a service provider of suitable quality and how performance results are to be assessed;
- the details to be included in the written agreement with the service provider; and
- a requirement for business continuity plans, including exit strategies for outsourced critical or important functions or activities

The risks covered are as follows:

- the Society outsources to an outsourcer that is not competent to carry out the role required;
- damage to the interest of policyholders due to failure of the outsourcer to deliver the service required;
- regulatory risk, money laundering and data protection issues caused by failure to select a suitable candidate;
- reputational risk caused by events as described above; and
- financial risk consequent on the above risks

The following table identifies the Key Outsourced Functions set out in the Society's Governance Map together with the Key Function Holder with oversight for each Key Function:

Key Outsourced Function	Key Function Holder
Internal Audit	Head of Internal Audit
Chief Actuary	Chief Finance Officer
IT and associated systems	Chief Executive
Investments (including property managers)	Chief Finance Officer
Guernsey business outsourcing	Chief Executive

All of the outsourced service providers are located in either the UK or Guernsey.

The examination of the potential service provider allows the Society to understand the main risks that might arise from outsourcing, to identify the most suitable strategies for mitigation or management of these risks and to ensure the service provider has the ability, capacity and any authorisation required by law to perform the outsourced activity.

Contingency plans have been developed for all Key Functions outsourced by the Society, irrespective of the service provider's own contingency plans, that will allow for the transfer to a new service provider or the function being resumed internally.

B.8 Any other information

There is no other material information regarding the system of governance of the Society.

C. Risk Profile (unaudited)

The most significant risks to the Society are all captured under the Solvency II Standard Formula stress tests used to determine the SCR. The profile of the Society's market and underwriting risks for the Insurance and Court funds as shown by the components of the SCR as at 31 December 2016 is as follows:

Capital requirement at 31/12/2016 (£m)					
Risk	**Insurance Funds**	**Guernsey**	**UK Courts**	**Total**	**Proportion of total (%)**
Property	0.6	0.7	14.5	15.8	34
Equity	2.9	0.5	6.3	9.7	21
Counterparty Default	1.5	0.0	1.6	3.1	7
Expense & inflation	2.8	-	-	2.8	6
Morbidity	2.8	-	-	2.8	6
Mortality Catastrophe	2.0	-	-	2.0	5
Spread (Credit)	1.7	0.0	0.3	2.0	5
Lapse	1.9	0.0	-	1.9	4
Mortality	1.5	-	-	1.5	3
Longevity	1.2	-	-	1.2	3
Operational	1.0	0.1	-	1.1	2
Interest rate	0.6	-	0.2	0.8	1
Currency	0.6	-	-	0.6	1
Morbidity Catastrophe	0.4	0.0	-	0.4	1
Premium & Reserve Risk	-	0.4	-	0.4	1
Concentration	0.0	-	-	0.0	0
Total pre-diversification	**21.4**	**1.7**	**22.9**	**46.1**	**100.0**

The highest capital requirements for the Society's Insurance funds are in respect of equity market falls, increases in expenses, increases in the incidence and duration of morbidity and mortality catastrophe risk. For the Society's UK Courts the highest capital requirements are in respect of property and equity market falls.

The table below shows a comparison of the capital requirements for the insurance funds at the end of 2016 and the start of the Solvency II regime at 1 January 2016:

Capital requirements by risk type (£m)	**01/01/2016 (unaudited)**	**31/12/2016**	**Movement**
Equity	4.5	2.9	(1.6)
Expense & inflation	4.5	2.8	(1.7)
Morbidity	2.7	2.8	0.1
Mortality Catastrophe	3.7	2.0	(1.7)
Lapse	1.5	1.9	0.4
Spread (Credit)	1.1	1.7	0.6
Counterparty Default	0.8	1.5	0.7
Mortality	1.2	1.5	0.3
Longevity	1.2	1.2	(0.0)
Operational	0.8	1.0	0.2
Property	1.2	0.6	(0.6)
Interest rate	1.6	0.6	(1.0)
Currency	0.9	0.4	(0.5)
Morbidity Catastrophe	0.4	1.5	1.1
Concentration	0.0	0.0	(0.0)
Total pre-diversification	**26.1**	**21.4**	**(4.7)**

The main changes over the year are:

- **Market risk** - reduced as a result of the de-risking exercise carried out in the year;
- **Expense and inflation risk** - decreased significantly, through increasing holdings in index-linked bonds and an expectation of a reduction in future expenses; and
- **Mortality catastrophe risk** - decrease in mortality risk under the life catastrophe stress as the reinsurance coverage was extended, although this was partially offset by new Group Shemes increasing the level and duration of the catastrophe risk.

Further details on the types of risk faced by the Society are given in Sections C1 – C6.

Prudent Person Principle

The Society is able to demonstrate, through a combination of activities and documentation, that the Prudent Person Principle (PPP) is being used to govern investment decisions and asset allocation for its insurance funds. This includes evidence that the assets backing members' policies are:

- held in the best interests of policyholders;
- are consistent with policy aims; and
- are sufficiently liquid.

There are well-documented processes for decision-making and validation of data and information provided by third parties.

The Prudent Person Principle means that the Society:

- only invests in assets with risks the Society can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs;
- invests in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole;
- ensures localisation of assets such as to ensure their availability;
- ensures assets held to cover technical provisions are invested in a manner appropriate to the nature and duration of the insurance liabilities;
- invests in assets in the best interest of all policyholders and beneficiaries taking into account any disclosed policy objectives;
- will only hold prudent levels of assets which are not admitted to trading on a regulated financial market;
- properly diversifies asset holdings in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings, or geographical area and excessive accumulation of risk in the portfolio as a whole; and
- does not expose itself to excessive risk concentration in assets issued by the same issuer, or by issuers belonging to the same group.

The main items of documentation are:

- **Principles and Practices of Financial Management (PPFM);**
- **How we manage our unit-linked funds;**
- **Investment Committee Terms of Reference;**
- **With-Profits Advisory Arrangements (WPAAs) and Unit-Linked Advisory Arrangement (ULAA) Terms of Reference; and**
- **Fund Manager mandates and reports** - fund managers operate within the mandates defined by the Investment Committee and are responsible for short-term tactical positions together with specific stock selection. A summary of investment policy is produced for each fund and reports are provided to the Investment Committee on their activity and performance.

There are no changes required to any of the investment strategies or portfolios in order to comply further with the Prudent Person Principle.

Risk concentration

The Society is not exposed to any material risk concentrations. Concentration risk in respect of financial investments is discussed in Section C3.

Risk mitigation

The most material risk mitigation technique used by the Society is reinsurance to reduce the impact of a catastrophe affecting lives insured under our Group Schemes. The level of reinsurance cover was increased in 2016 as part of the Society's de-risking exercise. There are no other material applications of risk mitigation techniques by the Society. Future consideration of such techniques would include a requirement for regular assessment and documentation in the quarterly Management Information pack supplied to the R&CC.

The risk mitigation techniques used by the Society at a less material level consist of risk transfer, risk avoidance, risk reduction and risk termination. The extent to which these are recognised in the calculation of the SCR is limited to a small amount of risk transfer of underwriting by use of reinsurance.

Reinsurance may be used as a mitigant where the level of risk attached to a customer or a portfolio is assessed to be greater than acceptable exposure in respect of both the claim size and volatility of claim experience.

The Board also conducts a reverse stress-testing exercise annually to identify and assess the scenarios most likely to cause the Society's current business model to fail, and/or lead its stakeholders to lose confidence in the organisation. For each scenario, mitigating actions are identified to protect the Society from the full impacts.

Key Risk Indicators (KRIs) are used by the Society to enhance the monitoring and mitigation of risks and facilitate risk reporting.

Risk sensitivity

The Society's stress testing approach to calculating capital requirements is supplemented by sensitivity and scenario testing as set out in the Stress and Scenario Testing Framework. Sensitivity testing is carried out as part of the business planning and ORSA process, using less extreme events than those used for setting capital requirements. The ORSA process includes a range of sensitivity tests which are selected each year reflecting specific economic conditions and areas where the Society is seeking additional insight into the level of risk to which it is exposed.

The ORSA process carried out during 2016 included consideration of significant equity falls or increased market volatility on the Society's Insurance Funds economic capital coverage (Solvency II Pillar 2) based on the equity holdings at 31 December 2015. Sensitivity tests included the effects of a 10% fall in equity values, a 30% fall in equity values and an increase of 25% in the volatility of asset values.

The results of these sensitivities demonstrated that a 10% equity fall would have had relatively little impact on the Pillar 2 economic capital coverage of the Insurance Funds (falling from 131% to 127%), but that a 30% equity fall would be the level at which the capital coverage was exposed (less than 100% coverage). The impact of a 25% increase in asset volatility would have reduced the economic capital coverage from 131% to 121%.

In addition to the sensitivity test of equity falls on the capital coverage for the Insurance Funds, the Society also carries out sensitivity testing on the impact on the Technical Provisions of all major risks.

C.1 Underwriting risk

The Society is exposed to life insurance and health insurance risks arising from both the perils covered and the processes followed in the conduct of the insurance business. The major areas of risk in this category that the Society is exposed to are mortality, morbidity and expenses.

Mortality risk

The Society holds £1.5 million of capital against mortality risk before taking risk diversification into account.

Mortality risk is the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance liabilities.

Mortality risk may occur in various ways, as a large scale event resulting in a significant increase in the number of deaths in a year (such as a major epidemic of influenza), or as a long-term trend of either increasing (for example due to a rise in obesity) or decreasing (for example as a result of better health education) mortality rates. Risks may also occur due to an inaccurate best estimate assumption or variation around the best estimate due to random fluctuations.

Diversification in the portfolio helps to mitigate mortality risk. The Society has a diversified population of members across its various funds with respect to age, gender, smoker status, level of life insurance cover, type of insurance cover and geographic location.

Although initial underwriting is limited (reflecting the Society's values in aiming to provide cover for the majority of applicants), this is taken into account in the product design and the level and types of covered offered.

Disability/Morbidity risk

The Society holds £2.8 million of capital against disability/morbidity risk before taking risk diversification into account.

Disability/morbidity risk is the risk of loss, or of adverse changes in the value of insurance liabilities, resulting from changes in disability and morbidity rates. It may occur due to either a large scale event or a gradual increase in claim rates and fall in recovery rates.

The disability and morbidity risks faced by the Society are spread across both Group schemes and individual business. This provides a level of diversity in terms of likelihood of disability or sickness (inception rates) or change in the severity of disability or sickness (recovery rates).

As for life insurance, the initial health insurance underwriting is limited, but this is taken into account in the product design and the level and types of covered offered.

Longevity risk

The Society holds £1.2 million of capital against longevity risk before taking risk diversification into account.

Longevity risk is the opposite of mortality risk, where a decrease in the mortality rate leads to an increase in the value of insurance liabilities.

Although the Society has a small annuity portfolio, the longevity capital requirement is mostly in respect of the costs associated with running off the closed with-profit funds and guaranteed annuity rates on pension policies.

Lapse risk

The Society holds £1.9 million of capital against lapse risk before taking risk diversification into account.

Lapse risk is the risk of loss or adverse change in liabilities due to a change in the expected exercise rates of policyholder options. The relevant options are all legal or contractual policy holder rights to fully or partly terminate, surrender, decrease, restrict or suspend insurance cover or permit the insurance policy to lapse.

The main elements of this risk for the Society are in relation to costs associated with running off the business and sickness policy liabilities, with little impact on other policy liabilities.

It is felt that members with strong links to the Society would be unlikely to surrender their policies in a financial crisis.

Expense risk

The Society holds £2.8 million of capital against expense and inflation risk before taking risk diversification into account.

Expense risk arises from the variation in the expenses incurred in servicing insurance contracts. This may be due to an increase in the monetary amount of expenses taken into account in the calculation of technical provisions, or an increase in the assumed future expense inflation rate.

The majority of the Society's expenses are incurred in staff costs, IT infrastructure and cost of land and buildings occupied. The projected expenses used in assessing the capital impact of expense and inflation risk are based on continuing tight cost control.

Life Catastrophe risk

The Society holds £2.0 million of capital against life catastrophe risk before taking risk diversification into account.

Life catastrophe risk stems from extreme or irregular death events whose effects are not sufficiently captured in the other life underwriting risk sub-modules. Examples could be a pandemic event or a nuclear explosion.

The majority of the life catastrophe risk for the Society relates to Group business which is mitigated by catastrophe reinsurance.

Health catastrophe risk

The Society holds £0.4 million of capital against health catastrophe risk before taking risk diversification into account.

Health catastrophe risk results from the significant uncertainty of pricing and provisioning assumptions related to outbreaks of major epidemics, as well as the unusual accumulation of risks under such extreme circumstances. This risk is not material for the Society.

Non-Similar to Life Techniques Health risk

The Society holds £0.4m of capital against premium and reserve risk for the Guernsey medical expenses business before taking risk diversification into account.

C.2 Market risk

Market risk arises from the level or volatility of market prices of financial instruments.

Interest rate risk

The Society holds £0.8 million of risk capital against interest rate risk before taking risk diversification into account.

Interest rate risk exists for all assets and liabilities which are sensitive to changes in the term structure of interest rates or interest rate volatility, whether valued by mark-to-model or mark-to-market techniques. The risk to the Society is that assets and liabilities are not adequately matched and so do not move in line.

Approximately one third of the Society's interest rate capital requirement is in respect of the defined benefit pension schemes.

Although the Society holds a significant amount of fixed interest investments (£94.0m at 31/12/2016), stress tests are applied to all assets and so the increase in the value of total free assets results in a relatively small capital requirement.

The Society's portfolio of fixed interest holdings is diversified by term and coupon. Stress tests performed on the slope and shape of the yield curve in previous years did not result in significant additional capital requirements and as the range of holdings is similar this is expected to continue to be the case.

Equity risk

The Society holds £9.7m of risk capital against equity risk before taking risk diversification into account, £2.9m in the UK insurance funds, £0.5m in Guernsey and £6.3 in the UK Courts funds.

Exposure to equity risk refers to all assets and liabilities whose value is sensitive to changes in equity prices. The Society's exposure to equities is in the form of direct equity holdings for all funds (valued at £35.1m as at 31/12/2016).

The Society owns a diversified equity portfolio that is representative for an average European insurance undertaking (i.e. it is not overweight in any high risk sectors). The sensitivity of assets and liabilities to changes in the volatility of the market parameters is not material. The Society does not hold any derivatives or hedge fund assets.

For the actively managed funds, the future risk profile could evolve as the components of the portfolio change over time. However, the restrictions within the investment mandates provided to the fund manager Quilter Cheviot are designed to maintain the current risk profile in line with the fund objectives declared to policyholders.

Property risk

The Society holds £15.8m of capital against property risk before taking risk diversification into account, £0.6m in the UK insurance funds, £0.7m in Guernsey and £14.5m in the UK Courts funds.

Property risk arises as a result of sensitivity to the level or volatility of market prices of the Society's direct property portfolio.

The Society's property holdings are all residential and commercial properties across the UK, valued at £68.5m as at 31/12/2016.

Currency risk

The Society holds capital of £0.6 million against currency risk before taking risk diversification into account.

Currency risk arises from changes in the level or volatility of currency exchange rates. The Society is exposed to currency risk arising from unhedged overseas equity holdings.

In 2016, the Society held direct equity holdings denominated in US Dollars ($), Euros (€), Danish Krone (DKK), Swedish Krone (SEK) and Swiss Francs (CHF).

The Society's currency risk capital requirement at 31/12/2016 is mostly in respect of the £5.0m of currency exposures in the Order Insurance Fund.

Currency exposure relating to the direct equity holdings in the POIS Flexible Growth Fund (within the Non-Profit Fund) is borne by policyholders.

There are no foreign currency exposures in the fixed interest securities, property or other investments (including cash).

C.3 Credit risk

Credit risk means 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 the Society is exposed, in the form of counterparty default risk, spread risk or market risk concentrations.

Counterparty default risk

The Society holds £3.1 million of capital against the risk of counterparty default before taking risk diversification into account.

Counterparty risk reflects possible losses due to unexpected default of the counterparties and debtors of the Society over the forthcoming 12 months, including risk-mitigating contracts e.g. reinsurance arrangements, securitisations, derivatives and receivables from intermediaries.

The risk for the Society is mostly in respect of the £26.9m of cash balances as at 31/12/2016 (all rated 'BBB' or above).

Spread risk

The Society holds £2.0m of capital against spread risk before taking risk diversification into account, £1.7m in the UK insurance funds and £0.3m in the UK Courts.

Spread risk results from the sensitivity of the value of assets, liabilities and financial instruments to changes in the level or volatility of credit spreads over the risk-free interest rate term structure.

Credit spread is the additional return earned over the risk-free rate. It reflects the riskiness of the assets and compensates the investor for the possibility of default. Any financial instruments which provide a fixed income stream will be sensitive to the risk of the credit spread increasing.

The classes of bond held by the Society to which this applies are:

- corporate bonds; and
- loans other than retail loans secured by a residential mortgage.

Government bonds are assumed to earn the risk-free rate and so no spread risk is assumed. The Society does not hold any securitisations and holds a non-material covered bond.

Although the Society holds a significant amount of corporate bond investments (£42.7m at 31/12/2016), the capital requirement is relatively small due to the high quality of the bonds (£13.2m being rated AA or AAA) and the majority having a modified duration of less than ten years.

Concentration risk

This risk is not material for the Society and no capital is held.

Concentration risk in respect of financial investments is restricted to the risk regarding the accumulation of exposures with the same counterparty. It does not include other types of concentrations (e.g. geographical area, industry sector, etc.). Exposures via investment funds need to be considered on a look-through basis.

Properties are excluded as none of the individual holdings are worth more than 10% of total assets. Gilts (fixed and index-linked) are also excluded as the risk factor for exposures to governments and central banks is 0%.

Analysis of the Society's direct equity and corporate bond holdings on a look-through basis shows small concentrations in respect of a handful of counterparties.

Any concentrations of more than 1.5% of the total assets considered for each fund results in a capital requirement, although in some cases the monetary amount of the holding may be relatively small.

C.4 Liquidity risk

Liquidity risk is that of not having sufficient liquid resources to meet changing market conditions and being unable to meet obligations as they fall due, or being able to secure them only at excessive cost.

Liquidity is required to honour all cash flow commitments, both on and off balance sheet, and these are generally met through cash flows supplemented by assets readily convertible to cash.

The management of liquidity should be consistent with the economic capital, regulatory and operational needs across the Society. The Board is responsible for defining the risk appetite and monitoring liquidity risk exposure. Liquidity risk oversight is performed by the Investment Committee, which sets and monitors appropriate asset ranges bearing in mind the liquidity needs for each fund.

Liquidity risk is regularly assessed by conducting a review of the funding profile against the nature of risk inherent within the Society. This includes determining the level of mismatch between cash inflows and the cash outflows of both assets and liabilities, including expected insurance and reinsurance cash flows such as claims, lapses and surrenders in the coming year.

In accordance with Article 260(2) of the Solvency II Delegated Acts, the Expected Profit Included in Future Premiums (EPIFP) has been calculated as £2.5m at 31/12/2016. This is the expected present value of future cash flows which result from the inclusion in the technical provisions of premiums relating to existing insurance contracts that are expected to be received in the future, but that may not be received for any reason, other than because the insured event has occurred.

Total liquidity needs in the short and medium term, including an appropriate liquidity buffer to guard against a liquidity shortfall, are determined with consideration of other factors such as the nature of business activity and operations and appropriate asset mix for each fund.

The level and monitoring of liquid assets, including quantification of potential costs or financial losses arising from an enforced realisation, is included in the annual review of liquidity risk appetite and the liquidity risk measures (e.g. holding sufficient cash to cover the combined undiversified insurance and operational risks). Monitoring of individual bank accounts takes place on at least a weekly basis.

Liquidity risk contingency plans set out the possibility of unexpected and potentially adverse business conditions including overdraft facilities and trigger points.

C.5 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events. Operational risk includes legal risks, excluding risks arising from strategic decisions, as well as reputational risks.

For the Society, operational risk is presented as being borne by the Non-Profit Funds (NPFs), as the closed PEF, Tunstall and POIS funds are not shown as having any capital requirements (due to full loss absorbency) and in practice most operational risk is borne by the Group Capital Fund.

Scenario-based risk assessments have been used in the Society's ORSA, with plausible but extreme adverse scenarios being constructed by staff within the Society in order to assess the potential likelihood and impact of extreme events. A simple statistical method has then been used to fit a LogNormal distribution to this data to determine capital requirements for these risks at a 99.5% confidence level.

Risk	Extreme Scenario
Member servicing processes	Severe system failure resulting in administration backlog / increased errors.
IT infrastructure	New regulations not being met due to insufficient IT capability.
Underwriting	High level of claims on Group business due to inadequate underwriting.
Business continuity	Head Office destroyed by fire, with staff sustaining injuries.
Latent product risk	Product review exercise uncovers multiple issues that require system changes.
Financial crime	Financial losses incurred due to external criminal gang activities.
Regulatory risk	Lack of resource and/or poor planning for major regulatory developments.
Employment practice	Costs associated with legal action taken by ex-staff members against the Society.
Legal risk	Legal costs and/or losses incurred due to contractual terms being challenged.
Third party dependency	Losses incurred due to failure of a third party to deliver a service.
Project risk	Additional costs incurred due to failure of a project to deliver the required outcomes.
Financial mis-statement	Discovery of historic data or calculation errors in the valuation reserves.
Misrepresentation at Point of Sale	Historic policy terms and conditions are found to be either inaccurate or deficient, leading to compensation claims.
Trading risk	Unable to trade in a timely manner for the unit-linked funds, exposing the Society to losses where asset values have increased.
Investment admin process risk	Unavailability of ICON system with recovery implemented offsite and investment transactions not being correctly reflected in estimated daily prices (policies needing to be corrected).
Unit pricing risk	Material unit pricing error occurring on a date with significant transactions on the affected fund, or risk of less significant errors which accumulate over time.

The costs associated with each risk are aggregated assuming a linear correlation of 50% of the member services, IT infrastructure, business continuity, financial crime, regulatory and third party risks, and 25% for all other risks.

The resultant operational risk capital requirement is then further diversified when combined with the capital requirements for other risk types (market, credit, insurance and pension scheme). The correlation between operational risk and these other risk types is set at a low level of 12.5% as they are largely unrelated (e.g. latent product risk is not impacted by variations in mortality rates).

C.6 Other material risks

There are no other material risks faced by the Society.

C.7 Any other information

There is no other material information to disclose regarding the risk profile of the Society.

D. Valuation for Solvency Purposes

The Solvency II Directive includes standards for the valuation of the three main elements of the Solvency II Balance Sheet: assets, technical provisions and other liabilities. The balance sheet is prepared on a market-consistent basis, whereby assets are accounted for at market value and liabilities are assessed on a best estimate basis.

The following table shows a high-level summary, with further details in the sections that follow;

£000s	**Total**
Total Assets	**274,527**
Total technical provisions	**(151,236)**
Total other liabilities	**(3,908)**
Excess of assets over liabilities	**119,383**

D.1 Assets

All material asset classes other than technical provisions have been valued in accordance with the Solvency II regulations and are therefore recognised at economic value. The asset values at 31 December 2016 are shown below:

In £000s	**Solvency II value (£000s) Group**	**UK GAAP value (£000s) Group**
Goodwill		910
Pension benefit surplus	77	256
Property, plant & equipment held for own use	151	98
Investments (other than assets held for index-linked and unit-linked contracts)	**208,520**	**203,457**
Property (other than for own use)	68,475	68,528
Holdings in related undertakings, including participations	10	10
Equities	**35,066**	**37,201**
Equities – listed	35,066	37,201
Equities - unlisted	0	0
Bonds	**94,004**	**92,949**
Government Bonds	51,280	50,939
Corporate Bonds	42,725	42,009
Collective Investments Undertakings	9,511	4,769
Derivatives	0	0
Deposits other than cash equivalents	1,455	0
Other investments	0	0
Assets held for index-linked and unit-linked contracts	**36,698**	**36,403**
Loans and mortgages	**213**	**213**
Loans on policies	64	64
Loans and mortgages to individuals	99	99
Other loans and mortgages	51	51
Reinsurance recoverables	**120**	**120**
Insurance and intermediaries receivables	698	1,758
Receivables (trade not insurance)	1,175	2,414
Cash and cash equivalents	26,810	30,924
Any other assets, not elsewhere shown	62	0
Total assets	**274,527**	**276,554**

Property

Property, including land and buildings held by the Society for operational purposes, covers freehold and leasehold investment properties held for long-term rental yields and capital growth.

Properties other than those held by the Society for operational purposes are valued at least annually on an open market value basis by qualified external professional valuers. Property held for operational purposes is valued at least annually on an existing use value basis by qualified external professional valuers.

Properties occupied by the Society are required to be depreciated over their expected useful economic lives under the requirements of the Friendly Societies Act 1992. In respect of investment properties, this requirement conflicts with the generally accepted accounting principle set out in section 16 of FRS 102 for Investment Properties, that no depreciation should be provided on such investments. The Board consider that, as these properties are held for investment, to depreciate them would not give a true and fair view, and that it is necessary to adopt FRS 102 in order to give a true and fair view. Depreciation is only one of the factors reflected in the annual valuations, and the amount which might otherwise have been shown cannot reasonably be separately identified or quantified.

Freehold land is not subject to depreciation. No depreciation is charged on freehold buildings as, in the Directors' opinion, it is considered that their estimated useful economic lives and residual values are such that the required depreciation charge is immaterial.

Financial Investments

Other financial investments comprise listed investments, units in authorised unit trusts, loans, mortgages, deposits with credit institutions and deposits with Investment Associations.

Listed investments and units held in authorised unit trusts are measured at their bid value at the balance sheet date, based on observable market prices.

Amounts receivable in respect of loans and mortgages are shown at the lower of the amounts advanced or the amount expected to be recovered where there is evidence of impairment. As there was no need for impairment identified, this is considered to be a material approximation of the economic value under Solvency II.

Deposits with credit institutions are carried at their historical cost as the economic value equals the fair value as these items are effectively cash deposits.

Deposits with Investment Associations are shown at cost plus interest accrued on the deposit which is the value at which the deposits could be withdrawn and is therefore considered to be a material approximation of the economic value under Solvency II.

The Society does not invest in derivative investments.

Investments in subsidiaries and associates are measured at cost less impairment, which is considered to be a material approximation to the adjusted equity method required under Solvency II in view of the immaterial balance involved.

Unit-linked business

Assets held in respect of unit-linked business are fair valued at bid price using market prices supplied by third party data providers.

Property, plant and equipment

Impairment reviews were carried out as part of the assessment of the net book value recognised in the UK GAAP value in the financial statements and, as there was no need for impairment identified, the carrying value form the financial statements is considered to be a material approximation of their economic value under SII.

Cash

Cash and cash equivalents are held at fair value.

Insurance receivables

Insurance receivables are outstanding premiums which are all past their due date and so are considered to be held at fair value.

Pension benefit surplus

The Society operates two defined benefit pension schemes for which the asset or liability recognised in the balance sheet is the present value of the defined benefit obligation at the reporting date less the fair value of the plan assets at the reporting date.

The actuarial valuations of both schemes have been updated to the accounting date by an independent qualified actuary. The schemes have been valued using the IAS19/IFRIC14 basis as permitted under Solvency II rules. This is a different treatment compared to the value attributed to pension schemes in the Society's Reports and Accounts.

Valuation in financial statements

Prepayments to the value of £193k shown in the financial statements have been removed from the Solvency II balance sheet as they relate mainly to software licences which are not considered to have any economic value.

Accrued interest has been reclassified and is shown in the Solvency II balance sheet in the economic value of the asset to which it relates.

The amount of goodwill in respect of the POIS business acquired under the transfer of engagements which is recognised in the financial statements has been de-recognised as it is not separately identifiable on the Solvency II balance sheet.

Other than the treatment of the defined benefit pension schemes there are no other material differences between the bases, methods and main assumptions used by the Society in the asset valuation for solvency purposes and those used for its asset valuation in financial statements.

D.2 Technical provisions

The value of technical provisions is equal to the sum of a best estimate liability (BEL) and a risk margin (RM).

The BEL takes account of all the cash inflows and outflows required to settle the Society's insurance contracts. It is the present value of the expected benefit payments and expenses less the expected premium income.

The RM assumes that the Society's insurance contracts are transferred to another insurer, and takes into account the cost of holding regulatory capital for that insurer until the contracts are settled. Only risks that are not easily hedged are included in the risk margin.

The technical provisions are calculated gross of any outward reinsurance and a separate reinsurance recoverable asset is included in the balance sheet.

The Society's technical provisions at 31 December 2016 are as follows:

£000s	Best Estimate	Risk Margin	**Total**
Technical provisions			
Health (similar to non-life)	342	27	**369**
Health (similar to life)	2,227	492	**2,719**
Life (excluding health and index-linked and unit-linked)	111,757	2,007	**113,764**
Index-linked and unit-linked	34,292	93	**34,385**
Total technical provisions			**151,236**

With-Profit Funds

The best estimate liabilities (BEL) consist of asset shares plus the cost of guarantees and any adjustment for the cost of smoothing in the Order Insurance Fund (OIF), Tunstall Fund (TF), Pure Endowment Fund (PEF) and POIS Fund.

For the Leek fund, because the guarantees are so far in the money, a gross premium reserve is calculated, effectively treating the policies as if they were non-profit policies. The gross premium reserve is calculated as the benefits expected to be paid, plus the expenses expected to be incurred, less expected gross premiums to be received.

A simplified stochastic model is used to calculate the cost of guarantees for conventional with-profit business, based on fitting a statistical distribution to a range of investment scenarios to make some allowance for the range of possible outcomes.

For accumulating with-profits business, the cost of guarantees has been calculated using Black-Scholes option pricing formulae.

Projected cash flows underlying the best estimate liability cease at the contract boundary for a given contract type. The boundary of the contract is determined by the future date where the Society has a unilateral right to either:

- reject premiums payable under the contract;
- terminate the contract; or
- amend premiums or benefits payable under the contract in such a way that the premiums fully reflect the risks.

The main impact on the Society is for with-profit recurrent single premium policies: any expected future premiums beyond the balance sheet date are ignored as these are not obliged to be paid by the policyholder. As a result, few premiums may have been received and a potentially substantial expense provision may be required. This affects the provisions for regular premium Individual Savings Accounts (ISAs) and Child Trust Funds (CTF).

Non-Profit business

The best estimate liabilities are calculated as a gross premium reserve, as described for the Leek Fund above.

For the purpose of calculating the value of future sickness claims the inception-annuity methodology has been employed throughout the valuation. The inception-annuity method considers the following two functions:

- the inception rate: This is the probability that a currently healthy life becomes disabled and remains disabled until the end of the deferred period; and
- the termination annuity: This is the present value at the date of disablement of expected claim payments until the claim ceases, either due to recovery, death or reaching the end of the maximum benefit period. The calculation allows for benefit escalation, interest and terminations (via death and recovery) from the end of the deferred period.

At any point in time the value of expected claims for a particular policy under the inception-annuity approach can be expressed as the sum across all future time periods of the inception rate multiplied by the disabled life annuity.

The Society's long-term sickness policies typically include a waiver of premium benefit while policies are in claim. This is included in the benefit amount used to calculate the best estimate liabilities.

A provision for claims currently in payment is calculated as the present value of all future payments that are expected to be made to these claimants. The same term structure of interest rates is used to discount these claim payments as used in the gross premium reserves. This provision forms part of the policy liabilities rather than being shown separately.

No provision for IBNR claims is established as the majority of the Society's business is written with short deferred periods. Reviews of claims on short-term sickness policies have not shown any evidence of delays in reporting.

Unit-linked business

Unit reserves are set in line with linked liabilities and non-linked reserves are derived using charges less expenses for unit-linked business. There is also a small reserve for the cost of guarantees related to some unit-linked business. Unit-linked liabilities consist of the unit reserve (value of units attached to policies), the non-unit reserve and a reserve for the cost of guarantees.

Unit liability

The unit liability is equal to the value of units allocated to policyholders. The total balance sheet value of the unit funds may be slightly different to this due to the operation of the box. The box effectively acts as a buffer and reduces the expense of making a series of small transactions.

Non-unit liability

The following approach has been adopted in determining the non-linked reserves for unit-linked policies:

- compare the future charges with the future directly attributable expenses on a policy by policy basis allowing for the cost of life cover; and
- if future charges are more than sufficient to meet future directly attributable expenses then credit can be taken for the excess, and a negative non-linked reserve held.

Group business

The BEL in respect of Group business has been estimated using a cash flow model allowing for future premiums, claims allowing for delays in claim notification, expenses and the cost of claims in payment. Group business has a contract boundary at the premium review date.

Guernsey Medical Expenses Business (MEB)

The BEL has been calculated for the Guernsey MEB using a cash flow model with a one-year contract boundary. The cash flow model allows for premiums, claims allowing for delays in claim notification and renewal expenses. The one year contract boundary is appropriate as these are annual policies which are all renewable on 1 January each year.

Additional expense liabilities

Although the basic liabilities include an explicit allowance for future expenses, there will still be an additional expense provision:

- for expenses above the maximum amount allowed to be charged to a ring-fenced with-profits fund either by virtue of an Instrument of Transfer or Board agreement;
- where asset share expenses do not equal capped expenses (this can be positive or negative); and
- for overhead expenses not attributed to policies.

The different types of expenses are explained in more detail in the assumptions section below.

Risk margin

The risk margin is calculated as a 6% per annum cost-of-capital charge on the non-market risk components of the SCR in each future year. The non-market risk components are the insurance, counterparty and operational risk components of the SCR. The 6% rate is laid down in the Solvency II regulations.

The Society has used a simplified method for calculation of the risk margin where it has been calculated on the basis of estimating all future SCRs 'at once' (the duration approach), as set out in EIOPA's Guidelines on the valuation of technical provisions (Guideline 62, Method 3 and Technical Annex IV).

The calculation has been carried out for each fund and the total risk margin has been calculated as the sum of the risk margins for each fund. For non-profit funds, the risk margin is split into lines of business (unit-linked, health and other) in proportion to liabilities or by risk capital components as appropriate.

In order to use this approximation, the following assumptions used in the methodology have been considered:

- for the basic SCR, the composition and the proportions of the risks and sub-risks do not change over the years;
- for counterparty default risk, the average credit standing of reinsurers and SPVs remains the same over the years;
- for operational risk and counterparty default risk, the modified duration is the same for obligations net and gross of reinsurance;
- market risk in relation to the net best estimate remains the same over the years; and
- the loss absorbing capacity of the technical provisions in relation to the net best estimate remains the same over the years.

Based on the work done during the Solvency II preparatory phase, the Society believes that it satisfies these requirements. However, this will be kept under review in future years.

Provisions other than technical provisions

These are provisions for outstanding claims, all of which are past due and therefore held at economic value.

Main assumptions

The assumptions used for calculating the BEL are realistic with no margin for prudence. The economic assumptions are based on market data.

The approach to setting non-economic assumptions is based on the Society's experience which is reviewed annually.

The mortality assumptions use standard CMI mortality tables, adjusted to reflect the Society's own experience where appropriate. The assumptions also allow for mortality improvement for with-profit business.

The sickness inception and recovery rates used in the valuation are based on industry standard tables of inception and recovery rates, adjusted for the actual experience of the Society. Termination rates allow for both recoveries, policyholders claiming who become well again and are eligible to claim again in the future, and deaths of policyholders who were claiming. Mortality rates for those policyholders claiming have been assumed to be the same as for those not claiming.

On expense assumptions, the Solvency II Directive requires that the Society takes into account all future expenses that relate to existing inforce business assuming that the Society continues to write new business in calculating the technical provisions. Solvency II Level 3 Guidance (Guideline 29) says that firms should consider expenses by homogeneous risk groups and as a minimum by line of business. Given the Society's size and structure it is deemed more appropriate to consider expenses by long-term business fund rather than by line of business.

The expense assumptions are derived by dividing the expected maintenance expenses over the coming year by the average number of policies in-force during the current year. Where the expenses charged to a fund are capped, either by virtue of an Instrument of Transfer or Board agreement, only the expense up to the capped level is provided for in each fund, with the excess being held in the Group Capital Fund.

The assumption for lapses and paid-ups are based on the Society's own experience where the investigation is carried out annually. The Society's approach to setting the best estimate basis is to generally use the same shape as the previous best estimate basis or revised if there is strong evidence that the shape no longer represents the actual lapse experience and to set the basis based on observed experience rounded to the nearest 0.25% unless the change would be immaterial.

Asset shares for the OIF, Tunstall and POIS funds are rolled forward from the previous year end at the gross return achieved on the backing assets. As the PEF, Tunstall and POIS funds (which are all closed to new business) are managed without an estate, the investment return applied to the asset share in these funds is adjusted so that there is no surplus in the fund.

Future investment returns are set at a level derived from the British Pound (GBP) risk-free spot rates. The risk-free yield curve for 31 December 2016 was published by EIOPA in the first week of January 2017 on their website (https://eiopa.europa.eu/regulation-supervision/insurance/solvency-ii-technical-information/risk-free-interest-rate-term-structures).

Uncertainty

In calculating the technical provisions, assumptions have been made about future experience on a best estimate basis in accordance with Solvency II regulations. Due to the uncertain nature of the business these assumptions are not likely to be borne out exactly in line with expectations and any deviation will have an impact on the amount of technical provisions and SCR, the extent of the impact varies depending on the sensitivity of the liabilities to the assumptions.

Valuation in financial statements

There are no material differences between the bases, methods and main assumptions used in the valuation for solvency purposes of the UK insurance business liabilities and those used for the Society's financial statements.

The treatment of the Guernsey medical expenses business differs in that the accounts show a general insurance business provision as a balancing item of surplus assets, whereas Solvency II technical provisions have been calculated as a best estimate liability plus risk margin for solvency purposes.

This is a material difference – the general insurance business provision plus outstanding claim reserve at year end 2016 is £3.65m compared to a Solvency II TP of £0.37m.

The pension benefit obligation has been revalued using the IAS19/IFRIC14 basis as permitted under Solvency II rules. This is a different treatment compared to the value attributed to pension schemes in the Society's Reports and Accounts, although there is no resulting difference in value.

Transitional measures and adjustments

The Society has not made use of any of the following transitional measures or adjustments referred to in EU Directive 2009/138/EC:

(i) the matching adjustment (Article 77b)
(ii) the volatility adjustment (Article 77d)
(iii) the transitional measure on risk-free interest rates (Article 308c)
(iv) the transitional deduction on technical provisions (Article 308d).

Reinsurance contracts

There is some exposure to the risk of reinsurer default.

There are two main areas of risk within the Society's business which are currently reinsured. Credit has been taken for these arrangements in calculating the SCR and therefore allowance has also been made for the risk of reinsurer default.

Group Schemes

Life catastrophe excess of loss cover is in place for the Group schemes, at a level of £3m in excess of £0.5m. The risk is split equally between HCC International Insurance Company plc and TransRe London Limited.

This was reviewed by the Board in 2015 for renewal purposes and having discussed the likely catastrophe event that might give rise to a claim, the renewal was completed at a lower level of cover (previously £5m in excess of £1m). At the 2016 renewal effective 07/10/2016 the Board decided to extend the scope of the cover to include losses from a pandemic event at the existing level of cover.

POIS Ring Fenced Fund

Two treaties exist with Swiss Re for business written within the POIS Fund. These were both closed to new business in 2002. The total reinsurance premium for 2016 is around £59,000 covering 600 policies (with technical provisions of £200k held by the reinsurer).

The small element of reinsurance risk is fully absorbed by the surplus within the fund.

Special purpose vehicles

The Society does not use any special purpose vehicles (SPVs).

Changes to methodology and assumptions over the reporting period

The key updates to methodology and assumptions used for calculating the technical provisions since the previous technical provision calculation at 1 January 2016 are:

- following up on an area of improvement identified at the previous valuation, a cash flow model has been introduced to value the Group business;
- the approach to valuing future expenses has been considered and a number of changes made, the most financially significant of which is to change the price inflation assumption from RPI to CPI;
- economic assumptions have been updated to 31 December 2016; and
- Guernsey medical expenses business has been included for the first time.

D.3 Other liabilities

Other liabilities of the Society at 31 December 2016 were as follows:

	Solvency II value (£000s) Group	UK GAAP value (£000s) Group
Other technical provisions	0	2,005
Provisions other than technical provisions	1,805	0
Pension benefit obligations	86	86
Payables (trade not insurance)	2,017	2,962
Total other liabilities	**3,908**	**5,052**

Other technical provisions in the financial statements consisted of outstanding claims, which have been re-classified as provisions other than technical provisions for the UK Life insurance funds and form part of the Guernsey fund technical provisions.

Other liabilities include payments due to HMRC in respect of PAYE and Vat, unclaimed balances from pre-incorporation and invoices awaiting payment, which may contain some immaterial amounts not yet due for payment which have not been adjusted for on the grounds of proportionality.

Other than the treatment of the Guernsey medical expenses business explained in D.2 there are no material differences between the bases, methods and main assumptions used by the Society for the valuation of other liabilities for solvency purposes and those used for their valuation in financial statements.

D.4 Alternative methods for valuation

There were no alternative methods required for the valuation of the Society's assets or liabilities.

D.5 Any other information

There is no other material information to be disclosed regarding the valuation of the Society's assets and liabilities for solvency purposes.

E. Capital Management

E.1 Own funds

The Society has a Capital Management Policy and a Medium-Term Capital Management Plan which outlines the overall aim and approach to be taken for capital management, together with the standards and parameters which must be adhered to and reporting requirements and responsibilities.

The objective is to ensure that the Society has sufficient capital resources to remain solvent on both a regulatory basis (Solvency II Pillar I) and an economic basis (Solvency II Pillar II).

The capital projections shown in the ORSA over the 3-year business planning period facilitate Board discussion on the capital requirements of each fund and the Society as a whole. Separate consideration is given to the in-force portfolio and the impact of writing new business.

There have not been any material changes to the capital management policy or processes in 2016.

Some of the Society's own funds are restricted by the ring-fenced adjustments described below to give eligible own funds. All of the Society's eligible own funds are classified as Tier 1 high quality unrestricted capital, i.e. assets which are free from any foreseeable liabilities and are available to absorb losses due to adverse business fluctuations on a going-concern basis and in the case of winding-up. This has been the position over the whole of 2016.

As the Society's eligible own funds are all Tier 1, they are available in full to cover the SCR and MCR.

Ring-Fenced Fund Adjustments

Under Solvency II the with-profits funds are classified as ring-fenced funds (RFFs), which means that the assets within these funds are for the benefit of those policyholders and cannot be used to support other areas of the business except in extremis. Hence any excess of assets over liabilities in the OIF, PEF, Tunstall, Leek and POIS funds cannot normally be used to support other areas of the business. If any of these funds have a deficit of assets over liabilities, then additional capital support can be provided from the non-profit funds (predominantly the Group Capital Fund).

Similarly, the assets of the Guernsey Court and UK Mainland Courts are ring-fenced for the benefit of the members of these courts and therefore cannot normally be used to support other areas of the business. This means these funds also meet the Solvency II definition of ring-fenced funds.

As the assets in these funds are not normally available to support other areas of the business the surplus assets are only available to cover the risks within these funds. This means the eligible own funds from these funds are restricted to notional SCR for these funds. The restrictions are as follows:

(£000s)	Excess of Assets over Liabilities	Notional SCR	Excess assets less SCR	Restricted Own Funds
OIF	3,098	3,968	(870)	0
PEF	0	15	(15)	0
TF	0	214	(214)	0
LF	(106)	28	(134)	0
POIS	0	121	(121)	0
Guernsey Court	4,105	1,420	2,684	2,684
UK Mainland Court	90,344	20,290	70,053	70,053
Total				72,737

Movements in Own Funds

The figures below show an increase in own funds of £25.4m over 2016 from £20.5m to £45.9m (opening balances are unaudited). This is due to:

- including the UK Courts into the results increasing own funds by £90.3m offset by £70.0m ring-fenced fund restriction;
- £1.0m increase from the change in methodology for valuing Group business (shown as a restatement of the 2015 figures);
- £1.4m from investment returns being higher than the EIOPA specified risk free rate used to discount liabilities;
- £0.5m from projected future expenses being lower than previously estimated through lower per-policy expenses and changes to future inflation assumptions;
- £0.7m in the Group Business Fund from premiums exceeding claims and expenses on Group business last year;
- £0.8m due to the fall in the risk margin due to a decrease in expense risk in the GCF;
- £1.6 million in respect of other small individual sources of surplus from a number of small improvements to best estimate assumptions;
- a strain of £1.5m from writing new business not on a profitable basis;
- a strain of £0.8m in the GCF from non-insurance expenses that are not reserved for; and
- the consolidation of the Guernsey general insurance business into the results (additional £4.1m Own Funds offset by £2.6m ring-fenced fund restriction).

Eligible Own Funds (£000s)	31/12/2015 (unaudited)	31/12/2016
Surplus Assets	**3,781**	**3,098**
Reconciliation Reserve		
Excess of assets over liabilities – UK insurance funds	20,499	24,935
Excess of assets over liabilities – Guernsey		4,105
Excess of assets over liabilities – UK Courts		90,344
Own shares (held directly and indirectly)	0	0
Foreseeable dividends, distributions and charges	0	0
Other basic own fund items	(3,781)	(3,098)
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring-fenced funds	0	(72,738)
Total Reconciliation Reserve	**16,718**	**43,546**
Other Own funds that do not meet the criteria to be classified as Solvency II own funds		**(741)**
Eligible Own Funds	**20,499**	**45,904**

Equity amount shown in financial statements

As a mutual insurer, the Society does not have any equity shown in its financial statements for comparison with the excess of assets over liabilities as calculated for solvency purposes.

Transitional arrangements

The Society does not have any basic own fund items subject to the transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC (for businesses that ceased to write new insurance contracts prior to 1 January 2016).

Ancillary own funds

Ancillary own funds consist of items other than basic own funds which can be called up to absorb losses and may comprise the following items:

(a) unpaid share capital or initial fund that has not been called up,
(b) letters of credit and guarantees,
(c) any other legally binding commitments received.

The Society does not have any items of ancillary own funds and has not sought approval from the PRA to recognise any ancillary own funds.

Items deducted from own funds

The Society does not have any items deducted from own funds for participations in financial and credit institutions.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The amounts of the Society's SCR and Minimum Capital Requirement (MCR) as calculated by the Society and submitted to the PRA are shown below at the reporting date and for the previous year, together with the level of capital coverage.

Note that the final amount of the SCR may change as a result of supervisory assessment.

SCR and MCR (£000s)	31/12/2015 (unaudited)	31/12/2016
Solvency Capital Requirement (SCR) – UK insurance funds	15,246	12,470
Solvency Capital Requirement (SCR) - Guernsey		1,420
Solvency Capital Requirement (SCR) - UK Courts		20,290
Solvency Capital Requirement (SCR)	**15,246**	**34,181**
Minimum Capital Requirement (MCR)	5,918	8,545
Total eligible own funds to meet the SCR	**20,499**	**45,904**
Total eligible own funds to meet the MCR	20,499	45,904
Ratio of Eligible own funds to SCR	**134%**	**134%**
Ratio of Eligible own funds to MCR	346%	537%

Movement in SCR over the reporting period

The key reason for the increase in the SCR from £15.2m to £34.2m is the inclusion of the UK Courts (additional £20.3m) and Guernsey (additional £1.4m). There has been a reduction in the UK insurance funds SCR from £15.2m to £12.5m in 2016 for the following reasons:

- decrease of £0.1m for the OIF caused by a £0.4m fall in market risk due to the de-risking carried out in the year, offset by an increase in lapse risk from an increase in the value of long dated guarantees due to the fall in the yield curve;
- decrease of £0.4m in the PEF reflecting both the de-risking carried out in the year and the increase in discretionary benefits in the fund being able to absorb risks;
- market risk for the non-profits funds decreasing by £1.6m primarily due to the investment de-risking carried out in the year;
- insurance risk for the non-profits funds falling by £2.5m due to:
  - a decrease in mortality risk under the life catastrophe stress as the reinsurance coverage was extended to provide benefit, although this was partially offset by new Group Schemes increasing the level and duration of the catastrophe risk;
  - expense risk also decreasing significantly partly due to holding more index linked investments and partly due to lower assumed future expenses; and
- default risk for the non-profits funds increasing by £0.8m partly due to taking credit for the reinsurance arrangements but was mainly due to improved modelling of the split of default risk between funds and updating bank credit ratings.
- the consolidation of Guernsey increases the SCR by £1.4m and the Courts by a further £20.3m.

Movement in MCR over the reporting period

The linear MCR is a function of:

- best estimate liabilities and capital at risk on protection business; and
- best estimate liabilities and written premium on general insurance business.

This amount has increased from £5.9m to £6.8m over 2016, mostly due to the increase in capital at risk for Group schemes, with only £0.1m of the increase due to inclusion of the Guernsey general insurance business.

The absolute floor of the MCR is set in Euros and has increased from £2.7m to £5.6m due to the weakened value of the pound (€:£ moved from 0.7182 to 0.9005) and the inclusion of the general insurance business (Life €3.7m + General €2.5m).

Overall the actual MCR has increased by £2.6m from £5.9m to £8.5m due to the increase in SCR from including the court business. The increase in the SCR increased the floor by £4.7m from £3.8m to £8.5m.

Minimum Capital Requirement (£000s)	31/12/2015 (unaudited)	31/12/2016
Linear MCR	5,918	6,806
SCR	15,246	34,181
MCR cap	6,861	15,381
MCR floor	3,811	8,545
Combined MCR	5,918	8,545
Absolute floor of the MCR	2,657	5,583
Minimum Capital Requirement	**5,918**	**8,545**

SCR components by risk type

The SCR risk module components using the Standard Formula approach as at 31/12/2016 are as follows (gross of management actions):

	Gross Solvency Capital Requirement (£000s)
Market risk	35,541
Counterparty default risk	3,754
Life underwriting risk	5,942
Health underwriting risk	3,474
Non-life underwriting risk	0
Diversification	(8,878)
Intangible asset risk	0
Basic Solvency Capital Requirement	**39,833**
Calculation of Solvency Capital Requirement	
Adjustment due to RFF/MAP nSCR aggregation	2,485
Operational risk	1,073
Loss-absorbing capacity of technical provisions	(9,211)
Loss-absorbing capacity of deferred taxes	0
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0
Solvency Capital Requirement excluding capital add-on	**34,181**

Simplified calculations

The Society has not used any of the simplified calculations permitted within the risk modules and sub-modules of the Standard Formula, but has used a simplified method for calculation of the risk margin as described in section D.2.

Undertaking Specific Parameters (USPs)

The Society has not used any undertaking-specific parameters pursuant to Article 104(7) of Directive 2009/138/EC.

Non-disclosure

The PRA has opted to allow non-disclosure of any capital add-on or the impact of undertaking-specific parameters, as provided for in the third subparagraph of Article 51(2) of Directive 2009/138/EC for a transitional period ending no later than 31 October 2017.

The Society has not applied to the PRA for any such non-disclosure permission.

The Society has not been informed of any capital add-on to be applied to its SCR, nor has it been instructed to use any undertaking-specific parameters in accordance with Article 110 of Directive 2009/138/EC (where the Standard Formula is deemed not to be appropriate).

Minimum Capital Requirement

The inputs used to calculate the Society's Minimum Capital Requirement (MCR) are as follows:

- medical expenses benefits;
- with-profit guaranteed benefits;
- with-profit discretionary benefits;
- unit-linked liabilities;
- other liabilities;
- capital at risk for all life obligations; and
- medical expenses written premiums.

The medical expenses written premiums are taken from the Society's income statement and apart from the capital at risk, all the other above inputs are all best estimate liabilities (BELs) taken directly from the Solvency II balance sheet.

A linear MCR is calculated by applying given factors to each of the five inputs. The MCR is then restricted by a cap and a floor, being 45% and 25% of the SCR respectively, with an absolute floor of €3.7m (Euros).

The capital at risk is the difference between guaranteed benefits and the associated technical provisions and has two elements:

Death capital at risk
This is dominated by Group Schemes which account for around £3.6bn of the total death capital at risk (note that a £10m increase in the technical provision would only reduce the capital at risk from £3.6bn to £3.59bn).

Disability capital at risk
The disability capital at risk for individual sickness policies is calculated assuming that claims are paid for the maximum claim period or until the policy end date, whichever occurs first. This adds approximately £30m to the capital at risk and so is immaterial.

Group Scheme disability capital at risk is more complicated, due to the fact that a life can be covered for different benefits which cannot be paid simultaneously. For example, life cover cannot be claimed at the same time as critical illness benefits, as critical illness cover is a survival benefit. Therefore, simply totalling the total sums assured may overstate the capital at risk.

Additional data would be required to determine the disability capital at risk for Group Schemes accurately, e.g. sickness cover may be provided at 50% of gross salary after a 26 week deferred period, but exact details of the current salaries of the lives covered are not held. Data on these variable coverages is not recorded consistently.

Given these limitations, the approach is to use the capital at risk reported from the Group administration system, which resulted in a total death and disability capital at risk for the Society of £6.6bn at the end of 2016.

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

The Society has not taken up the option set out in Article 304 of Directive 2009/138/EC to use the duration-based equity risk sub-module for the calculation of its SCR.

E.4 Differences between the Standard Formula and any Internal Model used

The Society is not using an internal model to calculate its SCR, as it has demonstrated that the Standard Formula is appropriate given the nature, scale and complexity of the Society's insurance business.

E.5 Non-compliance with the MCR or SCR

The Society has complied with both its MCR and SCR throughout 2016 and remains compliant at the reporting date of 31 December 2016.

E.6 Any other information

There is no other material information to disclose regarding the capital management of the Society.

Appendix I. Table of Abbreviations

BEL	Best Estimate Liability
BBNI	Bound But Not Incepted
BRCC	Business Risk and Compliance Committee
CFO	Chief Financial Officer
CMI	Continuous Mortality Investigation
CPI	Consumer Prices index
CRO	Chief Risk Officer
CTF	Child Trust Fund
EIOPA	European Insurance and Occupational Pensions Authority
EPIFP	Expected Profit Included in Future Premiums
FRS	Financial Reporting Standards
GBF	Group Business Fund
GCF	Group Capital Fund
GSP	Guaranteed Savings Plan
IBNR	Incurred but not reported
IFA	Independent Financial Advisor
ISA	Individual Savings Account
KRI	Key Risk Indicator
LF	Leek Fund
MCR	Minimum Capital Requirement
NPF	Non Profit Fund
OIF	Order Insurance Fund
ORSA	Own Risk and Solvency Assessment
PEF	Pure Endowment Fund
POIS	Post Office Insurance Society
PPFM	Principles and Practices of Financial Management
PPP	Prudent Person Principle
PRA	Prudential Regulation Authority
R&CC	Risk and Capital Committee
RCSA	Risk and Control Self-Assessment
RFF	Ring Fenced Fund
RM	Risk Margin
RPI	Retail Prices Index
SCR	Solvency Capital Requirement
SFCR	Solvency and Financial Condition Report
SPV	Special Purpose Vehicle
TESP	Tax Exempt Savings Plan
TF	Tunstall Fund
ULAA	Unit-Linked Advisory Arrangement
USP	Undertaking Specific Parameters
WPAA	With-Profits Advisory Arrangement

Appendix II: Extract of QRT forms

These are shown in the attached pdf "SFCR Disclosures"