Solvency and Financial Condition Report 2022 – Metfriendly

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Abbreviations used in this Report

AFH	Actuarial Function Holder
AWP	Accumulating With-Profits
ARC	Audit, Risk and Compliance [Committee]
BEL	Best Estimate Liabilities
CA	Chief Actuary
CEO	Chief Executive Officer [of Metfriendly]
CFO	Chief Finance Officer [of Metfriendly]
CNP	Conventional Non-Profit
CMI	Continuous Mortality Investigation
CWP	Conventional With-Profits
DTA	Deferred Tax Assets
FCA	Financial Conduct Authority
FLAOR	Forward Looking Assessment of Own Risks
HRG	Homogeneous Risk Group
IBNR	Incurred But Not Reported
ICOP	In Course of Payment
INSPRU	Prudential Sourcebook for Insurers (contains the regulations under Solvency I)
LOB	Line of Business
MCR	Minimum Capital Requirement
Metfriendly	Metropolitan Police Friendly Society Ltd
NED	Non-Executive Director
ORSA	Own Risk and Solvency Assessment
PPFM	Principles and Practices of Financial Management
PRA	Prudential Regulation Authority
PV	Present Value
R&A	Report and Accounts
RM	Risk Margin
RSR	Regulatory Supervisory Report
RST	Reverse Stress Test
QMI	Quarterly Management Information
SCR	Solvency Capital Requirement
SFCR	Solvency and Financial Condition Report
SF&I	Strategic Finance and Investment [Committee]
SIMF	Senior Insurance Management Function
TAS	Technical Actuarial Standard
TP	Technical Provisions
WPA	With-Profits Actuary
WPNED	With-Profits NED (the Advisory Arrangement adopted by Metfriendly)

SUMMARY

Background

Metropolitan Police Friendly Society Limited (also referred to as 'Metfriendly', 'the Society', "we" or "our" in this document) is a mutual organisation, owned by its Members, and established as a friendly society.

We are regulated by the Prudential Regulation Authority and the Financial Conduct Authority and are not part of a regulated group of companies and have no active subsidiaries.

All serving and former members of the police services and their families are eligible to join the Society, however the majority of Members and New business sales remain focused on those in the London area - reflecting our close and longstanding links with police services in the capital.

Our core products are with-profits savings and investment products which are intended to be held for the medium to long term. These include stocks and shares ISAs, which can be used for regular savings or lump sum investments. Our guaranteed five-year savings plan continues to be popular and provides a fixed return at the end of the term. Protection products, which include life and health insurance, complement our savings products. Health products, comprising Income Protection and Critical Illness, are tailored to the benefits provided to police officers through their employment. Our distribution model is to provide information, not advice, about our products, and we do not sell through intermediaries or pay commission to our field officers. We provide this information by running seminars to educate and support Members' financial needs.

As at 31 December 2022, Metfriendly had 18,118 Members and total assets of approximately £277m.

The current regulatory solvency framework for the European Economic Area ("EEA") insurance and reinsurance industry came into effect on 1 January 2016; this regime is known as Solvency II. The Solvency II regime applied to UK insurers until 31 December 2020, which was the end of the transition period agreed following the UK's exit from the EU (and the EEA). Since 1 January 2021, the UK has been free to determine an appropriate regulatory regime for insurance companies.

A few changes have been made to date to the Solvency II regime as it is applied to the UK, including a change to the Solvency II Technical Information used to value the Technical Provisions and in the calculation of the Solvency Capital Requirement. Otherwise references in this document to articles and guidance of the Solvency II Directive are equally applicable to the UK Solvency II regime.

Business Review

Our long-term strategy is defined by our Vision, Mission, Objectives and Strategy, which are underpinned by our values. Our Vision, Mission and Values really mean something to all our stakeholders and is something that all of us at Metfriendly believe in. It also means that putting our Members at the heart of everything we do is embedded in our strategy.

Our Vision: To be the trusted provider of financial solutions relevant to the Police Family.

Our Vision is about our aspiration, where we want to be. It is enduring, inclusive and idealistic. Over time, the way in which we deliver it will change as we seek to remain relevant in the future. The vision is underpinned by our Values, which describe how we go about our work and what is important to the Society:

Our Values

We earn T.R.U.S.T. by:

- Treating our Members, team and other stakeholders with courtesy, respect, and professionalism
- Recognising the unique profession of policing and proudly placing Members at the heart of our Society
- Understanding the need to continually improve in order to meet our Members' current and future needs
- Striving to get things right first time
- Taking care to act with honesty and integrity at all times.

These phrases encompass the values we uphold and are a good representation of how we should behave and work. They permeate throughout the Society, from the Board to Staff, and form the cornerstone of how we make decisions. The use of a mnemonic means something to us all and helps in bringing our values to life. TRUST is a word Metfriendly strongly associates with because our Members trust us with their hard-earned savings.

Our Mission: To be a commercially strong and modern mutual society that has the financial security of the Police Family at its heart.

Our mission is about how we want to achieve our vision. It is forward-looking and puts the Police at the heart of how we will work.

Strategic Objectives and Opportunities:

Our strategy for several years has been growth, primarily through increased market penetration. Each year we set objectives so we can monitor our progress. For 2022, we also determined to make your Society easier to access and much more efficient. I am delighted that we have been able to achieve both these goals.

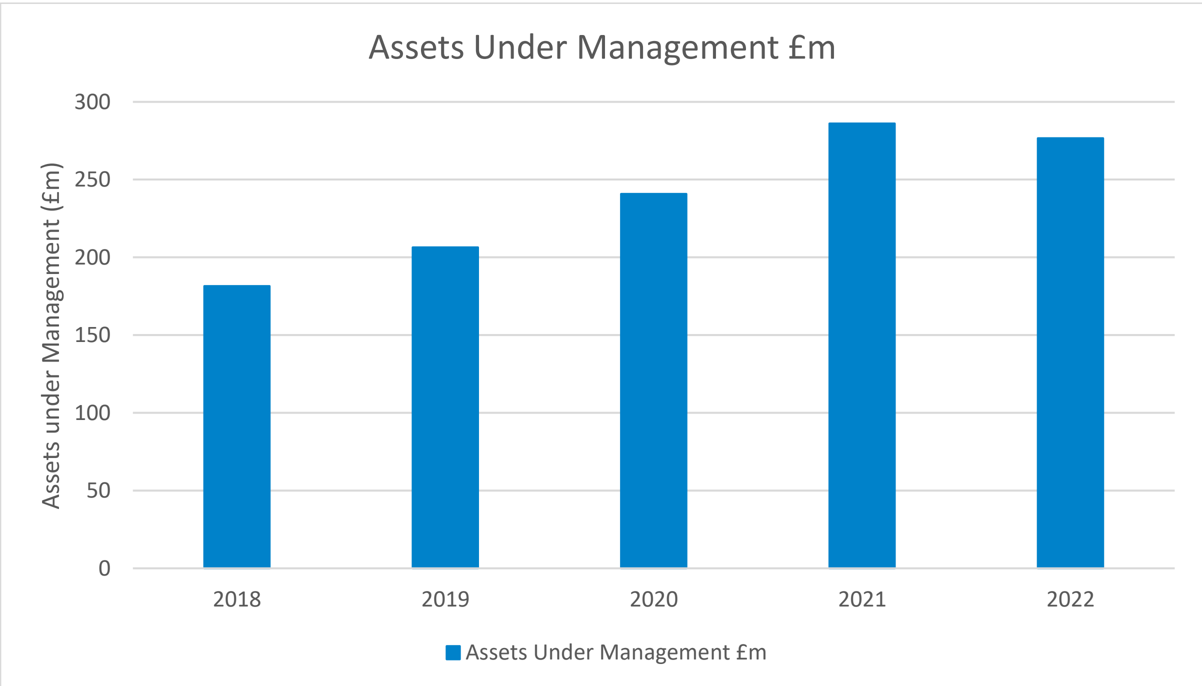
There are still further opportunities for Metfriendly to expand its business with the Police Family across the UK, and to deliver even greater efficiencies through the ability of our new systems to scale. This will continue to be a focus for Metfriendly in 2023.

Review of 2022

2022 was another strong year for Metfriendly, with the Society continuing to grow and improve despite a backdrop of challenging economic conditions.

A growing number of Members are trusting the Society with their investments and protection: Membership reached its highest ever level of 18,118 and a record amount was invested in Metfriendly for the second year running – only 2021 beat 2022 in terms of new business (2022 NB APE £7.4m; 2021: £9.3m) and premiums invested (2022 Gross Premiums Written £47m; 2021: £60m).

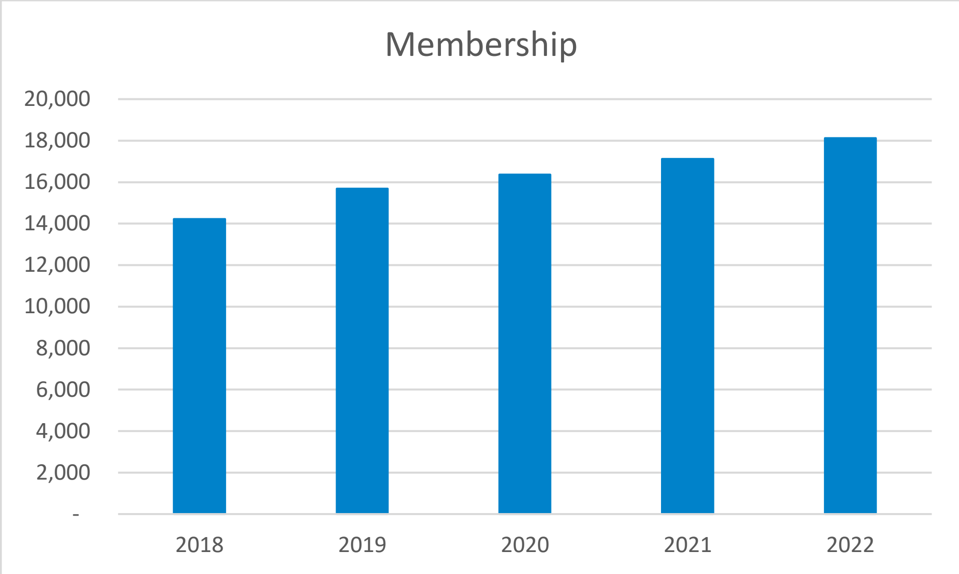
Assets Under Management[1] were affected by the downturn in global financial markets - total Assets Under Management at the end of the year were £277m (2021: £286m), as shown in the graph below.



[1] Assets Under Management are calculated as total assets less deferred tax assets and reinsurers' share of technical provisions.

1. Growth of your Society

We grew our membership from 17,118 at the end of 2021 to 18,118 at the end of 2022. We have been able to grow our membership through the Met and beyond. The graph below shows how membership numbers have changed over the last five years.



As well as the number of Members, we measure New Business growth using an internal measure, Annual Premium Equivalent (APE), which reflects the relative value of different product sales.

APE is calculated for new lump sum investments and new regular and recurrent savings and protection plans as:

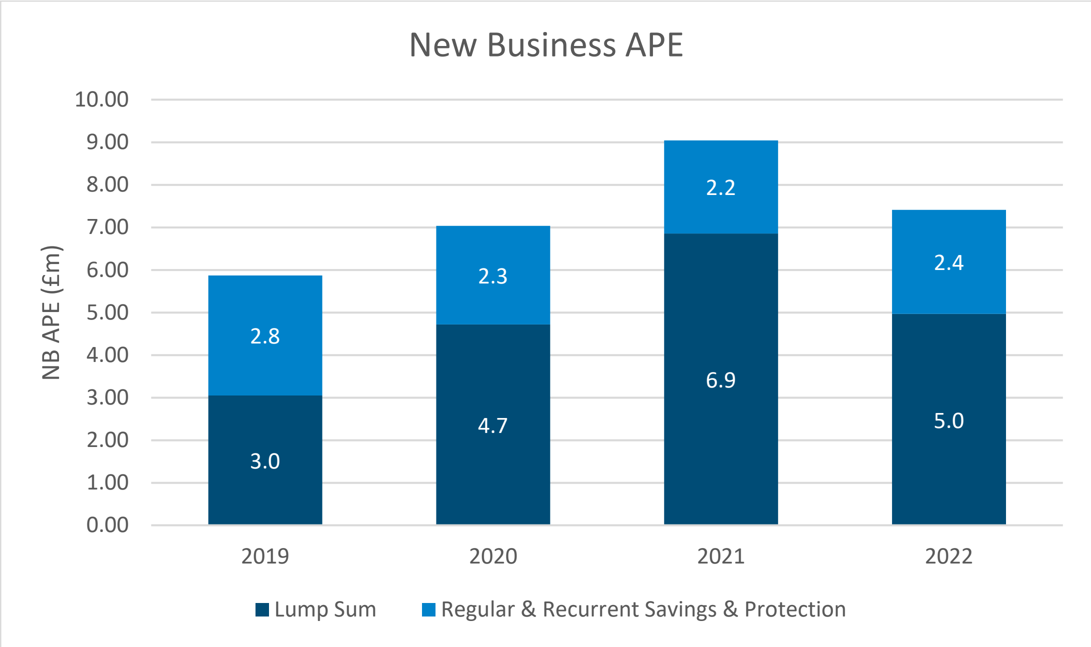
- For lump sum contributions: 15% of the premium received.
- For Regular and Recurrent savings: 12 times the initial monthly premium received.
- For Regular Premium Protection: 12 times the contractual monthly premium amount.
- For the Guaranteed Five Year Savings Plan ("G5YSP"): 6 times the monthly premium.

New Business APE was £7.4m in 2022 compared to £9.0m in 2021 (£7.0m in 2020).

2022 New Business APE from Lump Sum contributions was lower than 2021 as the sudden downturn in the global and national economies impeded some of our Members' ability to invest lump sums, and the (very welcome) lifting of pandemic-related restrictions meant that significant spends on holidays, weddings, etc, that were delayed in 2020 and 2021 were realised in 2022. We anticipate seeing this effect continue in 2023.

We have been delighted to see an increase in New Business APE from regular and recurrent savings, as members of the Police Family begin to develop a savings habit – one of the key themes of our family finance-based education seminars – although we are very aware of the cost-of-living pressures on family finances.

The following graph illustrates the increase in regular savings (including regular and recurrent savings, guaranteed five year savings and protection) relative to lump sums in 2022.



2. Making the Society easier for members to access

Project Darwin was instigated to bring our systems up to date and make it much easier for our Members to access their Society in the ways they would like to. It replaces a strong-but-inflexible system with one of equal strength and the ability to allow Members and prospective Members to engage with us online, and in the ways they have enjoyed for years. It is also making the processes much quicker for Members; applications that used to take 40 minutes, can now be processed in just a few minutes. This means we can spend more time understanding and addressing the needs of our Members.

I have been delighted with the delivery of Project Darwin to date. We decided to release each phase of the project as we go rather than develop and release everything in one go. Arguably, this may have increased some of the associated work, but it means members benefit from improved and quicker journeys much sooner, and efficiencies flow through to the cost to provide services immediately. The project is well controlled and currently on time and within budget.

Key member deliveries for Project Darwin have been the improved ease with which Members can open new accounts and top up their existing accounts. 20% of the total applications received in 2022 were processed through the new system, and all new savings applications were processed on the new system by the end of the year. All savings and protection business should be on the new system by the end of 2023 – a terrific achievement by a small, dedicated team.

Invisible to members but important nevertheless is the additional resilience and flexibility the new system is delivering for Metfriendly.

3 Improving the running of the Society for members

Building on the efficiencies delivered by Project Darwin, in 2022 we reviewed our costs across the Society with a view to ensuring we were running the Society – spending members' money – as efficiently as possible, while maintaining the excellent service for which Metfriendly is known. I am delighted that we have been able to achieve this, too.

This has meant our Member Service Assistants have more time available to help our Members. We set ourselves high standards for delivering service to our Members, and we met or exceeded all our service standards for the year.

One of the things we are proud of is our availability for our Members, who know they will not be kept on hold for an age before we answer the phone .

4. Defining our sustainability and Environment, Social and Governance agenda

We have identified the main sources of our carbon footprint and delivered some initiatives to reduce it, including offering our staff a salary sacrifice scheme for electric vehicles and reducing travel by holding more of our seminars and one-to-ones with members online. We have also proactively engaged our investment managers on actions they can take and initiated a review of our investments. However, we have not yet defined our future state and this work will continue into 2023.

We deliver against our social objectives through our Education and Enrichment programmes, Wellbeing activities and Sponsorships.

With a new Chair of the Board in place, there will be some changes in Board committees and membership. These will all be designed to ensure the governance arrangements continue to be fit for purpose and are focussed on the key success factors for the business and their associated risks,

Metfriendly benefits from excellent Non-Executive Directors (NEDs) with a range of backgrounds and skills: policing, financial and investments. These NEDs provide a depth of knowledge and experience we can call on to run the Society as well as challenge and support for the Executive Committee.

System of Governance

The Society's Board of Management ('the Board') is responsible for oversight of the organisation and setting its strategy. The Board is supported by four Board committees and the With Profits Working Group.

The Society has a clear reporting structure and requires all Senior Managers and Certified Employees under the Senior Managers and Certification Regime to have the requisite skills and experience to fulfil their roles and responsibilities. It has robust procedures for ensuring their fitness and propriety on appointment and whilst in office. This is supported by a pre-agreed training schedule for all.

The governance structure supports the Society's approach to risk management by ensuring that risks are managed prudently and in line with the Society's conservative risk appetite. This is based on ensuring that financial strength should not be compromised, but that this should be balanced against the requirement to achieve good investment returns for Members and to avoid holding excessive levels of Own Funds.

Risk management is overseen by the Board, with detailed review carried out on its behalf by the Audit Risk and Compliance (ARC) Committee. The ARC Committee has responsibility for our risk register, which provides information about the main risks facing the Society, and the controls we have put in place to reduce their likely frequency or impact. This Committee also oversees the annual Own Risk and Solvency Assessment (ORSA) process that takes place throughout the year, ensuring that it is fully integrated with the decision-making process.

An ORSA Report is approved by the Board in the fourth quarter of the year. This report summarises the key points of each ORSA process and is provided to the regulator along with the component reports. The ORSA report is available to all members of staff.

The Society's actuarial function is outsourced to Milliman LLP and this includes the roles of With Profits Actuary and Chief Actuary. Oversight of this arrangement is provided by the Chief Executive Officer, supported by the Chief Financial Officer and the Board. The activity of the With Profits Actuary is overseen through the With Profits Advisory Arrangement, a role held by a suitably qualified Non-Executive Director.

Risk Profile

The Society uses the Standard Formula to calculate its Solvency Capital Requirement (SCR) under the Solvency II regime, as this represents appropriate capital for an organisation with the Society's risks. The most material financial risk faced by the Society is market risk. We do not avoid market risk, recognising that we need to generate acceptable returns for Members. However, we seek to mitigate it by holding a well-diversified investment portfolio and matching our fixed liabilities with fixed income investment assets of appropriate duration.

We also consider reputational risk to be significant and therefore adopt a highly risk averse approach to safeguarding Member's data.

The Appropriateness of using the standard formula to assess the Society's capital requirements is reviewed on at least an annual basis by the Board.

Valuation for Solvency Purposes Summary

The Society has aligned its report and accounts with technical provisions required for reporting under Solvency II. The Society's principal assets as determined for solvency purposes reduced during 2022, to £276.8m as at 31 December 2022, from £287.3m as at 31 December 2021, primarily as investment losses more than offset net cash inflows from premiums, less claims and expenses.

The Society's liabilities comprise primarily technical reserves for benefits and guarantees accrued to Members, being the sum of the best estimate of liabilities and the risk margin. The total liabilities have reduced to £253.0m as at 31 December 2022, from £258.1m as at 31 December 2021, with the effect of market value falls exceeding that of new business written during the year.

The Society does not use adjustments (volatility, matching or transitional) in calculating its solvency ratio.

Capital Management Summary

The Society's Own Funds (capital) arise entirely from historical surpluses which have not been distributed to Members and so Own Funds are all Tier 1 capital.

The Society's solvency capital coverage ratio as at 31 December 2022 was 201% (2021: 193%) with Own Funds of £23.8m (2021: £29.2m) and a Solvency Capital Requirement of £11.8m (2021: £15.1m). The reduction in the SCR during 2022 primarily relates to: a reduction in non-Sterling and equity holdings within the Society's investments reducing currency and equity risk, a reduction in the Solvency II prescribed equity stress (through the symmetric adjustment) that reduces the equity risk capital requirement, an increased likelihood that guarantee charges are increased (in line with the modelled management action) in a number of market stress scenarios, and lower capital requirements for new business (from the market and life underwriting risk modules, and calculated formulaically in respect of operational risk) due to lower volumes of new business written during 2022 than 2021.

Under Solvency II the SCR is subject to a minimum level, known as the Minimum Capital Requirement ("MCR"). The MCR is calculated using a linear formula. Having derived the MCR using the prescribed formula, it is then subject to a cap and floor of 45% and 25% of the SCR respectively, and finally, an absolute minimum level, which is currently set at €4.0m; £3.4m in GBP (2021: €3.7m; £3.1m).

Following a decrease in the SCR over 2022 it is the absolute floor (£3.4m) that bites for the Society for the 31 December 2022 valuation. The amount of the Minimum Capital Requirement (MCR) is £3.4m at 31 December 2022 (2021: £3.8m). The eligible amount of Own Funds available to cover the MCR is £23.8m (2021: £29.2m), which gives an MCR coverage ratio of 690% (2021: 773%). The Society continues to be financially strong and has complied with both the Minimum Capital Requirement and the Solvency Capital Requirement throughout 2022 by a large margin.

Global investment markets have been significantly impacted during the year by exceptionally high inflation, significant interest rate rises, and UK political uncertainty, following the economic effects of Covid and the Russian invasion of Ukraine. The Society's investment strategy performed largely as expected in these conditions and the With-Profits Fund has been somewhat cushioned from the extremes of performance by investing in a diversified portfolio of assets.

At all times during the period to the date of submission / signing of this report the Society has been able to meet its capital requirements as measured by the SCR and MCR by a significant margin, and coverage against the key SCR measure has remained comfortably within the Society's risk appetite target range of 150%-300% of SCR. Our ORSA, and in particular the Forward Looking Assessment of Own Risks and Reverse Stress Tests, supports the Board's expectation that the Society will be able to continue to do so and has the necessary management actions available to mitigate significant further risks that may emerge.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the SFCR in accordance with the Prudential Regulation Authority ('PRA') rules and SII regulation.

The PRA Rulebook for SII firms in Rule 6.1 (2) and Rule 6.2 (1) of the Reporting Part requires that the Society must have in place a written policy ensuring the ongoing appropriateness of any information disclosed and that the Society must ensure that its SFCR is subject to approval by the Directors.

Each of the Directors, whose names and functions are listed in the Board of Directors section of the Report and Accounts, confirm that, to the best of their knowledge:

- **(a) Throughout the financial year in question, the Society has complied in all material respects with the requirements of the PRA rules and SII Regulations as applicable; and**
- **(b) It is reasonable to believe that, at the date of the publication of the SFCR, the Society continues so to comply, and will continue so to comply in the future.**

By Order of the Board

Graeme McAusland
Graeme McAusland (Mar 29, 2023 17:00 GMT+1)

Name	Graeme McAusland
Title	Chair
Date	29th March 2023

Consideration for requesting a REPORT OF THE EXTERNAL INDEPENDENT AUDITOR to the Directors of Metropolitan Police Friendly Society Limited ('the Society') pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms

The Society is classified as a "small insurer" for SFCR external audit purposes as defined in PRA Policy Statement PS25/18. Its score based on the results for the year-ended 31 December 2022 was, at 17.67, below the limit for audit, set by the PRA at 100.

Following consideration of the costs associated and the potential benefits, the Society's Board made the decision not to request an external audit of its Solvency and Financial Condition Report 2022.

A. BUSINESS AND PERFORMANCE

A.1 Description of the Business

A.1.1 Legal Structure

Metropolitan Police Friendly Society Limited ('Metfriendly' or 'the Society') is a friendly society, incorporated under the Friendly Societies Act 1992 and registered in the United Kingdom (registered number 496F). The Society's registered office is at Central Court, 1B Knoll Rise, Orpington BR6 0JA.

The Society is dual regulated under registered number 110026 by both the Financial Conduct Authority ('FCA') and the Prudential Regulation Authority ('PRA'). As an FCA designated flexible portfolio firm and a PRA designated P5 firm, the Society does not have individually named supervisors. Contact details for each regulator are as follows:

FCA: 12 Endeavour Square, London, E20 1JN firm.queries@fca.org.uk Freephone 0800 111 6768

PRA: Bank of England, Threadneedle Street, London EC2R 8AH firmenquiries@bankofengland.co.uk Phone 020 7601 4444

The Society's auditor is Mazars LLP, 30 Old Bailey, London, EC4M 7AU.

The Society is a mutual organisation, owned by its Members (i.e. its policyholders) and has no shareholders. At General Meetings, each member over the age of 18 has one vote, irrespective of the number of policies they hold, and all votes count equally. The Society is not part of a group and has no trading subsidiaries.

A.1.2 Description of the Business

Metfriendly operates solely in the UK and individuals living outside the UK are not eligible to take out policies with the Society. Members with policies who move abroad may not take out additional policies.

Membership of the Society is restricted to current and former police personnel and their family members providing a well-defined affinity group. Metfriendly's sales and marketing activities included physical events focussed in the Greater London area, alongside virtual events and direct marketing that enable access to a much wider geographical audience on a cost-effective basis.

The Society provides medium to long-term savings and investment products as well as protection policies, each of which is outlined in turn below. It does not provide cash savings accounts in any format. All savings and investment products are with-profits with the exception of the guaranteed 5 year savings plan. Employees and pensioners of the police service in London and certain other forces are able to make payments to the Society by deduction from their salary, as well as by direct payment to the Society.

As at 31 December 2022 the Society had total assets of £277m, 18,118 Members and 44 employees (plus 8 non-executive directors).

Savings plans include 'stocks and shares' ISAs for adults and Junior ISAs for children to facilitate monthly savings and also include an annual payment escalator option. Both are subject to minimum and maximum monthly amounts, and the annual limits imposed by statute.

The Society also offers a Lifetime ISA ("LISA") (minimum amount £50pm / £1,200 lump sum / £400 top-ups), available to members aged between 18 and 39. The LISA is designed to help save for a deposit on a first home or to supplement pension savings. Contributions are supplemented by a 25% government bonus. The LISA is subject to both the ISA and specific Lifetime ISA rules. Returns earned depend on the performance of the With-Profits Fund.

Longer-term savings plans are also available. A ten year savings plan allows monthly payments between £25 per month and £300 per month, with the first £25 per month being tax exempt (subject to a maximum of one such tax exempt policy per person – whether with the Society or another organisation). Longer term plans of 11 to 25 years can no longer be taken out, but some older plans of this duration are still active.

Returns earned on the above plans depend on the performance of the With-Profits Fund (see below).

Metfriendly also offers 5 year regular savings plans with guaranteed returns, depending on the regular fixed monthly savings amount (at least £20 per month) that is chosen at the start of the five year period. Members can select a Rolling Plan option that starts a new 5 year regular savings plan every calendar year.

Investment plans include a lump sum stocks and shares ISA (minimum amount £2,000) that is subject to the annual maximum ISA limits imposed by statute. The Society also offers a With Profit Bond that is subject to a minimum amount of £2,000. These lump sum products have no fixed term, but are intended for the longer-term, with annual bonuses and eligibility for a final bonus after at least three years. Returns earned depend on the performance of the With-Profits Fund.

Protection plans are designed to provide income protection for police officers and police staff in the event of sickness, critical illness, or injury. Life insurance protection is also available, either as a fixed sum or a reducing amount (for instance to cover the diminishing balance on a repayment mortgage). The Society also provides a lump sum critical illness plan to new recruits aged between 18 and 35.

The Society's **With Profits Fund** is invested in a range of assets spread across several pooled investment funds, with diversified allocations in cash, bond funds, a multi asset fund (holding equities, bonds, commodities and other assets) and property funds. The investment strategy aims to provide returns that are significantly better than those available on government bonds. Surplus funds in excess of asset shares and investment backing non-profit policies (guaranteed savings and protection plans) are invested in cash, liquidity funds and bond funds.

A.1.3 Significant External Events in 2023

The outlook for the economy and investment markets remains uncertain and the impact of inflation remains a key factor for the Society and its Members in 2023. In response, management and the Board have carefully considered the Society's financial and operational business plans, including the outlook for new business, expense and solvency forecasts for the going concern assessment period.

The Society has reviewed its risk management, solvency and liquidity positions to ensure that we remain within our risk appetite. We also subjected the solvency position to stress testing based on several scenarios, including scenarios considering the unfavorable impact in business volumes and further investment value falls, and the Society envisages that it will remain solvent based on these projections.

A.2 Underwriting Performance

The underwriting result encompasses premiums plus allocated investment returns, less claims, expenses, taxation and the increase in technical provisions, as reported in the UK GAAP accounts. Technical provisions are reported in the accounts on a Solvency II basis. Table A1 shows how the 2022 result arises by line of business, with Best Estimate Liabilities allocated to each line of business and the Risk Margin and Darwin expense reserve allocated to capital.

The 2022 result was an underwriting loss of £4.6m (2021: loss of £0.3m) and arose primarily as a consequence of increases in With-Profits guarantee costs, unrealised investment losses on Non-Profit and Own Funds investments, and the strain of writing new business.

Table A.1 2022 Results by Line of Business*

Underwriting Performance by Line of Business	Accumulating With Profits £m	Conventional With Profits £m	Other Savings £m	Protection £m	Attributed to Capital £m	**Total 2022 £m**	Total 2021 £m
Premiums	40.5	1.3	4.8	0.5	-	**47.1**	59.7
Investment Return	(23.7)	(0.9)	(0.7)	(0.2)	(1.7)	**(27.2)**	9.3
Claims	(17.6)	(1.1)	(4.8)	(0.2)	-	**(23.7)**	(20.7)
Expenses	(4.6)	(0.3)	(0.8)	(0.3)	-	**(6.0)**	(5.7)
Taxation	0.2	-	-	-	-	**0.2**	0.1
Decrease/(Increase) in Technical Provisions	2.1	1.6	0.9	0.5	0.2	**5.3**	(42.8)
Increase/(Decrease) in Reinsurance Asset	-	-	-	(0.2)	-	**(0.2)**	(0.1)
Total UW Performance	**(3.2)**	**0.6**	**(0.6)**	**0.1**	**(1.5)**	**(4.6)**	(0.3)

** - Table might contain differences due to rounding. Premiums and claims are shown net of reinsurance.*

Premiums from AWP business decreased by £12.7m compared to 2021 (2021: increased by £14.6m), as Lump Sum premiums returned to a lower level consistent with pre-Covid experience. 2022 investment returns were significantly impacted by unrealised losses arising from market interest rate rises and falls in Global equity, bond and UK commercial property values. Best Estimate Liabilities reduced as the impact of investment losses and economic assumption changes more than offset net increases from other changes.

All business was written in the UK. Accumulating With-Profits (AWP) business is written as single premium business with no fixed term and includes recurrent premiums initiated by the member in prior years where the member retains the right to vary or suspend premiums without penalty. Conventional With-Profits (CWP) business is written as regular premium business with a fixed payment term.

A.3 Investment Performance

The Society invests through pooled funds, with investment management expenses mainly charged directly to those funds. Where the Society receives a rebate of fees from the investment manager, this is recorded as investment income. Investments are selected for long term performance and returns are expected to fluctuate from year to year. A breakdown of the 2022 investment return is given in the Table A.2 below.

Table A.2 Breakdown of 2022 Investment Return*

Investment Income	Investment Income & Net Realised Gains	Net Unrealised Gains & Losses	**Total 2022 Investment Return**		Total 2021 Investment Return	
	£m	£m	**£m**	**%**	£m	%
Residual Assets	0.8	(3.4)	**(2.5)**	**(6.0%)**	(0.0)	(0.1%)
Bond Funds	2.8	(16.6)	**(13.8)**	**(17.5%)**	0.8	0.6%
Multi Asset Funds	1.8	(11.8)	**(10.0)**	**(7.9%)**	5.5	4.8%
Property Funds	1.0	(1.9)	**(0.9)**	**(5.0%)**	3.2	18.2%
Insurance Linked Security Funds	-	0.0	**0.0**	**63.8%**	-	22.3%
Deposits and Cash	0.0	-	**0.0**	**0.2%**	0.1	0.0%
Total	**6.4**	**(33.6)**	**(27.2)**	**(9.6%)**	9.4	3.5%

** - Table might contain differences due to rounding*

The Society separately identifies investments to meet Asset Shares of its With Profits business. These returned a loss of £24.7m (i.e. investment income and realised gains less unrealised losses and investment management expenses) in 2022, equivalent to an investment return of -10.2% (2021: profit of £9.4m, 4.3%).

The residual assets, comprising liquidity and bond funds backing Non-Profit business and Capital, returned a loss of £2.5m in 2022 equivalent to an investment return of -6.0% (2020: £0.01m, -0.1%).

A.4 Other Factors Affecting Performance

2022 acquisition expenses exceeded expense allowances received from new business written in the year and required a call on capital of £0.6m, although total margins from this new business over its life are expected to exceed total expenses from that business. In 2021, expense allowances covered actual expenses due to the high levels of new business written. Other expenditure of £0.8m (2021: £0.35m) on Project Darwin is capitalised as an intangible asset of £1.15m (2021: £0.35m) under UK GAAP and will be amortised in future years. The intangible asset is valued at nil for Solvency II purposes.

Investment losses and allowable expenses in excess of income give rise to a tax loss for the year, of which the majority is carried forward and will be available to offset against future taxable profits, but for which no net deferred tax asset and no tax credit has been recognised. The tax credit for the year mainly arises from the reversal of the prior year deferred tax and is not allocated to capital (2021: £Nil).

Technical Provisions attributed to capital reduced by £0.2m (2021: increased £1.2m) including a £0.3m reduction (2021: £1.0m increase) in the reserve for future expenditure on Project Darwin and a £0.1m increase (2021: £0.2m increase) in Risk Margin. These movements, along with the investment loss on excess assets, are attributed to capital in the underwriting performance shown above.

Overall performance has led to the UK GAAP Fund For Future Appropriations decreasing by £4.6m in 2022 (2021: increase of £0.3m) to £24.9m as at 31 December 2022 (2021: £29.5m).

B. SYSTEM OF GOVERNANCE

B.1 System of Governance

B.1.1 Description of the Board and Committees

The Society's Board of Management ('the Board') is responsible for oversight of the organisation and setting its strategy. As at 31 December 2022 the Board comprised 8 part-time Non-Executive Directors (including the Chair) and 3 full-time Executive Directors. The Chair supported by the Society Secretary, is responsible for leading the Board, whereas the Chief Executive Officer is responsible for leading the Society's operational activity and implementing strategy. Four of the Non-Executive Directors are former police officers, with the remainder having backgrounds in financial services.

The Chair is responsible for the performance of the Board as a whole. This includes appraising the performance of individual Non-Executive Directors and the Chief Executive Officer. The Senior Independent Director ('SID') (a Non-Executive Director) is responsible for leading an annual review of the Chair's performance, taking into account feedback from other directors. The SID also provided a point of contact for Members if they have concerns that they consider not to have been addressed satisfactorily through the normal conduit of the Chief Executive Officer or Chairman. One Non-Executive Director also fulfils the role of With-Profits Non-Executive Director ('WPNED'), leading oversight of the Society's management of its with-profits business and providing independent judgement as required by the FCA.

The governance structure at the 31 December 2022 is shown in the table below, comprising four Board committees whose membership, terms of reference and authority are set by the Board. The Chairs of each committee report to the Board at the next Board meeting following each committee meeting.

BOARD OF MANAGEMENT 2022

Joanna Young (Chair) (retired December 2022)

Annette Petchey (Chief Executive Officer)

Marcus Barnett (Non-Executive Director)

Martin Bellingham (Executive Director)[1]

Gerhardt Ekermans (Executive Director)[2]

Ben Grainger (Executive Director)[2]

Paul Grimshare (Executive Director)[1]

Rebecca Hall (Non-Executive Director)

Craig Haslam (Non-Executive Director)

Nicola Hayes (Non-Executive Director)

Graeme McAusland (Non-Executive Director)

Emma Richards (Non-Executive Director)

Lee Schopp (Non-Executive Director & SID)

1 Paul Grimshare & Martin Bellingham joined the Board during 2022.

2 Ben Grainger & Gerhardt Ekermans resigned from the Board in July 2022

The governance structure of the Committees at December 2022 was:

Audit, Risk and Compliance Committee	Remuneration, Nomination and Governance Committee	Member Committee	Strategic Finance & Investment Committee
Graeme McAusland (Chair)	Nicola Hayes (Chair)	Craig Haslam (Chair)	Lee Schopp (Chair)
Lee Schopp	Joanna Young	Joanna Young	Graeme McAusland
Rebecca Hall	Annette Petchey	Rebecca Hall	Nicola Hayes
Emma Richards	Craig Haslam	Marcus Barnett	Craig Haslam
			Paul Grimshare

The role of each Committee is summarised in the following paragraphs.

The **Audit, Risk and Compliance Committee** provides independent oversight of the Society's statutory reporting and systems of internal control, as well as ensuring its compliance with the Financial Services and Markets Act 2000 and other relevant regulations along with oversight of the Society's systems of risk and compliance management. The Committee's role includes supervising and monitoring the independence, quality and effectiveness of the Society's external audit auditor, its internal audit function and internal assurance programme.

The **Strategic Finance and Investment Committee** purpose is to provide independent oversight of the Society's strategic financial reporting and investment control, and to enable the Society's financial management, including investment strategy and with-profits business, to be reviewed in greater detail than at regular Board meetings.

The **Remuneration**, **Nomination and Governance Committee** oversees the Society's senior management arrangements and makes recommendations to the Board on matters relating to the appointment of Executive and Non-Executive Directors and individuals performing Senior Management Functions (SMF) roles. It keeps the Board's governance arrangements under review and makes appropriate recommendations to ensure that these are consistent with appropriate and proportionate governance practices. It also oversees and recommends to the Board matters relating to the remuneration of Executive and Non-executive Directors.

The **Member Committee** purpose is to put the Member, and the Police Family, at the centre of what Metropolitan Police Friendly Society Ltd ("MPFS") does, to take every opportunity to improve the trust Members have in MPFS and look after their wellbeing; through member interaction to review the Members' experience and journey throughout the Society, assuring and recommending changes based on feedback, market movements and affinity group plans. The committee is committed to listening to Members, to understanding their needs and creating output and actions that create a stronger brand and product for all Members.

B.1.2 Changes to the System of Governance During 2022

There were no changes to the Board committee structure during 2022. The Board reviewed the structure in late 2022 and moving forward the Strategic Finance and Investment Committee will focus on the investment aspect of the business and be called the Investment Committee. Strategic Finance aspects will be overseen directly by the Board.

B.1.3 Remuneration Practices and Policy

The Society's policy for remuneration is to attract and reward senior managers (including Executive Directors) and staff with annually reviewed fixed salaries that recognise their skill set and responsibilities, with changes to senior managers' salaries subject to review by the Remuneration Committee.

The Society operates a discretionary annual bonus scheme that allow for bonus payment not exceeding 12% or 20% (dependent on role) of annual salary.

The scheme is driven by performance against the strategic objectives of the Society as well as performance against personal objectives and behaviours. In 2022 a number of the objectives were achieved, and the Remuneration, Nomination and Governance Committee approved payment of a bonus. The scheme is reviewed each year by the committee.

All employees and senior managers are entitled to join a defined contribution group personal pension plan provided by the Society with employer's contribution of 9% of salary if the employee chooses to opt into a salary sacrifice arrangement of 2.5%. No early retirement schemes are available for employees or senior managers.

Non-Executive Directors' remuneration comprises a fixed annual amount which recognises the responsibilities held (for instance chairing a Board committee). No contributions are made to any pension arrangements on behalf of Non-Executive Directors.

There were no material transactions between the members of Metfriendly's Board (and its employees) and the Society in 2022. Whilst members of the Board who meet the eligibility criteria for membership are permitted to subscribe to Metfriendly policies and plans on normal terms (on their own behalf and that of close family members), these holdings are monitored with annual confirmation at Board level that none are considered material.

B.2 Fitness and Propriety

B.2.1 Fitness and Propriety Requirements

The Society requires all personnel responsible for the organisation's oversight and key functions to have the requisite skills, qualifications, knowledge and experience to fulfil their roles and responsibilities effectively, through their professional qualifications depending on the role (for instance accountancy, actuarial, legal, HR, managerial); or through their knowledge and experience (for instance holding similar positions elsewhere, or thorough senior experience of working with a police service or other membership based entity). Requirements include ensuring that Non-Executive Directors have sufficient time to fulfil their responsibilities, are independent (and are seen to be independent), have no material conflicts of interest, and demonstrate the character, integrity and behaviours conducive to being regarded as a 'fit and proper' person.

B.2.2 Fitness and Propriety Assessment

The Society assesses fitness and propriety on the appointment of a Non-Executive Director and any other key function holders on appointment (whether they are an existing member of staff or externally appointed) to ensure their honesty and financial soundness. This is done through carrying out background screening using the Disclosure and Barring Service (DBS) checks carried out through an external organisation.

The Board ensures that all those in Metfriendly who are involved in the recruitment process have been suitably trained to identify and assess the relevance and circumstances of offences, and that they have received appropriate guidance and training in the relevant legislation relating to the employment of ex-offenders, e.g., the Rehabilitation of Offenders Act 1974. The recruitment policy provides a further safeguard that these matters are fully addressed.

At interview, or in a separate discussion, the Society ensures that an open and measured discussion takes place on the subject of any offences or other matter that might be relevant to the position. Failure to reveal information that is directly relevant to the position sought could lead to withdrawal of an offer of employment. Having a criminal record will not necessarily bar applicants from working with the Society. This will depend on the nature of the position and the circumstances and background of the offences.

For external appointees references are also sought including information about any outstanding liabilities for commission payments, any relevant outstanding or upheld complaint against the candidate from an eligible complainant, and any information concerning their fitness and propriety to act in the relevant position.

On appointment, all SMF holders and directors are required to complete the Fitness and Propriety declaration which forms part of the CONNECT Application that is submitted for regulatory approval. An annual re-declaration is also required, with affirmations required in respect of the same questions asked on the CONNECT Application; together with confirmation that, taking into account the Society's Conflicts of Interests Policy, the individual is not aware of any personal interests, obligations, or other situations that could conflict with the performance of the controlled functions they perform.

At the start of each Board meeting, those present are also asked to declare whether they are aware of any personal conflicts of interest in relation to the agenda items.

Assessment of fitness and propriety of Board members and those holding regulated positions is also supported by:

- Staff and director appraisal processes
- Annual Board self-evaluation
- Regular (normally triennial) externally facilitated Board evaluation exercise

The Society's Conduct Risk Policy which is owned by the Board applies to all employees and directors, requiring them to observe all relevant FCA principles for business relating to conduct including: acting with integrity, due skill, care and diligence treating customers fairly; and managing any conflicts of interest fairly.

Non-Executive Directors and any other key function holders are provided with relevant training for their roles and are also required to keep their skills up to date including meeting any professional CPD requirements.

The tables below set out the Society's Senior Insurance Management Functions, followed by the Key Function Holders as at 31st December 2022:

SMF	HOLDER
SMF1 Chief Executive function	Annette Petchey
SMF2 Chief Finance function	Paul Grimshare
SMF3 Executive Director	Annette Petchey
	Paul Grimshare
	Martin Bellingham
SMF4 Chief Risk function	Robert Dagg
SMF9 Chair	Joanna Young
SMF10 Chair of the Risk Committee	Graeme McAusland
SMF11 Chair of the Audit Committee	Graeme McAusland
SMF12 Chair of the Remuneration Committee	Nicola Hayes
SMF 13 Chair of the Nominations Committee	Nicola Hayes
SMF14 Senior Independent Director	Lee Schopp
SMF15 With Profits Advisory Arrangement	Graeme McAusland
SMF16 Compliance Oversight Function	John Midlane
SMF17 Money Laundering Reporting Officer	Robert Dagg
SMF18 Other Overall Responsibility	Martin Bellingham (Sales & Marketing)
SMF20 Chief Actuary function (outsourced)	Lindsay Unwin*
SMF20a With-Profits Actuary (outsourced)	Lindsay Unwin*
Whistleblowing oversight function	Graeme McAusland

* Lindsay Unwin is an employee of Milliman LLP, with whom the Society has entered an outsourced services agreement.

KEY FUNCTIONS	HOLDER
(1) Risk Management function	Robert Dagg
(2) Actuarial function (outsourced)	Lindsay Unwin*
(3) Internal Audit function	Metfriendly being not classed as a significant firm by PRA or FCA and having outsourced its Internal Audit Function, does not have a SMF5 but has allocated specific responsibilities for oversight of the Internal Audit function to the Chair of the Audit, Risk and Compliance Committee (SMF11)
(4) Compliance function	Annette Petchey (Solvency II)
	John Midlane (FCA COBS)
(5) IT function	David Hurcomb – IT Development
(6) any other function which is of specific importance to the sound and prudent management of the firm	Alan Gray – Overseeing administration function for insurance contracts
	Graeme McAusland (WPAA)
	Dan Stimson – IT Infrastructure
(7) the function of effectively running the firm	Joanna Young (Chair)
	Graeme McAusland (NED)
	Lee Schopp (NED & SID)
	Craig Haslam NED
	Nicola Hayes (NED)
	Rebecca Hall (NED)
	Emma Richards (NED)
	Marcus Barnett (NED)
	Martin Bellingham
	Paul Grimshare
	Robert Dagg (CRO/CoSec)

* Lindsay Unwin is an employee of Milliman LLP, with whom the Society has entered an outsourced services agreement.

B.3 Risk Management System

B.3.1 Risk Management Overview

The Society's Risk Policy sets out how risk is managed by the organisation to ensure that risks are appropriately managed. This is supported by the Society's Values which set out values and expected behaviours that underpin culture, including risk culture, within the organisation, and are set by the Board. These include the exercise of prudence and judgement in financial management, including the requirement to manage Members' funds safely and soundly, but avoiding excessive caution which could unduly reduce returns to Members. The Society's Risk Policy recognises that there are natural tensions to consider in relation to risk tolerance, including:

- achieving good levels of new business, including new Members; whilst being mindful that new business can deplete capital, and inappropriate sales would cause reputational risk.
- achieving good investment returns through exposure to assets such as equities and property that can fluctuate in value, and inevitably are a source of risk:
- management of operational risk, whilst recognising that there are points beyond which the cost of further control improvements to reduce risks will be disproportionate as the incremental value of control benefits diminish.

Risk appetite is defined according to coverage for the Society's Solvency Capital Requirement and is set at a conservative level to ensure financial strength is not compromised, and at the same time, does not compromise the ability to achieve good investment returns for Members. This is reflected in the overarching aim of ensuring the coverage for the Solvency Capital Requirement (SCR) under the Solvency II regime is covered within a range which is currently set at 150% to 300%.

A wide target range of coverage is adopted to recognise that the Society's SCR and Own Funds are both sensitive to economic conditions. This SCR coverage ratio is also used to assess annually whether there may be excessive levels of capital such that it is appropriate to distribute some of this capital to with-profits members. An SCR coverage ratio in excess of 300% SCR is regarded as potentially excessive at which point surplus distribution of capital is considered by the Board in consultation with the With-Profits Actuary.

The Society uses the Standard Formula basis to assess its solvency capital requirements and does not use an internal model for any aspect of the capital assessment. It does not use a volatility or matching adjustment and does not use any transitional arrangements. An annual exercise is carried out to verify the continued appropriateness of the Standard Formula approach for the Society. This would be carried out more frequently if required as a result of a material change in the Society's risk profile.

B.3.2 Implementation of Risk Management System

Risk governance is overseen by the Board, with detailed review carried out by the Audit, Risk and Compliance Committee on its behalf, including regular review of the Society's risk register. The Committee reports the results of its review to the Board; and additionally, the strategic and material risks are also further considered by the Board itself. These include risks such as failing to maintain membership levels, succession planning, the ability to ensure expense costs can be covered from income, and the risk of a mismatch between the Society's assets and liabilities. At operational level, the Society's Leadership Team oversees operational risks, as well as reviewing new and emerging risks, and any changes to risk assessment factors or significant controls.

Key risk management information is highlighted within the Society's monthly management information pack received by all Board members and attendees. This includes a dashboard summary of key performance indicators measured against targets and ranges of tolerance. These are focussed on key areas of risk: membership numbers, new business levels, investment returns, expense levels, and the matching of assets against liabilities and solvency coverage. The management information pack also includes details of the latest assessment of the most strategic and material risks for Board consideration, both before and after the application of controls.

Risks are detailed in the Society's risk register by showing inherent risk scores for individual risks by reference to the likelihood of them occurring and the impact should they crystallise. Separate Appetite Statements explain the Society's approach to key risks. Risk triggers have also been identified to show the point at which management actions would be considered.

Residual risk is assessed by considering the effectiveness of controls in place to mitigate the likelihood and impact of each risk occurring; and those risks with the largest residual scores are reviewed by the Board.

For all risks, Metfriendly seeks to ensure that, after allowing for controls, the likely impact is well within available capital (less than 10% of Own Funds).

Section B4 below provides an overview of how the Society's risk management is implemented and integrated into the organisational structure, and decision-making process, as reflected in its ORSA.

As part of the ORSA detailed in section B4 below, when carrying out required stress and adverse scenario testing, an assessment is made of the most significant risks faced by the Society so that these are used as the basis for testing the resilience of the Society's capital coverage in adverse circumstances. This helps further inform the Society's approach to capital management, including risk appetite assessments and identification of trigger points when management actions would be considered to protect capital coverage should extreme circumstances (for example a severe market crash) occur.

As a small organisation, the Society's management work closely alongside other staff, enabling risk issues to be raised and recognised as they occur. The Society operates a Risk Working Group with the purpose of identifying and assessing new and emerging risks to the Society. The group meets regularly, usually monthly. It carries out regular horizon scanning to identify new and emerging risks arising from both external and operational factors. This enables in depth assessments of new risks to be carried out with input from across the business. All staff are trained in the process of identification and reporting of risks and incidents impacting the society.

Risk is a standing agenda item at Executive Team meetings, which are held weekly . This enables regular consideration of any changes to risk profiles and key controls for existing risks as well as consideration of any new and emerging risks identified by the Risk Working Group, ensuring that risk management is fully integrated into the decision-making process. It also enables follow-up actions, including any changes to the risk register, to be identified and implemented swiftly. The Risk Working Group reports to the Audit, Risk & Compliance Committee so that new and emerging risk information can be considered as it emerges.

The impact of any potential strategic plans on the Society's risk profile is taken into account, including forward capital projection estimates if appropriate. The Society's Chief Risk Officer and Chief Actuary attend relevant parts of Board meetings (including strategy discussions), as well as meetings of the Audit, Risk and Compliance Committee[2], ensuring that risk management is integrated into the organisational structure. The Society's Chief Risk Officer and Chief Actuary also received copies of the minutes of all Board and relevant Committee minutes.

[2] During 2021 under the previous committee structure, both the Audit and Compliance Committee and the Risk and Investment Committee.

B.4 Own Risk and Solvency Assessment (ORSA)

B.4.1 Description of ORSA Process

The Society's ORSA process is conducted throughout the year to ensure integration with decision-making. It comprises several key iterative activities that take part during the business planning and finance and risk management annual reporting cycles. These activities include:

- Preparation and review of a business plan and strategic plan
- Review of the investment strategy
- Review of the Society's expense allocations
- Assessment of the Society's Statutory Solvency
- Review of the Society's risk policy
- Product reviews
- Preparation of the Society's Forward Looking Assessment of Own Risk (FLAOR)
- Reverse stress tests

These activities culminated in the ORSA report itself.

B.4.2 Review and Approval of ORSA

The ORSA process is owned by the Board, with each element of the report being reviewed and approved by it, following review by the executive Leadership team. The Board's own review of each element will normally follow in-depth review by a relevant Board committee. The final ORSA report is also reviewed and approved by the Board prior to annual submission to the PRA. In the event of a significant change to the Society's risk profile or business model, individual elements of the ORSA would be updated.

The ORSA report considers the appropriateness of the standard formula under Solvency II to the capital needs of the Society. The Society has determined that the standard formula results in capital resource requirements which are appropriate to the Society's risk profile, such assessments are reviewed annually.

The ORSA process is carried out throughout the year, ensuring that it is fully integrated with decision-making processes, culminating in the ORSA report which is owned by the Board. The Chief Risk Officer coordinates the relevant processes, with input from the Society's relevant subject matters experts; and ensures that review and challenge is sought and reflected from the Leadership Team, Risk & Investment Committee and the Board at the appropriate time.

The results of the Forward Looking Assessment of Own Risks and Reverse Stress Test, together with review of the ongoing appropriateness of the Standard Formula ensure that the organisation's solvency needs are appropriately monitored and integrated with the risk management system. The FLAOR is carried out annually, with updates or a refresh should there be material changes.

B.5 Internal Control Function

B.5.1 Internal Control System

The Society has a financial control framework which underpins its financial reporting and regulatory reporting. This includes controls over data and data security to ensure that confidentiality is maintained, whilst also ensuring that policyholder data is accurate and complete so that valuation data used to compute the Society's assets is robust; as well as controls to address the risk of fraud and errors, including material misstatements in its statutory reports. They comprise manual and automated controls, reconciliations, segregation of duties, clearly delegated authority levels, and evidencing that controls have been carried out.

The internal control system is subject to internal audit review, overseen by the Audit, Risk & Compliance Committee. The external auditor also carries out controls testing as part of statutory audit work and reports any recommendations for improvements to the Audit, Risk & Compliance Committee, which follows up the implementation of any actions agreed in response. Key procedures include data reconciliations for the six months to 30 June and 12 months to 31 December to check:

- the integrity of data (e.g., opening and closing policy counts, sums assured and asset shares);
- premiums and controls reconciliations between the policyholder system and the accounting system;
- bank reconciliations;
- investment accounting reconciliations;
- cash flow monitoring against projections;
- reassurance account reconciliations;
- payroll reconciliations;
- outstanding debtor and creditor analysis; and
- variance analysis to inform understanding of any differences between budgeted and actual expenditure.

Valuation results are supported by analysis of movements between opening and closing actuarial liabilities and reserves; whilst components of change for key elements of capital such as surplus are also analysed to provide further assurance.

The Society's financial statements are subject to further controls in their production and review; and actuarial liabilities are assessed using actuarial best practices and are subject to review by the Audit, Risk & Compliance Committee. Following internal reviews and external audit review of the financial statements, they are presented to the Audit, Risk & Compliance Committee for detailed review, prior to final review and approval by the Board.

B.5.2 Compliance Function

The compliance function is carried out by an experienced in-house Compliance Officer who does not have any other operational role within the organisation, avoiding the possibility of any conflict of interest. The Compliance Officer reports to the Society Chief Risk Officer for operational matters, and the compliance function reports to the Audit, Risk & Compliance Committee at least quarterly. The Audit, Risk & Compliance Committee's remit includes ensuring that the Compliance Officer has sufficient resource to carry out their duties and has full access to the information they require to do so. The Committee approves the annual Assurance Plan for assurance activities and monitors progress against the plan.

B.6 Internal Audit Function

The Society's internal audit function is managed by the Society's Chief Risk Officer. Performance of internal audit activity is outsourced, principally to RSM Risk Assurance Services LLP, with a three-year rolling plan of testing which is updated and reprioritised as required, and at least annually, in line with business requirements and risk assessments.

The Audit, Risk & Compliance Committee is responsible for ensuring that the internal audit function is independent and objective. This Committee considers the appointment and remuneration of the internal auditor and meets at least annually with the internal auditors without management present. The Committee is responsible for reviewing and agreeing the internal audit test plan, and for ensuring that the internal audit function is adequately resourced and has access to the information it needs to carry out its role effectively. All internal audit reports are reviewed by the Audit, Risk & Compliance Committee which reviews the appropriateness, timing and implementation of management's responses to any recommendations that are made.

B.7 Actuarial Function

The Society's Actuarial Function is outsourced to Milliman LLP. The roles of Chief Actuary (SMF20 under the Senior Managers & Certification Regime 'SM&CR') and With-Profits Actuary (SMF20a) are outsourced and held by an experienced Principal at Milliman LLP. The holder of these roles is a Fellow of the Institute and Faculty of Actuaries and holds the required Practising Certificates. In carrying out her work she is supported by other qualified actuaries within Milliman.

B.8 Outsourcing

The Society's outsourcing policy requires due diligence to be carried out and appropriately evidenced on all potential outsourced service providers. For new contracts for material outsourcing arrangements (recurring annual fee over £100,000), pre-approval is required, and the Audit, Risk & Compliance Committee will review any proposal and recommend whether or not it should be approved by the Board. This must be supported by an assessment of the impact on the Society's risk profile arising from the proposed arrangement, or from any proposed change in outsource service provider. All outsourced arrangements must also be reviewed annually to ensure they remain fit for purpose.

The outsourcing contract with the service provider must include documented service level agreements, details of management information to be provided, and arrangements for service monitoring, relationship management and escalation procedures in the event of poor performance including arrangements for early termination if necessary.

An appropriate manager is appointed as the individual responsible for overseeing the services provided by the outsourced services provider on behalf of Metfriendly.

The following services that are outsourced by the Society are considered to be important or critical to the organisation:

- Actuarial services
- Internal audit services
- Outbound printing and distribution
- Elements of IT support (including some desktop support, telephony and storage)
- Payroll processing
- SII data reporting fulfilment
- Investment Management
- Web hosting

All the Society's outsourced services providers operate under UK jurisdiction.

As a small organisation, the Society's senior managers work closely with outsourced service providers. They are therefore well aware of ongoing service levels and quality of service, enabling any issues of concern to be raised and resolved promptly, without needing to invoke contractual escalation procedures which are available should they be needed.

The Society has outsourced the majority of its investment management to three investment managers. The bond funds (including the cash fund) are managed by Royal London Asset Management ("RLAM") whilst equity-like "real returns" are derived from a multi-asset fund managed by Columbia Threadneedle Investments ("CTI") and property funds managed by AEW, CTI and RLAM.

B.9 Adequacy of the System of Governance

The Society's system of governance is considered to be appropriate, taking into account the nature, scale and complexity of the risks inherent in the business. Its organisational structure and reporting lines reflect good practice as set out in the Annotated Corporate Governance Code for Mutual Insurers, against which the Society achieves compliance on an annual basis. Further evidence of the appropriateness of the governance system is provided by relevant reports received from internal audit, compliance and external audit in the course of their work.

C RISK PROFILE

C.1 Underwriting Risk

The most significant underwriting risk faced by the Society relates to its ability to recover its expenses from product margins. The Society is willing to meet limited excess expenditure from its Own Funds (capital). That expenditure is undertaken with a view to covering costs in the medium term.

During 2022 excess expenditure arose from 2 main elements:

- Activity directed at increasing new Members and acquiring new premiums, where a large part of the resulting product margins emerge over the longer term (e.g. through future margins, or repeat business) and total allowances are expected to exceed total expenditure. 2022 acquisition expenses exceeded expense allowances from new business written in the year by £0.6m and this was funded from capital. Total margins over the life of the 2022 new business are expected to exceed total expenses from that business. In 2021, due to the higher level of lump sum premiums written, expense allowances exceeded expenses incurred in the year.
- Expenditure on Project Darwin, which is intended to redesign and improve our core operational systems and processes in order to improve Member experience, reduce risks arising from manual processes and key person dependencies, increase our capacity to process new business and deliver operational efficiencies and cost savings. The Board has approved expenditure of £1.9m to be funded from capital and Best Estimate Liabilities includes a £0.8m expense reserve for the remaining spend in 2023.

Lapse rates are reviewed annually with modest and infrequent variations for all significant Society products.

For most of the Society's products, mortality and morbidity risk is minimal. Reinsurance protection is effected for the larger risks arising under protection policies:

- For life insurance policies (including mortgage protection), there are quota share treaties – for new business 70% is currently reinsured with Gen Re.
- For income protection policies, a quota share of 20% is reinsured with Gen Re. The Society can, and does, review the premium rates charged for this business – including for existing business.
- For critical illness policies underwritten from 2023, a quota share of 75% is reinsured with Gen Re.

Protection policies provide sufficient margins from their premiums to cover their expenses and reinsurance premiums, together with a modest level of fluctuations from net claims experience.

With the exception of the impact of lower premiums on expense allowances, there have been no material changes during 2022. Underwriting Risks account for a minor part of the Society's overall capital requirement. The Society considers such risks as part of its ORSA processes, including an ongoing review cycle of the products on offer and their terms. The Society believes that the Standard Formula is an appropriate way to quantify underwriting risks. The aggregate net (after allowance for the loss-absorbing capacity of technical provisions) solvency capital requirement for such risks as at the end of 2022 (before any allowance for diversification benefit between risk modules) is £2.5m (2021 - £2.3m).

C.2 Market Risk

Market risk is the major risk faced by the Society. The Society considers that its Members expect it to seek the rewards associated with investing in real assets, and it does not seek to mitigate the exposure to market fluctuations other than through reducing interest risk by holding fixed income assets of appropriate duration to match its fixed liabilities and by setting the overall level of asset exposure in its investment strategy. The Society does not hedge currency risk on investments.

Market risk derives from the Society's holdings in corporate bonds and risk assets, which are currently all held through pooled funds, thereby avoiding any significant concentration risk. Risk assets are held via a multi asset fund (investing globally in equities, fixed income, commodities and other assets), four UK property funds and a minor residual holding in an insurance linked securities funds. Risk assets are allocated entirely to the asset shares backing the Society's with-profits contracts.

Fluctuations in asset prices are largely matched by corresponding movements in the asset shares; in the case of corporate bonds the Society's capital is also exposed.

When asset shares fall in value, the cost of future guarantees will rise. Most of this guarantee cost is associated with the AWP products. For such business written since 2013, the only guarantee is that applying on death. However, for AWP business written prior to 01/01/2020, the Society would expect to enhance asset shares modestly on surrender claims rather than applying a Market Value Reduction (MVR). This MVR subsidy was removed for new AWP business written from 01/01/2020, but remains in place for AWP business written prior to that date.

The Society has exposure to a well-diversified portfolio of assets through the pooled funds in which it invests, and expects that these assets will perform broadly in line with general market movements. The Society recognises that the allowance for equity price stress to accommodate recent market movements (the symmetric adjustment) only provides limited protection in a falling market – accordingly, it expects its capital coverage to fluctuate with market conditions.

There have been no material changes in market risks during 2022, but the amount of risk assumed increases in line with new business levels and changes in the Society's asset holdings from fund manager tactical allocations. The Society considers such risks as part of its ORSA processes, including an annual review of the products on offer and their terms. The Society believes that the Standard Formula is an appropriate way to quantify its market risks. The aggregate net (after allowance for the loss-absorbing capacity of technical provisions and loss-absorbing capacity of the deferred tax) solvency capital requirement for such risks as at the end of 2022 (before any allowance for diversification benefit between risk modules) is £8.9m (2021: £11.6m).

In the Society's wider consideration of its capital requirements, it tests and considers the effect of:

- Price stresses significantly greater than those underlying the Standard Formula, and/or
- Price stresses in combination, effectively taking no credit for diversification.

C.3 Credit Risk

Credit risk derives mainly from the Society's holdings in Corporate Bond and Liquidity funds; using pooled funds which have investment constraints that avoid any significant concentration risk. These assets are partly allocated to asset shares with the balance held to meet non-profit liabilities (including the residual constituting own funds). Through the pooled funds, the Society holds a diverse mix of sterling-denominated bonds that are suited to matching its liabilities. The funds held are mainly invested in investment grade stocks with only a small proportion below investment grade or unrated, mitigating the potential default risk. The Society limits its holdings in cash to investment grade and less than 3% of total assets with any one banking group (5% for the Society's main current account).

The bond fund allocated to asset shares has an average duration of about 6 years. To the extent that the fund fluctuates in value, whether due to market or credit movement, this impacts the liabilities in a similar manner. The remaining bond funds have an average duration of about 2 years and are less sensitive to market movements. This is considered appropriate for the funds standing behind the Society's capital requirement.

The Society believes that the Standard Formula is an appropriate way to quantify credit risk in relation to the Society's holdings in Corporate Bond and Liquidity funds, and this risk is considered a market risk and contributes to that capital requirement (see Section C.2).

Credit risk also derives from the Society's reinsurance assets which form only a small proportion of its total assets. The Society monitors the credit ratings of the 2 reinsurers, one being AA- and the other AA+.

The Society considers such risks as part of its ORSA processes, including an annual review of the products on offer and their terms. The Society believes that the Standard Formula is an appropriate way to quantify credit risks in relation to its reinsurers and other counterparties. There have been no material changes in such risks during 2022 and the aggregate net (after allowance for the loss-absorbing capacity of technical provisions) solvency capital requirement for such risks as at the end of 2022 (before any allowance for diversification benefit between risk modules) is £0.5m (2021: £0.5m).

C.4 Liquidity Risk

The amount of credit taken for profit inherent in future premiums is immaterial and is not considered to represent any liquidity risk for the Society.

Liquidity risk is considered minimal as the Society limits its illiquid assets to less than 20% of total assets. At 31 December 2022 with-profit assets considered illiquid for liquidity risk management purposes (in the form of property funds) amounted to 7% of total assets. Given the size of The Society's own funds this provides ample assurance that assets could be realised to cover any conceivable run on its funds. The Society does not hold assets with material collateral requirements.

There have been no material changes in liquidity risk during 2022.

C.5 Operational Risk

The Society considers reputational risk to be significant. It adopts a highly risk averse approach to safeguarding policyholder data and cyber risk. Transmission of such data is always encrypted, and in the last year the Society has significantly increased controls from our Security Operations Centre & Event Management and through the independent accreditation of Cyber Essential Plus.

The Society assesses the likely maximum quantitative impact of various risks allowing for the effect of the risk controls which are in place – underwriting (error), human resources, compliance, cyber security, conduct of sales, customer care, supplier risk, systems and controls, and business continuity. No account is taken of the potential loss of future business from damage to reputation in the quantitative assessment of operational risk. However, the Risk Register does include consideration of potential reputational damage.

The Society holds capital as specified under the Solvency II Standard Formula for operational risks and capital required to cover quantifiable operational risks is in the region of £1.9m, a reduction from £2.6m in 2021 due to the lower volume of lump sum business written in 2022 when compared to 2021. The Society has carried out a separate quantification exercise to confirm that the standard formula continues to be appropriate for assessing its operational risk capital requirement.

C.6 Stress Testing & Scenario Analysis

The Society gives due consideration to the main risk drivers when conducting stress testing. It seeks to have sufficient capital to cover market stresses going beyond the amounts specified in the Standard Formula and quantifies combined adverse price movements in equities and property (and bonds when appropriate).

During the year the Society considered a range of stress test scenarios, including but not limited to business volume and mix stress testing, expense cap scenarios, higher inflation and lower investment return, climate risk scenarios and reverse stress test scenarios.

C.7 Investment Strategy

The Society's investment strategy provides for an appropriate mix of assets to cover the asset shares backing with-profits contracts and for a risk averse asset mix to cover the residual assets, and including appropriate matching of the duration of its assets to its liabilities. The Society monitors the performance of all its funds, and reports this in regular management information. Such reporting includes monitoring actual versus target asset allocation and proportions held in illiquid assets and in unrated or sub-prime bonds. The Society additionally seeks to avoid concentration by adopting pooled funds operated by three main investment managers, and reputation is a significant factor in choice of managers. Bond funds (including the liquidity fund) are managed by RLAM. Equity-like "real returns" are derived from a multi-asset fund managed by CTI and property fund holdings with AEW, RLAM and CTI.

C.8 Management Actions

To manage the product risk associated with with-profits contracts, the Society adopts various management actions, all of which are modelled in the technical provisions.

- Annual Bonuses are determined taking into account investment performance in the year, current long-term interest rates, and the extent to which an investment risk premium has been achieved; an allowance is then made for expenses and a final bonus.
- Asset mix is assumed to revert towards target levels within each year.
- Charges to asset shares for guarantee costs reflect the recent performance of the with profit fund and will rise when market prices are depressed.
- Final bonuses are allowed for by assuming asset share would be the normal pay-out both for maturity claims, and for surrender and death claims under accumulating with-profits products.
- Market Value Reductions (MVRs) are normally only applied to reduce surrender values below the accumulated sum assured after the Society has met the initial impact of a market fall.
- Other management actions modelled include changes in expense charges in stress scenarios and dynamic policyholder behaviour.

D VALUATION FOR SOLVENCY PURPOSES

D.1 Assets

The valuation of the Society's assets as at 31 December 2022 is shown in Table D.1 below calculated on a Solvency II basis which is used for both solvency purposes and on the UK GAAP basis shown in the report and accounts. The comparative figures for the previous year are also shown in Table D.1.

Table D.1 Assets*

Asset Description	UK GAAP as at 31 December 2022 £m	Solvency II as at 31 December 2022 £m	UK GAAP as at 31 December 2021 £m	Solvency II as at 31 December 2021 £m
Liquidity and Bond Funds	**122.3**	122.3	**120.4**	120.4
Multi-Asset Funds	**122.0**	122.0	**133.8**	133.8
Insurance Linked Security Funds	**0.0**	0.0	**0.0**	-
Property Funds	**18.9**	18.9	**20.8**	20.8
Cash	**9.9**	9.9	**8.8**	8.8
Reinsurers' Share of Technical Provisions	**1.1**	1.1	**1.3**	1.3
Tangible and Intangible Assets	**1.2**	0.1	**0.5**	0.1
Insurance Receivables	**0.2**	0.2	**0.1**	0.1
Reinsurance Receivables	**0.1**	0.1	**0.2**	0.2
Other Debtors	**0.4**	0.4	**0.2**	0.2
Deferred Tax Asset	**-**	-	**-**	-
Prepayments and Accrued Income	**1.8**	1.8	**1.6**	1.6
Total Assets	**277.9**	276.8	**287.6**	287.3

** - Table might contain differences due to rounding.*

The main bases for determining the value of assets are as follows.

D.1.1 Investments

Units in unit trusts and other pooled fund vehicles are included at published bid prices or single price for single priced fund. For the AEW UK Core Property and AEW UK Real Return Funds where the single price and Net Asset Value are quoted, the Net Asset Value is used. Prepayments and accrued income include dividends due on an ex-dividend basis and fixed interest and bank deposit interest due on an accruals basis.

D.1.2 Deferred Taxation

A deferred taxation liability is provided, in respect of timing differences where there is a reasonable probability that such taxation will become payable or recoverable. A deferred taxation asset is recognised, in respect of excess expenses and utilised losses where there is a reasonable probability that such taxation will be recoverable from future taxable profits in the foreseeable future.

The Society has unused tax losses carried forward that have no expiry date for which no deferred tax asset has been recognised at 31 December 2022: excess management expenses and other tax losses of £5.9m and deferred acquisition expenses of £2.5m (2021: £nil). The value of the net deferred tax asset not recognised at a 20% tax rate is £1.4m (2021: £nil).

D.1.3 Tangible and Intangible Assets

Depreciation or amortisation is provided on fixed and intangible assets in order to write off the cost of such assets over their estimated useful lives. The Solvency II balance sheet asset of £0.1m (2021 £0.1m) relates to leasehold premises and depreciated linearly over the outstanding lease term to April 2025 and computer equipment and office fixtures and fittings which are depreciated linearly over the lifetime of the equipment.

The Solvency II and UK GAAP valuation of intangible assets are different at 31 December 2022 and 2021. An intangible asset has been capitalised under UK GAAP in relation to £0.35m of software development expenditure ('Project Darwin') incurred in 2021 and a further £0.80m incurred in 2022. The cost of the completed asset will be amortised in future year over the estimated useful life of the new software and systems. However, under Solvency II, intangible assets are ascribed a value only when they can be sold separately and when there are quoted prices in an active market for the same or similar assets. This intangible asset does not meet these criteria and so is valued at nil on the Solvency II balance sheet.

D.2 Technical Provisions

The Technical Provisions are determined in line with the regulations set out in Article 77 of the Solvency II Directive[3] and are equal to the sum of the best estimate liabilities ('BEL') and the risk margin ('RM').

D.2.1 Technical Provisions as at 31 December 2022

Table D.2 below sets out the segmentation of Metfriendly's business into lines of business for Solvency II purposes. All lines of business are written within a single with-profits fund and no products span more than one line of business.

Table D.2 Lines of Business

Metfriendly – Solvency II Lines of Business	
Category	**Description**
Life With-Profits Participation	This includes conventional with-profits savings products and accumulating with-profits products (both tax-exempt and taxable), both legacy business and current product lines. A global reserve held in relation to significant one-off IT expenses to be incurred in 2023 (Project Darwin) has been allocated entirely to the Life With-Profits Participation line of business on proportionality grounds.
Other Life Insurance	This includes the 5 year non-profit savings plan and level term, decreasing term and mortgage protection business and accelerated critical illness business.
Health Insurance	This comprises a small amount of income protection business, which is not considered material, and a small amount of standalone critical illness business.

[3] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0138&from=EN

The technical provisions as at 31.12.22 for each material line of business are given in table D.3 below.

Table D.3 Solvency II and UK GAAP Provisions

Component (£m)	Line of Business	Technical Provisions as at 31.12.22 (£ m)	Technical Provisions as at 31.12.21[1] (£ m)
BEL	Life With-Profits Participation[3]	234.5	238.5
	Other Life Insurance	12.4	13.7
	Health Insurance	1.2	1.3
Risk Margin		1.5	1.5
Total Technical Provisions[2]		249.6	254.9

1. Technical Provisions are gross of reinsurance.
2. Total Technical Provisions for 31 December 2021 include £0.1 of rounding with respect to prior rows.
3. Total Technical Provisions for 31 December 2022 for Life With-Profits Participation line of business includes a £0.8m global reserve held in relation to significant one-off IT expenses to be incurred in 2023 (Project Darwin). The comparative value in the Total Technical Provisions for 31 December 2021 is £1.0m. This has been allocated entirely to the Life With-Profits Participation line of business on proportionality grounds.

On proportionality grounds, Metfriendly has no plans to calculate the risk margin by line of business, only at the fund level. The Society uses the simplification permitted under Guideline 63[4] to apportion the risk margin to its three lines of business, this methodology is unchanged from that used as at 31 December 2021.

D.2.2 Best Estimate Liabilities

The best estimate liabilities are determined as the sum of the mathematical liabilities for the with-profits business and the non-profits protection and savings business. These are determined using a cash flow projection model for all lines of business (with the exception of the income protection business which is calculated outside the model and is not considered a material component of the Society's business, comprising less than 0.4% of the total BEL).

With-profits best estimate liabilities as at 31 December 2022 are taken as the sum of:

- the asset shares as at 31 December 2022; less
- the present value ('PV') of future charges for the cost of guarantees; plus
- the present value of the cost of those guarantees; less
- the present value of any surrender penalties; less
- the present value of mortality charges, where applicable.

The PV of charges for, and costs of, guarantees are determined from the projected monthly cash flows associated with the with-profits insurance contracts, based on the average of 1,000 investment return simulations with due allowance for expected management actions, as described in section C8.

The non-profit best estimate liabilities (with the exception of the small amount of income protection business) are based on a projection of future monthly cashflows, at a policy by policy level, using best estimate experience assumptions for future demographic assumptions.

The model discounts monthly cashflows using the risk-free interest rate term structure as specified by the PRA at the valuation date to calculate the BEL; in accordance with Article 77 of the Solvency II Directive.

4 https://www.eiopa.europa.eu/sites/default/files/publications/eiopa_guidelines/tp_final_document_en.pdfhttps://eiopa.europa.eu/Publications/Guidelines/TP_Final_document_EN.pdf

In addition, a global reserve is included in the BEL in relation to significant one-off IT expenses to be incurred in 2023 (Project Darwin).

Projection Basis

Appendix D.1 sets out the basis and assumptions used to determine Metfriendly's Solvency II Technical Provisions as at 31 December 2022.

Mortality Assumptions

Metfriendly's mortality experience is reviewed annually. For a valuation as at 31 December X, the experience analysis is based on experience over the years X-5 to X-1 and considers both the most recent experience, and a rolling four year average, for each line of protection business. Mortality assumptions are set with reference to standard mortality tables, generated by the Continuous Mortality Investigation ('CMI'). These tables are based on industry wide experience for assured lives. Mortality experience in the year X is also reviewed at a high level (for example with regards to the impact of Covid-19 in 2022) to ensure that the findings of the analysis remain reasonable in light of the most recent experience emerging.

Morbidity Assumptions

Metfriendly has limited morbidity experience, and any analysis of its own experience would not be statistically credible. Morbidity assumptions are set with reference to industry wide practice and are based on standard morbidity tables.

Expense Assumptions

Metfriendly takes into account all expenses that will be incurred in servicing its insurance obligations in setting the best estimate assumptions, namely:

- The cost of maintenance expenses associated with existing insurance obligations
- The cost of overhead expenses incurred in managing the Society
- The cost of investment management expenses associated with existing insurance obligations

Metfriendly analyses its expenses annually and apportions the non-acquisition expenses between the with-profits, non-profits savings and protection business.

The best estimate assumptions for maintenance expenses are derived from this analysis and take the form of a percentage of office premium deduction for the savings products (both with-profits and the non-profit guaranteed 5 year savings plan) and a per policy expense charge for all the non-profit protection lines of business except the income protection, for which an expense allowance of 15% of the ICOP reserve plus 30% of the IBNR is used.

A charge for maintenance expenses is applied to with-profits asset shares as a deduction of 1.0% p.a. (1.0% p.a. as at 31 December 2021) to the investment return achieved by the assets backing the with-profits business. An explicit allowance for fund management charges (AMCs) on the bond, equity and property funds of 0.4% p.a. (0.4% p.a. as at 31 December 2021) is also charged monthly to the projected with-profits asset shares.

These assumptions and charges are netted for tax where appropriate.

Future acquisition expenses are not included in the cash flow projections, as only the expenses relating to the future management of the existing insurance obligations need to be considered.

Lapse Assumptions

Milliman carried out the 2022 annual review of Metfriendly's lapse experience, at a policy level. Best estimate lapse assumptions for use in the model to calculate the Solvency II reporting figures are derived from this review. The lapse rates used in the model are assumed to vary with duration in-force, and by product type as appropriate. The lapse rates are determined at a policy level, split by duration for all the business in-force based on the persistency experience of those policies written in the last 10 years for whom the experience is likely to be more relevant.

Reinsurance

As the reinsurance recoverables are treated as an asset, the best estimate liabilities are determined and reported gross of reinsurance in accordance with Article 77 of the Solvency II Directive. The value of reinsurance recoverables are determined in a manner consistent with that used to calculate the gross best estimate liabilities, using the same model, in line with Article 41 of the Delegated Acts and are included as a separate asset on the Solvency II balance sheet. This figure includes an adjustment for reinsurer counterparty default in accordance with Article 81 of the Solvency II Directive.

Tax

In normal economic conditions the tax relief on investment losses and expenses for taxable with-profits business is assumed to be recoverable and is credited to asset shares when deriving the asset share liabilities. Metfriendly has determined that the tax losses incurred during 2022 are not recoverable and a manual deduction of £1.2m has been included in the technical provisions to unwind the tax relief otherwise credited to the taxable asset shares as at 31 December 2022. This is offset by a manual increase to the present value of the cost of guarantees (net of charges with respect of those guarantees) of £0.2m due to this additional decrease in taxable asset shares.

D.2.3 Risk Margin

The formula by which the risk margin is to be calculated is set out in Article 37 of the Delegated Acts. It is based on the capital that a party taking over the business would need to establish to support the unavoidable risks that are being taken on, known as non-hedgeable risks.

Metfriendly assumes that all market risks are hedgeable, and therefore excludes them from the projected SCR used in the Risk Margin calculation. Metfriendly considers the following to be non-hedgeable risks:

- Insurance Risks:
  - Mortality Risk
  - Expense Risk
  - Lapse Risk
  - Morbidity Risk
  - Catastrophe Risk
- Health Risks:
  - Health Morbidity Risk
  - Health Expense Risk
  - Health Lapse Risk
  - Health Catastrophe Risk
- Counterparty Default Risk
- Operational Risk

The Risk Margin is determined by projecting the Solvency Capital Requirement ('SCR') in respect of the non-hedgeable risks set out above. The SCRs for each non-hedgeable risk, with the exception of operational risk, are projected assuming the initial value of SCR runs off in line with appropriate risk drivers, making use of the simplified method permitted under Article 58 of the Commission Delegated Regulation (EU) 2015/35. This approach is consistent with Method 1 of the Hierarchy of Simplifications outlined in the Solvency II Guidelines[5].

The operational risk SCR for the Risk Margin is explicitly recalculated at each future year based on projected BEL and premium cashflows. Table D.4 below sets out the risk drivers that are used to project the future SCR based on the initial values by risk module.

Table D.4 Risk Drivers

[5] https://www.eiopa.europa.eu/sites/default/files/publications/eiopa_guidelines/tp_final_document_en.pdf

Risk	Risk Module	Capital Requirement (£k) for the reference undertaking as at 31 December 2022	Projection risk driver
Mortality	Life Underwriting	438	Non-profit: Capital at risk in-force on term assurance business (net of reinsurance) With-profits: Asset share in-force
Disability – Morbidity	Life Underwriting	10	Capital at risk in-force on term assurance business (net of reinsurance)
Expenses	Life Underwriting	497	Non-profit: Capital at risk in-force for term assurance business (net of reinsurance) With-profits: Asset share in-force
Lapses	Life Underwriting	1678	Non-profit: Capital at risk in-force on term assurance business (net of reinsurance) With-Profits: Asset share in-force
Life Catastrophe	Life Underwriting	88	Capital at risk in-force on term assurance business (net of reinsurance)
Disability – Morbidity	Health (SLT) Underwriting	284	Income Protection: Proportion of income protection policy holders in-force Standalone Critical Illness: Capital at risk in-force on standalone critical illness business (net of reinsurance)
Expenses	Health (SLT) Underwriting	133	Capital at risk in-force on standalone critical illness business (net of reinsurance)

Lapses	Health (SLT) Underwriting	105	Capital at risk in-force on standalone critical illness business (net of reinsurance)
Health Catastrophe	Health Underwriting	19	Proportion of income protection policy holders in-force
Counterparty Default	N/A	521	Asset share in-force
Operational Risk	N/A	725	Formulaic calculation based on projected premiums, technical provisions and Basic SCR for the reference undertaking (excluding market risk). No driver used.

D.2.4 Uncertainty in the Technical Provisions

Asset Shares

The asset shares as at 31 December 2022 as determined by the Society, comprise around 93% of the technical provisions. The Chief Actuary carried out an analysis of the movement in asset shares from 31 December 2021 to 31 December 2022 based on information provided by Metfriendly and compared the results with the relevant entries in the accounts. The asset shares, as part of the technical provisions, are also subject to external audit.

Assumptions

A number of scenarios have been considered to illustrate the impact on technical provisions of certain changes in the underlying demographic and economic assumptions as at the valuation date, to highlight that there is a level of uncertainty when setting these assumptions. The results of these investigations are set out in table D.5 below.

Table D.5 Impact on Technical Provisions of different assumptions

Scenario	Impact on Technical Provisions ("TP")	Impact on Own Funds £m
An increase in risk free rates of 1%	Decrease of £10.5m, 4% of TP	Decrease of £1.9m, 8% of Own Funds
A widening of credit spreads of 1%	Decrease of £9.1m, 4% of TP	Decrease of £3.2m, 13% of Own Funds
An absolute increase of 3% in the underlying implied volatility in the equity investments	Increase of £0.2m, 0.1% of TP	Decrease of £0.2m, 1% of Own Funds
A fall in market value of equities by 20%	Decrease of £7.4m, 3% of TP	Decrease of £1.5m, 6% of Own Funds
A 10% deterioration in the demographic assumptions underlying the valuation of the best estimate liabilities for the non-profit business	Increase of £0.7m, 0.3% of TP	Decrease of £0.4m, 2% of Own Funds

Modelling

Further tests have been carried out to assess the sensitivity of the present value of the cost of, and the charge for, the guarantees if full rather than reduced model points are used, and if 5,000 rather than 1,000 investment return simulations are used. This analysis is performed to highlight the level of uncertainty in attempting to model the complexity of estimated future investment returns. The results of these investigations are set out below and show that the difference is not material for the grouping of model points, or for the comparison between the 5,000 and 1,000 investment return simulations. Hence reduced model points and 1,000 investment return simulations have been used to calculate the best estimate liabilities and in the 1-in-200 stress calculations used to calculate the solvency capital requirement.

Model Points

The cost of guarantees and charges in the base run (i.e. to calculate the best estimate liabilities) using reduced model points ('MP') are compared against a base run using full model points in order to determine the impact of using reduced model points. The results are shown in the tables D.6 and D.7 below.

Table D.6 Comparison of Cost of Guarantees using Full or Reduced Model Points

Comparison of present value of the Cost of Guarantees			
	Reduced MP (£ m)	**Full MP (£ m)**	**Difference (%)**
CWP	0.26	0.26	0.16%
AWP	4.59	4.60	-0.17%
Total	4.86	4.86	-0.16%

Table D.7 Comparison of Charges for Cost of Guarantees using Full or Reduced Model Points

Comparison of present value of the Cost of Guarantees Charges			
	Reduced MP (£ m)	**Full MP (£ m)**	**Difference (%)**
CWP	0.17	0.17	-0.05%
AWP	4.29	4.28	0.16%
Total	4.46	4.45	0.15%

The differences are considered sufficiently small that results from the reduced model points can be used without adjustment.

Number of Investment Return Simulations

The investment returns are modelled stochastically by using a large number of randomly generated economic scenarios. 1,000 such scenarios are used and to demonstrate that this is sufficiently large the base run using 1,000 scenarios is compared against a run using 5,000 scenarios. The results of this comparison are given in tables D.8 and D.9 below.

Table D.8 Comparison of Cost of Guarantees using 1,000 and 5,000 Scenarios

Comparison of present value of the Cost of Guarantees			
	5,000 scenarios (£m)	1,000 scenarios (£m)	Difference (%)
CWP	0.27	0.26	-1.47%
AWP	4.61	4.59	-0.42%
Total	4.88	4.86	-0.48%

Table D.9 Comparison of Charges for Cost of Guarantees using 1,000 and 5,000 Scenarios

Comparison of present value of the Cost of Guarantees Charges			
	5,000 scenarios (£m)	1,000 scenarios (£m)	Difference (%)
CWP	0.17	0.17	-0.20%
AWP	4.30	4.29	-0.24%
Total	4.47	4.46	-0.24%

The differences are considered sufficiently small that results from the 1,000 rather 5,000 scenarios can be used without adjustment.

Risk Margin

The sensitivity of the risk margin to the variability in the initial amounts of the SCRs to be projected and a parallel upward shift in the risk free interest rate curve have been investigated.

A 1% parallel increase in the risk free interest rate curve decreases the risk margin by £0.1m (£0.1m as at 31 December 2021), from £1.5m to £1.4m.

The risk margin is most sensitive to any changes in the SCR of the reference undertaking, an increase of 10% to all the initial SCRs for the non-hedgeable risks increases the risk margin by 10% (10% as at 31 December 2021) from £1.5m to £1.7m as at 31 December 2022.

D.2.5 Difference in Technical Provisions Reported Under Solvency II and Those Published in the Financial Statements

There are no differences between the technical provisions reported under Solvency II and those published in the financial statements (UK GAAP) as at both 31 December 2022 and 31 December 2021.

Adjustments

As at 31 December 2022 and 31 December 2021, the Society does not make use of any of the following potential adjustments: matching adjustment; volatility adjustment; transitional provisions on the risk-free interest rate term structure; or transitional measures for technical provisions.

D.2.6 Reinsurance Recoverables

The reinsured amounts have been separately calculated in accordance with Article 81 of the Solvency II Directive. The reinsurance recoverables relate to the non-profit protection business, including the income protection business. The reinsurance recoverables have been determined on a basis consistent with the valuation of the gross liabilities.

D.2.7 Material Changes over the Period

There have been no material changes in assumptions made in the calculation of the technical provisions as at 31 December 2022 compared to those used as at 31 December 2021.

D.3 Other Liabilities

The other liabilities as at 31 December 2022 are given in the Table D.10 below.

Table D.10 Other liabilities*

Other Liabilities	Solvency II / UK GAAP as at 31 December 2022 £m	Solvency II / UK GAAP as at 31 December 2021 £m
Deferred Tax Liability	-	0.3
Insurance and intermediaries payables	2.3	1.7
Reinsurance payables	0.0	0.1
Payables (trade not insurance)	0.2	0.3
Pension benefit obligations	-	-
Accruals and deferred income	0.7	0.7
Other (all taxation)	0.1	0.1
Total Other Liabilities	**3.4**	**3.2**

** - Table might contain differences due to rounding.*

There are no material differences for the other liabilities above between the valuation basis, methodology and assumptions used for the UK GAAP accounts and those used for the Solvency II balance sheet.

D.4 Alternative Methods for Valuation

The Society does not make use of any alternative valuation methods.

D.5 Any Other Information

There is no further material information regarding the valuation of assets and liabilities.

APPENDIX D.1 – BEST ESTIMATE ASSUMPTIONS

Table D.11 below set out the Solvency II best estimate assumptions as at 31 December 2022 and 31 December 2021 for comparison.

Table D.11 Assumptions for Solvency II Best Estimates

Assumption category		**31/12/2022**	**31/12/2021**
Discounting	PRA Solvency II Yield Curve	1-year rate: 4.460% (3.702% increase) 2-year rate: 4.470% (3.464% increase) 5-year rate: 4.062% (3.012% increase) 10-year rate: 3.710% (2.762% increase) 25-year rate: 3.449% (2.599% increase)	1-year rate: 0.758% 2-year rate: 1.006% 5-year rate: 1.050% 10-year rate: 0.948% 25-year rate: 0.850%
Decrements	Mortality	**80% of standard mortality tables**: AMC/AFC00 for with-profits endowment business and G5YSP TMN/TFN00 for term assurance business (non-smokers) TMS/TFS00 for term assurance business (smokers)	**80% of standard mortality tables**: AMC/AFC00 for with-profits endowment business and G5YSP TMN/TFN00 for term assurance business (non-smokers) TMS/TFS00 for term assurance business (smokers)
	Morbidity	**100%/120%** of standard morbidity tables (non-smokers/smokers): CIBT93 M/F with 2% p.a. deterioration rate	**100%/120%** of standard morbidity tables (non-smokers/smokers): CIBT93 M/F with 2% p.a. deterioration rate
	Lapses	**Lapse rates assumed for all business.** In particular: Decreasing Term Assurances: 9.0% p.a. year 1-6 6.0% p.a. years 7+ Mortgage Protection Assurances: 10% p.a. years 1-6 8% p.a. years 7+ Level Term Assurances: 4.0% p.a. year 1 2.5% p.a. years 2+ Guaranteed 5 year savings plan: 5.0% p.a. year 1 6.0% p.a. year 2 5.5% p.a. year 3 4.5% p.a. year 4 3.5% p.a. final year Table 8: 2.5% p.a. Table 10: 1.0% p.a. Table 11: 6.0% p.a. years 1-5 4.0% p.a. years 6+	**Lapse rates assumed for all business.** In particular: Decreasing Term Assurances: 9.0% p.a. year 1-6 6.0% p.a. years 7+ Mortgage Protection Assurances: 10% p.a. years 1-6 8% p.a. years 7+ Level Term Assurances: 4.0% p.a. year 1 2.5% p.a. years 2+ Guaranteed 5 year savings plan: 5.0% p.a. year 1 6.5% p.a. year 2 6.0% p.a. year 3 5.0% p.a. year 4 3.5% p.a. final year Table 8: 2.5% p.a. Table 10: 1.0% p.a. Table 11: 6.0% p.a. years 1-5 4.0% p.a. years 6+

Assumption category		31/12/2022	31/12/2021
		Tables 21 and 22 5.0% p.a. years 1-5 3.0% p.a. years 6+ Table 12: 6.0% p.a. years 1-5 4.0% p.a. years 6+ Tables 15 and 16: 5.0% p.a. years 1-5 3.0% p.a. years 6+ Table 19: 5.0% p.a. year 1 8.0% p.a. years 2-5 5.0% p.a. years 6+ Table 26: 7.0% p.a. Table 25: 10.5% p.a. year 1 15.0% p.a. years 2-6 11.0% p.a. years 7-10 8.0% p.a. years 11+ Table 27: 9.0% p.a. year 1 12.0% p.a. year 2 16.0% p.a. years 3-5 13.0% p.a. years 6-7 9.0% p.a. years 8+ Tables 29 and 32: 7.5% year 1 15.0% years 2+ Tables 30 and 33: 2.0% p.a. years 1-3 3.0% p.a. years 4-11 12.0% p.a. years 12-13 6.0% p.a. years 14 Table 24: 2.0% p.a. year 1 6.0% p.a. years 2-3 8.0% p.a. years 4-6 6.0% p.a. years 7+ Table 28: 2.0% p.a. years 1-2 6.0% p.a. years 3-6 12.0% p.a. years 7-8 6.0% p.a. years 9+	Tables 21 and 22 5.0% p.a. years 1-5 3.0% p.a. years 6+ Table 12: 6.0% p.a. years 1-5 4.0% p.a. years 6+ Tables 15 and 16: 5.0% p.a. years 1-5 3.0% p.a. years 6+ Table 19: 5.0% p.a. year 1 8.0% p.a. years 2-5 5.0% p.a. years 6+ Table 26: 7.0% p.a. Table 25: 10.5% p.a. year 1 15.0% p.a. years 2-6 11.0% p.a. years 7-10 8.0% p.a. years 11+ Table 27: 9.0% p.a. year 1 12.0% p.a. year 2 16.0% p.a. years 3-5 13.0% p.a. years 6-7 9.0% p.a. years 8+ Tables 29 and 32: 7.5% year 1 15.0% years 2+ Tables 30 and 33: 2.0% p.a. years 1-2 5.0% p.a. years 3-11 12.0% p.a. years 12-13 6.0% p.a. years 14 Table 24: 2.0% p.a. year 1 6.0% p.a. years 2-3 7.5% p.a. years 4-6 6.0% p.a. years 7+ Table 28: 2.0% p.a. years 1-2 6.0% p.a. years 3-6 12.0% p.a. years 7-8 6.0% p.a. years 9+

Assumption category		31/12/2022	31/12/2021
		Stand-alone critical illness : 14.0% p.a. years 1-2 7.0% p.a. years 3+ Table 31 (Lives Aged 18-34 at Issue): 15.0% p.a. year 1 21.0% p.a. years 2-3 27.0% p.a. years 4+ Table 31 (Lives Aged 35+ at Issue): 8.5% p.a.	Stand-alone critical illness : 14.0% p.a. years 1-2 7.0% p.a. years 3+ Table 31 (Lives Aged 18-34 at Issue): 14.0% p.a. year 1 21.0% p.a. years 2-3 27.0% p.a. years 4+ Table 31 (Lives Aged 35+ at Issue): 8.0% p.a.
Expenses	Per Policy (term assurances)	£50.00 p.a.	£49.00 p.a.
	Per Premium (AWP and G5YSP)	5.5%	5.5%
	Investment (With-profits)*	1.00% p.a. of asset share	1.00% p.a. of asset share
	Fund Expenses (AMCs)	0.4% p.a. deduction to investment return	0.4% p.a. deduction to investment return
	Expense Inflation	3.50% p.a.	4.00% p.a.
IP			
IBNR		Premiums (net of 30% for expenses) – 68% for 2022, 52% for 2021, 24% for 2020, 12% for 2019 and 4% for 2018.	Premiums (net of 30% for expenses) – 68% for 2021, 52% for 2020, 24% for 2019, 12% for 2018 and 4% for 2017.
ICOP		Best estimate of claims data, additional 15% for expenses.	Best estimate of claims data, additional 15% for expenses.

E. Capital Management

E.1 Own Funds

The Society's Own Funds arise entirely from historical surpluses which have not been distributed to Members. As such the capital is all Tier 1 and there are no restrictions on the availability of those funds to support the MCR or SCR. The Society expects its Own Funds to remain sufficient to cover the SCR and plans its business accordingly – there is no intention to raise capital by other means.

The Own Funds have been quantified as total assets less technical provisions and other liabilities. This amounted to £23.8m as at 31 December 2022 (£29.2m as at 31 December 2021).

Solvency II Own Funds decreased over 2022 by £5.4m (2021: decrease of £0.6m). The material contributory factors to this decrease in Own Funds in 2022 were:

- An increase in the net cost of guarantees arising from a reduction in With-Profits asset shares;
- investment losses, mainly from unrealised gains, on Non-Profits and residual investments;
- new business strain, including the cost of promotional bonuses and acquisition costs in excess of current year expense margins from new business; and

partly offset by:

- a reduction in With-Profits and Non-Profit liabilities arising from a significant increase in the risk free yield curve as at 31 December 2022 when compared to that as at 31 December 2021.

E.1.1 Reconciliation of UK GAAP fund for future appropriations ("FFA") to Solvency II Own Funds

The FFA in the financial statements represents the surplus in the Society's with-profits fund on a UK GAAP basis for which the allocation between participating policyholders has yet to be determined. The FFA is effectively the net assets on a UK GAAP basis.

The reconciliation below shows the differences between the FFA in the UK GAAP financial statements and the Solvency II Own Funds.

Table E.1 Reconciliation of UK GAAP fund for future appropriations (FFA) to Solvency II Own Funds

31 December (£m)	2022	2021
Fund for future appropriations per UK GAAP financial statements	**24.9**	**29.5**
Adjustments to move to Solvency II valuation basis:		
Adjustments to intangible assets (see D.1.3)	(1.1)	(0.4)
Total Own Funds under Solvency II	**23.8**	**29.2**

1. **Total Own Funds under Solvency II for 31 December 2021 include £0.1m of rounding with respect to prior rows.**

E.2 Solvency Capital Requirement and Minimum Capital Requirement

E.2.1 Solvency Capital Requirement ('SCR') and Minimum Capital Requirement ('MCR')

The SCR and MCR as at 31 December 2022 amount to £11.8m and £3.4m, respectively (comparative figures as at 31 December 2021 were £15.1m and £3.8m). The amount of the SCR split by risk module, before any diversification benefit is applied between risk modules, is shown in Table E.2 below. The values shown are after allowance for the loss-absorbing capacity of technical provisions and loss-absorbing capacity of deferred tax.

Table E.2 SCR by Risk Module before Diversification Benefit

Risk Module		SCR £m as at 31 December 2022	SCR £m as at 31 December 2021
Market Risk		8.9	11.6
Life Insurance Risk		2.1	1.8
Health Insurance Risk		0.4	0.4
Counterparty Risk		0.5	0.5
Operational Risk		1.9	2.6

Metfriendly uses the Standard Formula to determine its Solvency Capital Requirement, it does not make use of any company specific parameters or undertaking specific parameters.

The PRA has granted Metfriendly quarterly reporting exemptions through a Modification by Consent. The Modification Directive is effective from 19 August 2020 and ends on the date that the relevant rule within the directive is revoked, or no longer applicable to the Society.

Table E.3 MCR and MCR biting constraint

Date		SCR £m	MCR £m	Linear MCR biting?
Day 1		7.7*	2.7	Linear MCR
Year End 2021		15.1	3.8	MCR – MCR floor
Year End 2022		11.8	3.4	MCR – absolute floor

* The Day 1 SCR figure has been restated (previously £7.2m) to reflect modelling improvements incorporated as part of the 2016 year-end investigations.

A formulaic cap and floor apply to the calculation of the MCR. At 31 December 2021 the MCR floor (25% of SCR) was biting. However, following a decrease in the SCR in 2022, the absolute floor component of the MCR bites at 31 December 2022.

The decrease in the SCR during 2022 primarily relates to: a reduction in non-Sterling and equity holdings within the Society's investments reducing currency and equity risk, a reduction in the Solvency II prescribed equity stress (through the symmetric adjustment) that acts to reduce the equity risk capital requirement, an increased likelihood that guarantee charges are increased (in line with the modelled management action) in a number of market stress scenarios, and lower capital requirements for new business (from the market and life underwriting risk modules, and calculated formulaically in respect of operational risk) due to lower volumes of new business written during 2022 than 2021.

E.2.2 Simplifications

The following simplifications are used in the standard formula when determining the Society's SCR:

Life Catastrophe SCR

For with-profit business, due to low materiality, the formula simplification for catastrophe risk SCR which is based on the capital-at-risk is applied. This is because the run-time for this stress would be unduly onerous for an immaterial contribution, which is estimated to be of the order of £10k to the overall Life Underwriting SCR.

Income Protection

The income protection business comprises less than 0.4% of the total technical provisions (including the risk margin). The number of policyholders in force has been in a gradual decline for some years. As such, it is considered appropriate, given the nature, scale and complexity of this business to determine the approximate level of capital under the 1-in-200 morbidity stress as 100% of the annual premium for the in force business. This amounts to £0.2m as at 31 December 2022.

Loss Absorbing Capacity of Deferred Tax

The actuarial model used to project the cash flows does not allow for any deferred tax benefit following a market stress. Consequently, a manual reduction is made to the capital requirement to reflect the loss-absorbing capacity of deferred tax up to the value of the existing deferred tax liabilities. Further work to demonstrate to the regulator the recoverability of any increases in deferred tax assets has not been commissioned by Metfriendly, on materiality grounds and given their utilisation is dependent on future investment returns.

The loss-absorbing capacity of deferred tax is determined as the proportion of the asset shock that transmits into guarantee costs for that part of the deferred tax benefit that is deemed to be recoverable. The loss-absorbing capacity of deferred tax amounted to £0.0m as at 31 December 2022.

Smoothing

The impact of smoothing is expected to be neutral in the long term and therefore Metfriendly does not hold any additional capital in respect of smoothing.

E.3 Use of Duration Based Equity Risk Sub-Module

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

E.4 Internal Model Information

Metfriendly does not use an internal model for determining its SCR.

E.5 Non-Compliance with the MCR or SCR

Metfriendly has a MCR coverage ratio of 690% and an SCR coverage ratio of 201% as at 31 December 2022 and is financially strong. It has complied with the both the Minimum Capital Requirement and the Solvency Capital Requirement throughout 2022 by a large margin.

E.6 Any Other Information

There is no other material information regarding the capital management of Metfriendly.

2022 SFCR_FINAL

Final Audit Report 2023-03-29

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