Foresters Friendly Society

Solvency and Financial Condition Report (SFCR) as at 31 December 2018

V4.0 16 May 2019

Contents

Summary **5**

A. Business and Performance **7**

A.1 Business 7

A.2 Underwriting Performance 9

A.3 Investment Performance 11

A.4 Performance of other activities 12

A.5 Any other information 14

B. System of Governance **15**

B.1 General Information on the System of Governance 15

B.2 Fit and Proper requirements 21

B.3 Risk management system 22

B.4 Internal control system 27

B.5 Internal Audit function 28

B.6 Actuarial function 28

B.7 Outsourcing 29

B.8 Any other information 29

C. Risk Profile **30**

C.1 Underwriting risk 33

C.2 Market risk 35

C.3 Credit risk 36

C.4 Liquidity risk 38

C.5 Operational risk 38

C.6 Other material risks 39

C.7 Any other information 40

D. Valuation for Solvency Purposes **41**

D.1 Assets 41

D.2 Technical provisions 44

D.3 Other liabilities 49

D.4 Alternative methods for valuation 49

D.5 Any other information 50

E. Capital Management **51**

E.1 Own funds 51

E.2 Solvency Capital Requirement and Minimum Capital Requirement 54

E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement 56

E.4 Differences between the Standard Formula and any Internal Model used 56

E.5 Non-compliance with the MCR or SCR 56

E.6 Any other information 56

Appendix I. Table of Abbreviations 57
Appendix II: Extract of QRT forms 58

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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 2018.

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 2018.

The Society has opted to not have the SFCR and accompanying QRT disclosures externally audited, in line with Policy Statement 25/18 published by the PRA on 17 October 2018. However, many of the underlying methods, assumptions, processes and controls used for the Solvency II valuation are also used for the UK GAAP valuation of technical provisions within the annual report and accounts, which is subject to external audit.

There have been a number of developments over 2018, these include:

- Launch of our new Junior ISA ("JISA") product for Foresters under the age of 18.
- Reprice of existing with-profits ISA, Bond and Tax Exempt Savings Plan products, to reduce the cost of the guarantees offered as part of these products.
- Acquisition of a significant group life scheme in the South of England, expecting to increase annual premium income by £700k.

More details of our strategic initiatives can be found in our annual report and accounts document, published on our website (www.forestersfriendlysociety.co.uk/about-us/reports-and-governance).

The 2018 year-end valuation shows that the Society is solvent with Own Funds of £44.6m (2017: £46.7m), with a capital coverage ratio ("CCR", Own Funds coverage of SCR) of 115% (2017: 121%).

The CCR for the UK Insurance Funds (excluding UK Courts and Guernsey ring-fenced funds) is 134% (2017: 156%), which is below the target CCR of 140%, but within the target range of 120%-170%.

The CCR for the Order Insurance Fund ("OIF") is 128% (2017: 143%) and outside the target range of 140%-200%. The negative asset share return of -3.1%, increasing the cost of guarantees, and new business strain has contributed to the fall in the CCR.

The Society will urgently investigate a number of capital optimisation options before half-year that will increase the CCR of the OIF but avoid any detrimental impact to member outcomes. These options include:

- rebalancing the invested assets to more closely match the liabilities of the fund, reducing market risk within the SCR; and
- further diversifying the invested assets to reduce the SCR associated with equity risk.

Section E provides further information on the change in the own funds as a percentage of the SCR.

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

(a) throughout 2018, 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 2018 Solvency and Financial Condition Report was approved by the Board on 11 April 2019 and authorised for issue.

On behalf of the Board:

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

A. Business and Performance

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

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 is consolidated within these financial statements.

The Insurance business is divided into two distinct parts:

- products available to individuals, either directly from the Society or via a 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 tax exempt regular 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.
With-Profits (Stocks & Shares) ISA	A flexible medium to long-term tax-free savings plan that 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.

Product	Description
Lifetime ISA (LISA)	A savings account that enables saving towards purchasing a first time buyer property with a value of less than £450,000; and/or to provide a method of saving for retirement. Contributions of up to £4,000 in each tax year are permitted and the government will add a bonus of 25% to member monies paid into the LISA.
Junior ISA (JISA)	A tax-free with-profits savings plan for the under 18s that can accept regular investments or one-off lump sum investments up to the maximum annual Junior 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-profits 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 tax exempt regular 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

The Society saw volatile markets in 2018, with large falls in equity markets over the fourth quarter. Whilst interest rates increased over 2018, bond yields remain historically very low.

The CCR for the Order Insurance Fund ("OIF") is 128% (2017: 143%) and outside the target range of 140%-200%. The negative asset share return of -3.1%, increasing the cost of guarantees, and new business strain has contributed to the fall in the CCR. The Society will urgently investigate a number of capital optimisation options ahead of half-year that increase the CCR of the OIF but avoid any detrimental impact to member outcomes.

A.2 Underwriting Performance

2018 Underwriting Performance

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

Technical Account: Long Term Business All figures in £'000	With-Profits	Unit-Linked	Non-Profits	Group Business	2018 Total	2017 Total
Earned premiums, net of reinsurance						
Gross premium written	8,417	5,670	134	13,374	27,595	26,869
Outward reinsurance premiums	(63)	-	-	(195)	(258)	(228)
Net premium written	**8,354**	**5,670**	**134**	**13,179**	**27,337**	**26,641**
Investment income	3,845	2,503	480	0	6,828	7,885
Net unrealised gains on investments	(6,446)	(5,809)	(407)	-	(12,662)	2,342
Total Technical Income	**5,753**	**2,364**	**207**	**13,179**	**21,503**	**36,868**
Claims incurred						
Gross claims payable	(10,917)	(8,731)	(103)	(10,287)	(30,038)	(29,226)
Change in other technical provisions						
Long term business provision						
- gross amount	6,498	-	2,090	(611)	7,977	1,068
- reinsurers' share	(24)	-	-	39	15	(95)
- net of reinsurance	6,474	-	2,090	(572)	7,992	973
Technical provisions for linked business						
- net of reinsurance	-	7,133	-	-	7,133	(1,478)
Net change	**6,474**	**7,133**	**2,090**	**(572)**	**15,125**	**(505)**
Other Expenditure						
Net operating expenses	(1,478)	(1,459)	(2,144)	(869)	(5,950)	(5,276)
Amortisation of PVIF	-	(700)	-	-	(700)	(210)
Investment expenses and charges	(180)	-	(597)	-	(777)	(779)
Fund transfer	625	-	(625)	-	-	-
Total Other Expenditure	**(1,033)**	**(2,159)**	**(3,366)**	**(869)**	**(7,427)**	**(6,265)**
Total Technical Charges	**(5,476)**	**(3,757)**	**(1,379)**	**(11,728)**	**(22,340)**	**(35,996)**
Surplus of technical income over technical charges	**277**	**(1,393)**	**(1,172)**	**1,451**	**(837)**	**872**
Transfer from/(to) Fund for Future Appropriations	(277)	1,393	1,172	(1,451)	837	(872)
Balance on Technical Account	**-**	**-**	**-**	**-**	**-**	**-**

Following the merger of the Non-Profit funds on 1 January 2018, Group Capital Fund results that were previously reported in the Non-Technical Account are now reported in the Technical Account. The table above reflects this change, with a restated prior year comparison.

There was a net transfer from the Fund for Future Appropriations ("FFA") of £0.8m over the reporting period (2017: £0.9m transfer to FFA). Profits from the group business has been offset by losses from individual business, which includes the Society's IT project costs over 2018 of £1.1m and expense overruns of £0.9m.

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

Technical Account: General Business All figures in £'000	2018 Total	2017 Total
Earned premiums, net of reinsurance		
Gross premium written	2,443	2,371
Investment income	129	123
Total Technical Income	2,572	2,494
Claims incurred		
Gross claims payable	(2,260)	(2,137)
Other Expenditure		
Net operating expenses	(151)	(160)
Total Technical Charges	(2,411)	(2,297)
Surplus of technical income over technical charges	161	197
Transfer from/(to) general business fund	(161)	(197)
Balance on Technical Account	-	-

There was a net transfer to the Fund for Future Appropriations (FFA) of £0.16m over the reporting period (2017: £0.20m).

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 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 All figures in £'000	2018 Total	2017 Total
UK long-term insurance business		
Investment income		
Income from property investments	349	399
Income from listed investments	5,214	5,226
Income from other investments	284	259
Gains/(Losses) on realisation of property investments	59	26
Gains/(Losses) on realisation of listed investments	922	1,975
Total investment income	**6,828**	**7,885**
Total unrealised gains/(losses) on investments	(12,662)	2,342
Total UK investment returns	(5,384)	10,227
Investment management expenses and charges	777	779
Guernsey medical expense insurance business		
Income from investments	129	123
Gains/(Losses) on investments	-	-
Unrealised gains/(losses) on investments	-	-
Total Guernsey investment returns	**129**	**123**

2018 saw turbulent market conditions with particularly poor investment returns in quarter four.

Securitisations

The Society does not hold any investments in securitisations.

A.4 Performance of other activities

Courts

The Society has 189 branches ('Courts') which are the local point of contact for members. The Courts have assets amounting to £83.1m (2017: £81.3m) and table below provides the allocation of these funds.

Allocation £'000	2018	2017
Court Investment Fund property	53,326	51,229
Leeds Investment Association deposits	10,918	10,193
Fixed interest	7,930	5,491
Derby Investment Association deposits	4,222	3,811
Locally managed property	2,981	3,036
CIF Cash and cash equivalents	1,351	3,387
Debtors	110	240
Guernsey insurance assets	(1,586)	(1,167)
Court Reserve Fund	(2,592)	(2,202)
Society Court Funds	**76,660**	**74,018**
Leeds Investment Association surplus assets	6,482	7,237
Consolidated Court Funds	**83,142**	**81,255**

The Society also manages a number of Discretionary Benefit Funds amounting to £13.5m (2017: £13.7m) 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 £8.4m (2017: £7.9m) 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 1974. 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.

Non-Profit Fund (NPF)

The Society's Non-Profit Fund (NPF) comprises those assets not allocated to any of the Society's with-profits, Court or Guernsey funds or and is available to support all other funds as the Board shall decide after taking advice from the Chief Actuary.

The NPF holds technical provisions which are included within the Technical Account of the Society's financial statements. The NPF technical provisions cover the Society's conventional non-profit and unit linked business, as well as expense liabilities that are not charged to other parts of the Society.

The NPF supports solvency 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 and the Discretionary Benefit Funds. The 'Society' column below consists of 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.

All figures in £'000s	2018		2017	
	Group	Society	Group	Society
Investment income				
Income from property investments	3,348	3,019	2,403	2,105
Income from listed investments	595	230	1,030	709
Income from other investments	72	0	145	52
Sub-total income	**4,015**	**3,248**	**3,578**	**2,866**
Gains/(losses) on the realisation of listed investments	(261)	(261)	(91)	(91)
Gains/(losses) on the realisation of property investments	4,844	4,852	158	167
Sub-total realised gains/(losses)	**4,583**	**4,591**	**67**	**76**
Court held assets:				
Income from property investments	146	146	142	142
Income from mainland Court investments	599	1,507	446	1,295
Other income – Courts	429	429	403	403
Gains/(losses) on realisation of investments	(22)	(22)	9	9
Sub-total Court-related investment income	**1,152**	**2,060**	**1,000**	**1,849**
Total Non-Technical investment income	**9,750**	**9,899**	**4,645**	**4,791**
Total Non-Technical unrealised gains/(losses)	**(5,086)**	**(4,162)**	**1,115**	**(77)**
Unrealised gains/(losses) on Court investments	**1,870**	**1,870**	**1,506**	**1,506**
Total Non-Technical investment returns	**6,534**	**7,607**	**7,266**	**6,220**
Non-Technical Investment management expenses and charges	**369**	**369**	**233**	**233**

Non-Technical Expenses

Non-Technical Account expenses of £369k (2017: £233k) relate to the investment costs of the Courts' investments.

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

B.1 General Information on the System of Governance

This section outlines how the Society is directed and controlled and provides an overview of the Society's 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 2018 was a mix of four Non-Executive Professional Directors, two Non-Executive Member Directors and three Executive Directors (the Chief Executive, Finance Director 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

Three Executive Directors were in post at the end of 2018: Paul Osborn (Chief Executive), Rachel Hardy (Finance Director) 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, Risk and Compliance Committee (ARCC)

The ARCC 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 ARCC 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.

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

The ARCC, 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 ARCC, 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 ARCC and on occasions, directly to the Board.

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, High Sub-Chief Ranger and members of the Membership Committee. It also makes recommendations to the ARCC 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, membership and Chairmanship of Sub-Committees, High Chief Ranger and High Sub-Chief Ranger.

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/fund-information). 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 Risk Officer (CRO)

The Risk Function is led by the CRO. The CRO is a senior role within the Society and is approved under the Senior Managers and Certification Regime (SM&CR). The CRO is a member of the Business Risk and Compliance Committee (BRCC) and reports directly to the Chief Executive, with a dotted line to the ARCC Chair. The CRO is supported by a Risk & Compliance Assistant.

The CRO provides independent 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. The role has responsibility for oversight of the Risk Management Framework and performance of the Society's Own Risk and Solvency Assessment (ORSA).

The CRO is invited to attend Board and Committee meetings where relevant and provides reports to the ARCC.

Chief Actuary (CA)

The CA is currently outsourced to Alexandra Kim Durniat, Partner, Insurance Actuarial Practice, of Barnett Waddingham LLP, with internal oversight provided by the Chief Finance Officer. The CA is a Fellow of the Institute of Faculty of Actuaries and holds a practising certificate and is approved under the SM&CR. The CA is supported by a team of qualified and part-qualified actuaries.

The CA 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 CA is invited to attend relevant Board and Committee meetings where relevant. 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.

Chief Compliance Officer (CCO)

Compliance Oversight is led by the CCO and is approved under the SM&CR. The CCO is a member of the BRCC and reports directly to the Chief Executive, with a dotted line to the ARCC Chair. The CCO is supported by a Risk & Compliance Assistant.

The CCO is appropriately skilled in respect of the regulatory environment, data protection, financial crime and monitoring. The CCO is also not involved in the day to day running of operations of the Society.

The CCO is invited to attend Board and Committee meetings where relevant and provides reports to the ARCC. 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.

Internal Audit Function

The Internal Audit Function is currently outsourced to Mazars LLP, who reports directly to the Chair of the ARCC. The ARCC has access to a wide skill set through the use of Mazars. 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 Chair of the ARCC 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 ARCC based on the results of the audit findings.

Changes to the system of governance in the reporting period

In May 2018 the in-house CA resigned and the role was subsequently outsourced.

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 Society monitors its gender pay gap.

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 consumer 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 membership and Chairmanship of Sub-Committees, 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. All bonus payments made by the Society to employees who are not Executive Directors are below 25% of base salary. Variable bonuses above 25% could only apply to Executive Directors.

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 CCO, CRO and CA do not participate in a substantial bonus scheme based on quantitative performance.

Material transactions

There have been no material transactions conducted during 2018 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 Responsibilities 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. Considerations will be made 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

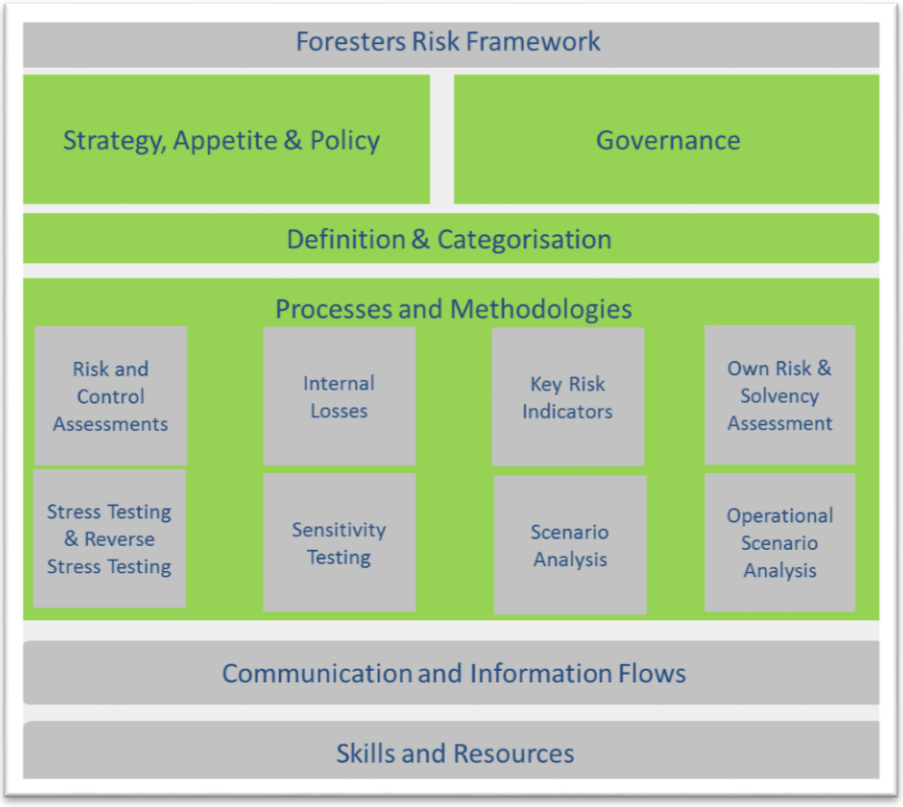
The outcome of any assessment would be reported to the Board with any actual and potential risks being reported to the CRO as part of the management of risks across the whole Society.

B.3 Risk management system

The Society's Board has ultimate responsibility for management of risk across the Society. The Board is responsible for approving the risk strategy and risk appetite for the Society, reviewing and approving the ORSA Report, ensuring an effective Risk Management Framework and Risk governance model is in place.

Risk Management Framework

The Society operates the below Risk Management Framework which brings together the risk management strategy, governance, processes and reporting.



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

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.

Key areas of the Society's risk management framework are described below.

Risk Strategy

The Society's risk strategy is intended to have a lifespan of three to five years and is aligned with the business strategy. By acting in accordance with the following high level preferences, the aim is to enhance overall capital efficiency and returns:

- Foresters is a Friendly Society in the business of taking on risks in the course of providing financial solutions for members, where they can be managed efficiently.
- Foresters will focus on risks where it is believed it can provide value to members, and for which members are willing to pay the appropriate amount. These are primarily insurance and investment risks.
- As a Friendly Society, risks are only taken that are rewarded being commensurate with the risk, and where the appropriate skills are available to manage this. Risks that expose the Society to very volatile or extreme potential outcomes which would threaten the Society's ability to continue are avoided.

Risk Appetite and Limits

The Society's risk appetite supports the delivery of the risk strategy. It is the level of risk the Society is prepared to take whilst pursuing its business strategy. The risk appetite is determined by the Board. The Board also determines the risk tolerance from the stated risk appetite which provides a framework to apply risk limits and actions. Management monitors the Society's risk profile against the risk appetite and reports this to the Board.

Risk Policies

The Society has in place risk policies that set out the requirements for the management of the Society's risks along with the risk management framework. These policies are reviewed on an annual basis.

Risk Identification, Monitoring and Reporting

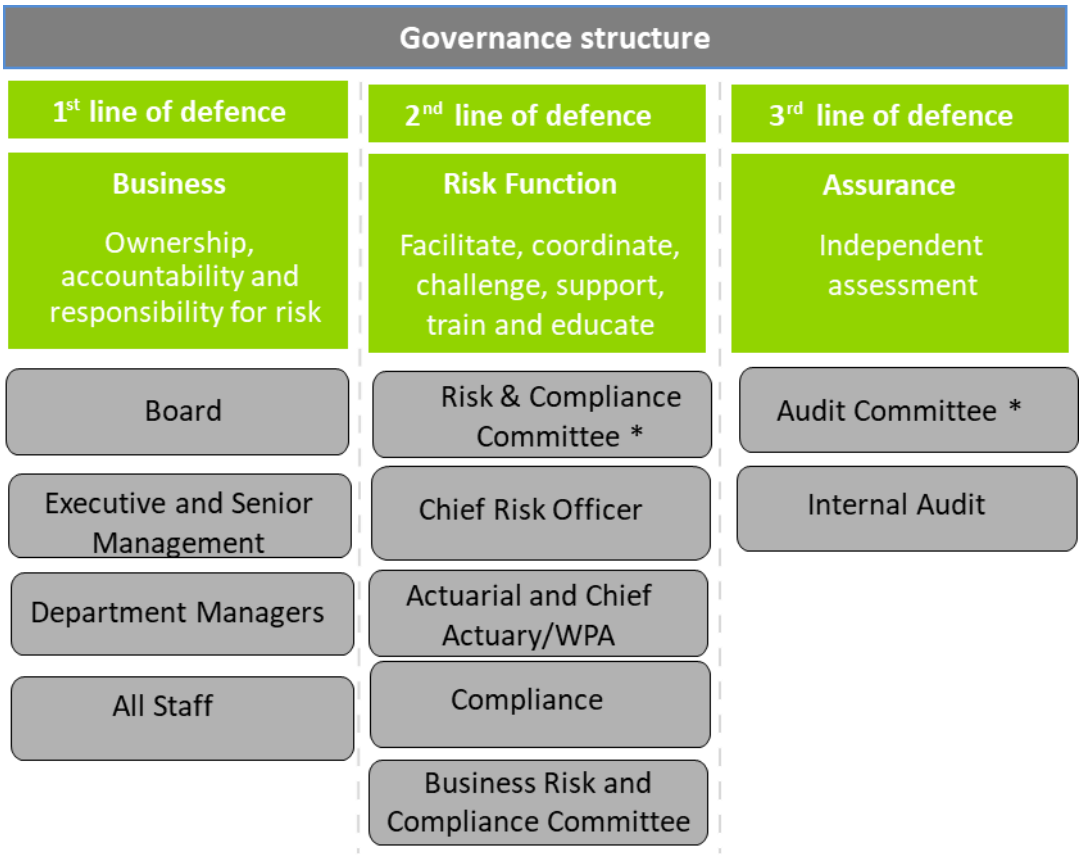
The Risk function maintains the risk management system and oversees the implementation of requirements of the risk framework. All material risks are identified, assessed and monitored. A Risk and Control Assessment process is in place supported by identification of risks through stress testing for financial risks, business risks and insurance risks. Individual risks are assigned to and owned by a specified individual within the Society.

All risks identified are assessed against a matrix for probability of occurrence and financial and non-financial impact. Emerging risks are also identified and monitored and are part of the risk reporting process.

The BRCC assess the top risks on a quarterly basis and report change in Risk exposures to the ARCC.

Risk Governance

The Society's risk 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.



The combined Audit, Risk and Compliance Committee separates Risk and Audit related matters by segregating the agenda to ensure clarity on risk and audit areas, and ensuring the Non-Executive Director members taken together have the appropriate skills to address both Risk and Audit matters

The responsibilities of the key functions within the three lines of defence model are explained in the Key Functions part of Section B.1.

Own Risk and Solvency Assessment (ORSA)

A key element of the Society's Risk Management Framework is the ORSA. The ORSA 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. 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.

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.

ORSA Processes

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:

- Review and approval of the ORSA Policy;
- Providing a steer on the design and content of the ORSA process;
- Setting the Risk Appetite;
- Challenging risk identification and mitigation;
- 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 and risk exposure;
- 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;
- Other qualitative assessment on a longer term horizon.

Stress and Scenario Testing

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. These scenarios cover areas such as a market collapse, 'Bad' Brexit, a pandemic, sales and profitability challenges. This allows the Board to review and challenge the Business plan on a forward looking basis. 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. Qualitative scenarios are also considered on Cyber Security threats and Brexit implications.

Reverse stress tests are considered to identify and assess the scenarios most likely to cause the current business model to fail and/or lead its stakeholders to lose confidence in the organisation. Mitigating actions can be considered and put in place as appropriate. During 2018 the Society considered a number of extreme operational events, pandemic sickness scenario, a new global economic crisis, civil unrest in Northern Ireland in relation to the Society's group scheme.

ORSA Communication

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.

Frequency of the ORSA

The ORSA process is undertaken on an annual basis aligned to the Strategy and Business Planning process to ensure informed risk and capital based decisions are made to protect the sustainability and long-term viability of the Society.

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;
- Collapse of financial markets;
- Significant strategic projects.

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 2019, 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 the symmetric adjustment, instead of the less onerous transitional stress test (transition has been removed from 2018 year-end reporting);
- 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 yields are based on the yield down curve specified in the EIOPA Insurance Stress Test 2018 Technical Specifications as this is considered to be more onerous than the Standard Formula Interest Rate down shock.

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 ARCC, 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's internal control system aims to ensure financial reports are reliable, the society operates effectively and efficiently and our activities comply with applicable laws and regulations.

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 ARCC 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 ARCC 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 framework for the documentation and oversight of annual and periodic policy reviews.

The Society has no appetite for regulatory breaches. 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 Chief Compliance Officer who also performs the roles of the Money Laundering Reporting Officer and Data Protection Officer. The Chief Compliance Officer reports directly to the Chief Executive and a dotted line to the Chair of the ARCC. The Chief Compliance Officer is supported by a Risk & Compliance Assistant.

External resource is used to provide expertise as required. The Compliance Manager is invited to attend Board Sub-Committee meetings where relevant and provides information and reports to the ARCC on key regulatory areas.

The annual Compliance Plan is approved by the ARCC 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;

- monitor and challenge the behaviours and controls in place to promote the compliance culture; and
- maintain the Society's Responsibilities Map.

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 Chief Compliance Officer 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. The Internal Audit function report directly to the Chair of the ARCC. The ARCC review and approve the annual internal audit plan. 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 have unlimited access to the Society's information and premises to allow them to carry out their role effectively.

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. No direct responsibility for operational activities are held by the internal audit function.

B.6 Actuarial function

The Society has an in-house actuarial team led by the Head of Actuarial. The Society outsources the Chief Actuary role to Kim Durniat of Barnett Waddingham. The Head of Actuarial and Chief Actuary report to the Finance Director.

The Chief Actuary is responsible for the work of the Actuarial function, particularly in respect of:

- the calculation of technical provisions;
- the appropriateness of the methodologies and underlying models used, as well as the assumptions made in the calculation of technical provisions;
- assessment of the sufficiency and quality of data used in the calculation of technical provisions;
- comparison of best estimates against experience;
- inform the Society's governing body of the reliability and adequacy of the calculation of the technical provisions;
- express an opinion on the overall underwriting policy and adequacy of reinsurance arrangements of the Society;
- contribute to the effective implementation of the risk management system through advice and guidance and in particular with respect to the risk modelling underlying the calculation of the Solvency Capital Requirement and Minimum Capital Requirement and to the Society's ORSA.

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 Responsibilities Map together with the Key Function Holder with oversight for each Key Function:

Key Outsourced Function	Senior Manager / Key Function Holder
Internal Audit	ARCC Chair
Chief Actuary	Finance Director
With-Profits Actuary	Finance Director
IT and associated systems (infrastructure and hosting)	Chief Executive
Investment Managers and Property Managers	Finance Director
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. The Society remains ultimately responsible for the oversight, performance and service provided by the outsourced function.

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

The most significant risks to the Society are all captured under the Solvency II Standard Formula stress tests used to determine the SCR. The table below sets out 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 2018:

Capital requirement at 31/12/2018 (£m)					
Risk	**Insurance Funds**	**Guernsey**	**UK Courts**	**Total**	**Proportion of total (%)**
Property	-	0.7	16.0	16.7	33.4
Equity	4.6	0.6	5.5	10.7	21.3
Expense & inflation	5.0	-	-	5.0	10.0
Morbidity	3.5	-	-	3.5	7.0
Spread (Credit)	2.9	-	-	2.9	5.7
Lapse	2.2	-	-	2.2	4.4
Counterparty Default	0.6	0.0	1.2	1.8	3.6
Mortality Catastrophe	1.8	-	-	1.8	3.5
Mortality	1.3	-	-	1.3	2.6
Operational	1.1	0.1	-	1.2	2.3
Longevity	0.8	-	-	0.8	1.6
Morbidity Catastrophe	0.7	-	-	0.7	1.4
Currency	0.7	-	-	0.7	1.3
Interest rate	0.5	0.0	-	0.5	1.0
Premium & Reserve Risk	-	0.4	-	0.4	0.8
Concentration	0.0	0.0	0.0	0.0	0.0
Total pre-diversification	**25.5**	**1.8**	**22.8**	**50.1**	**100.0**
Diversification*	(8.9)	(0.4)	(1.9)	(11.2)	
Total post-diversification	**16.6**	**1.5**	**20.8**	**38.9**	

**Includes restriction on Loss Absorbing Capacity of Technical Provisions of £0.3m*

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

The table below compares the Society's capital requirements at the end of 2018 and 2017:

Capital requirements by risk type (£m)	2018	2017	Movement
Property	16.7	16.4	0.3
Equity	10.7	11.7	(1.0)
Expense & inflation	5.0	3.0	2.0
Morbidity	3.5	4.5	(1.0)
Spread (Credit)	2.9	2.5	0.3
Lapse	2.2	1.7	0.4
Counterparty Default	1.8	3.0	(1.2)
Mortality Catastrophe	1.8	0.8	1.0
Mortality	1.3	1.4	(0.1)
Operational	1.2	1.5	(0.3)
Longevity	0.8	1.2	(0.4)
Morbidity Catastrophe	0.7	0.5	0.2
Currency	0.7	0.6	0.1
Interest rate	0.5	0.7	(0.2)
Premium & Reserve Risk	0.4	0.4	0.0
Concentration	0.0	0.0	0.0
Total pre-diversification	**50.1**	**49.9**	**0.2**
Diversification	(11.2)	(11.4)	0.2
Total post-diversification	**38.9**	**38.5**	**0.4**

The main changes over the year are summarised below.

- Expense and inflation risk – increased over the year by £2.0m, primarily due to a methodology change to how this capital requirement is calculated.
- Counterparty default risk – reduced over the year by £1.2m, primarily due to an internal reallocation of funds held by the Society.
- Equity risk – reduced over the year by £1.0m, due to a drop in equities held by the Courts, together with a fall in the equity stress from the symmetric adjustment; offset by an increase in equity capital within the insurance funds, from a higher allocation to equities within the Order Insurance Fund and the implementation of a new cost of guarantees model. The Society has chosen to no longer take credit for the equity transitional stress from this valuation.
- Mortality catastrophe risk – increased over the year by £1.0m, the addition of a new Group scheme has led to an increase in this risk. The level of catastrophe reinsurance cover has remained constant over 2018.
- Morbidity risk – reduced over the year by £1.0m, primarily due to the run-off of capital as Group schemes come closer to their renewal dates.

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 in 2018 remained the same as 2017 levels. Reinsurance cover is approved by the Board. 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 Risk Information pack supplied to the ARCC.

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 as part of the ORSA to identify and qualitatively 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 key risks and identify trends to support risk reporting and escalation.

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 number of sensitivity tests used in 2018 increased to support the Board review of the annual business plan, these sensitivities explored impacts to changes in levels of sales, expenses, asset values and group scheme claim pay outs.

The ORSA process carried out during 2018 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 2017. 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 sensitivity results concluded a 10% equity fall and 25% increase in volatility would have relatively little impact on the Pillar 2 economic capital coverage. This is because OIF has sufficient capital cushion to withstand these market falls and the ring-fenced fund deduction simply reduces.

A 30% equity fall would have the largest impact although not as significant as the 2017 ORSA (25% last year compared to 5% this year). This is due to future bonuses under this scenario have been set to zero as a management action following a significant market shock to avoid further exposure to market risk. This will result in a lower cost of guarantees which reduces the adverse impact on liabilities and capital coverage. This management action was not carried out in the past which exacerbated the reduction on capital coverage. In addition, closed with-profit funds may require additional support from NPF to meet capital requirements where they have limited discretionary benefits to absorb the significant market shock. This is true for Tunstall in all scenarios and for the OIF under the 30% equity fall.

The capital coverage would remain above the capital target level of 140%. The 30% equity fall where the capital coverage ratio is 141% is marginally above the capital target. This is based on the economic capital position as at 31 December 2017. The changes made to the valuation methodology and assumptions over 2018 means the stressed CCR position would be lower.

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 expenses, morbidity and mortality.

Expense risk

The Society holds £5.0m (2017: £3.0m) of capital against expense and inflation risk before taking risk diversification into account. The capital held in respect of this risk has increased over the year due to a change in methodology for assessing the capital requirement.

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.

Disability/Morbidity risk

The Society holds £3.5m (2017: £4.5m) of capital against disability/morbidity risk before taking risk diversification into account. The capital requirement

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.

Lapse risk

The Society holds £2.2m (2017: £1.7m) of capital against lapse risk before taking risk diversification into account. The capital held in respect of this risk has increased over the year due to a change in methodology for assessing the capital requirement.

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 policies and sickness policy liabilities, with little impact on other policy liabilities.

Mortality Catastrophe risk

The Society holds £1.8m (2017: £0.8m) of capital against mortality catastrophe risk before taking risk diversification into account. This has increased due to the acquisition of a new Group scheme, whilst maintaining the same level of catastrophe reinsurance cover.

Mortality 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 mortality catastrophe risk for the Society relates to Group business which is partially mitigated by catastrophe reinsurance.

Mortality risk

The Society holds £1.3m (2017: £1.4m) 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.

Longevity risk

The Society holds £0.8m (2017: £1.2m) of capital against longevity risk before taking risk diversification into account. The capital requirement has fallen over the year due to the recognition of future expected surrenders and an increase in risk-free rates has reduced the capital held against this risk.

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-profits funds and guaranteed annuity rates on pension policies.

Morbidity Catastrophe risk

The Society holds £0.7m (2017: £0.5m) of capital against morbidity catastrophe risk before taking risk diversification into account. This has increased over the year due to a correction in Group scheme data, provided as part of a scheme renewal over 2018.

Morbidity 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 (2017: £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.

Property risk

The Society holds £16.7m (2017: £16.4m) of capital against property risk before taking risk diversification into account, nil (2017: £0.6m) in the UK insurance funds, £0.7m (2017: £0.6m) in Guernsey and £16.01m (2017: £15.1m) in the UK Courts funds. The UK insurance funds have no property risk capital as previously held investments were transferred to the UK Courts and investment in new property funds had not yet commenced.

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 £66.8m as at 31/12/2018 (2017: £71.3m).

Equity risk

The Society holds £10.7m (2017: £11.7m) of risk capital against equity risk before taking risk diversification into account, £4.6m (2017: £3.1m) in the UK insurance funds, £0.6m (2017: £0.8m) in Guernsey and £5.5m (2017: £7.8m) 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 (2018: £48.3m, 2017: £44.6m).

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 are designed to maintain the current risk profile in line with the fund objectives declared to policyholders.

Currency risk

The Society holds capital of £0.7m (2017: £0.6m) against currency risk before taking risk diversification into account. This is all within the UK insurance funds.

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 2018, as in 2017, 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 31/12/2018 is mostly in respect of the £7.3m (2017: £6.6m) 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).

Interest rate risk

The Society holds £0.5m (2017: £0.7m) of risk capital against interest rate risk before taking risk diversification into account. A fall in interest rates is the most onerous scenario for the Society. The capital requirement has fallen over 2018 due an increase in fixed interest holdings, leading to a better matched position.

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.

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.

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 £1.8m (2017: £3.0m) of capital against the risk of counterparty default before taking risk diversification into account, £0.6m (2017: £1.8m) in the UK insurance funds and £1.2m (2017: £1.2m) in the UK Courts, via the Court Investment Fund portfolio.

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 has fallen over the year and due to a reallocation of funds with significant reduction in cash balances as at 31/12/2018 (2018: £4.1m, 2017: £25.9m, all rated 'BBB' or above).

Spread risk

The Society holds £2.9m (2017: £2.5m) of capital against spread risk before taking risk diversification into account, £2.9m (2017: £2.1m) in the UK insurance funds and nil (2017: £0.5m) 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.

UK Government bonds are exempt from spread risk capital under Solvency II regulations, so no spread risk capital is held. The Society does not hold any securitisations.

The Society's holdings of corporate bonds are predominantly within the with-profits funds and invested as part of with-profits investment strategies.

Concentration risk

This risk is not material for the Society and a trivial amount of capital is held (2018: £0.0m, 2017: £0.0m).

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 ring-fenced fund results in a capital requirement, although in some cases the monetary amount of the holding may be relatively small.

C.4 Liquidity risk

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

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.

In accordance with Article 260(2) of the Solvency II Delegated Acts, the Expected Profit Included in Future Premiums (EPIFP) has been calculated as £2.9m as a 31/12/2018 (2017: £3.0m). 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.

C.5 Operational risk

The Society holds £1.2m (2017: £1.5m) of capital against operational risk before taking risk diversification into account, £1.1m (2017: £1.4m) in the UK insurance funds and 0.1m (2017: £0.1m) in the Guernsey Court.

Operational risk is the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events. The Society accepts that operational risks will occur in the normal course of business, but manages the risks within its framework.

The Society uses the standard formula approach for calculating its exposure to operational risk for Pillar 1 reporting.

The most material operational risks that the Society is exposed to are:

- Cyber Security threats, data security risks and internal or external financial crime impacting on members and reputation.
- IT system instability, leading to system outages, system interruptions, resulting in not being able to meet customer demand or expectations.
- Business disaster from external threats resulting in the inability to continue critical functions and business processes after the occurrence of a disaster, impacting on members of the Society.
- Risk of regulatory breaches either current regulation or regulatory developments not executed adequately.
- Conduct risk of not treating members fairly for new business or legacy books containing multiple issues by ineffective controls being in place.
- Process failures from administrative errors, unit pricing errors and investment administration errors.

All operational risks are assessed through the Society's Risk and Control assessment process, review of internal operational risk event data, Key Risk Indicator trends and expert judgement. Risks are assessed from a financial and non-financial impact and follow the Society's categorisation model to ensure risks are assessed in line with the risk management framework. The Internal Audit function review operational related risks as part of the annual audit plan and report key findings to the ARCC. Audit findings are used to assess the control effectiveness and design held within the Society's Risk and Control assessments.

The Society monitors its operational losses through its loss reporting and assessment of the control environment, governance structures are in place to manage the Society within its operational risk appetite.

Scenario based risk assessments are used in the Society's ORSA, with plausible but extreme adverse scenarios being constructed to assess the likelihood and impact of the extreme event. The Society currently has 15 operational risk scenarios. A simple statistical method is used to fit a Log-Normal distribution to this data to determine capital requirements for these risks at a 99.5% confidence level.

For further information on the Society's risk framework see section B3.

C.6 Other material risks

In addition to the risks identified above, the Society is also exposed to a number of other risks for which it does not hold capital as it is not the most appropriate mitigant. The most material of these risks are: business risk, strategic risk, and reputational risk. These risks are detailed below.

Business Risk

Business Risk is the risk arising from changes to the business, including the inability to carry out the Business Plan and desired strategy. This is considered as part of the business planning and reverse stress testing processes.

The Society does not hold capital in respect of new business risks, as the potential impact on capital resources in excess of capital requirements has not been considered significant. As part of the Society's ORSA process sensitivities and scenarios were assessed in terms of new business sales, increasing new business is key to the long term viability of the Society.

A 50% reduction in OIF sales was modelled along with sensitivities in respect of 20% more sales than plan and 20% less sales than plan. As a result of these sensitivities and scenarios actions were developed along with increased monitoring of overall sales plans, and sales results including volume, mix and profitability has been implemented.

Strategic Risk

Strategic risk is the risk of not achieving the strategic plan as a result of internal or external factors that serve to undermine either the strategy itself or its execution. Strategic risk is a function of the incompatibility of two or more of the following components:

1) The Society's strategic goals,
2) The business strategies developed,
3) The resources deployed to achieve these goals,
4) The quality of implementation and the situation of the markets the Society is operating in.

Strategic risks are identified by the Board in setting the Society's strategy, the business planning process and the ORSA process which will then form part of the Society's overall risk assessment. For each strategic risk the correlation between these risks and other material risks are considered. For each strategic risk, associated controls and actions are to be identified and monitored. Strategic risks are identified through the Society's Risk and Control Assessment process.

Any strategic risk that is outside of management tolerance should be escalated to the ARCC through the risk reporting process. If the risk is of a significant nature, the ARCC should be informed by the CRO or CEO as soon as appropriate to do so.

The current main strategic risk for the Society is the delivery of the IT project (replacement policy administration system). A risk assessment specifically for the IT project has been developed and is monitored on an ongoing basis.

Reputational Risk

Reputational risk is the risk of loss resulting from damage to a firm's reputation, which may include lost revenue or increased operating, capital or regulatory costs, consequent to an adverse or potentially criminal event, even if the company is not found guilty. Reputational risk is a risk in its own right but may also arise as a consequence of the crystallisation of other risks.

Reputational risk is effectively managed through business controls, including but not restricted to appropriate recruitment and vetting procedures and a suitable business culture and ethos, supplemented by effective media relations and communications activity.

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 an economic value basis.

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

£000s	2018	2017
Total Assets	266,818	279,409
Total technical provisions	(137,367)	(151,744)
Total other liabilities	(5,147)	(4,319)
Excess of assets over liabilities	124,304	123,345

D.1 Assets

All material asset classes have been valued in accordance with the Solvency II regulations and are therefore recognised at economic value. The asset values at 31 December 2018, and comparatives at 31 December 2017, are shown below:

All figures in £'000s	2018		2017	
	Solvency II value	UK GAAP value	Solvency II value	UK GAAP value
Goodwill	0	0	0	700
Pension benefit surplus	220	362	318	419
Property, plant & equipment held for own use	101	51	133	82
Investments (other than assets held for index-linked and unit-linked contracts)	**222,999**	**220,388**	**213,553**	**209,310**
Property (other than for own use)	66,831	66,881	71,294	71,346
Holdings in related undertakings, including participations	0	0	10	10
Equities	**42,162**	**46,988**	**39,849**	**43,129**
Equities – listed	42,162	46,988	39,849	43,129
Equities - unlisted	0	0	0	0
Bonds	**102,253**	**100,939**	**90,715**	**89,558**
Government Bonds	51,330	51,063	43,110	42,839
Corporate Bonds	50,723	49,876	47,605	46,719
Structured Notes	200	0	0	0
Collective Investments Undertakings	11,396	5,580	11,155	5,268
Derivatives	0	0	0	0
Deposits other than cash equivalents	356	0	530	0
Other investments	0	0	0	0
Assets held for index-linked and unit-linked contracts	**30,961**	**30,748**	**38,118**	**37,881**
Loans and mortgages	**111**	**111**	**200**	**200**
Loans on policies	57	57	61	61
Loans and mortgages to individuals	53	53	88	88
Other loans and mortgages	0	0	51	51
Reinsurance recoverables	**40**	**40**	**25**	**25**
Insurance and intermediaries receivables	1,614	1,614	1,514	1,514
Receivables (trade not insurance)	1,550	3,100	1,314	2,942
Cash and cash equivalents	9,222	10,765	24,234	27,371
Any other assets, not elsewhere shown	0	0	0	0
Total assets	**266,818**	**267,180**	**279,409**	**280,445**

The table below provides a reconciliation between the UK GAAP and Solvency II value of assets at the valuation date. Other in-line differences in the balance sheets are presentational.

All figures in £000s	2018	Comments
UK GAAP value of assets	**267,179**	
Prepayments	(220)	See explanation below: "Receivables (trade not insurance)".
Pension scheme valuation	(142)	See explanation below: "Pension benefit surplus".
Solvency II value of assets	**266,818**	

For 2017 year-end, the difference in the value of assets also included the goodwill relating to the Society's interest in the expected cash flows of the in-force business associated with the Post Office Insurance Society acquisition in 2014. The goodwill within the 2018 year-end accounts has now been fully amortised.

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. Properties held for operational purposes are valued at least annually on an existing use value basis by qualified external professional valuers.

Property asset values have been determined by reference to present and future income flows based on current day values supported by market evidence. In addition, lease terms, floor areas and enquiries within the market place have also been factored in.

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.

Deposits with credit institutions are carried at their historical cost as the economic value equals the fair value since 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 currently invest in derivative contracts.

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 from 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. These are held at fair value which may include a provision for impairment where they are past their due date.

Receivables (trade not insurance)

Prepayments to the value of £220k (2017: £230k) 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.

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 IAS 19 / IFRIC 14 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, but the difference in value is not material at £142k (2017: £101k).

Valuation in financial statements

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 BEL is 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 2018, with comparative figures at 31 December 2017, are as follows:

£000s	2018			2017		
	Best Estimate	Risk Margin	Total	Best Estimate	Risk Margin	Total
Technical provisions						
Health (similar to non-life)	262	28	**290**	257	28	**285**
Health (similar to life)	1,754	814	**2,568**	2,730	873	**3,602**
Life (excluding health and index-linked and unit-linked)	103,381	2,494	**105,875**	110,309	1,809	**112,118**
Index-linked and unit-linked	28,490	144	**28,633**	35,557	181	**35,738**
Total technical provisions			**137,367**			**151,744**

With-Profits Funds

The best estimate liabilities (BEL) consist of asset shares plus the cost of guarantees less the present value of future charges, net of future expenses, on accumulating with-profits business only, 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 newly developed stochastic model is used to calculate the cost of guarantees for all with-profits business. The model projects a large number of future economic scenarios and investment returns, to determine the expected cost of the guarantees provided by the Society. The economic scenarios and the distribution of returns is based on observed market data, where available, and assumptions regarding the volatility of property and corporate bonds assets, and the correlation of returns between the asset classes modelled.

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-profits 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 incurred but not reported ("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-profits 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 Non Profit Fund.

The Society's approach to setting the best estimate basis for lapse and paid-ups is to generally use the same shape as the previous best estimate basis but to revise 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 2018 was published by EIOPA in the first week of January 2019 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 emerge as an experience variance over time.

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 2018 is £4.01m (2017: £3.82m) compared to a Solvency II technical provision of £0.29m (2017: £0.36m).

The pension benefit surplus has been revalued using the IAS 19 / IFRIC 14 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, with an immaterial resulting difference in value. The value under IAS 19 / IFRIC 14 is £0.22m compared to £0.36m in the Reports and Accounts.

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 equity risk sub-module (Article 308b)
(iv) the transitional measure on risk-free interest rates (Article 308c)
(v) 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 £9m in excess of £0.5m (unchanged over 2018). The risk is split equally between HCC International Insurance Company plc and TransRe London Limited.

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 net reinsurance recoverable is £205k (2017: £228k).

The small element of counterparty default risk from the reinsurance 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 provisions calculation at 31 December 2017 are:

- implementation of a new cost of guarantees valuation model; and
- economic assumptions have been updated to 31 December 2017.

D.3 Other liabilities

Other liabilities of the Society at 31 December 2018, with comparatives at 31 December 2017, were as follows:

£000	2018		2017	
	Solvency II value	UK GAAP value	Solvency II value	UK GAAP value
Other technical provisions	-	2,588	-	2,296
Provisions other than technical provisions	2,392	-	2,128	-
Pension benefit obligations	-	-	-	-
Payables (trade not insurance)	2,755	2,711	2,191	2,191
Total other liabilities	**5,147**	**5,299**	**4,319**	**4,488**

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 5-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 2018.

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 2018.

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 the notional SCR for these funds. The restrictions as at 31 December 2018 are as follows:

2018 (£000s)	Excess of Assets over Liabilities	Notional SCR	Excess assets less SCR	Restricted Own Funds
OIF	7,376	5,760	1,616	1,616
PEF	0	9	(9)	-
TF	0	373	(373)	-
LF	(55)	20	(74)	-
POIS	0	81	(81)	-
Guernsey Court	4,404	1,469	2,934	2,934
UK Mainland Court	95,950	20,824	75,126	75,126
Total				**79,676**

The Leek fund has an excess of liabilities over assets which is supported by the Non Profit Fund. In the PEF, Tunstall and POIS funds, any surplus arising is fully distributed to policyholders' asset share through adjustments to the discretionary benefits before the allocation of operational risk at a fund level. The allocation of operational risk in these funds has given rise to the negative excess assets shown in the table above.

The equivalent position as at 31 December 2017 is shown below:

2017 (£000s)	Excess of Assets over Liabilities	Notional SCR	Excess assets less SCR	Restricted Own Funds
OIF	6,761	4,737	2,024	2,024
PEF	0	10	(10)	-
TF	0	172	(172)	-
LF	(57)	25	(81)	-
POIS	12	101	(89)	-
Guernsey Court	4,332	1,588	2,744	2,744
UK Mainland Court	93,428	22,271	71,156	71,156
Total				**75,924**

Movements in Own Funds

The figures below show a fall in eligible own funds of £2.1m over 2018, from £46.7m to £44.6m. This is due to a number of offsetting factors, listed below:

- £1.6m increase from Group scheme profits;
- £1.3m increase from changes in best estimate assumptions, primarily due to a reallocation of costs within the Society into the OIF; offset by
- £1.5m reduction from adverse variances within the year, primarily driven by project costs that are not reserved for;
- £1.4m reduction in Courts SCR, reducing the amount of eligible own funds recognised in respect of the Courts;
- £1.2m strain from writing new business;
- £1.0m paid into the OIF as part of the compensation settlement; and
- a number of smaller but offsetting items.

Eligible Own Funds (£000s)	2018	2017
Surplus Assets	7,376	6,761
Reconciliation Reserve		
Excess of assets over liabilities – UK insurance funds	23,951	25,586
Excess of assets over liabilities – Guernsey	4,404	4,332
Excess of assets over liabilities – UK Courts	95,950	93,428
Own shares (held directly and indirectly)	-	-
Foreseeable dividends, distributions and charges	-	-
Other basic own fund items	(7,376)	(6,761)
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring-fenced funds	(79,676)	(75,924)
Total Reconciliation Reserve	**37,252**	**40,661**
Other Own funds that do not meet the criteria to be classified as Solvency II own funds	**-**	**(698)**
Eligible Own Funds	**44,628**	**46,724**

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)	2018	2017
Solvency Capital Requirement (SCR) – UK insurance funds	16,632	14,665
Solvency Capital Requirement (SCR) - Guernsey	1,469	1,588
Solvency Capital Requirement (SCR) - UK Courts	20,824	22,271
Solvency Capital Requirement (SCR)	**38,925**	**38,525**
Minimum Capital Requirement (MCR)	12,270	11,364
Total eligible own funds to meet the SCR	**44,628**	**46,724**
Total eligible own funds to meet the MCR	44,628	46,724
Ratio of Eligible own funds to SCR	**115%**	**121%**
Ratio of Eligible own funds to MCR	364%	411%

Movement in SCR over the reporting period

There has been little change in the overall SCR over the year (£400k increase). However, there are a number of offsetting movements and these are discussed below.

An increase in the UK insurance funds SCR of £1.9m, from £14.7m to £16.6m, as a result of:

- Increase of £1.0m in SCR for the OIF, primarily caused by a change in the equity markets trigger level, below which point equities are sold to protect the Society from further equity downside exposure, and from negative investment returns over 2018, increasing the SCR contribution from the cost of guarantees.

- Increase of £0.8m in SCR for the Non Profit Fund, primarily from a change in methodology for assessing expense risk.

A reduction in the UK Courts SCR of £1.5m, from £22.3m to £20.8m, primarily due to lower value of property assets and a lower equity stress due to the symmetric adjustment.

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.

The MCR has increased by £0.9m over 2018, from £11.4m to £12.3m, driven by an increase in the linear MCR. The linear MCR has increased over 2018 due to the acquisition of a new Group scheme, increasing the capital at risk element of the MCR calculation.

The absolute floor of the MCR is set in Euros (Life €3.7m + General €2.5m), and it has broadly remained unchanged at £5.5m.

The table below sets out the high-level calculation of the MCR. Further detail can be found within the accompanying QRTs.

Minimum Capital Requirement (£000s)	2018	2017
Linear MCR	12,270	11,364
SCR	38,925	38,525
MCR cap	17,516	17,336
MCR floor	9,731	9,631
Combined MCR	12,270	11,364
Absolute floor of the MCR	5,510	5,447
Minimum Capital Requirement	**12,270**	**11,364**

SCR components by risk type

The SCR risk module components using the Standard Formula approach as at 31/12/2018 are set out in the table below. The SCR components shown within the table are gross of loss absorbing capacity of technical provisions, with the loss absorbency allowed for as an end-piece adjustment. This presentation is consistent with the QRTs that accompany this report.

£000s	Gross Solvency Capital Requirement	
SCR components by risk type	**2018**	**2017**
Market risk	37,663	40,931
Counterparty default risk	1,908	3,534
Life underwriting risk	7,579	5,626
Health underwriting risk	4,004	5,191
Non-life underwriting risk	-	-
Diversification	(9,013)	(9,742)
Intangible asset risk	-	-
Basic Solvency Capital Requirement	**42,142**	**45,539**
Calculation of Solvency Capital Requirement		
Adjustment due to ring-fenced fund aggregation	5,771	3,252
Operational risk	1,165	1,475
Loss-absorbing capacity of technical provisions	(10,153)	(11,742)
Loss-absorbing capacity of deferred taxes	-	-
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	-	-
Solvency Capital Requirement excluding capital add-on	**38,925**	**38,525**

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-profits guaranteed benefits;
- with-profits 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 €5.2m (Euros).

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

- death capital at risk; and
- disability capital at risk.

The capital at risk is associated with the Group business (2018: £14.1bn, 2017: £13.2bn) and is the major contributor to the Society's MCR.

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 2018 and remains compliant at the reporting date of 31 December 2018.

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

ARCC	Audit Risk and Compliance Committee
BEL	Best Estimate Liability
BBNI	Bound But Not Incepted
BRCC	Business Risk and Compliance Committee
CA	Chief Actuary
CIF	Court Investment Fund
CCO	Chief Compliance 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
FD	Finance Director
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
JISA	Junior ISA
KRI	Key Risk Indicator
LF	Leek Fund
LISA	Lifetime ISA
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
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
SM&CR	Senior Managers and Certification Regime
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"