# Solvency & Financial Condition Report (SFCR)

For the year ended 31 December 2018

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# Summary

This is the Society's Solvency Financial Condition Report (SFCR) based on the financial position as at 31 December 2018.

## Business and Performance

Despite 2018 proving to be a challenging year across the industry, the Society continued to grow, seeing total assets increase to a record high, with the highlights of our year as follows:

- Total assets increased by 4% to a record £144.3 million
- Traditional premium income received was £16.8 million
- 1,614 new policies were opened
- Traditional membership increased by 3% to 11,635
- Including the Child Trust Fund we now have 78,953 policies and accounts

The Society seeks to attract members by demonstrating higher potential investment returns over the life of a policy and aims to retain them through a combination of performance, following high standards of ethics and principles, and delivering consistently high levels of personal service. The Society has a three-strand distribution model, which can be summarised as follows:

- Intermediaries - Financial Adviser advised and non-advised sales and non-advised referrals
- Direct - Internet applications, local Heartland advertising and newspaper editorials
- Social Proof - Member referrals (Tell-a-Friend), Advocates, Community Fund, Social Media

The Society's key strategic priorities are as follows:

- Meet its contractual obligations to policyholders
- Deliver higher potential returns over the life of a policy
- Maintain a healthy free asset ratio

As the Society is a mutual, and has no shareholders to satisfy, any surplus profits achieved are redistributed to our members by way of bonuses, ensuring that our members remain our sole focus.

## System of Governance

Authorised by the Prudential Regulation Authority, and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, the Society recognises the importance of strong corporate governance, ensuring that a well-established governance framework, internal controls, and committee structure are maintained at all times. The Society seeks to adopt the highest standards of corporate governance for its size and complexity and has adopted the Annotated Version of the UK Corporate Governance Code for Mutual Insurers.

The Society's governing body is its Committee of Management (the "Committee"). The Committee is appointed and elected in accordance with the Society's Rules. The Rules also set out the provisions to appoint a Chairman, Vice-Chairman, Trustees, Chief Executive and other officers, as set out in the Society's Management Responsibilities Map. The system of governance is discussed in greater detail under section B.

## Risk Profile

The Society's principal activity is the provision of long-term savings, investment and protection policies to its members, with over 15,000 policies (excluding CTF) in force at the end of 2018. The risk profile of the Society has not materially changed over the past 12 months.

The Committee is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives and the Committee seeks to adopt a low-to-medium risk appetite in accordance with the scale and nature of the Society's business. The main risks to the Society are insurance, market, liquidity and operational risk, which are discussed in greater detail in section C. These risks are quantified and accounted for within the Society's Solvency Capital Requirement (SCR), as detailed in Section E.

## Valuation for Solvency Purposes

The Society is now well into the Solvency II era, with the valuation as at the 31 December 2018 being the third valuation under the regulatory regime.

For Solvency II purposes, the asset valuation differs to that as shown in the annual report and accounts using UK GAAP and this can be summarised as follows:

| Reconciliation of assets (£000) | 2018 | 2017 |
|---|---|---|
| Total value of assets for SII purposes | 144,166 | 137,979 |
| Add property acquisition expenses | 2 | 342 |
| Add website development costs | 6 | 13 |
| Add tangible fixed assets on a cost basis | 58 | 44 |
| Add prepayments and recharges | 24 | 28 |
| Add software development | 50 | - |
| **Total assets shown in the report & accounts** | **144,306** | **138,406** |

## Capital Management

The Society's capital management plan extends to having appropriate procedures in place to correctly identify and manage the components of its funds and to maintain sufficient capital to ensure long term solvency and the protection of members' investments. The Society reviews, as part of its regular ORSA process, the current and likely future capital position of the business and whether there is a material risk that its solvency may be threatened. In the event that the Society's projected solvency position is at risk, defined as not having sufficient capital resources to cover the SCR, then the Society will draw up appropriate plans to rectify that position.

The Society's Solvency II capital position can be summarised as follows:

| | 2018 | 2017 |
|---|---|---|
| Own funds | 14,768 | 17,154 |
| Less: SCR | (9,735) | (10,526) |
| Surplus funds | 5,033 | 6,628 |
| *Solvency Ratio* | *152%* | *163%* |

Section E covers the Society's Capital Management Plan in more detail.

## Other Information

After changes to the PRA regulation, the SFCR document is no longer externally audited.

# A. Business and Performance

## A.1 Business

The address of the registered office is:

3 Maple Park, Maple Court
Wentworth Business Park
Tankersley, Barnsley
South Yorkshire
S75 3DP

Sheffield Mutual is an unincorporated registered friendly society, authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

The PRA can be contacted at:

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

The FCA can be contacted at:

Financial Conduct Authority
24 The North Colonnade
London
E14 5HS

The Society's updated mission statement is: "To provide a friendly alternative to bank and building society savings accounts; by delivering greater potential returns through transparent and high performing products, an excellent and personal member service and by being one of the most trusted and secure friendly societies in the UK."

The Society's updated vision is: "To be the UK's most trusted and member focussed independent mutual friendly society."

Sheffield Mutual is a member-owned mutual, providing long-term largely with-profits insurance products predominantly to middle market customers residing in the UK. This core activity is supplemented by the provision of unit linked CTF accounts to a mainly HMRC allocated customer base.

The Society strives to be efficient relative to its scale and this is achieved through robust cost management. The pursuit of controlled growth and consistent investment yields are seen as key drivers of sustainability and stability in terms of ongoing financial strength. This financial strength is augmented by a mutual model, which allows the Society to distribute surplus profit to members by way of policy bonuses.

The Society's business strategy is fully reviewed and re-defined on a three yearly basis. The strategy review is facilitated by an expert third party and is approved by the Committee of Management. An interim review and reaffirmation of the strategy takes place on an annual basis.

The external auditors for the Society are BHP LLP (2 Rutland Park, Sheffield, S10 2PD).

## A.2 Underwriting Performance

During 2018 the Society looked to achieve a sustainable level of controlled growth. Investor confidence however appeared to be low in the face of the uncertainty surrounding 'Brexit', in addition to other geo-political factors which shook global stock markets, particularly in October 2018. With this in mind, the Society experienced a fall in the Society's traditional premium income from £19.7 million to £16.8 million. However, given the increasing levels of premium income received by the Society in recent years, we still believe that this is a satisfactory outcome.

Subscriptions and transfers to the Investment ISA continued to be the driving force behind the Society's premium income, totalling almost two thirds of the total premium income.

Regular premiums amounted to £3 million, mainly due to the attractive Tax Exempt Savings Plan, for which we remain among the top performers.

Investment and Income Bonds accounted for almost 17.5% of the total premium income, a slight fall on 2017 which saw higher than normal levels due to the limited availability 'Loyalty Bond' offer.

Despite achieving a lower level of premium income during 2018, the Society still achieved respectable growth, with over 800 new members and an overall increase in the Society membership of 3%.

The Committee declared annual policy bonuses worth in excess of £1.5 million for members in 2018 and all with-profits bond, ISA and endowment policies had their interim bonus rates declared in full. The Committee also maintained final bonus rates on bonds encashed after five years, maintained the final bonus rates on maturing regular premium endowments, extended the qualifying final bonus years for the Investment ISA and extended final bonus payments for Junior ISAs, which have been in force for at least five years.

During 2018, claims incurred remained at a similar level to the prior year, increasing by 2%. Maturing endowment policies saw an expected increase of over 20% compared to 2017. ISA withdrawals saw an increase of over 18%. Again, this was anticipated as the ISA book continues to grow. Death benefits and surrendered policies fell by 42% and 27% respectively.

The Solvency II Quantitative Reporting Template (QRT) S.05.01.02 (section H) presents a tabulated version of the Society's underwriting performance, entitled 'Premiums, claims and expenses by line of business'.

A summary of the transfer to the fund for future appropriations is provided below:

| | 2018 £ | 2017 £ |
|---|---|---|
| Single premium income | 13,552,047 | 16,551,624 |
| Regular premium income | 3,248,175 | 3,110,634 |
| Investment and other income | 4,924,361 | 4,594,312 |
| Unrealised investment gains | 100,584 | 7,293,526 |
| Total Income | 21,825,167 | 31,550,096 |
| Claims incurred | (5,312,072) | (5,204,555) |
| Acquisition, administrative expenditure and taxation | (1,631,613) | (1,616,291) |
| Realised losses on disposal of investment properties | (62,862) | - |
| Unrealised losses on investments | (9,287,057) | (620,964) |
| Change in long term business provisions | (8,204,154) | (22,167,844) |
| Transfer to / (from) Fund for Future Appropriations | (2,672,591) | 1,940,442 |

Members and Policies

The following tables show how membership has developed in recent years:-

| Year Ending | Number of Members (Excl. CTF) | Number of Policies (Excl. CTF) |
|---|---|---|
| 31.12.16 | 10,678 | 13,654 |
| 31.12.17 | 11,294 | 14,837 |
| 31.12.18 | 11,635 | 15,604 |

| Year Ending | Number of New Members (Excl. CTF) | Number of New Policies (Excl. CTF) |
|---|---|---|
| 31.12.16 | 1,130 | 1,915 |
| 31.12.17 | 1,092 | 1,996 |
| 31.12.18 | 833 | 1,614 |

| Year Ending | Number of New CTF Accounts | Number of CTF Accounts |
|---|---|---|
| 31.12.16 | 9 | 63,612 |
| 31.12.17 | 13 | 63,480 |
| 31.12.18 | 9 | 63,349 |

## A.3 Investment Performance

The Society maintains a diversified portfolio, which is well positioned to deal with the market risks and volatility, whilst also benefiting from any future gains. The year end balances of the Society's investment assets are as follows:

| | 2018<br>£ | 2017<br>£ |
|---|---|---|
| Land and buildings | **37,651,800** | 38,842,270 |
| Listed investments (excluding CTF) | **57,758,760** | 48,447,806 |
| Mortgages on land and buildings | **971,250** | 971,250 |
| Bank and money market deposits | **2,504,682** | 2,451,870 |
| | **98,886,492** | 90,713,196 |
| Unit linked assets - CTF | **38,976,683** | 42,387,596 |
| | **137,863,175** | 133,100,792 |

The growth in business resulted in a 4% increase in total assets at the end of the year to a record £144.3 million (2017: £138.4 million).

The Society's listed investments are managed professionally by Investec Wealth & Investment Ltd in accordance with a Committee approved mandate. The Society invested new money of £8.6 million through Investec in 2018 and after adjusting for the new money added during the year the portfolio, now totalling £46 million, produced a total annual loss after charges (including income) of 4.4%. The Society paid a total of £156,011 relating to Investec's investment management fees in 2018 (£124,799 in 2017).

An additional £1 million investment was made during 2018 into the Fidelity Emerging Markets fund and a further £2.5 million was invested into a new investment for the Society; the Global Special Situations fund, managed by Fidelity, in order to complement the Society's existing overseas holding. After a decline in global stock markets during Q4 2018, the Emerging Markets fund stood at £6.2 million and the Global Special Situations fund stands at £2.4 million.

During 2018 the Society disposed of three of its commercial properties to consolidate the portfolio. The Society now owns 42 geographically diversified commercial properties, generating stable rental yields, with a total value of circa £37.7 million.

Last year the Society reported an initial £2 million investment in the Schroder UK Property Fund in order to diversify the property portfolio by increasing exposure to the London and the South East and in 2018 we invested a further £1.5m. At the end of the year this fund had returned 4.46%, with a total value of £3.6 million. The Society paid a total of £5,899 (£7,984 in 2017) relating to Schroders investment management fee.

Taking into account the overall performance of the direct portfolio and UK Property Fund combined, the Society managed to achieve a healthy 6% return. The Society paid a total of £49,871 relating to property related fees in 2018 (£39,679 in 2017).

The poor stock market performance resulted in a net unrealised loss of £9.2 million for the year as illustrated below:

| | 2018 £ | 2017 £ |
|---|---|---|
| Net unrealised gain / (loss) on investment properties | (142,270) | (604,856) |
| Net unrealised gain on revaluation of fixed assets | 25,000 | - |
| Net unrealised gain / (loss) on UK Real Estate Fund | 75,584 | (16,108) |
| Net unrealised gain / (loss) on listed investments | | |
| -With Profits | (4,730,977) | 2,962,107 |
| -Unit Linked | (4,413,810) | 4,331,419 |
| | (9,186,473) | 6,672,562 |

The Society's available capital decreased from £17.2 million to £14.8 million with a solvency ratio of 152%; thereby maintaining a strong financial base. The Society's investment and other income (including realised gains and losses) was £4.86 million and after taking account of the unrealised losses the overall return on the non-CTF assets for the year was -0.47%.

Our investment advisers believe that market performance will improve in 2019, with an end to the Brexit uncertainty potentially leading to a 'Brexit bounce'. The Committee will continue to manage the potential volatility by focusing on quality, balance and diversity when making investment decisions. The Committee makes investment decisions for the long-term and, whilst remaining alert to short-term market volatility, we are focussed on maintaining consistent returns and the security of our members' funds. Despite a less favourable year for our investment portfolio, through the process of smoothing, combined with effective cost control, we are able to declare the interim annual bonuses on all policy types for 2018. We are also boosting pay-outs to members through the payment of improved final bonuses where appropriate.

The next table shows the asset split of the Society's investment fund at the end of 2018, with previous years' figures for comparison purposes. This table excludes Child Trust Fund investments, which are part of a separately managed Unit Linked fund.

| | | 2018 % | 2017 % | 2016 % |
|---|---|---|---|---|
| Property | | 41.59 | 45.01 | 48.76 |
| Mortgages on land and buildings | | 0.98 | 1.07 | 1.48 |
| Listed investments: | - equities | 27.15 | 25.86 | 25.61 |
| | - fixed interest | 25.43 | 22.39 | 17.75 |
| | - alternative assets | 2.33 | 2.97 | 3.32 |
| Cash (excluding current account funds) | | 2.52 | 2.70 | 3.08 |
| | | 100.00 | 100.00 | 100.00 |

## A.4 Performance of Other Activities

All activities are included within Sections A.2 and A.3.

## A.5 Any Other Information

All relevant and material items are covered in Sections A.1 – A.3.

# B. System of Governance

## B.1 General Governance Structure

The Society is governed by its Rules and the main governing body is the Committee of Management, which is constituted and elected in accordance with the procedures as laid down in the Rules. The detailed procedures and policies for the Committee of Management are set out in the Society's Committee Manual.

The Society seeks to adopt the highest standards of corporate governance for its size and complexity and has adopted the Annotated Version of the UK Corporate Governance Code for Mutual Insurers with its 'comply or explain' regime.

In 2018 the Committee comprised of the non-executive Chairman, two Trustees, five other non-executive members and two executive members (Chief Executive and Finance Director). The Committee determines the strategic direction of the Society and reviews its operating and financial position. The Committee met on ten occasions during 2018 and there is a schedule of regular reports and information, which they consider at the meetings and which is agreed annually. Reports are provided to the Committee in advance of each meeting. The Chief Executive is responsible for carrying out the agreed strategy and the day to day running of the Society and there is a clear division of responsibilities between the roles of the Chief Executive and Chairman.

There are certain decisions that are reserved for the Committee and these include:

- declaration of annual bonus rates
- acquisition/disposal of significant assets
- committee succession planning
- approval of the annual report and accounts
- approval of the Own Risk and Solvency Assessment (ORSA)
- remuneration policy

The Chairman is responsible for ensuring that members of the Committee receive accurate, timely and clear information in order to discharge their duties effectively and the Society's Secretary is responsible for ensuring good information flows within the Committee and between senior management and the Committee. The roles of Chief Executive and Secretary should ideally be split, but the Committee is confident that it receives good information flows, guidance and support, and believes that the cost of employing a separate Secretary would not at this stage be an appropriate use of funds. The Committee and Sub-Committee can also obtain assistance from the executive team and other staff members if required.

## Senior Managers and Certification Regime (SM&CR)

On 10 December 2018 the Senior Managers & Certification Regime (SM&CR) replaced the Senior Insurance Managers Regime (SIMR), which resulted in a number of updates to the roles and responsibilities of the Committee of Management.

The Chief Executive is responsible for allocating each of the SM&CR prescribed responsibilities to one or more approved persons in accordance with the PRA Rulebook (Insurance – Allocation of Responsibilities).

The Society has appointed the following SM&CR functions in accordance with the PRA Rulebook (Insurance – Senior Manager Functions):

- Chief Executive function (SMF1)
- Chief Finance function (SMF2)
- Chairman function (SMF9)
- Chairman of Risk Committee function (SMF10)
- Chairman of Audit Committee function (SMF11 - effective 1 Jan 19)
- Chairman of With-Profits Advisory Arrangement function (SMF15)
- Compliance oversight function (SMF16)
- Money Laundering Reporting Officer function (SMF17)
- Chief Actuary function (SMF20)
- With-Profits Actuary function (SMF20a)

The above are the key functions the Committee has discussed and agreed as effectively running the Society.

The Society has identified that the following are also key functions, as these are functions whose operation, if not properly managed and overseen, could potentially lead to significant losses being incurred, or to a failure in the ongoing ability of the Society to meet its obligation to policyholders:

- IT Infrastructure Support
- Investment Management

Oversight of the above key functions is carried out by one of the Society's internal SM&CR function holders.

It is the Society's policy, in accordance with its Rules to appoint a Vice-Chairman rather than a Senior Independent Director (SID). Notwithstanding this, it is the role of the Vice Chairman to carry out the annual appraisal of the performance of the Chairman.

## Finance & Risk Sub-Committee - FRSC (Until 31 Dec 2018)

Throughout 2018 the Society had a FRSC, which met monthly and comprised of the two Trustees, the Society's Chairman and one other Committee member by rotation, plus the Chief Executive and Finance Director. Matters which were dealt with by this Sub-Committee were occasionally discussed by the full Committee depending upon the timing of meetings. The Sub-Committee was not chaired by the Society's Chairman and the position of Sub-Committee Chairman was rotated between the Trustees on a bi-annual basis. The Sub-Committee's main responsibilities were:

- to review monthly Income & Expenditure
- to review the Balance Sheet on a quarterly basis
- to consider and review recommendations from, and performance of, the Society's investment managers and agree sales, purchases and investment mandates as necessary
- to monitor the Society's property portfolio and agree sales and purchases within delegated limits
- to monitor the Society's risks, ensuring that they are managed effectively
- to monitor outstanding audit observations, ensuring that any recommended actions are carried out

The above Sub-Committee was in place until 31 December 2018, however from 1 January 2019 the Sub-Committee was split into two separate committees: the Finance & Investments Sub-Committee and the Audit & Risk Sub-Committee. It is expected that these Sub-Committee's will enhance independence in communication and oversight particularly around the internal and external audit process.

## Finance & Investments Sub-Committee – FIC (From 1 Jan 2019)

The Sub-Committee's main responsibilities and composition are largely similar to those of the previous FRSC but for clarity are outlined below. The Sub-Committee will meet on at least 11 occasions during the year and will consist of the two Trustees, the Society's Chairman and one other Non-Executive Committee member by rotation, plus the Chief Executive and Chief Operating Officer. The Sub-Committee will not be chaired by the Society's Chairman and the position of Sub-Committee Chairman will be rotated between the Trustees on a bi-annual basis. The Sub-Committee's main responsibilities are:

- to review monthly Income & Expenditure and budget performance
- to review the Balance Sheet on a quarterly basis
- to consider and review recommendations from, and performance of, the Society's investment managers and agree sales, purchases and investment mandates as necessary
- to monitor the Society's property portfolio and agree sales and purchases within delegated limits

## Audit & Risk Sub-Committee – ARC (From 1 Jan 2019)

This Sub-Committee will monitor and act as the risk management function and provide oversight of the Society's financial reporting process and internal controls. It will comprise of at least three non-executive members and will meet on at least three occasions during the year. Executives will attend by invite only. The Sub-Committee will not be chaired by the Society's Chairman and the position of Sub-Committee Chairman should be held by a member having an accountancy qualification. The Sub-Committee's main responsibilities are:

- to review the external auditor's qualifications, independence and performance
- to review the integrity of the Society's financial statements
- to monitor the performance of the Society's outsourced internal audit function
- to review the Society's internal accounting and financial controls
- to review the selection and formal tendering process for internal auditor and external auditor, as required
- to manage the Society's risk position

## Remuneration Policy

The approach to remuneration is designed to ensure that the Society can attract, retain and motivate people with the necessary skills, experience and qualities to run the Society prudently and effectively.

The overriding principle of the policy is to ensure that remuneration arrangements are aligned to the long-term objectives of the Society and that there are no remuneration arrangements that would adversely affect the financial (solvency) position of the Society and / or the Society's risk profile.

The Committee is sensitive to pay and employment conditions elsewhere, although does not fully assess remuneration levels relative to other organisations, preferring instead to act with an element of independence. It may use annual remuneration data provided by the Association of Financial Mutuals, or any other such organisation, as a comparable measure, to ensure salaries and fees remain attractive. It may also seek independent third-party advice periodically.

Incentives are provided to staff members including the executive team through discretionary bonus schemes. The policy is to ensure that the maximum pay-outs that are available under the scheme are modest in relation to basic salaries and that they are structured with a balanced set of indicators, so as not to encourage risk taking or other behaviours and conflicts of interest that are not in the best interests of the Society and its members.

The remuneration of the executive team and staff is reviewed on an annual basis, with amendments made to job descriptions as deemed appropriate. The bonus schemes are also reviewed annually against the key indicators set and amended if appropriate. The remuneration of the Non-executives is reviewed on a triennial basis.

The Society has no formal redundancy policy, preferring to deal with situations individually as and when they arise. No termination payments would be made in excess of an employee's statutory or contractual rights.

Remuneration arrangements with service providers are simple and transparent, and do not encourage risk taking.

Currently the Remuneration Sub-Committee is inactive and its duties and responsibilities are discharged by the full Committee of Management. The decision not to have a separate committee is based on the Society's risk profile and lack of complexity in its operations.

## B.2 Fit and Proper Policy

The aim of the fit and proper test is to prevent unsuitable people from serving on the Society's Committee of Management, performing a controlled function or performing an outsourced key function (actuarial, compliance, internal audit and risk management). The Society carries out these tests and enquiries as part of the recruitment / appointment process.

The Society uses information from various sources to carry out the checks. If any applicant fails to pass the fit and proper test, the Society will not appoint them. An existing appointment will be terminated immediately if information comes to the Society's attention which casts doubt on the person's suitability to carry out the controlled function. The Society's secretary would be responsible for notifying the regulator in these circumstances.

Existing Committee of Management members and key function holders are required to complete an annual 'fit and proper person' declaration, which ensures that any matters that should be brought to the Society's attention are properly disclosed, in order to assess their continuing fitness and proprietary.

Where the Society replaces a key function holder because they are considered no longer to be fit and proper, the Society's Secretary will notify the regulator as soon as reasonably practicable.

## B.3 Risk Management System Including the Own Risk and Solvency Assessment (ORSA)

The Society aims to employ proportionate tools and techniques, for a firm of its size, to enable it to deliver its objectives in a controlled manner. The oversight and direction of the Committee remains central to risk management and it ensures, through the Finance & Risk Sub-Committee (FRSC) (Audit & Risk Committee – ARC - from 1st January 2019), that appropriate policies, procedures and processes are implemented across the business to control and monitor both the actual and potential risk exposures which arise from the Society's operations. The Committee ensures exposed risks are aligned to the Society's risk appetite and that any unacceptable risk exposures are identified and either terminated or where appropriate mitigated.

In addition to the ongoing assessment of known risk exposures, the executive team monitor external and emerging risks within the Society's forward-looking Risk Matrix, which is reviewed by the FRSC / ARC on a quarterly basis. The Committee has an open communication culture that promotes the immediate escalation of actual or emerging risks. The Committee is ultimately responsible for the Risk Management Framework and defines, through its Risk Appetite Statement, the acceptable levels and types of risk exposure that it considers likely to arise in the delivery of its strategic objectives.

If any significant risks emerge the Matrix will be submitted more frequently, or in extreme circumstances, a special meeting of the FRSC / ARC would be convened. Risks which could threaten the Society's business model are assessed, managed and mitigated through a process known as reverse stress testing. The full Committee is provided with an Annual Risk Analysis, which summarises the Society's principal risks and how they are managed and mitigated. The ORSA is also central to the risk management framework.

Whilst general risk oversight and direction is delivered through the FRSC / ARC, which meets monthly, the day-to-day risks within the business are managed by the executive team.

The Society has adopted and is continually developing a 'Three Lines of Defence' approach to its operational implementation of the Risk Management Framework. The Three Lines of Defence approach simplifies and clarifies the varying roles and responsibilities of staff as follows:

### First line of defence – Operational Management

Operational Management is in the best position to assess risk exposures and is fully responsible for the risks our operations create. Ongoing oversight is provided through the executive team.

### Second line of defence – Committee of Management, Sub-Committee & Actuarial Function

The second line of defence, which is independent of operations, is responsible for quantification, analysis and assessment of all risks. These governing bodies and functions create and uphold principles, policies and frameworks for risk management and facilitate risk assessment. The second line's role is the four-eyes oversight of the first line of defence, against inappropriate actions or activities and to confirm adherence to Policies and the Committee's appetite.

### Third line of defence – Internal Audit

The third line of defence, which is independent of operations and management, is responsible for the testing and assessment of the Society's governance and control frameworks. Internal audit reports directly to the Committee of Management.

The Risk Policy and Risk Management Framework connects with the business as follows:

- The Risk Matrix is maintained on a day-to-day basis by the executive team and presented to the FRSC / ARC
- Actions arising from the Risk Matrix are documented and, where appropriate, escalated to the Committee
- The Annual Risk Analysis is prepared by the executive team and presented to the Committee
- Actions arising from the Analysis are documented and then reflected in the ORSA document
- The Committee of Management reviews the ORSA risk appetite and tolerances at least annually, or more frequently if there is a significant change in the Society's business or external environment
- The ORSA and Risk Matrix is used as a framework for conducting appropriate capital stress testing for the FLAOR
- Stress testing is carried out at least annually or more frequently if required – ad-hoc testing will be carried out to deal with extreme or unusual events

### ORSA

The authors of the ORSA are the Society's executive team, with input from the Society's actuary. The ORSA will be updated at least annually based on the preceding 31 December SCR calculation or more frequently if business conditions require it. The ORSA and FLAOR will consider likely changes to the Society's risk profile and capital needs over a three year business planning period.

The primary purpose of the ORSA report is to document the processes and procedures that are in place to identify, assess, monitor, manage and report on the short and longer term risks the Society faces, in order to determine the capital necessary to ensure that solvency needs are met at all times. Crucially section 6 of the ORSA provides an assessment of whether the Society's risks deviate materially from the assumptions underlying the SCR calculation.

The Committee of Management owns the ORSA process and the minutes of the relevant Committee meetings will record the challenges provided, the decision made and the feedback loops of the ORSA and FLAOR process.

The qualitative content of the ORSA will be approved by the Committee of Management, which is the Society's administrative, management and supervisory body, in August each year. The ORSA is designed to be for both internal use and to act as the ORSA supervisory report.

## Capital Management Policy

As a mutual organisation the Society has no easy access to external capital and no shareholders. All capital, therefore, is classified Tier 1.

The Society must ensure, therefore, that after reserving for technical provisions sufficient free capital is retained to meet regulatory requirements and to ensure that the balance sheet can withstand the impact of extreme events. Sufficient capital is also retained to enable the Society to achieve controlled growth and the investment freedom to deliver greater potential returns to members.

The Committee sets a range for the management of the Society's free assets and solvency ratio. These ranges are agreed at the triennial strategy review and then re-affirmed or adjusted annually. The Chief Executive will report the free assets and solvency ratio to the Committee quarterly, following the PRA quarterly capital reporting exercise. The resulting discussions will be minuted together with any management actions agreed to manage the free capital.

The Committee will manage the free capital through various actions, including:

- Adjusting bonus distributions
- Changing the asset mix
- Reviewing the valuation basis within regulatory constraints
- Reducing the Society's operating costs
- Contracting the Society's balance sheet e.g. restricting new business

The Society's free capital is not held separately and is part of the Society's with-profits fund. A proportion of the free capital is derived from the mutual capital and surpluses from non-profit business, and is not attributable to the current generation of policyholders.

The surplus in relation to the Child Trust fund is currently retained with Legal & General in an equity tracker fund. This surplus is partly used to offset the Society's operating costs, resulting in lower management expenses for with-profits policyholders. It is also the Society's practice, since 2014, to recognise a proportion of the CTF surplus in the with-profits asset share calculation.

## Medium Term Capital Management Plan ("MTCMP")

The Society has developed a MTCMP, which considers the impact of actions or events, such as the distribution of surplus, with capital management implications. Such events may also include acquisitions, disposals, transfers of business or other forms of restructuring – none of which are envisaged over the current medium-term planning period. A number of considerations, such as capital issuance, maturity of own-fund items, limits of tiers and dividend distributions, are not relevant to Sheffield Mutual.

## B.4 Internal Control System

The Society has an established framework of internal controls for the management of risk within the business and to safeguard the interests of members. The Committee reviews the effectiveness of its internal control systems at least annually by receiving reports from the external Compliance Consultant and our Internal Auditors.

### Compliance Function

The Society is required to allocate a director or senior manager the function of:

- Having responsibility for oversight of the Society's compliance; and
- Reporting to the Committee in respect of that responsibility

The Compliance Officer for the Society is responsible for monitoring adherence to the FCA's COBS (Conduct of Business) rules. Support and guidance is provided by the Society's external compliance consultant, David Williams of Haven Risk Management.

The Committee of Management receive an annual audit report from the external compliance consultant and all staff receive annual training in relation to money laundering, data protection and complaints handling.

## B.5 Internal Audit Function

The Society has an Internal Audit Function which is overseen by the Chairman of the Committee of Management. The reporting structure ensures independence of the internal audit function. The Society outsources the performance of the internal audit activity to independent accountants KPMG.

The Society has an annual internal audit plan, which is prepared by KPMG in accordance with industry standards and guidance, and taking account of the activities and governance arrangements of the Society. The plan includes a combination of a regular risk-based cycle of key testing priorities combined with a forward looking audit. The Committee has authorised the internal auditors to carry out audits which are not included in the plan, should the need arise during the course of the audit programme. The annual internal audit plan is presented to the Committee of Management and approved, normally in May each year.

The internal audit is carried out over the summer months and will normally involve around 10 working days on site. Draft reports are provided to the executive team for management comments prior to a presentation of the findings and recommendations to the Committee, normally in October each year. The observations will identify the person(s) responsible for remedying any shortcomings and the period of time envisaged for achievement.

Following Committee approval of the internal audit report the agreed recommendations are logged by the executive team and a report is provided monthly to the FRSC / ARC showing progress against each observation. The internal auditors provide an assurance report on the completion of the observations as part of the subsequent year's internal audit. The executive team and members of the Committee may call upon the internal audit function to give an opinion or assistance on other matters at any time.

## B.6 Actuarial Function

The Society is required to have an actuarial function in order to meet the requirements of being Directive and to comply with Solvency II. The actuarial function is currently outsourced to OAC Actuaries and Consultants in accordance with a service agreement. The appointment of Cara Spinks of OAC as a controlled function holder has been approved by the regulator. Mrs Spinks also holds the function of With-Profits Actuary.

The Chief Actuary reports directly to the Committee of Management and provides the following services and statutory duties:

- Carrying out the annual valuation of assets and liabilities in accordance with regulatory requirements, after first agreeing the valuation basis with the Committee
- Reporting any material deviations from actual experience when using projected best estimates and proposing changes to the valuation basis / models in order to improve best estimate calculations
- Assessing the reliability and consistency of internal and external data against relevant standards
- Making recommendations on internal procedures to improve data quality to meet current regulatory requirements
- Calculation of the technical/mathematical provisions in accordance with regulatory requirements
- Reporting to the Committee of Management on at least an annual basis in relation to the above
- Assistance with the completion of annual and quarterly regulatory returns
- Carrying out the Forward Looking Assessment of Own Risks (FLAOR), including appropriate scenario and stress testing, and reporting to the Committee annually
- Taking account of the impact on technical provision to provide advice to the Committee on underwriting and pricing policy
- Completion of data requests for information providers
- Any other tasks as described in the current service agreement

As With-Profits Actuary:

- Advising the With-Profits Advisory Arrangement
- Recommendations in relation to bonuses and distribution of surpluses
- Input in to the Society's PPFM
- Annual report to the Committee of the With-Profits Actuary
- Making recommendations to assist the Committee of Management in ensuring that closed book customers are treated fairly and proportionately

There are considered to be no activities that would result in any conflicts of interest.

## B.7 Outsourcing Policy

The Society outsources the following critical or important operational functions:

- Internal Audit (a key function)
- Investment Management
- Actuarial Services (a key function)
- IT Services

The performance of each outsourcing firm is reviewed by the Committee of Management at least annually and this review is recorded in the Committee minutes. With the exception of IT, the outsourcing firm is required to present to the Committee in person at least annually providing the opportunity for Committee members to assess performance and raise questions / issues.

The Chief Executive is the designated person responsible for the day-to-day performance and monitoring of outsourcing firms, apart from IT, which is designated to the Chief Operating Officer, and is responsible for escalating any issues to the Committee of Management.

The executive team will carry out whatever checks they feel appropriate to provide assurance for the ongoing competency and financial standing of the outsourcing firm and key employees. This may include requesting copies of third party governance reports, fit & proper person assessments, insurance policies, annual reports & accounts and/or the commissioning of a themed audit. Outsourcing firms are normally appointed for a minimum three year period or on an open ended basis. Appointments are made following a documented tender process, which involves a minimum of three firms. The Committee will receive presentations from each firm and will make the final decision regarding appointment. This is documented in the Committee minutes.

Outsourcing will not be carried out in the following circumstances:

- If it would materially impair the quality of the Society's system of governance
- If it would unduly increase the Society's operational risk
- If it would impair the ability of the regulatory authorities to monitor the compliance of the Society with its obligations
- If it would undermine or detract from the service provided to members

The outsourced functions are essential to the Society's operations, but only IT would represent an immediate risk to the delivery of services to the Society's members. In the case of any difficulties with the incumbent outsourced provider, the contingency is that services could be switched rapidly to another known infrastructure support provider. The Society owns the physical IT infrastructure, which is located on the Society's premises.

The Committee of Management remain fully responsible for discharging the Society's legal and regulatory obligations when they outsource functions.

## B.8 Any Other Information

All relevant and material items are covered in previous sections.

# C. Risk Profile

The Society has a risk-averse culture, which helps to protect members' interests and reduce exposure to the principal risks and uncertainties facing the business. The FRSC/ARC is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives and the Committee seeks to adopt a low-to-medium risk appetite in accordance with the scale and nature of the Society's business.

It seeks to undertake a structured approach for the effective management of risk and aims to employ proportionate tools and techniques to enable it to deliver its objectives in a controlled manner. Having regard for the nature and complexity of the Society's business the Committee has resolved to avoid unnecessary work on risks which do not have a large impact on the Society.

The Committee is satisfied that the Society has robust risk and governance procedures and sufficient capital to deal with a range of risks and adverse scenarios, both now and over the business planning period. The analysis of risks also demonstrates that there are no current, emerging or anticipated risks which could materially alter the Society's risk profile or strategy in the medium term.

The Society has a clearly defined risk appetite for each category of risk (defined in terms of a risk tolerance) and business policies are set accordingly.

- Zero Tolerance – any significant risk is unacceptable/no appetite to take risks
- Low Tolerance – nil to very small risk acceptable/significant controls
- Medium Tolerance – exposure to risk within manageable limits tolerated and
- High Tolerance – prepared to accept high risks in pursuit of business

## C.1 Insurance Risk (Low Tolerance)

Insurance Risk is the risk of loss due to uncertainties over timing, amounts and occurrence of events insured by the Society. Insurance related risks include mortality risk, persistency risk, taxation, new business and renewal expense risk - with persistency risk being the main item. The Society has no exposure to longevity risk, nor does it have any reinsurance arrangements.

The Committee has adopted a low tolerance to insurance risk by taking a low risk view on product development and applying high standards of life underwriting.

The Society manages insurance risk by:

- a structured approach to product development and pricing, including provision for expenses
- a formal actuarial analysis of the performance of the insurance portfolio which feeds into the development of products and the calculation of technical provisions
- robust management and challenge of expenses
- proactive management of new business flows and
- monitoring persistency rates, which are reported to the Committee at least bi-annually

The table below shows the concentration of insurance risk for the Society.

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Sickness and death | 1,047 | 1,410 |
| Pure endowments | 14,537 | 14,195 |
| Endowments | 728 | 715 |
| Taxable saving plans | 6,742 | 6,216 |
| Investment bond | 20,489 | 18,396 |
| ISA | 49,924 | 40,793 |
| Pension bond | 961 | 1,076 |
| Other | 955 | 963 |
| Total | 95,383 | 83,764 |

## Mortality Risk

Mortality risk is the risk of loss arising to the Society, due to differences in the trends of the level, trend or volatility of mortality rates compared to the assumptions made when a product is designed and priced.

Although difficult to predict mortality rates when pricing a product, under normal circumstances they are subject to well established trends.

## Persistency Risk

This is the risk that the assumptions made on the rate that policyholders surrender or lapse policies differ from the actual rate. This could result in the possibility of the Society incurring a loss due to higher than expected policy surrenders and lapses.

The persistency experience of the Society varies over time, but has been relatively low and stable. Factors affecting persistency include members' perception of the Society and the insurance industry, investment performance and the general economic environment.

## Expense Risk

Expense risk is the risk that actual expenses incurred by the Society vary from the assumed rate over the life of the policies.

A large proportion of the Society's expenses are incurred in staff costs and actuarial work, which are relatively predictable. The Society also employs a robust cost control culture in order to minimise cost increases whenever possible.

## C.2 Market (Investment) Risk (Medium Tolerance)

Market Risk is the risk of losses arising from changes in the value of assets or in the income from the assets. The Society manages market risk so that the returns generated are in line with members' expectations and support the Society's future strategic and operational objectives.

For assets backing member liabilities, market risk is managed by matching, within broad parameters, the duration and profile of the assets with the underlying liabilities.

The Society's FRSC / FIC oversees the Investment Policy and strategy, which the Society implements through the use of investment mandates. Each mandate aims to manage the market risk using some or all of the following mechanisms:

- defined performance benchmarks
- limits on asset allocation by asset type, market capitalisation and geographical spread

The table below sets out the concentration of market risk for the Society.

| | United Kingdom | Asia & Africa | North & South America | Europe Excluding UK | Grand Total |
|---|---|---|---|---|---|
| | £ | £ | £ | £ | £ |
| Oil & Gas Producers | 2,484,259 | - | - | - | 2,484,259 |
| Basic Materials | 1,211,803 | - | - | - | 1,211,803 |
| Industrials | 710,673 | - | - | - | 710,673 |
| Consumer Goods | 2,348,528 | - | - | - | 2,348,528 |
| Health Care | 1,226,945 | - | - | - | 1,226,945 |
| Consumer Services | 802,235 | - | - | - | 802,235 |
| Telecommunications | 305,960 | - | - | - | 305,960 |
| Utilities | 337,600 | - | - | - | 337,600 |
| Financials | 3,987,992 | - | - | - | 3,987,992 |
| Technology | 300,550 | - | - | - | 300,550 |
| Investment & Unit Trusts | 4,694,582 | - | - | - | 4,694,582 |
| Property | 1,340,345 | - | - | - | 1,340,345 |
| Infrastructure | 975,332 | - | - | - | 975,332 |
| Open Ended Investment Companies | 257,332 | 4,951,410 | 2,162,682 | 1,151,116 | 8,522,540 |
| Total | **20,984,136** | **4,951,410** | **2,162,682** | **1,151,116** | **29,249,344** |

The Society is exposed to interest rate risk where changes in interest rates result in changes to market values or cash flows and where this is not matched by the change in the value of liabilities. This risk can be greater if the term of fixed interest investments is not well matched to the term of the liabilities.

The Society's strategy is to deliver higher potential returns to members and to preserve the Society's position as a market leading with-profits regular premium product provider. This necessitates a relatively high exposure to higher risk assets as a means of improving yields. The Society achieves this by holding a relatively high exposure to property (up to 60% of non-CTF assets), through directly owned commercial property and commercial mortgages.

The Society's assets are carefully selected, diversified and closely monitored in order to avoid losses. The Society has experience and expertise built up over many years in the commercial property sector.

## C.3 Credit Risk (Medium Tolerance)

Credit Risk is the risk of loss due to failure by another party to perform in meeting its financial obligations. The Society adopts a medium tolerance to credit risk in support of the Society's strategic objectives and in matching Policyholder liabilities. This means that modest losses would be tolerated in order to secure higher potential returns. The Society seeks to minimise other forms of credit risk, in particular those related to deposit takers. The Society has taken the following steps to mitigate credit risk:

- bond holdings adhere to minimum credit rating criteria i.e. must be mainly '-A' rated or above
- diversified portfolio of commercial mortgages to reduce the potential impact of default
- defined commercial lending policy with strict underwriting guidelines
- counter-party limits are in place for cash deposits
- The Society's debt securities are mainly investment grade and the Society does not expose itself to sub-prime debt securities.

## C.4 Liquidity Risk (Medium Tolerance)

Liquidity Risk is the risk that the Society, although solvent, is unable to meet payments as they fall due from cash or near cash holdings. The Society's objective on liquidity risk management is to ensure that sufficient funds are available over the short and medium term to meet the needs of the Society. This includes new business costs, planned strategic activities, member withdrawals, claims payments and day to day cash flow requirements. Cash flows are generally predictable with fixed amounts due on fixed dates. Deaths and surrenders are less predictable but (under normal circumstances) are subject to well established trends.

Any significant mismatch between cash inflows and outflows would be identified by the executive team and this would trigger a Committee review of the level of liquid assets (particularly cash holdings) and the impact on the liquidity situation of writing new business.

The Society has a medium tolerance to liquidity risk, which means that cash and near cash holdings are kept at relatively modest levels so that yields are not adversely affected. This approach is considered appropriate given the predictable nature of most policy claims and the fact that the Society is a positive cash generator.

Liquidity risk is managed as follows:

- budgets are prepared to forecast the short term and medium term liquidity requirements
- assets of suitable marketability and maturity are held to meet the member liabilities as they fall due
- credit risk of deposit takers is managed by having appropriate counterparty and credit limits in place

## C.5 Operational Risks

### Operational Losses (Low tolerance)

This is the risk of losses due to inadequate systems and controls, error or management failure. The Society's objective is to analyse, record and monitor the operational risks it faces, seeking to extinguish or minimise risks wherever possible.

The Committee has set a low tolerance to operational losses, which equates to up to circa 10% of Operational Risk Capital per annum or circa 50% for an exceptional single event. Therefore, up to circa £60,000 operational losses are tolerated per annum, or circa £300,000 for a single exceptional event. The Society has established controls to manage operational risk within these tolerances. The Committee owns the risk policy, whilst the FRSC / ARC oversees the policy and reviews the risk register and issues/losses register to ensure the risk policy is effectively deployed and risks are mitigated.

The executive team manages the risks within the business, ensuring that controls are in place to mitigate risks. The executive team are also the custodian of the risk policy and register, and the Committee reviews these documents on a regular basis.

In 2018 the Committee took the decision to appoint a Chief Operating Officer to manage operational risks as a priority due to the increasing need to monitor and report on risk and compliance.

### Reputation (Zero tolerance)

The Society's reputation is critical to its success and the Committee has set a zero risk tolerance for managing reputational risk. Any adverse publicity is unacceptable and the Society's approach to strategy and managing the business avoids any reputational threat.

### Customer Services (Zero tolerance)

This is the risk of complaints and poor TCF through backlogs, errors and omissions. The Committee has set a zero tolerance to complaints, whereby no reportable complaints are acceptable. The Society's policies, systems and staff culture are geared to avoiding issues that would lead to complaints and every case is escalated to the executive team.

### Business Continuity (Low tolerance)

This is the risk of a break in service to customers due to events beyond the Society's control. The main risk is a loss of the Society's head office as a result of an insured risk. The Committee has set a low tolerance to business continuity, meaning that a major disruption in services would be accepted for up to 3 working days. The Society has a documented Business Continuity Plan and has invested in outsourced disaster recovery facilities in order to minimise any impact on customer service. Online back-ups are performed daily and data restoration from the online back-up is subject to annual testing.

### Compliance (Zero tolerance)

This is the risk of breaches of compliance in relation to such matters as conduct of business rules, anti-money laundering and data protection. The Committee has set a zero tolerance for such breaches, which means any incidence of non-compliance is unacceptable and remedial actions taken promptly. The Society works to 100% completion of mandatory staff training and all compliance matters are handled by the executive team with support and guidance as required from Haven Risk Management.

### Security (Zero tolerance)

This is the risk of fraud, financial crime, information security breaches and incidents of physical security. The Committee has set a zero tolerance for security, which means that no breaches or incidents are tolerated.

### Regulatory & Legal (Zero tolerance)

Regulatory Risk is the risk of losses due to a breach of current regulation or a failure to react appropriately to changes in regulation. The Committee has set a zero tolerance to regulatory risk, meaning that the Society would not seek to push the boundaries of regulation. The Society monitors its operations to ensure compliance and reviews all relevant changes of legislation and FCA/PRA rules to ensure operational procedures are compliant.

### Employee & Management (Low tolerance)

Employee and Management Risk is the risk to the Society's operations to issues such as staff turnover and reliance on the executive team. The Committee has set a low tolerance to such risks and tries to manage them by having competitive employment terms and conditions, a pleasant working environment and ensuring that effective contingency arrangements can be put in place at short notice.

## C.6 Other Material Risks

### Asset Liability Management Risk (Low tolerance)

Asset Liability Management risk (ALM risk) is the risk of unexpected economic outcomes resulting from market movements affecting the Society's balance sheet structure. The objectives of the ALM policy are to manage financial risks in order that the Society generates value for policyholders whilst not incurring losses that would jeopardise the safe functioning and solvency of the Society.

ALM Risk management of the Society involves the application of four basic elements in the management of assets and liabilities (the Society has no off balance sheet instruments):

- Appropriate Committee and senior management oversight
- Adequate risk management policies and procedures
- Appropriate risk measurement, monitoring, and control functions
- Comprehensive internal controls and independent audits.

## Solvency (Medium Tolerance)

Solvency risk is the risk of having insufficient available capital to meet the minimum regulatory capital and deliver strategic objectives. The Committee is mindful that the preservation of capital is critical, given that the Society has no access to external capital.

The Society's financial strength is important to maintain confidence with key stakeholders such as members, business partners (particularly financial advisers) and regulators. However, the Committee also needs the flexibility to invest in assets that are capable of delivering higher potential returns to members and these assets, such as commercial property, have a higher capital requirement due to the range of stresses applied.

The Committee has set a medium tolerance to solvency and looks to maintain at least 125% x SCR after management actions. The Committee has also set a 'hard trigger' point to take management actions at a free asset ratio of below 2% and a 'soft trigger' point of below 3% to consider management actions available to increase solvency.

## Strategy, Change & Adaptability (Low tolerance)

This is the risk of the Society entering new markets and launching new products. The Committee has set a low tolerance for such matters, meaning that change is acceptable where it is necessary to maintain the status quo or the established business model. Investment in change is generally made when the outcome is known or the cost and implications of failure is low. The Society would not normally deviate from well-established market or products, where the Society has experience and, therefore, the risk of initiatives being unsuccessful is negligible.

## Political & Economic (Medium tolerance)

Political and Economic Risk is the risk of political decisions and/or economic circumstances having an adverse effect on the Society's strategy and business plans. As these risks are essentially out of the Society's control, the Committee has set a medium tolerance, meaning that the Society's business model is designed to be resilient in order to withstand such events.

## C.7 Any Other Information

As part of the ORSA process, in order to evaluate various plausible and reasonable deviations from the central business planning assumptions, the Society's actuary provides a forward looking assessment of its likely future solvency position on a range of scenarios and to highlight the key risks to which the business is exposed, based on the central business planning assumptions. The following stresses and scenario tests are performed:

- New business volumes at 75% / 125% of plan
- Expenses at 75% / 125% of plan
- Asset share investment returns +1% and - 1%
- Lapse rates at 75% / 125% of plan
- A 25% fall in the value of all property assets
- Combined scenario: 25% fall in property, 15% fall in equities and expenses 10% higher
- "Risks from guaranteed return products" scenario: 25% fall in equities, asset share returns -1% and lapse rates at 75% of plan

The Society's actuary is satisfied that the Society's solvency ratio remains fairly strong during these stress tests, with additional opportunities available to make improvements through on-going consideration of the management actions applied.

The key risks to the solvency ratio falling below the Society's 125% minimum threshold are:

- a 25% fall in property, 15% fall in equities and expenses 10% higher, or
- a 25% fall in equities, asset share returns -1% and lapse rates at 75% of plan.

Overall the Committee is satisfied that the Society's solvency ratio remains reasonably strong in all scenarios and stable over a three year term.

The combined scenarios unsurprisingly takes the solvency ratio under the 125% minimum threshold. A key driver of this is the 25% fall in property values and 25% fall in equities. The Committee took steps to reduce the overall equity/property content of the investment portfolio over 2017 and 2018 and also further diversified the equity portfolio. This has helped to reduce the risks faced from a sudden market shock.

The Committee regularly reviews the approach taken to management actions and the uptake of new business to ensure that the cost of guarantees written on new policies is not unduly detrimental to the solvency position.

# D. Valuation for Solvency Purposes

## D.1 Assets

Assets have been valued in accordance with Article 75 of the Solvency II Directive which requires that the assets are valued at the amount for which they could be exchanged between knowledgeable willing parties in an arms' length transaction.

The value of the assets is shown in the following table:

| Value of the assets (£000) | 2018 | 2017 |
|---|---|---|
| Gilts | 5,431 | 4,979 |
| Other fixed interest | 20,100 | 15,059 |
| Equity | 28,383 | 26,152 |
| Total listed investments | 53,914 | 46,190 |
| Property | 41,313 | 40,736 |
| Commercial mortgages | 975 | 975 |
| Cash and deposits | 8,602 | 7,126 |
| Other assets | 385 | 564 |
| Total before Child Trust Fund | 105,189 | 95,591 |
| Child Trust Fund | 38,977 | 42,388 |
| **Total value of assets for SII purposes** | **144,166** | **137,979** |

The listed investments are all included at market value.

The property portfolio is fully revalued every five years with a desktop valuation in the intervening years so that changes in market value can be taken into account. A reduction of £1,800 has been made to the value reported in the report and accounts to allow for the expenses of acquiring property during 2018.

Commercial mortgages are included at the face value of the mortgage, as long as that amount is less than the value of the property backing the mortgage.

Cash and deposits are valued at face value.

Other assets are shown at the value calculated in the accounts.

There are no listed investments which are not held on an active regulated market.

The Society had inadmissible assets of £138,000 consisting of website development (£6,000), tangible assets on a fixed cost basis (£58,000), software development (£50,000) and prepayments and recharges (£24,000).

There are no leasing arrangements or material deferred tax assets.

There are no related undertakings.

There has been no significant exercise of judgement in arriving at the values shown.

The following table reconciles the value of assets reported for Solvency II purposes with those shown in the accounts:

| Reconciliation of assets (£000) | 2018 | 2017 |
|---|---|---|
| Total value of assets for SII purposes | 144,166 | 137,979 |
| Add property acquisition expenses | 2 | 342 |
| Add website development costs | 6 | 13 |
| Add tangible fixed assets on a cost basis | 58 | 44 |
| Add software development costs | 50 | - |
| Add prepayments and recharges | 24 | 28 |
| Total assets shown in the report & accounts | 144,306 | 138,406 |

## D.2 Technical Provisions

The following table summarises the technical provisions:

| Technical provisions (£000) | 2018 | 2017 |
|---|---|---|
| Asset shares | 89,392 | 76,141 |
| Cost of guarantees | 5,135 | 5,010 |
| Expense reserve | (1,461) | (227) |
| Non-profit liabilities | 1,430 | 1,879 |
| Child Trust Fund liability | 35,218 | 38,843 |
| Value of Child Trust Fund margins | (2,219) | (2,801) |
| Total best estimate liabilities | 127,495 | 118,845 |
| Risk margin | 886 | 961 |
| **Total technical provisions** | **128,381** | **119,806** |

### Methodology

The components of the best estimate liabilities have been calculated as follows:

i) The value of with profits business at the valuation date is taken to be total asset shares at the valuation date plus the present value of the cost of future guarantees plus a reserve for expenses in excess of the charges made for expenses to the asset share.

ii) The asset share is the accumulation of premiums paid less claims and expenses rolled up at the rate of investment return earned on the fund from year to year.

iii) The cost of future guarantees calculation projects both the asset shares and guaranteed benefit amounts on a per policy basis on various assumed rates of investment growth and future annual bonuses. Rates of investment growth are distributed around the risk-free rates prescribed by EIOPA. On each rate of assumed growth, the excess of guaranteed benefit over projected asset share is discounted back to the valuation date using the risk-free rates prescribed by EIOPA and summed over all policies. A lognormal probability distribution is then applied to the range of investment outcomes to obtain the present value of the cost of guarantees.

iv) Expenses charged to the asset shares are assumed to be those underlying the premium basis and therefore an additional expense reserve is calculated to cover the cost of any actual expenses as projected in the business plan exceeding those in the premium basis. Credit is taken for the excess of expenses charged to the asset share over the actual expenses. The shortfalls and excesses are discounted back to the valuation date using the risk-free rates prescribed by EIOPA.

v) The liabilities in respect of non-profit business are calculated as the value of the future benefits plus the value of future expenses less the value of any future premiums. The values are based on a best estimate of future cashflows. These cashflows are discounted back to the valuation date using the risk-free rates prescribed by EIOPA.

vi) The Child Trust Fund ("CTF") liability is the value of all the units allocated to CTF policyholders using the "Society price" which allows for the deduction of the annual management charge.

vii) The value of CTF margins represents the present value of future profits on CTF business which is the discounted value of future loadings arising on the CTF business over future CTF expenses. The latter is available to offset the additional expense reserve on with profits business and contributes to overall surplus funds.

The risk margin is calculated for the business as a whole. It represents the cost of providing the Solvency Capital Requirement ("SCR") excluding diversifiable market risk for the run-off of the business using the required cost of capital rate of 6%.

The requirement to split the risk margin by line of business has been achieved by allocating the risk margin to the various lines of business in proportion to the best estimate liabilities. The following table shows the split:

| Risk margin (£000) | 2018 | 2017 |
|---|---|---|
| With-profits | 647 | 654 |
| Unit-linked | 229 | 292 |
| Other | 10 | 15 |
| **Total risk margin** | **886** | **961** |

The value of the risk margin is calculated using the simplified assumption that the amount of the SCR excluding diversifiable market risk will reduce in line with the run-off of the best estimate liabilities, and the yearly values are discounted using the risk-free yield curve.

## Assumptions

The basis used to produce the best estimate liabilities is set out below. These are the realistic assumptions that the Society has set based on actual experience.

i) Asset share growth rate for 2018: Asset shares have been rolled forward using the actual investment return achieved on the backing assets during 2018 less the actual investment expenses plus the CTF enhancement. The investment return credited to asset shares is -0.47%.

ii) Discount rate: The risk-free yield curve published by EIOPA at the reporting date has been used. Example spot rates are shown in the following table:

| Projection year | 1 | 2 | 3 | 4 | 5 | 10 | 15 | 20 | 25 |
|---|---|---|---|---|---|---|---|---|---|
| 2018 | 0.98% | 1.06% | 1.12% | 1.17% | 1.20% | 1.34% | 1.43% | 1.46% | 1.46% |
| 2017 | 0.56% | 0.68% | 0.79% | 0.87% | 0.94% | 1.19% | 1.33% | 1.38% | 1.37% |

iii) Central future growth rate for asset shares and CTF funds: the risk-free yield curve published by EIOPA has been used for the central cost of guarantee calculation. The central growth rate is then varied for the purposes of applying the probability distribution to calculate the cost of guarantees.

iv) Mortality: 25% of the standard mortality table ELT 15(M). This is an update from the 2017 basis of 40% ELT 15(M).

v) Sickness: The remaining sickness business is very trivial and ignored on these grounds.

vi) Tax: 10% applied where appropriate.

vii) Expenses: Per policy expenses have been calculated based on the budgets and projected new business in the Society's business plan.

viii) Expense inflation: The per policy expenses are increased after 2022 in line with the implied inflation curve published by the bank of England. For the 2018 valuation a deduction of 0.25% has been made for illiquidity and the inflation risk premium. Example spot inflation rates are shown in the following table:

| Projection year | 1 | 2 | 3 | 4 | 5 | 10 | 15 | 20 | 25 |
|---|---|---|---|---|---|---|---|---|---|
| 2018 | 2.84% | 2.84% | 2.84% | 2.84% | 2.85% | 3.04% | 3.26% | 3.33% | 3.26% |
| 2017 | 2.89% | 2.89% | 2.84% | 2.84% | 2.86% | 3.13% | 3.40% | 3.54% | 3.54% |

ix) Annual bonuses: Set to 0 for regular premium business and to continue at the proposed 2018 declared interim rates for all other business.

x) Lapses:

| | |
|---|---|
| Regular premium endowment business | 4% in year 1, reducing uniformly to 2% by year 5, and then reducing to 1% year 12 onwards |
| Investment/Income Bond | 3% pa for the first 5 years, 20% in year 6, then 10% pa |
| Pension Bond | 6% pa for 10 years then maturity |
| ISA | 6% pa for 10 years then 10% thereafter |
| Staff Pension | 3% pa until age 65 then retire |
| CTF | 1% pa |
| All other business | 0% pa |

xi) It is also assumed that all ISA and bond business matures at age 75 subject to a minimum term of 10 years.

xii) The lapse assumptions are the same as the 2017 assumptions.

Cost of guarantees assumptions:

i) The distribution of future equity returns is assumed to be lognormal, with the mean set to the log of the risk-free rate corresponding to the average outstanding duration of the liabilities.

ii) The volatility used for the distribution has been assessed by looking at the realised volatility of the assets backing the non-CTF business and making an adjustment for the market's future expectations of volatility.

Management actions are applied in accordance with the agreed management action plan which is determined and agreed by the Committee annually.

### Other information

With any modelling exercise there will be an underlying level of uncertainty present. Uncertainty arises primarily from the data being used, the choice of assumptions, and from the choice of model.

The data used is checked rigorously to mitigate the risk that errors may materially affect the valuation result. Data is also reviewed over time to check for consistency between different time periods. A reconciliation is carried out between reporting periods to allow for actual movements in the data over the year.

Assumptions may be demographic or economic and are set using historical experience and the current market environment and expectations. Actual and emerging experience is reviewed against expectations at least annually and more frequently if necessary. The results of these analyses are fed into the assumption setting process for the valuation. Results are assessed for their sensitivity to key assumptions.

The model used is tested regularly to mitigate the risk that errors may materially affect the valuation. The choice of model is made so as to comply with the regulations whilst ensuring an efficient projection process and some simplifications may be necessary to achieve this.

There are no material differences between the valuation for solvency purposes and the values that are shown in the financial statements.

No use has been made of a matching adjustment.

No use has been made of a volatility adjustment.

No use has been made of the transitional provisions for risk-free interest rates.

No use has been made of transitional deductions from technical provisions.

There are no reinsurance arrangements in force.

## D.3 Other liabilities

The only other liabilities the Society has are current liabilities of £1,016,000. These consist of creditors, including taxation and social security, plus accruals and deferred income. The value used for valuation purposes is the same as that shown in the financial statements.

## D.4 Alternative methods for valuation

We value our property by asking an external and independent professional property consultant, who offers a property valuation service, to provide us with a value. The valuer looks at other, similar properties and considers their price (where they have recently been sold) and their rental value. No other alternative valuation methods have been employed.

## D.5 Any other information

The value of assets and liabilities reported for Solvency II purposes are shown in the attached reporting template S.02.01.02 – “Balance Sheet”.

The breakdown of technical provisions is reported in the attached reporting template S.12.01.02 – “Life and Health SLT Technical Provisions”.

No other material information is supplied.

# E. Capital management

## E.1 Own Funds

The Society's business strategy is fully reviewed and re-defined on a three-yearly basis. The strategy review, which was last undertaken in 2018, is facilitated by a third party and is approved by the Committee of Management. An interim review and reaffirmation of the strategy takes place on an annual basis in October.

The Society is a Friendly Society with a single members' fund and all capital is Tier 1. There have been no significant changes in own funds over the reporting period. The Society's own funds are shown in the following table:

| Own funds (£000) | 2018 | 2017 |
|---|---|---|
| Total admissible assets | 144,166 | 137,979 |
| Less liabilities: | | |
| Technical provisions | (128,381) | (119,806) |
| Other liabilities | (1,017) | (1,019) |
| **Own funds** | **14,768** | **17,154** |

i) There are no restrictions on the use of own funds.

ii) There are no material differences between the equity in the Society's financial statements and the free capital for solvency purposes other than the £140,000 shown in the financial statements for assets classified as inadmissible for Solvency II purposes.

iii) There are no items of own funds subject to a transitional arrangement.

iv) There are no items of ancillary own funds.

v) There are no deductions from own funds and no restrictions on availability and transferability.

## E.2 Solvency Capital Requirement and Minimum Capital Requirement

The Society uses the Standard Formula to calculate its Solvency Capital Requirement ("SCR"). The assumptions and parameterisations underlying the Standard Formula are set by the regulations.

The SCR at 31 December 2018 was £9,735,000 (2017: £10,526,000) after allowing for management actions. This figure is subject to supervisory assessment.

The SCR split by risk module is shown in the following table:

| £000 | 2018 | 2017 |
|---|---|---|
| Market risk | 8,552 | 9,128 |
| Counterparty default risk | 500 | 762 |
| Life underwriting risk | 1,139 | 1,194 |
| Diversification benefit | (1,137) | (1,352) |
| **Basic SCR** | **9,054** | **9,732** |
| Operational risk | 681 | 794 |
| **Solvency Capital Requirement** | **9,735** | **10,526** |

The SCR has reduced from the 2017 year end despite the growth in business during the year. The main reason for this is a change in the equity SCR shock rate.

The Society's surplus funds after capital requirements are shown in the following table:

| | | |
|---|---|---|
| Own funds | 14,768 | 17,154 |
| Less: SCR | (9,735) | (10,526) |
| **Surplus funds** | **5,033** | **6,628** |

The Society has not adopted any of the Standard Formula simplifications set out in the Delegated Act for the SCR calculation, and does not use any undertaking-specific parameters.

The Minimum Capital Requirement ("MCR") is the minimum amount of capital that the Society must hold. The MCR is calculated using a linear formula and must lie between 25% and 45% of the SCR after management actions have been allowed for. It has an ‘absolute floor’ of €3.7m. The Society's MCR is calculated on the absolute floor basis which equates to £3,288,000 at the reporting date.

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

The Society does not use the duration-based equity risk sub-module in the calculation of the SCR.

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

The Society does not use an internal model.

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

The Society has complied with the SCR and the MCR throughout the reporting period.

## E.6 Any other information

The statement of the Society’s Own Funds is shown in the attached reporting template S.23.01.01 – “Own Funds”.

The breakdown of the Society’s SCR is shown in the attached reporting template S.25.01.21 – “Solvency Capital Requirement - for undertakings on the Standard Formula”.

The Society’s MCR is shown in the attached reporting template S.28.01.01 – “Minimum Capital Requirement – only life or only non-life insurance or reinsurance activity”.

No other material information is supplied.

# F. Approval by the Administrative, Management or Supervisory Body of the SFCR and Reporting Templates

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

We are satisfied that:

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

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

For and on behalf of the Committee of Management:

Jamie Bellamy
Chief Executive
22 March 2019

# G. Glossary

## Abbreviations

| | |
|---|---|
| ALM | Asset Liability Management |
| ARC | Audit & Risk Committee |
| CEO | Chief Executive Officer |
| CFO | Chief Finance Officer |
| COBS | Conduct of Business |
| COO | Chief Operating Officer |
| CTF | Child Trust Fund |
| EIOPA | European Insurance and Occupational Pensions Authority |
| FCA | Financial Conduct Authority |
| FIC | Finance & Investments Committee |
| FLAOR | Forward Looking Assessment of Own Risks |
| FRSC | Finance and Risk Sub Committee |
| HMRC | Her Majesty Revenue and Customs |
| MCR | Minimum Capital Requirement |
| MLRO | Money Laundering Reporting Officer |
| MTCMP | Medium Term Capital Management Plan |
| NED | Non-Executive Director |
| ORSA | Own Risk and Solvency Assessment |
| PPFM | Principles and Practices of Financial Management |
| PRA | Prudential Regulation Authority |
| QRT | Quarterly Reporting Template |
| RPI | Retail Price Index |
| SCR | Solvency Capital Requirement |
| SFCR | Solvency and Financial Condition Report |
| SID | Senior Independent Director |
| SIMF | Senior Insurance Management Function |
| TCF | Treating Customers Fairly |

# H. Solvency and Financial Condition Report Templates

(Monetary amounts in GBP thousands)

## General information

| | |
|---|---|
| Undertaking name | Sheffield Mutual Friendly Society |
| Undertaking identification code | 2138004A1I62DEXLB278 |
| Type of code of undertaking | LEI |
| Type of undertaking | Life undertakings |
| Country of authorisation | GB |
| Language of reporting | en |
| Reporting reference date | 31 December 2018 |
| Currency used for reporting | GBP |
| Accounting standards | Local GAAP |
| Method of Calculation of the SCR | Standard formula |
| Matching adjustment | No use of matching adjustment |
| Volatility adjustment | No use of volatility adjustment |
| Transitional measure on the risk-free interest rate | No use of transitional measure on the risk-free interest rate |
| Transitional measure on technical provisions | No use of transitional measure on technical provisions |

## List of reported templates

S.02.01.02 - Balance sheet
S.05.01.02 - Premiums, claims and expenses by line of business
S.12.01.02 - Life and Health SLT Technical Provisions
S.23.01.01 - Own Funds
S.25.01.21 - Solvency Capital Requirement - for undertakings on Standard Formula
S.28.01.01 - Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

**S.02.01.02**

## Balance sheet

| | | Solvency II value |
|---|---|---|
| | **Assets** | C0010 |
| R0030 | Intangible assets | |
| R0040 | Deferred tax assets | |
| R0050 | Pension benefit surplus | |
| R0060 | Property, plant & equipment held for own use | 300 |
| R0070 | Investments (other than assets held for index-linked and unit-linked contracts) | 98,641 |
| R0080 | *Property (other than for own use)* | 37,650 |
| R0090 | *Holdings in related undertakings, including participations* | 0 |
| R0100 | *Equities* | 14,373 |
| R0110 | *Equities - listed* | 14,373 |
| R0120 | *Equities - unlisted* | |
| R0130 | *Bonds* | 25,225 |
| R0140 | *Government Bonds* | 5,418 |
| R0150 | *Corporate Bonds* | 19,807 |
| R0160 | *Structured notes* | 0 |
| R0170 | *Collateralised securities* | 0 |
| R0180 | *Collective Investments Undertakings* | 18,489 |
| R0190 | *Derivatives* | |
| R0200 | *Deposits other than cash equivalents* | 2,903 |
| R0210 | *Other investments* | 0 |
| R0220 | Assets held for index-linked and unit-linked contracts | 38,977 |
| R0230 | Loans and mortgages | 975 |
| R0240 | *Loans on policies* | 0 |
| R0250 | *Loans and mortgages to individuals* | |
| R0260 | *Other loans and mortgages* | 975 |
| R0270 | Reinsurance recoverables from: | 0 |
| R0280 | *Non-life and health similar to non-life* | 0 |
| R0290 | *Non-life excluding health* | |
| R0300 | *Health similar to non-life* | |
| R0310 | *Life and health similar to life, excluding index-linked and unit-linked* | 0 |
| R0320 | *Health similar to life* | 0 |
| R0330 | *Life excluding health and index-linked and unit-linked* | 0 |
| R0340 | *Life index-linked and unit-linked* | 0 |
| R0350 | Deposits to cedants | 0 |
| R0360 | Insurance and intermediaries receivables | |
| R0370 | Reinsurance receivables | |
| R0380 | Receivables (trade, not insurance) | |
| R0390 | Own shares (held directly) | |
| R0400 | Amounts due in respect of own fund items or initial fund called up but not yet paid in | 0 |
| R0410 | Cash and cash equivalents | 5,274 |
| R0420 | Any other assets, not elsewhere shown | 0 |
| R0500 | **Total assets** | 144,166 |

**S.02.01.02**

## Balance sheet

| | | Solvency II value |
|---|---|---|
| | **Liabilities** | C0010 |
| R0510 | Technical provisions - non-life | 0 |
| R0520 | *Technical provisions - non-life (excluding health)* | 0 |
| R0530 | *TP calculated as a whole* | |
| R0540 | *Best Estimate* | |
| R0550 | *Risk margin* | |
| R0560 | *Technical provisions - health (similar to non-life)* | 0 |
| R0570 | *TP calculated as a whole* | |
| R0580 | *Best Estimate* | |
| R0590 | *Risk margin* | |
| R0600 | Technical provisions - life (excluding index-linked and unit-linked) | 95,154 |
| R0610 | *Technical provisions - health (similar to life)* | 0 |
| R0620 | *TP calculated as a whole* | 0 |
| R0630 | *Best Estimate* | 0 |
| R0640 | *Risk margin* | 0 |
| R0650 | *Technical provisions - life (excluding health and index-linked and unit-linked)* | 95,154 |
| R0660 | *TP calculated as a whole* | 0 |
| R0670 | *Best Estimate* | 94,497 |
| R0680 | *Risk margin* | 657 |
| R0690 | Technical provisions - index-linked and unit-linked | 33,228 |
| R0700 | *TP calculated as a whole* | 35,218 |
| R0710 | *Best Estimate* | -2,219 |
| R0720 | *Risk margin* | 229 |
| R0740 | Contingent liabilities | |
| R0750 | Provisions other than technical provisions | |
| R0760 | Pension benefit obligations | |
| R0770 | Deposits from reinsurers | |
| R0780 | Deferred tax liabilities | |
| R0790 | Derivatives | |
| R0800 | Debts owed to credit institutions | |
| R0810 | Financial liabilities other than debts owed to credit institutions | |
| R0820 | Insurance & intermediaries payables | 75 |
| R0830 | Reinsurance payables | |
| R0840 | Payables (trade, not insurance) | 486 |
| R0850 | Subordinated liabilities | 0 |
| R0860 | *Subordinated liabilities not in BOF* | |
| R0870 | *Subordinated liabilities in BOF* | 0 |
| R0880 | Any other liabilities, not elsewhere shown | 455 |
| R0900 | **Total liabilities** | 129,398 |
| | | |
| R1000 | **Excess of assets over liabilities** | 14,768 |

**S.05.01.02**

## Premiums, claims and expenses by line of business

### Life

| | | Line of Business for: life insurance obligations | | | | | | Life reinsurance obligations | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Health insurance | Insurance with profit participation | Index-linked and unit-linked insurance | Other life insurance | Annuities stemming from non-life insurance contracts and relating to health insurance obligations | Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations | Health reinsurance | Life reinsurance | Total |
| | | C0210 | C0220 | C0230 | C0240 | C0250 | C0260 | C0270 | C0280 | C0300 |
| | **Premiums written** | | | | | | | | | |
| R1410 | Gross | | 16,790 | 492 | 10 | | | | | 17,292 |
| R1420 | Reinsurers' share | | 0 | 0 | 0 | | | | | 0 |
| R1500 | Net | 0 | 16,790 | 492 | 10 | | | | | 17,292 |
| | **Premiums earned** | | | | | | | | | |
| R1510 | Gross | | 16,790 | 492 | 10 | | | | | 17,292 |
| R1520 | Reinsurers' share | | 0 | 0 | 0 | | | | | 0 |
| R1600 | Net | 0 | 16,790 | 492 | 10 | | | | | 17,292 |
| | **Claims incurred** | | | | | | | | | |
| R1610 | Gross | | 5,231 | 122 | 81 | | | | | 5,434 |
| R1620 | Reinsurers' share | | 0 | 0 | 0 | | | | | 0 |
| R1700 | Net | 0 | 5,231 | 122 | 81 | | | | | 5,434 |
| | **Changes in other technical provisions** | | | | | | | | | |
| R1710 | Gross | | | | | | | | | 0 |
| R1720 | Reinsurers' share | | | | | | | | | 0 |
| R1800 | Net | 0 | 0 | 0 | 0 | | | | | 0 |
| R1900 | **Expenses incurred** | 0 | 1,481 | 34 | 39 | | | | | 1,555 |
| R2500 | **Other expenses** | | | | | | | | | |
| R2600 | **Total expenses** | | | | | | | | | 1,555 |

**S.12.01.02**

## Life and Health SLT Technical Provisions

| | | Insurance with profit participation | Index-linked and unit-linked insurance | | | Other life insurance | | | Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations | Accepted reinsurance | Total (Life other than health insurance, including Unit-Linked) | Health insurance (direct business) | | | Annuities stemming from non-life insurance contracts and relating to health insurance obligations | Health reinsurance (reinsurance accepted) | Total (Health similar to life insurance) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Contracts without options and guarantees | Contracts with options or guarantees | | Contracts without options and guarantees | Contracts with options or guarantees | | | | | Contracts without options and guarantees | Contracts with options or guarantees | | | |
| | | C0020 | C0030 | C0040 | C0050 | C0060 | C0070 | C0080 | C0090 | C0100 | C0150 | C0160 | C0170 | C0180 | C0190 | C0200 | C0210 |
| R0010 | **Technical provisions calculated as a whole** | | 35,218 | | | | | | | | 35,218 | | | | | | |
| R0020 | Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole | | | | | | | | | | 0 | | | | | | |
| | **Technical provisions calculated as a sum of BE and RM** | | | | | | | | | | | | | | | | |
| | **Best estimate** | | | | | | | | | | | | | | | | |
| R0030 | **Gross Best Estimate** | 93,066 | | -2,219 | | | 1,431 | | | | 92,277 | | | | | | |
| R0080 | Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default | | | | | | | | | | 0 | | | | | | |
| R0090 | Best estimate minus recoverables from reinsurance/SPV and Finite Re | 93,066 | | -2,219 | 0 | | 1,431 | 0 | | | 92,277 | | | | | | |
| R0100 | **Risk margin** | 647 | 229 | | | 10 | | | | | 886 | | | | | | |
| | **Amount of the transitional on Technical Provisions** | | | | | | | | | | | | | | | | |
| R0110 | Technical Provisions calculated as a whole | | | | | | | | | | 0 | | | | | | |
| R0120 | Best estimate | | | | | | | | | | 0 | | | | | | |
| R0130 | Risk margin | | | | | | | | | | 0 | | | | | | |
| R0200 | **Technical provisions - total** | 93,713 | 33,228 | | | 1,441 | | | | | 128,381 | | | | | | |

S.23.01.01

## Own Funds

| | Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35 | Total | Tier 1 unrestricted | Tier 1 restricted | Tier 2 | Tier 3 |
|---|---|---|---|---|---|---|
| | | C0010 | C0020 | C0030 | C0040 | C0050 |
| R0010 | Ordinary share capital (gross of own shares) | 0 | 0 | | 0 | |
| R0030 | Share premium account related to ordinary share capital | 0 | 0 | | 0 | |
| R0040 | Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings | 0 | 0 | | 0 | |
| R0050 | Subordinated mutual member accounts | 0 | | 0 | 0 | 0 |
| R0070 | Surplus funds | 0 | 0 | | | |
| R0090 | Preference shares | 0 | | 0 | 0 | 0 |
| R0110 | Share premium account related to preference shares | 0 | | 0 | 0 | 0 |
| R0130 | Reconciliation reserve | 14,768 | 14,768 | | | |
| R0140 | Subordinated liabilities | 0 | | 0 | 0 | 0 |
| R0160 | An amount equal to the value of net deferred tax assets | 0 | | | | 0 |
| R0180 | Other own fund items approved by the supervisory authority as basic own funds not specified above | 0 | 0 | 0 | 0 | 0 |
| R0220 | **Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds** | 0 | | | | |
| R0230 | **Deductions for participations in financial and credit institutions** | 0 | 0 | 0 | 0 | |
| R0290 | **Total basic own funds after deductions** | 14,768 | 14,768 | 0 | 0 | 0 |
| | **Ancillary own funds** | | | | | |
| R0300 | Unpaid and uncalled ordinary share capital callable on demand | 0 | | | | |
| R0310 | Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand | 0 | | | | |
| R0320 | Unpaid and uncalled preference shares callable on demand | 0 | | | | |
| R0330 | A legally binding commitment to subscribe and pay for subordinated liabilities on demand | 0 | | | | |
| R0340 | Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC | 0 | | | | |
| R0350 | Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC | 0 | | | | |
| R0360 | Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC | 0 | | | | |
| R0370 | Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC | 0 | | | | |
| R0390 | Other ancillary own funds | 0 | | | | |
| R0400 | **Total ancillary own funds** | 0 | | | 0 | 0 |
| | **Available and eligible own funds** | | | | | |
| R0500 | Total available own funds to meet the SCR | 14,768 | 14,768 | 0 | 0 | 0 |
| R0510 | Total available own funds to meet the MCR | 14,768 | 14,768 | 0 | 0 | |
| R0540 | Total eligible own funds to meet the SCR | 14,768 | 14,768 | 0 | 0 | 0 |
| R0550 | Total eligible own funds to meet the MCR | 14,768 | 14,768 | 0 | 0 | |
| R0580 | **SCR** | 9,735 | | | | |
| R0600 | **MCR** | 3,288 | | | | |
| R0620 | **Ratio of Eligible own funds to SCR** | 151.70% | | | | |
| R0640 | **Ratio of Eligible own funds to MCR** | 449.11% | | | | |

| | **Reconcilliation reserve** | C0060 |
|---|---|---|
| R0700 | Excess of assets over liabilities | 14,768 |
| R0710 | Own shares (held directly and indirectly) | 0 |
| R0720 | Foreseeable dividends, distributions and charges | |
| R0730 | Other basic own fund items | 0 |
| R0740 | Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds | 0 |
| R0760 | **Reconciliation reserve** | 14,768 |
| | **Expected profits** | |
| R0770 | Expected profits included in future premiums (EPIFP) - Life business | |
| R0780 | Expected profits included in future premiums (EPIFP) - Non- life business | |
| R0790 | **Total Expected profits included in future premiums (EPIFP)** | 0 |

S.25.01.21

## Solvency Capital Requirement - for undertakings on Standard Formula

| | | Gross solvency capital requirement | USP | Simplifications |
|---|---|---|---|---|
| | | C0110 | C0090 | C0120 |
| R0010 | Market risk | 11,830 | | |
| R0020 | Counterparty default risk | 500 | | |
| R0030 | Life underwriting risk | 1,846 | | |
| R0040 | Health underwriting risk | 0 | | |
| R0050 | Non-life underwriting risk | 0 | | |
| R0060 | Diversification | -1,609 | | |
| R0070 | Intangible asset risk | 0 | | |
| R0100 | **Basic Solvency Capital Requirement** | 12,568 | | |

| | | |
|---|---|---|
| | **Calculation of Solvency Capital Requirement** | C0100 |
| R0130 | Operational risk | 681 |
| R0140 | Loss-absorbing capacity of technical provisions | -3,514 |
| R0150 | Loss-absorbing capacity of deferred taxes | 0 |
| R0160 | Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC | 0 |
| R0200 | **Solvency Capital Requirement excluding capital add-on** | 9,735 |
| R0210 | Capital add-ons already set | 0 |
| R0220 | **Solvency capital requirement** | 9,735 |
| | **Other information on SCR** | |
| R0400 | Capital requirement for duration-based equity risk sub-module | 0 |
| R0410 | Total amount of Notional Solvency Capital Requirements for remaining part | 0 |
| R0420 | Total amount of Notional Solvency Capital Requirements for ring fenced funds | 0 |
| R0430 | Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios | 0 |
| R0440 | Diversification effects due to RFF nSCR aggregation for article 304 | 0 |

**USP Key**

**For life underwriting risk:**
1 - Increase in the amount of annuity benefits
9 - None

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

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

**S.28.01.01**

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

| | Linear formula component for non-life insurance and reinsurance obligations | C0010 |
|---|---|---|
| R0010 | $MCR_{NL}$ Result | 0 |

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

| | Linear formula component for life insurance and reinsurance obligations | C0040 |
|---|---|---|
| R0200 | $MCR_L$ Result | -716 |

| | | Net (of reinsurance/SPV) best estimate and TP calculated as a whole | Net (of reinsurance/SPV) total capital at risk |
|---|---|---|---|
| | | C0050 | C0060 |
| R0210 | Obligations with profit participation - guaranteed benefits | 43,350 | |
| R0220 | Obligations with profit participation - future discretionary benefits | 49,716 | |
| R0230 | Index-linked and unit-linked insurance obligations | 32,998 | |
| R0240 | Other life (re)insurance and health (re)insurance obligations | 1,431 | |
| R0250 | Total capital at risk for all life (re)insurance obligations | | 6,567 |

| | Overall MCR calculation | C0070 |
|---|---|---|
| R0300 | Linear MCR | -716 |
| R0310 | SCR | 9,735 |
| R0320 | MCR cap | 4,381 |
| R0330 | MCR floor | 2,434 |
| R0340 | Combined MCR | 2,434 |
| R0350 | Absolute floor of the MCR | 3,288 |
| R0400 | **Minimum Capital Requirement** | 3,288 |