Solvency and Financial Condition Report

2020

Start

Keeping life colourful

Dear Members,

As the people responsible for your Society, the regulator requires us to report to you on the extent to which your benefits are secure in a document called the Solvency and Financial Condition Report ('SFCR'). I am delighted to present the SFCR for the year ended 31 December 2020.

We ensure that the Society is there for you when you need it the most in two main ways. First, we make sure that the Society has a healthy financial position, now and in the future (called 'having sufficient capital'). Second, we make sure that we run the Society properly (called 'having effective governance'). This report describes the work we have done in 2020 to demonstrate that we have sufficient capital and have effective governance, and so ensure the security of your benefits.

Running any business involves risk. There is always a risk that the finances deteriorate or that we fail to run the Society properly. We, the Board, are obliged to take every reasonable step to ensure that we identify and manage the risks that the Society faces.

The SFCR is organised into six sections. The sections and their contents are set by the regulator. We have added explanatory boxes throughout this year's report to explain any new terms as they are used and have summarised them in a glossary at the end. We have deliberately tried to avoid technical language but have sometimes had to strike a balance between the regulatory requirements and keeping things simple.

I hope you enjoy reading this report. We are always delighted to discuss the Society with our Members at the Annual General Meeting or at any other time. If you have any comments, questions or suggestions, please do not hesitate to contact me.

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Business and Performance

2020 has been a difficult year. The pandemic has affected most, if not all, aspects of normal daily life, and it has affected the Society's performance. We have been unable to grow our sales, we have received many enquiries from Members worried about their income when they can work but are prevented from working due to lockdown or falling demand. Our plans do not cover these circumstances. Our 2020 claims performance has been similar to previous years, although no-one knows what the impact will be of long-covid. Stable claims performance indicates that our underwriting has been appropriate.

We were unable to sell as much new business as we had planned primarily because of lockdown. We temporarily removed some products from sale because we were worried that they might be sold inappropriately. We added a coronavirus exclusion for plans with shorter waiting periods, because we were worried that some people were buying plans expecting them to pay a benefit while they were isolating. We introduced a payment suspension option for Members who had made at least three payments. These changes were made to protect existing Members and to support them in these uncertain times.

Our investments have generally preserved value. This follows a decision in 2019 to maintain only a small proportion of the Society's assets in equities. We have continued to draw down on our investments to support new business and to pay for the development of our new computer system, called PRISM.

Our strategy is to grow by providing useful plans to new and existing Members, and we are confident that the strategy remains appropriate.

Our business model describes how we will implement our strategy. Our view is that our best chance of success is to develop new plans and plan features that Members and Advisers see as attractive and which are competitively priced. We manage our underwriting and claims handling ourselves, because we have expertise in this work.

PRISM has, at the time of writing in 2021, been launched alongside the first modernisation of our plan range. We will use the foundation that PRISM provides to support strategic growth.

Given that we are relatively small, our business model includes buying in specialist services which we cannot carry out ourselves. We decided in 2019 to establish our own actuarial function, rather than outsource it. I am pleased to report that this function is now established in house.

As a result of our strategy, business model and plans, we expect to grow the value of the Society for our Members.

Risk Profile

All insurers manage risk. It is management's job to organise the affairs of their firm to ensure that benefits can be reliably paid when an insured event happens and a claim is made.

The regulator wants to know that insurers understand the risks that they face. It has created a formula for insurers to use that calculates the cost of the risks being run based on the nature of the firm. If the firm has enough capital to cover the calculated cost, the benefits are estimated to be at least 99.5% certain of being paid over the year following the calculation. We think that this formula is the best way of measuring the Society's cost of risk from the methods available.

We have performed the necessary calculations using this formula. The results indicate that **we have more than enough capital to ensure that Members' benefits will be paid** over the next twelve months (which is the regulatory requirement). The Board is satisfied that it will continue to be able to meet claims as they fall due in the future.

Summary

The formula identifies the source of the risks and calculates a cost for each of them. Using this formula in 2020, we have established that our biggest risks arise if plans lapse sooner than expected, if sickness worsens or if we spend too much. We know too from other work that it is important that our plans are priced to achieve a reasonable level of profit, that we do not sell too much guaranteed-rate business and that we sell enough plans overall to support our Head Office expenses.

We continually manage these risks, as well as all of the other risks that we face.

Managing Our Risk Profile

Risk is managed by having sufficient capital and having an effective system of governance. **We have sufficient capital and an effective system of governance.** This report sets out how we have concluded that this is the case.

Having Sufficient Capital

Every year, we estimate the benefits that we expect to need to pay our Members and the assets that we have to meet them. We allow for future payments on existing plans, for expected sickness and for a proportion of Members to stop making payments to their plans. This review is called the annual valuation.

The valuation proves that the Society has enough capital to meet Member benefits.

We calculate the risk in the Society's business using the formula mentioned earlier. The cost of risk is called the Solvency Capital Requirement or SCR. It is a measure of how much extra capital the Society needs to be 99.5% sure that it can meet all Member benefits in the next year. If an insurer has more capital than the SCR, the chance of there being a problem in the next twelve months is even lower than 0.5%. We have more capital than the SCR.

The Society's Valuation

This year, our valuation showed a healthy buffer of assets over liabilities. This buffer is called, in regulatory jargon, 'Own Funds'.

The SCR is the capital needed to cover the cost of the risks calculated by the formula. While we followed the rules to calculate the SCR and we think the number we calculated is correct, the regulator reserves the right to disagree and may ask us to change it.

Surplus capital is regulatory jargon for the difference between Own Funds and the SCR. The surplus capital provides extra protection to Members and is available for other purposes, such as investment in the Society's strategy.

Table 1 shows that the Society has almost £18m of surplus capital when it has allowed for the cost of risk calculated by the regulator's formula mentioned earlier:

Table 1: Surplus Capital, £000	31 Dec 2020	31 Dec 2019
(a) Own Funds	59,807	73,048
(b) Solvency Capital Requirement ('SCR')	41,983	47,415
(c) Surplus Capital (a) – (b)	17,824	25,633

Summary

Surplus capital has fallen over 2020. This is caused by a number of changes, some which have increased and some which have reduced surplus. Principal factors include the capital impact of new business that was sold in 2020, changes in interest rates, changes in how we plan to manage the business in future and changes in assumptions, especially about future possible sickness.

We expect our surplus capital to reduce over the next year as we invest more in new business and in developing the Society. This new business will mean that the SCR in 2021 will increase and the surplus capital will fall. The Board will continue to monitor the SCR and the surplus capital, to ensure that risk does not grow too high and that capital does not fall too much.

The regulator classifies capital into tiers, depending on how reliably the capital can be called upon. All of the Society's capital is Tier 1. Tier 1 capital is the best quality capital (the most reliable).

The regulator sets a minimum level of capital called the Minimum Capital Requirement or MCR which, for the Society, is one quarter of the SCR. If an insurer's capital falls below the MCR, the regulator will intervene. We are a long way from our capital being below this level. **In conclusion, we have more than enough capital to confidently support the payment of Member benefits over the next twelve months.**

An Effective System Of Governance

The Society has an effective system of governance.

We have procedures in place to make sure that those working for the Society, especially at a senior level, are fit and proper. The risk management system has been reviewed this year and is effective. An Own Risk and Solvency Assessment has been performed. Pay is properly managed. This work has been useful in helping the Board and others make decisions.

The internal control system has similarly been reviewed and strengthened. The Society has effective compliance, actuarial, risk management and internal audit functions.

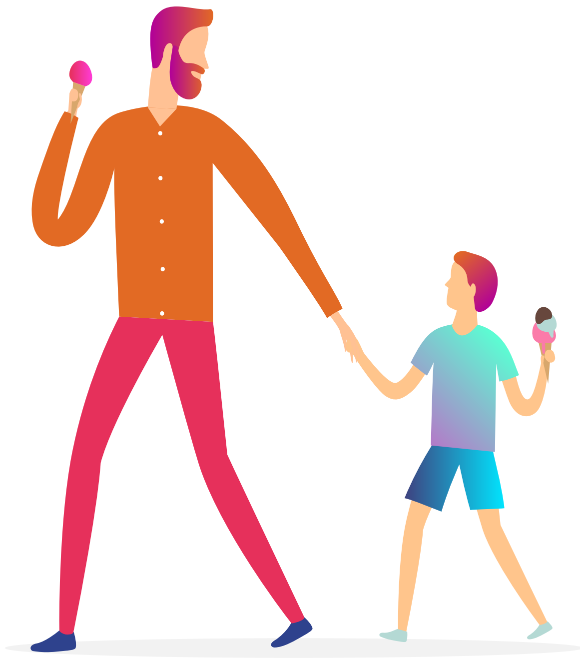
Our Independent Auditor at 31 December 2020, is BDO LLP. At 31 December 2019, it was PricewaterhouseCoopers LLP. We changed Independent Auditor during the year.

Our Internal Auditor is EY LLP, unchanged from last year.

We created an in-house actuarial function during 2020. This function was previously provided by OAC plc. The With-Profits Actuary work continues to be provided by OAC plc.

We continue to monitor those firms to whom we have outsourced services.

In conclusion, we are satisfied that our system of governance is effective, given the nature, scale and complexity of the Society's risks.



Summary

The Impact Of Coronavirus

This report describes the Society in 2020, but there are parts of it that are forward looking. We have described the impact of the coronavirus as appropriate. As with most businesses, it has introduced an unprecedented level of uncertainty into the Society's prospects. The Board has considered the possible impact and has concluded that the Society is able to continue to meet its obligations to Members and regulators. That said, the situation is fast moving and the Board is continuing to monitor the position as events unfold.

Our Responsibility

The Directors are responsible for preparing this, the 2020 Solvency and Financial Condition Report, so that it meets the regulator's financial reporting rules and the rules that apply to insurance companies (called Solvency II regulations). The Directors are responsible for making sure that the working environment is robust enough to ensure that this report is accurate and free from any material mistakes, from any cause, including fraud or someone's error.

We are satisfied that, throughout 2020, the Society complied in all material respects with the requirements of the regulators' rules and the Solvency II regulations. It is reasonable to believe that the Society has continued to comply since and will continue to do so in future.

By Order of the Board
Stuart Tragheim
Chief Executive & Director
6 April 2021

Solvency and Financial Condition Report 2020

A. Business and Performance

Start

A. Business and Performance

A.1 Business

The Original Holloway Friendly Society Limited ('the Society') exists to provide a replacement income when you, one of our Members, cannot work because of illness or injury (which we call 'sickness'). We protect a proportion of your income when you cannot work and try to help you get back to work where we can.

In 2016, the Board took time to assess the future of the Society. The Board decided that it wanted to grow the Society and to provide its plans to more people. This ambition required the Society to grow. To grow, we had to change how we worked. 2020 was the fourth year in a five-year plan to grow the Society by increasing the number of Members.

The coronavirus pandemic gives rise to a significant amount of uncertainty, with potentially far-reaching impacts for many businesses. The results set out in this report represent the position as at 31 December 2020 as required by the regulations. It shows how we have responded to the pandemic in 2020 and the implications of our response on our capital and governance.

Products

We currently offer four income protection (or 'IP') plans. Each protects your income up to a pre-agreed amount. Each protects you until your chosen retirement date, provided you keep making the agreed payments.

One of our plans pays out for up to one or two years (called 'Short Term Income Protection') for any single cause. The others pay out until your chosen retirement date. Short Term Income Protection is cheaper because the benefit payment period is capped and it has different features, so it appeals to different people.

Our 'Purely Protection' and Short Term Income Protection plans have payments that increase with age, according to a pre-agreed schedule. The cost of your protection increases, hopefully as your income increases.

'one2protect' has level payments which are guaranteed for five years from the plan start date. The payments may then be varied, depending on how sick, or not, Members with this plan have been collectively. If there have been a high number of claims, the payments will increase. If there have been a low number of claims, the payments will be reduced. one2protect, unlike the other plans, has different payments depending on your job.

We also offer a Holloway plan. This plan pays you an income if you cannot work, with an additional benefit of some savings and the right to share in the profits generated by these plans. As a result of this feature, this is a With-Profits (or 'WP') plan.

What is a Holloway plan?

We understand that we were the first firm to combine income protection and savings. The resulting innovative plan, introduced around 1875, was named after our founder, George Holloway, MP for Stroud.

We may, in the future, offer new plans or adjust or stop offering existing plans.

As you might realise, this is a simplified description. Our plans are available only through appropriately qualified Advisers who can explain them, including how they can be adjusted for your needs and what options are available. Advisers act for you, not for us, although we do pay commission to them for every new plan which is bought. They can offer plans from a range of providers, not just from us.

We manage a number of plans, some of which are no longer available. These can be divided into three types: Income Protection (or IP) plans, With-Profits (or WP) plans and Unit Linked (or UL) plans.

A. Business and Performance

The Unit Linked plan is closed to new business. It was a savings plan where the benefit was linked to investment performance.

Everyone who has a plan issued by the Society becomes a Member.

The Society is owned by its Members. It has no shareholders. Therefore, everyone at the Society works for you, our Members. The Society's Board of Management ('Board') makes decisions on your behalf. You elect the Directors who serve on the Board.

What is a Board?

Most companies are run by a Board of Directors. These are the people who direct the company, decide its strategy and ensure its governance. The Board oversees plans, performance and activity and, if not satisfied, makes changes.

The Board is chosen by the owners of the company. For us, the Board is chosen by you, our Members at the annual general meeting.

The Society has Members throughout the UK, the Channel Islands and the Isle of Man. It offers its plans throughout the UK and in the Isle of Man.

We are, legally speaking, a friendly society, registered and incorporated under the UK Friendly Societies Act 1992 with the registered number 145F. We are authorised and regulated by the Prudential Regulation Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA'). Our Firm Reference Number is 109986, which you can use if you want to write to either regulator.

The PRA is responsible for our prudential regulation. You can contact the PRA by writing to Prudential Regulation Authority, 20 Moorgate, London, EC2R 6DA or by calling 0207 601 4878.

The FCA is responsible for regulating our conduct. You can contact the FCA by writing to the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN or calling 0207 066 1000.

Our independent auditor is BDO LLP ('BDO'). BDO can be contacted by writing to 55 Baker St, Marylebone, London W1U 7EU or by telephoning 020 7486 5888.

What is an independent auditor?

An independent auditor is a firm appointed mainly to provide independent assurance to Members that a Society's accounts are broadly accurate.

The economic uncertainty arising from the coronavirus pandemic is bound to affect the level of future sales in the insurance market. The Society has considered this in its assessment of future prospects. It will continue to refine its assessments as the situation becomes clearer.

A. Business and Performance

A.2 Underwriting Performance

What is underwriting?

Underwriting is the name for the processes involved in accepting a new plan and providing cover to a Member in return for agreed premiums. By accepting a new plan, the Society is making assumptions about future sickness, the expense of administration and for how long the Member will continue to pay premiums to keep the plan going.

Underwriting success can be judged by the difference between payments received and claims paid. Underwriting is effective if the payments received are greater than the claims paid. Table 2 shows the payments and claims for the three plan types described earlier (Income Protection (IP), With-Profits (WP) or Unit Linked (UL)). Reinsurance is included and is explained a little later.

Table 2: Underwriting Performance, £000

	IP		WP		UL		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
Gross Payments (P)	7,690	5,816	2,737	2,911	-	-	10,427	8,727
Reinsurance Out	-	-	(60)	(71)	-	-	(60)	(71)
Net Earned Payment Income								
Gross Claims	(2,868)	(1,777)	(557)	(667)	(50)	(120)	(3,475)	(2,564)
Reinsurance In	-	-	6	14	-	-	6	14
Claims incurred net of reinsurance (excl. withdrawals and maturities)								
Surplus (S)	**4,822**	**4,039**	**2,126**	**2,187**	**(50)**	**(120)**	**6,898**	**6,106**
% Surplus (S÷P)	**62.7%**	**69.4%**	**77.7%**	**75.1%**	**-**	**-**	**66.2%**	**70.0%**

Key: IP = Income Protection, WP = With-Profits, UL = Unit Linked

Income Protection business has a healthy underwriting result. It is lower than 2019, reflecting increased claims particularly on our Short Term Income Protection plan. Very little new With-Profits business was sold in 2020. The With-Profits results include Members claiming their investment balances. The Unit Linked plans are closed to new business and have all completed their payment-paying term.

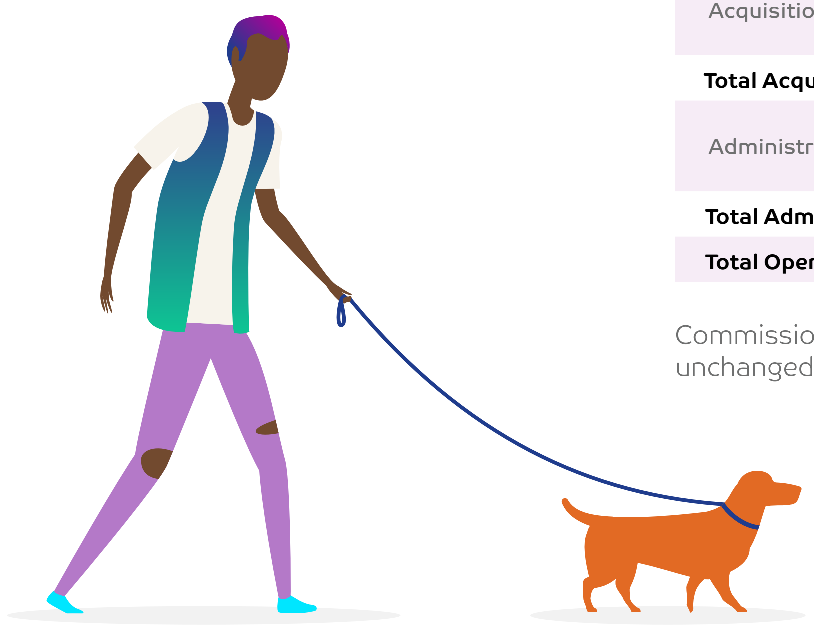
Overall, a healthy underwriting surplus was generated for the Society. The surplus meets expenses, including strategic expenses or is retained as value for Members, current and future.

Reinsurance is not very important for the Society at the moment. It may become more important in future if we decide to offer new types of plans or add reinsurance to our existing plans.

A. Business and Performance

What is reinsurance?

Reinsurance is insurance for insurance companies. An insurer can use reinsurance to reduce its own risk, to provide technical support and to help with cash flow. Reinsurance is provided by specialist firms called reinsurers.



Our reinsurance payments and recoveries are very small.

Our main source of income is payments from Members. We receive income from our investments. Details of this income are in section A.3.

Table 3 shows the Society's expenses.

Table 3: Operating Expenses, £000

Expense Type		2020	2019
Acquisition	Commission	1,821	4,954
	Sales-related Expenses	4,759	5,280
Total Acquisition Expenses		**6,580**	**10,234**
Administrative	Maintenance Expenses	2,618	2,277
	One-off Expenses	61	77
Total Administrative Expenses		**2,679**	**2,354**
Total Operating Expenses		**9,259**	**12,588**

Commission has reduced in line with the reduction in new business. Other expenses are mostly unchanged. This reflects the decision to maintain the infrastructure during the pandemic.

A. Business and Performance

Underwriting & Claims in General

With more new Members, we have to underwrite more people. We have a dedicated team to do this work. We expect our underwriting standards to be maintained as we grow.

Managing claims is an important part of our work. We pride ourselves on working with Members to help them claim quickly and without fuss and helping them get back to work as soon as they can. We take steps to ensure that our Members' assets are not subject to fraud, so take care to ensure that claims are valid.

We continue to develop our underwriting and claims management facilities. As a result of the pandemic, we have excluded coronavirus-linked claims from new sales and have taken steps to establish alternative methods of ensuring claim validity. We will continue to pay valid coronavirus-linked claims on existing business.

A.3 Investment Performance

We classify our investments into three categories: equities (shares), fixed interest (UK gilts and bonds) and cash and property. Table 4 below shows how our investments have performed:

Table 4: Investment Performance, £000
During 2020 & 2019

Asset Type / Return Type	Equities		Fixed Interest		Cash and Property		Total	
	2020	2019	2020	2019	2020	2019	2020	2019
Realised Capital (Loss)/Gain	(240)	1,536	(108)	65	-	-	(348)	1,601
Income Received	94	292	492	495	13	48	599	835
Unrealised Capital (Loss)/Gain	(202)	347	485	479	-	(17)	283	809
Investment Expenses	(9)	(21)	(72)	(71)	(7)	(8)	(88)	(100)
TOTAL	**(357)**	**2,154**	**797**	**968**	**6**	**23**	**446**	**3,145**

During the year, we made no significant changes to our investment profile.

We now hold most of our spare cash in an AAAm-rated cash fund, as advised by LGT Vestra.

Given our limited exposure to equities, the stock market falls in 2020 have had a limited effect on the Society's balance sheet. Some corporate bonds have lost value as a result of reduced demand over the same period, but the reduction in interest rates has increased the value of others. In general, the Society is invested in cash, cash funds, high-quality corporate bonds and gilts and the portfolio has largely maintained its value.

At the end of the year, we held no securitised assets (this is a type of investment: the regulations say that we must let you know if we hold them).

The Society has a small portfolio of assets to support its Unit Linked plans. During 2020, the management of this portfolio was transferred to LGT Vestra.

A. Business and Performance

A.4 Performance of Other Activities

The Society did not perform any other activities.

A.5 Any Other Information

Nothing additional to report.

Solvency and Financial Condition Report 2020

B. System of Governance

Start

B. System of Governance

What is governance?

Governance covers everything done to be sure that a business is running properly. It includes legal requirements, the need to be fair to Members, and the need to organise the business sensibly and with due regard for risk.

B.1 General Information on the system of governance

What is a system of governance?

This means everything that is in place to make sure that the Society is well governed.

We have an effective system of governance in place. It ensures that we manage the Society safely and reliably. The system of governance reflects our size, the range of plans we offer and our historic expertise in the work that we do. The system of governance for a large company is different to that of a small one. It is important that the approach chosen fits the company. We think that ours does.

Regulation asks for three things in the system of governance: (a) a transparent organisational structure, (b) clear and appropriate segregation of responsibilities, and (c) a well-established and effective system for ensuring the transmission of information. We have these in place. In short, (a) all of our Colleagues know what their jobs are and who does what, (b) we insist that everyone's work is checked by someone else and that no-one is allowed to do work where there might be a conflict, and (c) we work hard to make sure that everyone knows what is going on, and if not, that it is clear where to go for help.

The system of governance is regularly reviewed by the Board and its Audit and Risk Committee.

What is the Audit and Risk Committee?

The Board has set up Committees to help it with oversight. The Audit and Risk Committee oversees internal and independent audit, compliance, actuarial and risk management activities. It ensures that the risk management and internal control systems are effective. Details of its terms of reference (the rules it follows) are on our website.

About the Board

The Board is a group of people, called Directors, who, together, run the Society at a high level. It is chosen by our Members and is responsible to them and to the regulators.

The Board is made up of Non-Executive Directors who are independent (principally, they don't work in the Society other than as Directors, nor do they have any personal interest* in it) and Executive Directors who work in the Society as well as being Directors. There are more Non-Executive Directors on the Board than there are Executive Directors. If it comes to a vote, Executive Directors cannot out-vote the independent Non-Executive Directors.

* All of the Directors have plans with the Society. As everyone knows about this, it is not believed to be a barrier to them acting and thinking independently. It is explicitly allowed in the Society's Rules.

The Board is, as at 31 December 2020, made up of eight people: six Non-Executive Directors, the Chief Executive and the Chief Financial Officer. One Non-Executive Director retired during 2020, having reached the end of his expected term of office.

B. System of Governance

The Board decides the strategy, hires the Chief Executive and other senior people, and monitors performance. The Board can consider anything it chooses. Mainly, it considers business plans, culture, financial and other reporting, the quality of the system of governance, risk management, the prudential management of the Society and its own succession. The Board is led by the Chair. This year, the focus has been primarily on considering how the Society should respond to pandemic challenges.

What is the Chair?

The Chair is the Non-Executive Director who leads the Board. It is an important role with specific responsibilities to the regulator and to Members.

There are three Board Committees which help the Board do its work. These Committees and the Board hold the Executive to account.

What (or who) is the Executive?

The Executive refers a small group of senior employees. At the end of 2020, the Executive comprised the Chief Executive, the Sales & Marketing Director, the Chief Actuary and the Chief Financial Officer.

These are the employees who run the Society, led by the Chief Executive, responsible to the Board.

The Nomination and Remuneration Committee is two committees sitting at the same time.

The Nomination Committee is, as at 31 December 2020, made up of four people: two independent Non-Executive Directors, the Chair and the Chief Executive. It considers the Board's performance and its current and future make up. The Remuneration Committee is made up of three people: two independent Non-Executive Directors and the Chair. It considers all aspects of pay, including Executive pay, and bonus plans (short-term, long-term and sales). This joint Committee meets at least twice a year. It helps the Board by making sure that the Board and its Committees work effectively, including having a plan for succession, and that there is effective oversight of pay and benefits.

The Investment Committee is, as at 31 December 2020, made up of four people, all of whom are independent Non-Executive Directors. It considers the selection and performance of our investments and ensures that they are invested according to the Prudent Person Principle. The Committee meets at least twice a year. It helps the Board to have confidence in the approach to investment and performance of investment managers.

What is the Prudent Person Principle?

This is a phrase in the regulations. It means that investments should be only those that a prudent person would make.

The Audit and Risk Committee (or 'ARC') is, at 31 December 2020, made up of three people all of whom are independent Non-Executive Directors. It considers the effectiveness of our financial management, risk management and internal controls systems and the controls around compliance. The Committee draws on the work of the independent auditor, the internal auditor, the risk management function, the actuarial function and the compliance function. The Committee meets at least four times every year. It helps the Board have confidence in the quality of our system of governance and the accuracy of our financial statements.

B. System of Governance

Main Business Functions

There are three main functions of the business: sales and marketing, Member services and operations, and finance and risk.

The sales and marketing function is responsible for:

- presenting us to Members and Advisers before and after they have bought a plan
- dealing with press enquiries
- writing and designing material
- finding new Advisers
- managing the relationship with Advisers
- agreeing commission rates, and
- designing new propositions and products and making sure existing ones remain fit for purpose.

Its role is to make sure there is a healthy flow of new Members.

The operations function is responsible for:

- the handling of our Head Office activities involving Members and their plans
- dealing with Members, underwriting and administration
- handling claims when Members cannot work
- keeping the IT systems going
- managing new IT developments
- looking after all aspects of the Head Office building
- disaster recovery planning (how the Society would cope in an emergency)
- people management, and
- project and change management.

Its role is to handle all aspects of managing plans after sale, as well as the computer systems, buildings and so on.

The finance, risk, compliance and actuarial function is responsible for the money, be it money coming in (as payments from Members), money being paid to Members who are ill or injured (claims), or money being paid to cover commissions, wages, suppliers, training, insurance, consultancy fees etc.. Part of this responsibility is the proper accounting for every penny received and spent. The function includes:

- the risk management systems (does the Society understand the risks it is running? has it thought about how to manage risks to prevent a problem?)
- the actuarial function (is there sufficient capital, now and over the long term?)
- the compliance function (does the Society comply with the rules?)
- the company secretarial function (are Board/ Committee meetings being run properly?)
- liaison with independent and internal audit and the actuarial functions, and
- liaison with the With-Profits Actuary.

Its role is to ensure that the Society is managed and controlled to the high standards expected of an insurer.

B. System of Governance

How the system of governance has changed during 2020

The system of governance has continued to be embedded throughout the Society.

The process to appoint the Society's next Chair of the Board reached its conclusion, when the previous Chair retired and the new Chair was welcomed to the role. The change meant that a new Non-Executive Director was recruited to serve as the ARC Chair and to take responsibility for Internal Audit.

The process to recruit a Chief Actuary was concluded in 2019 and the chosen candidate began work in early 2020.

The appropriate regulatory approvals for these roles were submitted and approvals received.

The Board sub-committee to oversee the progress of the PRISM project has continued to meet. The sub-committee comprises two Non-Executive and two Executive Directors.

Review of the System of Governance

The Board and its ARC have continued to monitor the performance of the system of governance and to suggest changes where necessary.

Boards are expected to be assessed by someone who is independent and external on a regular basis. Appropriate work has been commissioned in 2021 to provide this external assessment.

Remuneration Policy and Practice

We will only be successful if our people work hard and do a good job. The Society's future is in the hands of its employees, whom we call Colleagues, who need to be rewarded properly for doing a good job.

The Society's approach to paying Colleagues is set out in its Remuneration Policy. Our Remuneration Policy tries to make sure that the right behaviour at work is rewarded. This is a balance between continuing doing everyday work to the right standards and coping with the changes that growth requires.

We have a clear idea why the Society exists (to be there when Members need us the most – our mission) and what it has to be if it is to grow (to be the most recommended specialist provider – our vision). We have a clear idea of what makes the Society special (our values). The Remuneration Policy supports the mission, vision and values and tries to recognise and reward those who support them through their behaviour at work.

Rewards have to be in proportion to the overall success of the Society. They have to reflect each person's contribution.

Our Remuneration Policy is based on the following:

- there needs to be a balance between achievements and risk taking
- rules must be met, values demonstrated and standards maintained
- no-one should benefit through an accident or because the rules did not cover every possible situation (so payments are discretionary), and
- everyone should have the opportunity to earn a bonus based on how well they work.

Pay at the Society is made up of (i) salary, benefits and pension, (ii) either a sales incentive plan or an annual bonus plan and (iii) a long term incentive plan.

(i) Salary, benefits and pension are paid to all Colleagues.

The salary, benefits and pension are competitive. They are regularly compared with the pay and benefits of similar firms, at every level.

B. System of Governance

Benefits include car allowance, private medical and dental and other standard benefits (death-in-service, paid holiday, sick pay etc.). The benefits offered differ according to role and seniority.

(ii) The sales incentive plan is open to all Colleagues working directly in the sales function. All other Colleagues directly employed are eligible for the annual bonus plan.

The sales incentive plan generates bonuses based on quarterly and annual sales performance, and performance on a number of conduct and capability measures.

The annual bonus plan requires threshold sales and expense targets to be hit. If they are, a bonus becomes payable depending on performance against a set of numeric and activity targets.

As the first lockdown began, the Society decided that it would be inappropriate to implement an annual or sales incentive plan in 2020 and the plans were cancelled. A simpler, more modest plan was introduced across the Society.

(iii) The long term incentive plan is open to selected members of the Executive Committee.

The long term incentive plan considers performance over three-yearly periods. It pays a bonus if the Society's value is higher than agreed targets each year for three years. Any bonus is decided upon after each three-year period is over, is at the Remuneration Committee's discretion, and is paid over the two years following the end of the performance period.

As the first lockdown began, the Society decided that it would be inappropriate to implement a long term incentive plan in 2020 and the planned 2020-2022 plan was cancelled. No alternative was introduced.

There are two such plans that have reached the end of their performance period for 2017-2019 and 2018-2020. There is one plan currently in place for the performance period 2019-2021.

The Purpose of Remuneration

We use pay to attract and keep good people who have the skills and experience that the Society needs to grow. Salary, pension and benefits are set in comparison with similar firms and to attract people to the Society.

All bonus plans should encourage the activities needed for the Society to grow.

Terms of Appointment of Executive Directors and Other Members of the Executive

The employment terms, including pay, for the Society's most senior executive functions are overseen by the Remuneration Committee. No individual is involved in setting her or his own remuneration. We expect variable remuneration to form a significant part of Executive remuneration.

The long-term incentive plan should allow us to attract and retain Executives of the right quality and should encourage them to focus on building the Society's long-term value. The Remuneration Committee is responsible for all payments under this bonus plan. It can choose to ignore the amounts calculated from the bonus formulas, and instead to increase or reduce bonuses payable. It is expected that this would only happen to fairly reflect contributions made, where not to do so would be harmful to the Society's long-term success. The Committee can reduce, withdraw or claw back any payments under the long term incentive plan in certain circumstances.

No Executive service agreement has a notice period longer than one year and there are no loss-of-office or other benefits linked to resignation, except pay during notice periods. Any severance package for an Executive is subject to agreement by the Remuneration Committee. There are no early retirement or supplementary pension schemes.

B. System of Governance

Terms of Appointment of Non-Executive Directors

Non-Executive Directors are paid fixed fees. The fees reflect the work required of each role. There are no other benefits offered. The notice period is one month. There are no loss-of-office or other benefits linked to resignation from the Board. Re-election varies depending on time served, but no Director may serve for more than three years following their election at the Society's Annual General Meeting without re-election. Serving for more than nine years requires particular consideration. There are no early retirement or supplementary pension schemes.

Remuneration throughout the Society

The Remuneration Policy applies to all Colleagues. The annual bonus plan is open to all non-sales Colleagues. The resulting bonus is expected to form no more than 60% of annual pay. The sales incentive plan is open to members of the sales team, but not senior sales management (who instead are part of the annual bonus plan). The resulting bonus is expected to form no more than 125% of annual pay.

Transactions with Connected Parties

During 2020, the Society did not do any paid work with people or firms which are closely connected with its Directors or senior managers.

Governance in 2021

The widespread move to working from home as a result of the coronavirus has introduced new operational risks. The Society has worked to ensure that these risks are managed and that the high standards of governance that have been established can be maintained.

B.2 Fit and proper requirements

We need members of the Executive and Senior Leadership Team to have the skills, knowledge and expertise to run the Society properly and to develop and implement our strategy. The most important quality is experience. Professional qualifications are important for some roles, as is a willingness to make the changes necessary to allow us to be there for our Members in their times of need and to demonstrate our strengths to Advisers.

What is the Senior Leadership Team?

This is the group of people who work for members of the Executive. On a day-to-day basis, the Senior Leadership Team makes sure that the Society is properly run. Members of this team attend the monthly Executive, and some other Committee, meetings and, depending on their job, may occasionally attend or present at Board meetings.

Our Board ensures that those running the Society are properly qualified and have the knowledge and experience to do their work properly. They must have good reputations and have integrity. The regulator calls this being fit and proper. For the most senior people, the Nomination Committee ensures that applicants are fit and proper. For other roles, the Executive has this responsibility.

The regulator is kept up to date with all changes in senior management, including key function holders (the regulator's label for specific functions). We share the information used to confirm that someone is fit and proper. In particular, if someone was thought to be no longer fit and proper, we would tell the regulators.

When someone joins our Executive or Senior Leadership Team for a role that requires regulatory approval, a specialist firm is hired to collect the information needed to decide whether they are fit and proper. This firm considers fitness mainly by validating statements made by the candidate, including qualifications earned. It considers probity by searching for indicators of poor behaviour, including criminal record checks. It asks for references from previous employers. The Board ultimately decides whether it feels that someone at this level is fit and proper. For these roles, having made its assessment, the Board has to propose the individual to the regulator to be approved before the person can begin in the role.

B. System of Governance

In all other roles, the checking process is tailored for the role.

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

(a) Risk Management System

Insurers are required to have an effective risk management system. This system must include strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, at an individual and at an aggregated level, to which they are or could be exposed, and their interdependencies. This statement of what must be covered by the risk management system is taken from the regulations. We reviewed our Risk Management System in 2020.

Our Risk Management System is built around the business plan. Risks to the plan are automatically considered when the business plan is developed. The Risk Management System also covers the plans to improve governance and monitors the insurance risk elements of the Solvency Capital Requirement ('SCR').

What is the Solvency Capital Requirement?

This is the amount that the regulator says the Society has to hold to ensure Member benefits are secure in most circumstances over one year. We calculate it using a formula provided by the regulator. It is often shortened to SCR.

The Board is satisfied that the Risk Management System is effective. It is well integrated into the Board processes and is becoming embedded into other parts of the Society.

The Society's Risk Management System starts by defining the risks that the Society faces, split into risks to the business plan, governance risks, insurance risks (as defined in the SCR formula) and operational risks. A risk tolerance is defined for each risk. The tolerance links back to the business plan, governance plans, SCR and risk profile, or operational thresholds. Management then reports to the Board if one or more threshold is, or looks like it might be, exceeded.

What is a risk tolerance?

Most measures of performance have an expected value or target. The risk is that the actual value is higher or lower than the target, to an extent that might cause harm or cause the plan to be re-considered.

The Executive continually monitors risks, including operational risks, that come to light. Where appropriate, reports are made to the Board, to ensure that Directors are informed about the risks that materialise.

What is operational risk?

Operational risk is the risk of some planned activity going wrong because a process fails, a system fails or someone does something wrong. The regulator includes fraud and legal problems as operational risks.

B. System of Governance

The Society maintains a risk register.

What is a risk register?

The Society's risk register is a list of the risks that it faces with details of how the risks are identified, measured, monitored, managed and reported.

We have established a management committee called the Risk and Controls Committee to review risk and internal control information, and to decide what should be passed to the Board and when. The risk management function is led by the Chief Risk Officer ('CRO'). As a member of the Executive, the CRO is always involved in discussions and decisions about strategy and tactics. The CRO makes sure that risk consequences are considered and sometimes has to respond to challenges about risk. Reporting is via the Risk and Controls Committee.

We regularly discuss how risk might affect outcomes and our solvency, even if no change is expected. We especially consider risk and the impact on solvency when developing new plans.

What is solvency?

Regulators recognise that the more surplus money a firm has, the more secure the Member benefit. 'Solvency' is the jargon used by insurers to mean the surplus money that a firm has in excess of that needed to meet Member claims in most circumstances.

Insurers talk about capital rather than money. Capital is defined a little later on.

When considering a risk, insurers look at the impact the risk might have on their surplus capital - hence, the impact on solvency.

Generally, high or increasing solvency is a good thing, low or declining solvency is a concern, unless the change was planned or there is a good reason for it.

When the Board or a Committee has a decision to make, the papers describing the decision include CRO comment. The CRO is expected to cover the impact of the decision on our risks and our solvency. The result is that the Board makes decisions in full knowledge of the possible impacts of the decision on risk, on solvency and on the system of governance, assuming different outcomes.

(b) Risk Management Function

Insurers are required to have a risk management function as part of their Risk Management System. The Society's Chief Financial Officer serves as CRO and runs the risk management function. The risk management function makes sure that the Risk Management System works properly.

The Society's Risk Management System is aligned to its business planning. Business planning includes considering how the Society might perform in different scenarios, including if its risks materialise. There is an overlap between business planning and risk management and thus the performance of both functions by the same person, given the Society's size, is sensible.

The CRO reports to the Chair of the ARC on risk matters and is a Director of the Society. These arrangements provide the authority necessary for the role. The CRO regularly discusses the work for the risk management function, its resources, and the Risk Management System, with the ARC.

(c) Own Risk and Solvency Assessment

What is an Own Risk and Solvency Assessment?

The regulation requires insurers to undertake an Own Risk and Solvency Assessment, or ORSA, whenever its risks change, or at least annually.

The ORSA is a judgement by the Board of the insurer's risks and the impact on the insurer's solvency. Importantly, it is the Board's view, not the regulator's (and not the view using the regulatory formula).

The starting point for the own risk and solvency assessment (ORSA) is the ORSA policy. This is a document required by the regulator to set out how an ORSA is to be done.

The ORSA process is a series of steps. The Board and others consider all of the risks that we face and their possible impact. The impact of each risk might be how it affects capital, how management has to behave to manage the risk, or a mixture of both.

What is capital?

Capital is the name for the resources available to meet the Society's outgoings.

For the Society, capital is made up of cash, investments and the difference between payments from Members (inflow) and future claims and expenses (both outflow).

We design a number of risk tests. Some just look at a single risk and suggest the extent to which it might move. Others look at groups of risks occurring together. The tests are used to see the impact on the Society if risks occur as suggested. The Board considers the results and may ask for new tests when it sees what the first results reveal.

When the Board is satisfied that it has considered all possible risks, it can start to think about the right level of solvency given those risks. The question the Board is trying to answer is how much surplus capital we need to be confident that we can meet all Member benefits and withstand all of the risks that we face, given the business plan.

What is surplus capital?

Surplus capital is the capital over and above that needed to meet expected Member benefits and the SCR.

We then perform a number of routine checks before drawing up a draft ORSA report for the ARC to consider. Based on the ARC's views, a final report is presented to the Board. This includes the Board's proposal on the necessary level of surplus capital that we need to have confidence that Member benefits can be paid. Once agreed by the Board, the report is sent to the regulator.

Throughout this process, an ORSA record is kept containing details of the intermediate results and discussions on risk matters.

Once the ORSA report is agreed, the Board conducts a review of the process. The results of the review are fed into the review of the ORSA policy and the next scheduled ORSA.

The results of the ORSA have to be shared throughout the Society. Integrating the ORSA is part of the risk management function work described earlier.

The ORSA happens at least once per year. A new ORSA is organised immediately if our risk profile changes dramatically. In 2020, we performed the ORSA between September and December.

The ORSA is now considered as part of the Society's strategic planning and the results are routinely used in business decisions and business projections.

B. System of Governance

In conclusion, the Society has decided, following its 2020 ORSA, that it has enough capital to meet its needs over the next five years, given its risk profile. It is the Society's plan to operate within its own resources. We have no plan to raise capital, so plans for capital do not affect our planned risk management.

We will review this position again once the 2020 financial statements have been issued, and review future financial condition allowing for end-2020 assumptions.

(d) Decision Making

Insurers are required to write down their decision-making procedure as part of their risk management system. We have done this.

We have taken steps to ensure that the Board does not make decisions without understanding the risks to that decision. One of the purposes of the Risk Management System is to ensure that all of the risks affecting major decisions are understood and that ways to manage or remove risks are considered before the decision is made. Thinking about risk as a day-to-day feature of decisions, rather than something separate, should improve the quality of Board and Committee decisions.

B.4 Internal Control System

(a) About the Internal Control System

Insurers are expected to have an effective internal control system.

We have an effective internal control system, which covers administrative and accounting procedures, an internal control framework, appropriate reporting arrangements at all levels of the Society and a compliance function. These are regulatory requirements.

Our internal controls are generally managed by the person responsible for each function. These managers are responsible for making sure that there is the right mix of controls and for managing changes safely within their functions.

Each manager assesses the effectiveness of their controls and discusses their plans to improve control where necessary. After each meeting, a report is produced for the Risk and Controls Committee, which in turn produces a report for the ARC. Internal control assurance work has been different this year because Colleagues have generally been working from home. We took extra care to ensure that under these new conditions, work was being done to the same standards that applied in the office.

As a result of the resource focusing on ensuring safe operations, it was not possible for the regular control meetings to take place. Instead, monthly interviews were held with each manager to understand the risks being faced in each area. In parallel, a number of aspects of the internal control environment reporting were reviewed and enhanced. The meetings will restart in 2021.

The Head of Operational Risk is responsible for documenting and managing internal controls.

These structures and accountabilities (regulatory language) form the Society's internal control system.

In conclusion, the Board is satisfied that the Society has an effective internal control system.

(b) Compliance Function

The regulator requires that every insurer has an effective compliance function.

The compliance function advises the Board on the effectiveness and completeness of the structures in place to ensure that the Society complies with the laws, regulations and rules of Solvency II and a number of other regulations. It considers changes in regulations and how they might affect the Society. The function considers the risk of non-compliance.

B. System of Governance

What is Solvency II?

Solvency II is the name given to the regulations that UK insurers have to follow. It sets out what insurers have to do to protect Member benefits.

The areas discussed in this document are all required under Solvency II, as is the production of this document.

The Compliance Officer is appointed by the Board and has a direct reporting line to the ARC Chair and to the Chief Executive as well as a day-to-day reporting line to the Chief Financial Officer. These arrangements provide the authority necessary for the role.

The Compliance Officer is industry experienced and has access to external support should it be needed. Their responsibility covers compliance, money laundering, other financial crime prevention and data protection. The Chief Financial Officer is the Board-appointed Director responsible for money laundering and financial crime controls.

It is important that, while the Compliance Officer is employed by the Society, she or he can independently decide whether something is in accordance with the rules, without being swayed by her or his manager or by wider management. The Board is satisfied that the Compliance Officer has operational independence by nature and professional training, and that this is maintained through the reporting line to the ARC.

The Society's planned compliance activities, including compliance monitoring, are set out in an annual compliance plan that is considered by the ARC. It reports progress on this, and any other, work at regular ARC meetings. It is available to all other functions of the Society to offer advice.

The activities selected for inclusion in the plan depend on the Compliance Officer's assessment of the areas that require review in the light of both the Society's business plan and issues emerging which have a compliance implication. The Compliance Officer regularly considers whether the function has enough time and resource to ensure that the Society is appropriately compliant and reports her conclusions on this subject to the ARC.

In conclusion, the Board is satisfied that the Society has an effective compliance function.

B.5 Internal Audit Function

The regulator requires that every insurer has an effective internal audit function.

The internal audit function considers the adequacy and effectiveness of the internal control system and other elements of the system of governance. It is objective and independent from the operational functions. These are regulatory requirements.

Internal audit performs an independent risk assessment and agrees the areas it will investigate with the ARC. It produces a report after each investigation describing its findings and its recommendations. This report is presented to management, which ensures that appropriate actions are taken within an appropriate timescale. A summary of activity and investigation results, including progress towards implementing the recommendations, is provided to the ARC by the internal audit function.

The internal audit function has, throughout 2020, been provided by a professional services firm called EY.

Over a multi-year cycle, EY agrees the areas to be investigated with the ARC and produces a work plan for the next year. During 2020, a number of investigations were carried out, covering the areas deemed highest risk by the ARC. A report was produced after each investigation as well as an annual report on our governance, risk and controls.

By using an external firm as internal auditor, we judge that internal audit is independent and objective. EY does not provide any additional services to the Society.

The Chair of the Audit & Risk Committee serves as the Head of Internal Audit. A member of the compliance team liaises between the Head of Internal Audit, the internal auditor and the ARC. These arrangements ensure that the function has appropriate authority.

As part of continuing review, the Head of Internal Audit regularly considers whether there is enough resource, in terms of days of EY time, directed to internal audit work, and discusses his conclusions on this subject to the ARC.

In conclusion, the Board is satisfied that the Society has an effective internal audit function.

B.6 Actuarial Function

The regulator requires that every insurer has an effective actuarial function.

What is an actuary?

An actuary is a specialist insurance professional who is trained in actuarial work.

Actuarial work tends to involve projecting events over the long term. Events include sickness, investment returns and expenses.

Actuaries use these projections to confirm the financial health of insurers.

Until recently, our Chief Actuary and actuarial function were provided by an external actuarial consulting firm, OAC plc ('OAC'). In 2019, we decided that we would appoint a dedicated Chief Actuary and introduce an in-house actuarial function. Our function was established in early 2020, taking formal responsibility from OAC over the summer. The regulatory application for our in-house Chief Actuary was submitted and regulatory approval was granted in January 2021.

The actuarial function carries out a number of tasks set out in the regulations and provides a number of required reports to the Board.

The Chief Actuary heads the actuarial function and reports to the Chief Financial Officer, with explicit additional reporting lines to the ARC. These arrangements ensure that the function has appropriate authority.

The Chief Actuary liaises with the ARC and the Board throughout the year, especially when there are decisions to be made that require actuarial advice. The Chief Actuary is always available to members of the Executive and Board to discuss matters of actuarial interest.

The Chief Actuary is industry experienced and has access to external support should it be needed.

It is important that, while the Chief Actuary is employed by the Society, they can independently decide whether something is in accordance with the rules or guidance, without being swayed by her or his manager or by wider management. The Board is satisfied that the Chief Actuary has operational independence by her nature and professional training, and that it is maintained through the reporting line to the ARC.

OAC continues to provide our With-Profits Actuary. The contract is an annual one, which has been in place since 1 January 2010. The With-Profits Actuary is industry experienced. She carries out a number of tasks set out in the regulations, including recommending bonus rates on With-Profits plans to the Board.

B. System of Governance

OAC maintains a small team focused on the Society's affairs, led by the With-Profits Actuary. This team works for other OAC clients as well as the Society. OAC takes steps to ensure that any conflicts are managed, and it discusses these with the ARC where necessary. OAC liaises with the Chief Actuary to plan the work required and to ensure that there is sufficient resource available to perform it to the appropriate standard. The With-Profits Actuary reports to the Chief Actuary with an explicit additional reporting line to the ARC. These arrangements ensure that the With-Profits Actuary has appropriate authority. By using an external firm, we judge that the With-Profits Actuary is independent and objective.

In conclusion, the Board is satisfied that the Society has an effective actuarial function, including the Chief Actuary and the With-Profits Actuary.

B.7 Outsourcing

We outsource some functions of our business, including:

- investment services
- computer system development (part)
- hosting of web-based services
- telephone interviewing and data collection, to aid underwriting
- initial medical reviews and nurse triage
- mailing and AGM voting management
- call recording
- internal audit (see B5), and
- With-Profits-Actuary services (see B6).

In all cases, we remain fully responsible to our Members for the quality of the service.

We do not outsource critical or important operational functions or activities if we judge that the result would be a poorer system of governance, would unduly increase operational risk, would reduce the regulator's ability to oversee the extent of our compliance with its rules, or would undermine continuous and satisfactory service to Members.

We outsource typically to UK-based organisations, although some work may be done elsewhere in the EU or the world. In these cases, we take steps to ensure that the provider agrees that no personal information is sent outside the EU without proper measures to keep it safe.

We alert our regulator prior to any outsourcing of critical or important functions or activities as well as to any subsequent material developments regarding those functions or activities.

B.8 Any Other Information

Due to the coronavirus pandemic, most Colleagues are now working from home, while all have facilities to do so. All key functions and controls are operating normally. We have adjusted to remote working and the uncertainty of knowing how long this approach will be required. The additional risks are being monitored and managed.

Solvency and Financial Condition Report 2020

C. Risk profile

Start

C. Risk Profile

The Society's risks are not unusual. They are managed transparently.

C.1 Underwriting Risk

We don't know who will buy our plans. Underwriting, as described earlier, includes the processes for accepting a new plan including the assumptions made about future sickness, the expenses of administering the business and for how long the plan will be in existence. As a result, underwriting risks are those involved with sickness, with expenses and with lapses (defined later in this section).

The nature of our underwriting risk has changed as our new business has increased and as we have made changes to our assessment processes. During 2020, we have continued to review and monitor these processes. We always monitor experience carefully and consider changes to our processes or assumptions as a result. This year, we have changed our assumptions about expected sickness, lapses and expenses.

What is experience?

Insurers make a lot of assumptions in their planning and projections. Experience is the term used to describe what actually happened rather than the assumption that was made.

Sickness risk

With every new plan presented to us, we assess the potential Member's health and lifestyle so that we can decide the best protection that we can offer and the cost and conditions of that protection. Sickness risk is the risk that our Members are ill or injured more often or for longer than we expect. We may find that we have charged too much or too little, or we might not have applied the right extra conditions.

We regularly compare the sickness and other benefit payments that are made with those that were assumed in the annual valuation. If the number, value or duration of claims is higher or lower than assumed, we will consider whether changes need to be made, and if so, what they should be.

What is a valuation?

Every year, we are required to calculate the value of the plans that we administer, primarily to make sure that we have enough capital to meet the benefits that are due to Members. This process is called the valuation.

Most of our plans have guaranteed payment rates, so it is important that the experience is as close as possible to that expected.

We assess the risk of worsening sickness by close monitoring of new claims and active management of existing claims. We mitigate it by better underwriting at point of sale, better pricing and effective underwriting at claims stage.

We continually review our claims procedures to ensure that they are effective for Members.

Lapse risk

We assume that some plans will stop paying premiums every year. When this happens, we say the plan has lapsed. We compare the number of plans that actually lapse with the number that we assumed would. Every plan that lapses leaves fewer to bear the remaining expense. Thus, lapse risk and expense risk are connected.

C. Risk Profile

What is a lapse?

When a Member decides not to continue with their plan, we say that the plan has 'lapsed'.

Plans may also end because the Member dies, the Member reaches retirement or the plan reaches its maturity date.

We assess lapse risk by closely monitoring payment collections and other processes which might lead a Member to decide not to continue with their plan.

Lapse risk is mitigated by prompt service, sensitive review of individual circumstances (recognising that lapse may be appropriate in some circumstances) and by thinking about how to ensure that Members keep their plan going where is it sensible for them to do so.

The coronavirus pandemic has led to a sharp increase in new sales in the early months of 2020. We were concerned that some of these new plans would only last until the pandemic was over. If they then lapsed, this would weaken the Society. We took a number of steps to protect the Society and its Members at this time, including adding a coronavirus exclusion for new Members and withdrawing some plans from sale.

We were concerned that existing Members in financial difficulty might be unable to afford their payments but not want to give up their plans. We introduced a new feature that allowed Members in these circumstances to pause their cover and their payments while lockdown continued. This feature remains in place at the time of writing.

Expense risk

Expense risk is the risk that expenses are higher than expected or increase more quickly than are expected. It is important that our expenses are appropriate for the Society's size, so we monitor the expense per plan as well as overall expenses. If there are fewer plans than expected, even if expenses are as budgeted, the expense per plan will be higher. There are several reasons why there might be fewer plans than expected. The most common are because our sales are lower or because more plans lapse. We consider expenses in various categories, depending on what causes higher spending.

We assess expense risk by continually monitoring spending in all categories and the number of plans in place. We mitigate it by planning and careful use of resource.

We recognise that the eventual cost of PRISM is hard to estimate. We have mitigated this uncertainty through planning and challenge and through robust testing.

The coronavirus pandemic has required us to support all our Colleagues in working from home. The expense to do this has been relatively modest. Early on in lockdown, we reviewed our budgets, cancelling or deferring much of the non-people expense and paring back all bonus plans for all Colleagues. We continue to manage expenses very carefully.

As discussed above, at the start of the coronavirus pandemic, a decision was taken to withdraw some plans from sale, leading to a reduction in new plans being sold over the year and a reduction in numbers of plans over which to spread expenses. The results shown and the Society's plans have been revised to allow for this.

Other health risks

There is a risk that Members die and their plans cease earlier than expected. There is a risk that Members live longer than expected. Neither of these risks is very significant for us. There is a risk that future sickness is higher than expected because of long-covid. The possible impacts are difficult the know with certainty at the moment.

Concentration of underwriting risk

Sickness risk and lapse risk are very material for the Society. Beyond this there is no obvious concentration of risk, other than by plan type and by distributor. We always aim to sell a large volume of each of the plans that we offer and through a variety of distribution partners.

C. Risk Profile

Reinsurance

We do not generally use material levels of reinsurance, although we may do so in future.

Underwriting Risk Sensitivity

Table 5 shows the sensitivity on Own Funds of the underwriting risks described above:

Table 5: Approximate Impact of Changes to Assumptions on Own Funds, £000 — Underwriting

		2020
Own Funds as at 31 December		59,807
Assumption	**Change**	**Impact**
Spells of sickness	sickness incidences increase by 10%	(5.431)
Length of sickness	sickness recovery rates reduce by 10%	(13,531)
Death rate	10% fewer Members die	(882)
Lapse rate	10% more Members leave	(5,032)
	10% fewer Members leave	4,996
Expenses	10% increase in servicing expenses	(1,779)

The sensitivity tests are carried out by varying the assumptions as described and re-calculating the Society's Own Funds in full.

Outlook

In ordinary times, our underwriting risk would be expected to increase as a result of the Society's growth plans. Given the economic impact of the coronavirus pandemic, it is possible that our growth plans will have to be re-assessed. This may mean that some risks do not grow as quickly as expected. On the other hand, we may see more claims than we expected because of the coronavirus, more lapses or have to spend more, at least on a per plan basis. This may lead us to review our underwriting and claims handling, and our expenses.

C.2 Market Risk

Market risk is the risk that asset values fall or risk-free interest rates do not move as expected.

The size and nature of our market asset risk depends on the assets that we hold. For the Society this includes the risk that our investments in equities, bonds and property fall or there is an adverse movement in foreign currency exchange rates on any non-GBP denominated assets. There is a risk that our assets become overly concentrated in a small number of issuers so are at risk of one of these failing. All of these asset market risks are small for the Society.

The material market risk for the Society is a change in risk-free interest rates that could lead to an increase in the liability that needs to be held for our plans. As the number of plans increase over the year the market risk related to risk-free interest rates has increased. The risk-free interest rates have fallen due to the coronavirus pandemic meaning that our liabilities have increased as has the risk related to movements in risk-free interest rates.

One way to reduce the risk-free interest rate risk is to match the outgo on our liabilities with the income from our assets. Matching is difficult for us due to the nature of our liabilities so mitigating this risk over the long-term is not possible for us.

Over the short term we can work out roughly how much we might be called upon to pay and at what times, based on assumptions about the future. We know, from our business plan, how much we expect to spend on commission and day-to-day expenses. With this information, we can make sure that we strike the right balance between immediately available, short-term assets and assets invested for the longer term.

Matching by currency is straightforward. All of our liabilities are denominated in Great British Pounds ('GBP'), so we match by investing mainly in GBP-denominated assets. As a result, our currency risk is low.

C. Risk Profile

We invest our assets in line with the Prudent Person Principle, as required by regulation.

We ensure this by carefully selecting investment managers and designing their instructions to cover the security, quality, liquidity and profitability of the assets they select. Assets are always invested in the best interests of Members.

We only invest in assets where we can properly identify, measure, monitor, manage, control and report, and appropriately take into account their risks in our assessment of solvency.

We mitigate market risk by ensuring that our investment policy is set with a proper understanding of the nature of the Society's liabilities and its future cash demands, by specifying the degree of diversification required, selecting suitable benchmarks and by monitoring the activity of the selected investment managers.

We invest in a wide range of assets to reduce the chance that poor performance or the failure of a single asset could have a significant impact on the performance overall. Section D.1 describes the portfolio in terms of the different types of asset.

We hold equities and bonds from a diverse range of issuers, so our asset concentration risk is very low. The only property that we hold directly is Holloway House, our headquarters, but as this has a low value in comparison to our other asset holdings it attracts low concentration risk.

Market Risk Sensitivity

The Society is sensitive to changes in a number of economic factors. Table 6 shows the impact on Own Funds of changes in these factors:

Table 6: Approximate Impact of Changes to Assumptions on Own Funds, £000 – Investment

Own Funds as at 31 December 2020		59,807
Assumption	**Change**	**Impact**
Risk-free yields	risk-free yields increase by 100 basis points	(5,601)
	risk-free yields reduce by 50 basis points	(2,607)
Corporate bonds	corporate bond asset values fall by 10%	(1,519)
Equities	equity values fall by 10%	(285)

The sensitivity tests are carried out by varying the assumptions as described and re-calculating the Society's Own Funds in full.

Outlook

The risk from changes to risk-free interest rates is expected to increase over the business plan term as more plans are sold and the liability for these increases in size. The current low interest rate environment, which has been exacerbated by the coronavirus pandemic, has increased this risk.

The risk from falling asset values is expected to reduce over the business plan term: the value of assets is expected to fall as more money is paid out as commission for new business, to meet the higher expense base and as an investment in the Society's strategy. In addition, the assets are invested in less volatile asset categories. The recent market falls due to the coronavirus pandemic have had a limited effect on the Society's balance sheet.

C.3 Credit Risk

Credit risk is the risk that someone owes you money and cannot pay. It exists with Adviser commission balances and reinsurance recoveries.

We pay commission to Advisers assuming that a number of payments will be made by the Members that they introduce. If a Member ceases to make payments early in the plan lifetime, we expect the Adviser to repay some of the commission that they received. This is a credit risk, that is the risk that the Adviser will not have the money to repay. We think that this risk is low because we choose Advisers carefully and continually monitor the amounts owing. As sales have grown, the size of this risk has increased. With the economic uncertainty introduced by coronavirus, there may be more plans lapsing, and some Adviser firms may not be able to repay their commission debt.

We have some agreements with reinsurers. We expect them to pay a proportion of claims on some plans. This is a credit risk, that the reinsurer cannot pay us. We think that this risk is low because we have such low levels of reinsurance and we only use higher quality reinsurers.

C.4 Liquidity Risk

What is liquidity and liquidity risk?

Liquidity is the term used to describe how easy it is to get hold of cash when it is needed. Liquidity changes when the economy changes: for example, when property is hard to sell, it is illiquid,

Liquidity risk for us occurs when a benefit cannot be paid because we cannot physically get hold of the cash to pay. We take steps to make sure that this can never happen, as far as we can tell.

Liquidity risk arises if we cannot pay a claim when it falls due because we could not physically provide the cash, even though we have sufficient assets.

Our sources of cash are payments from Members, investment income, sale of investments, reinsurance payments and the surpluses that we generate. Generally, Member payments are a reliable and high-quality source of liquidity. The liquidity expected from investment income and assets sales depends on the instructions we give to investment managers. We want to invest in high quality assets with good liquidity, but we know that we don't need all of our assets to be in cash immediately. By investing to match the expected claims by timing, we can increase the return expected without affecting our ability to pay Member benefits.

We invest our cash and deposits across reputable institutions with high credit ratings, and thus high liquidity, over the short term. The quality is measured by each bank's or fund's credit rating. We choose a mix to reduce our reliance on a single bank or fund. We have a significant holding in a cash fund recommended by LGT Vestra LLP. We believe that this fund is diverse and well managed.

We have taken steps to increase our liquidity in case of higher claims from Members who cannot work because of coronavirus. As discussed on C2 we regularly monitor and manage our short-term expected cashflow to ensure we have enough immediately available, short-term assets.

As a result of this management, our liquidity risk is low and is expected to remain low.

The regulators require us to note that the valuation of our income protection plans includes expected profit in future premiums of £75.498m (2019: £86.136m). This is important because this amount is available to meet Member benefits over time regardless of how liquid our assets are. That said, this amount is generated over the lifetime of the plans, so it may not be available when it is needed.

C. Risk Profile

C.5 Operational Risk

Operational risk is a wide category of risk. It is the risk of something going wrong. This might be people working in the Society doing things wrong, or not doing things that they should. It might be a process that is faulty or a process that is missing. It might be a computer program that goes wrong or a computer system that crashes. It might arise from a fraud, from a reputational failing or from poor strategy. There doesn't tend to be an upside from operational risk.

Our exposure to operational risk is high because we are changing so much of what we do. Change always invokes risk, because things don't always go to plan. We seek to manage operational risk by planning carefully, thinking about risks, and managing people and projects with sensitivity and understanding. We try and make sure that we consider what might go wrong before we make a change, that we test and check things while in development, and that when a change is finally introduced, we monitor it carefully to make sure the expected result is achieved.

In line with Government advice regarding the pandemic, all of our Colleagues began working from home in March 2020. While some returned later on in the year, most of our Colleagues remain working from home. During the early months of the lockdown, we diverted resource to double check that our controls were working as normal, despite home working.

We measure operational risk through the Risk Management System (see B.3) and through the Internal Control System (see B.4). By its nature, we are managing a number of often-very-different risks under the heading of operational risk. The measures used are particular to the individual risk.

The impact of operational risk on the business plan is considered in the ORSA. For most operational risks, when they materialise, the effect is on the level of sales or expense or both.

We have no particular concentration to operational risk. We protect ourselves against legal challenges, using directors' and officers' insurance, and fire, theft etc., using an appropriate insurance policy.

The Society's risk management and internal control systems make sure that operational risk is managed to acceptable levels.

C.6 Other Material Risks

We assess material risks in our ORSA. We consider the business plans and the areas where results are uncertain. We then consider the range of possible results within normal conditions allowing for individual risks and for groups of risks happening together. The risks that have the greatest impact on solvency are the most material risks.

The Board has to assess all of the Society's risks continually. That said, there is the possibility that an unexpected risk emerges. A risk assessment would be incomplete if it did not mention this possibility.

C.7 Any Other Information

Nothing additional to report.

Solvency and Financial Condition Report 2020

D. Valuation for Solvency Purposes

Start

D. Valuation for Solvency Purposes

D.1 Assets

The value of our assets on a Solvency II basis is shown in Table 7:

Table 7: Solvency II Assets, £000		
Asset Type	**31 Dec 2020**	**31 Dec 2019**
Property – office, own use	775	800
Equities – listed	1,605	2,354
Bonds – government	8,596	9,904
Bonds – corporate	12,432	14,880
Bonds – other	503	159
Tangible assets	120	143
Collective investment undertakings	1,075	4,038
Assets held for Unit Linked contracts	746	795
Cash with investment managers	2,540	57
Cash at bank and in hand	629	1,312
Other	101	24
Solvency II Asset Value	**29,122**	**34,466**

The office property is assessed every three years by a qualified valuer at open market value (last performed in November 2020) and a desktop valuation annually in the interim.

Equities, government bonds and collective investment undertakings are valued using quoted market prices in active markets provided by third party pricing sources.

Corporate and other bonds are valued using prices from a single broker. The prices are thus from an external source. Cash and cash equivalents are included at face value.

There have been no changes to the valuation approach used and no significant exercise of judgement in arriving at the values shown.

The Society holds no unlisted equities, derivatives, loans or mortgages. Leasing arrangements are as at the balance sheet date in the 2020 financial statements. It has no deferred tax assets.

We use the same bases, methods and main assumptions to value assets for solvency purposes as we use in our financial statements, other than the exceptions shown below in Table 8 which reconciles the differences:

Table 8: Society Asset Reconciliation, £000		
	31 Dec 2020	**31 Dec 2019**
Value of assets presented in financial statements	**67,556**	**79,763**
Intangible assets: administration system	(4,152)	(2,758)
Intangible assets: plan and software development	(98)	(117)
Prepayments	(105)	(95)
Technical Provisions gross of reinsurance, excl Unit Linked	(34,079)	(42,327)
Solvency II value of assets	**29,122**	**34,466**

The rules for considering solvency are different from the rules for presenting financial information. The solvency rules are concerned with Member protection. The financial information presentation rules are concerned with providing a true and fair view. One difference in practice is that what can be treated as an asset is different. Solvency assets cannot include intangible assets (for us, work done to develop plans or systems that are not yet live) and some prepayments. Solvency assets cannot include Technical Provisions.

D. Valuation for Solvency Purposes

D.2 Technical Provisions

We have to calculate two numbers that measure the value of our plans: the Best Estimate Liability and the Risk Margin. Added together, these numbers are called the Technical Provisions.

The Best Estimate Liability is the realistic assessment of every plan's worth when administered by the Society.

The Risk Margin is the extra money that someone else would require to take on the Society's plans and look after them, in the same way that we do. It is calculated using a formula set by UK regulations.

The Technical Provisions are calculated by the actuarial function. The approach is well established.

We have to calculate the Technical Provisions for all of our plans. Since the Society began in the 1870s, it has offered a number of different plan types. We continue to administer all of these for as long as our Members wish to keep their plans going, whether or not we currently offer them to new Members.

Table 9 summarises the Technical Provisions by line of business:

Table 9: Technical Provision Components, £000

Plan Type	Income Protection (Health)		Unit Linked		Total	
	2020	2019	2020	2019	2020	2019
Best Estimate Liability	(67,938)	(78,272)	746	795	**(67,192)**	**(77,477)**
Risk Margin	33,859	35,946	0	0	**33,859**	**35,946**
TP	**(34,079)**	**(42,326)**	**746**	**795**	**(33,333)**	**(41,531)**

(a) How are the calculations done? The Best Estimate

Income Protection (or IP) Plan Types

We calculate the expected expenses and claims costs for each plan and subtract the expected payments. The difference between the two numbers is the net cash outflow. We calculate the net cash outflow for each plan, month by month.

The net cash outflow is made up from all the possible things that might happen on a plan. Then, for each plan, for every future month, we calculate the net cash outflow in that month:

Net Cash Outflow = expected monthly sickness benefit
+
expected expenses (to cover investment and administration)
-
expected payments

D. Valuation for Solvency Purposes

The calculations include assumptions about the probability that a Member becomes sick, or that their plan lapses or ends for any other reason. We separately consider plans where Members that are currently sick and receiving payment under their plans so that we allow for the additional cash outflow.

We assume that each plan bears an equal share of the investment and administration expenses for every month and that the total expenses are covered in full. We expect new plans to bear their share of future expenses, and we allow for plans that end, whatever the reason.

The monthly cash flows are added up and converted to today's value: that is, a lump sum now equivalent to all future cash flows. This value is the Best Estimate Liability for these plans.

To convert the future cash outflows to today's value, we use risk-free interest rates provided by our regulator, the PRA, with no adjustment.

The technical name for this approach is the gross premium valuation. The technique being used to calculate a lump sum is called 'discounting projected monthly net cashflows'.

Some IP plans have benefits on maturity, death or lapse. We have some discretion over these payments. We allow for their expected cost within the Best Estimate Liability.

Each year, the benefits on these plans are increased by different types of bonus reflecting investment returns and other surplus generated over the year.

We have some reinsurance arrangements in place on a small number of older plans. None of these arrangements are material. They have been ignored in the valuation.

Unit Linked (or UL) Plan Types

The Best Estimate Liability for these plans is the value of the benefit payable on request. No new payments are expected on these plans.

(b) How are the calculations done? The Risk Margin

The Risk Margin is an amount over and above the Best Estimate Liability equal to the amount that another insurer would need to take on the Society's business.

The regulator sets out how the Risk Margin is to be calculated. The Risk Margin is the cost of holding the SCR, excluding the market risk component, required in every future year, allowing for a required return of interest of 6% per year.

The full formula set down by the regulator can be quite onerous for an insurer as small as we are. The regulator recognises this and has allowed a simpler formula to be used. We have decided to use 'simplification 1', which estimates the future SCR in proportion to the underlying risk driver of each risk. So, for example, the amount of capital held in respect of sickness risks is assumed to change in proportion to the expected value of future sickness benefits payable.

(c) Assumptions

The calculations need a number of things to be assumed, specifically:

1. if and when Members might fall sick and how quickly they might recover
2. if and when Members might stop their plans
3. how much it will cost to run the Society and implement its strategy
4. how expenses and benefits will grow with inflation, and
5. if and when plans might end because of death.

D. Valuation for Solvency Purposes

1. if and when Members might fall sick and how quickly they might recover
We investigate our sickness experience every year, although there are relatively few cases. We look at how many Members become sick and how long it takes them to recover. The low number of cases means that it is harder to use the experience to decide on an assumption. We therefore consult industry data which suggests rates of sickness and recovery. The tables we use are called CMIR12.

We use our sickness experience to adjust the CMIR12 tables so that they are appropriate for our experience. The adjustments used vary by main product group and duration of sickness. We have recently carried out a review of the approach used to calculate these adjustments and we have increased the Technical Provisions to include the updated approach.

2. if and when Members might stop their plans
If a Member stops their plan, the plan is said to have lapsed. The lapse rate is the proportion of plans that lapse during a given period. The assumed rates of lapse and withdrawal used for the valuation are set based on recent lapse experience by main product groups.

3. how much it will cost to run the Society and implement its strategy
In the valuation, we work out the expense that we expect to incur all future years from 1 January 2021, based on the activities we expect to carry out.

The type of expense is important. Some expenses are expected to occur every year (for example, the expense of people to look after Member queries). Some expenses are linked to sales and only happen once in a plan lifetime. Others are one-off, such as the investment in PRISM. The projections that we use take into account the expenses related to the business in force at the valuation date but not expenses on plans that have not been written yet.

4. how expenses and benefits will grow with inflation
We assume that expenses increase each year based on inflation and the expected growth in the business. Some plan types have benefits that increase with inflation. We make assumptions about these different types of inflation based on market data.

5. if and when plans might end because of death
We use industry tables to assess if and when plans might end due to death, although the impact on the Best Estimate is very small. For Members who are currently healthy we use the AMCOO tables, and for Members who are sick we use the CMIR12 tables. As for sickness we adjust these tables so that they reflect our recent experience.

Other Relevant Information

Currency
Our liabilities are all recorded in Great British Pounds, sometimes shortened to GBP.

Options and guarantees
None of our plans have financially significant options or guaranteed surrender values.

Uncertainty associated with the value of Technical Provisions
Calculating Technical Provisions involves predicting the future. All of the predicted values are determined using assumptions, which may not work out in practice.

D. Valuation for Solvency Purposes

The uncertainties include economic uncertainty (e.g. what will interest rates be?), Member behaviour (e.g. when might Members make withdrawals from their plans) and fate (e.g. when might a Member fall sick?). In practice, the uncertainties might increase or reduce the cash flows, and hence increase or reduce the Best Estimate Liability.

We are particularly sensitive to:

- the risk-free interest rates set by the regulator
- expense assumptions, given the scale of the change that the Society is undergoing
- sickness assumptions, given the lack of data to support the assumption setting, and uncertainty on future sickness levels, and
- lapse assumptions, given the lack of data to support the assumption setting, potential changes in Members behaviours and the sensitivity of lapse rates to changes in regulation and general economic health.

The long-term impact of the coronavirus pandemic is not yet known and could lead to changes in the assumptions used to calculate the Technical Provisions in future.

Use of Transitional Measures

The regulator allows insurers to use 'transitional measures' or a 'volatility adjustment' or a 'matching adjustment' if they need to. We do not need to, and we have to state this in this document. The Society has not used transitional measures or the volatility or matching adjustment.

Differences between Solvency Valuation and Financial Statement Valuation

We use the same bases, methods and main assumptions to value liabilities for solvency purposes as we use in our financial statements.

What are the financial statements?

Financial statements are the reports that we are required to produce by law. They are available on our website or on request, free of charge. They are sometimes referred to as the Report and Accounts.

D.3 Other liabilities

The Society's other liabilities are Creditors as shown in Table 10 below.

Table 10: Creditors, £000 at 31 December

Liability Type	31 Dec 2020	31 Dec 2019
Arising out of reinsurance operations	7	8
Claims outstanding	294	206
Other creditors including tax and social security	2,348	2,735
TOTAL	**2,649**	**2,949**

There is no observable market for these specific liabilities or any similar liabilities that could be regarded as a suitable basis for the valuation. The value is therefore based on an estimate of the expected cash flows, i.e. the settlement value. No account has been taken of the effect of discounting short-dated payables as the effect is deemed to be immaterial.

We have some obligations that we have to meet within the next 12 months. Their value has been calculated in accordance with our chosen accounting policies as used in our financial statements. The financial statements are available on our website, www.holloway.co.uk

D.4 Alternative methods for valuation

We don’t use any other alternative methods for valuation.

D.5 Any other information

The results set out in this report show the position at 31 December 2020. We are comfortable that we do not need to make any additional adjustments for the possible impact of the coronavirus pandemic within the Technical Provisions or assets shown in this section based on the information we know now. This could change as understanding of the effects of the pandemic on the long-term develops.

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

Capital Management

Start

Capital Management

E.1 Own funds

We are governed by the Friendly Societies Act 1992. Under that Act, the Society is an incorporated society with a single Members' fund and no defined mutual member fund. As such, it has no shareholders and our Members are the Society's ultimate owners. The Society's organisation is very simple: all its capital is held in tangible and realisable assets.

The table below, a copy of Table 1, shows the Own Funds and Surplus Capital:

Table 1: Own Funds, £000

Item	31 Dec 2020	31 Dec 2019
Own Funds	59,807	73,048
Solvency Capital Requirement	41,983	47,415
Surplus Capital	17,824	25,633

What are Own Funds?

This is jargon for an insurer's total assets, counted using the rules of Solvency II.

Own Funds – Objectives, Policies and Processes

Own Funds – Objectives

We manage our assets according to our investment policy. Broadly, this requires us to invest to ensure we can pay all Member benefits as they fall due, to invest in ways that treat Members fairly and meet their expectations, to invest to meet all solvency requirements and, having met these criteria, to invest to maximise returns, subject to a level of acceptable volatility.

Given the strategy, we aim to invest to meet the Society's requirements for cash over the business plan period, bearing in mind the payments from Members that we expect to receive, the claims that we expect, the expenses we expect to incur and the new plans that we expect to go on risk.

We aim to generate a return on the assets held. We aim to be able to meet the benefits due to Members.

Own Funds – Policies

Investment Policy from time to time, the Board agrees the Society's investment policy. This describes the powers and limits of authority of the Society's selected investment managers. The Investment Committee makes sure that the Investment Policy is followed.

ORSA Policy the regulator requires us to produce a policy setting out how we will run our ORSA. At least once a year, we run our ORSA process (see Section B.3). Part of this process is to allow the Board to assess the level of future Surplus Capital expected allowing for all sorts of different risks over time. The Board wants to be sure that it always has enough capital to pay Member benefits, and that it knows which risks could threaten this position.

The ORSA process includes testing of many different risks. It allows the Board to understand where there might be a problem and to draw up plans to deal with it. The plans will depend on the situation, but might include a change of strategy, re-pricing or re-designing our plans, or changing how we organise the business (usually so it runs at a lower cost). More dramatic action includes closing to new business or transferring the business to another firm.

Own Funds – Processes

At least twice every year, the Society reviews the performance of its investment managers to ensure that the investment policy is being followed and to assess performance.

Capital Management

Material Changes

There have been no material changes to the Society's investment mix during 2020.

Capital Tiers

The regulations classify capital in different tiers. All of the Society's Own Funds are Tier 1 (the highest quality tier of capital) and have always been Tier 1.

At 31 December 2020, our Tier 1 capital was £59,807 (2019: £73.048m). There are no restrictions on how we might use our Own Funds. They are fully available to cover the SCR and the MCR.

What is the MCR?

The MCR, or Minimum Capital Requirement, is the threshold at which the regulator is allowed to take over the running of an insurer. It is much lower than the SCR (a quarter of the amount).

The level of Own Funds and of Surplus Assets has changed over the reporting period reflecting the progress of the strategy, the revised assumptions made in the valuation, the changes to the Management Action Plan, the investment in new business and the resulting movement in Technical Provisions and SCR as summarised in section D2 and E2.

Required Statements

The regulations require us to set out a number of points about our Own Funds. Specifically:

- there are no Own Fund items subject to a transitional arrangement
- under the rules, insurers are allowed to hold Ancillary Own Funds. Ancillary Own Funds count as capital, but are slightly less easy to get hold of. We don't have any Ancillary Own Funds, and
- there are no deductions from our Own Funds and no restrictions on their availability and transferability.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The following table summarises the Society's SCR and MCR:

Table 11: Solvency and Minimum Capital Requirement, £000

	31 Dec 2020	31 Dec 2019
Market risk	12,076	11,351
Counterparty default risk	0	254
Health underwriting risk	36,869	42,832
Diversification across all risks	(7,379)	(7,389)
Basic Solvency Capital Requirement	**41,566**	**47,047**
Operational risk	417	368
Solvency Capital Requirement	**41,983**	**47,415**
Minimum Capital Requirement	**10,496**	**11,854**

The SCR has fallen. This follows a number of changes, some which increased the SCR, some which reduced it. New sales increased the SCR. A revised approach to the actions that we might take in the event of adverse experience reduced it. Finally, the SCR was calculated using the same updated assumptions as used in the Technical Provisions calculations. The overall effect of these three types of changes was a reduction in SCR.

Capital Management

We are satisfied with the result of the calculations to give the SCR and MCR. The regulator reserves the right to assess the result and ask us to amend it. If this happens, we will amend this document and describe the changes.

Required Statements

The regulations insist that we set out a number of points about our SCR and MCR. Specifically:

- there are no simplifications applied to the SCR calculation
- there are no undertaking-specific parameters used in the SCR calculation, and
- the MCR for the Society is 25% of the calculated SCR.

The MCR is calculated using a regulator-provided formula. The change in the MCR over the year follows the change in the SCR.

E.3 Duration-based equity risk sub-module in the calculation of the SCR

The regulations allow the SCR to be calculated using something called the duration-based equity risk sub-module. We don't use this and have to state that this is the case.

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

We calculate our SCR using the standard formula, as set out by the regulator.

Insurers are allowed to use an internal model, which is an approach that is tailored to the individual insurer. We judge that using such a model would not produce a better result for the Society and would be much more expensive than the approach we have taken, so we don't use an internal model.

The regulations require us to describe the differences between the standard formula and the internal model, but that does not apply to us.

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

We complied with the rules regarding the maintenance of the SCR and the MCR continuously throughout 2020.

E.6 Any other information

The coronavirus pandemic is generating significant global economic disruption. We have considered the impacts of the pandemic in our assumptions for the valuation. Based on this work, it is our best estimate that the Society will continue to meet the SCR and MCR in this pandemic scenario. If the situation worsens, there could be an adverse impact on the Society. The situation is volatile and we will continue to assess the impact on the Society as things change.

Summary of Explanatory Notes

The notes are not intended to be definitions, nor are they very technical. They have been provided to aid understanding. If you would like a technical definition or to understand more about the limits of the explanation, we would be happy to provide more details.

Term	Explanatory Note
Actuary	An actuary is a specialist insurance professional who is trained in actuarial work. Actuarial work tends to involve projecting events over the long term. Events include sickness, investment returns and expenses. Actuaries use these projections to confirm the financial health of insurers.
Audit and Risk Committee	The Board has set up Committees to help it with oversight. The Audit and Risk Committee oversees internal and independent audit, compliance, actuarial and risk management activities. It ensures that the risk management and internal control systems are effective. Details of its terms of reference (the rules it follows) are on our website.
Board	Most companies are run by a Board of Directors. These are the people who direct the company, decide its strategy and ensure its governance. The Board oversees plans, performance and activity and, if not satisfied, makes changes. The Board is chosen by the owners of the company. For us, the Board is chosen by you, our Members at the annual general meeting.
Capital	Capital is the name for the resources available to meet the Society's outgoings. For the Society, capital is made up of cash, investments and the difference between expected premiums (inflow) less current and future claims and expenses (both outflow).
Chair	The Chair is the Non-Executive Director who leads the Board. It is an important role with specific responsibilities to the regulator and to Members.
Executive	The Executive refers a small group of senior employees. At the end of 2020, the Executive comprised the Chief Executive, the Sales & Marketing Director, the Chief Actuary and the Chief Financial Officer. These are the employees who run the Society, led by the Chief Executive, responsible to the Board.
Experience	Insurers make a lot of assumptions in their planning and projections. Experience is the term used to describe what actually happened rather than the assumption that was made.
Independent auditor	An independent auditor is a firm appointed mainly to provide independent assurance to Members that a Society's accounts are broadly accurate.
Financial statements	Financial statements are the reports that we are required to produce by law. They are available on our website or on request, free of charge. They are sometimes referred to as the Report and Accounts. They include a balance sheet and profit and loss account.
GBP	Great British Pounds, the international code for pounds sterling

Capital Management

Term	Explanatory Note
Governance	Governance covers everything done to be sure that a business is running properly. It includes legal requirements, the need to be fair to Members, and the need to organise the business sensibly and with due regard for risk.
Holloway plan	We understand that we were the first firm to combine income protection and savings. The resulting innovative plan, introduced in the 1880s, was named after our founder, George Holloway, MP for Stroud.
Lapse	When a member decides not to continue with their plan, we say that the plan has 'lapsed'. Plans may also end because the Member dies, the Member reaches retirement or the plan reaches its maturity date.
Liquidity	Liquidity is the term used to describe how easy it is to get hold of cash when it is needed. Liquidity changes when the economy changes: for example, when property is hard to sell, it is illiquid.
Liquidity risk	Liquidity risk for us occurs when a benefit cannot be paid because we cannot physically get hold of the cash to pay. We take steps to make sure that this can never happen, as far as we can tell.
MCR	The MCR, or Minimum Capital Requirement, is the threshold at which the regulator is allowed to take over the running of an insurer. It is much lower than the SCR (a quarter of the amount).
Operational risk	Operational risk is the risk of some planned activity going wrong because a process fails, a system fails or someone does something wrong. The regulator includes fraud and legal problems as operational risks.
Own Risk and Solvency Assessment	The regulation requires insurers to undertake an Own Risk and Solvency Assessment, or ORSA, whenever its risks change, or at least annually. The ORSA is a judgement by the Board of the insurer's risks and the impact on the insurer's solvency. Importantly, it is the Board's view, not the regulator's (and not the view using the regulatory formula).
Own funds	This is jargon for an insurer's total assets less its liabilities, counted using the rules of Solvency II.
Prudent Person Principle	This is a phrase in the regulations. It means that investments should be only those that a prudent person would make.
Reinsurance	Reinsurance is insurance for insurance companies. An insurer can use reinsurance to reduce its own risk, to provide technical support and to help with cash flow. Reinsurance is provided by specialist firms called reinsurers.
Risk register	The Society's risk register is a list of the risks that we face with details of how the risks are identified, measured, monitored, managed and reported.

Capital Management

Term	Explanatory Note
Risk tolerance	Most measures of performance have an expected value or target. The risk is that the actual value is higher or lower than the target, to an extent that might cause harm or cause the plan to be re-considered.
Senior Leadership Team	This is the group of people who work for members of the Executive. On a day-to-day basis, the Senior Leadership Team makes sure that the Society is properly run. Members of this team attend the monthly Executive, and some other, Committee meetings and, depending on their job, may occasionally attend or present at Board meetings.
Solvency	Regulators recognise that the more surplus money a firm has, the more secure the Member benefit. 'Solvency' is the jargon used by insurers to mean the surplus money that a firm has in excess of that needed to meet Member claims in most circumstances. Insurers talk about capital rather than money. When considering a risk, insurers look at the impact the risk might have on their surplus capital: hence, the impact on solvency. Generally, high or increasing solvency is a good thing, low or declining solvency is a concern, unless the change was planned or there is a good reason for it.
Solvency II	Solvency II is the name given to the regulation that UK insurers have to follow. It sets out what insurers have to do to protect policyholder benefits. The areas discussed in this document are all required under Solvency II, as is the production of this document.
Solvency Capital Requirement	This is the amount that the regulator says the Society has to hold to ensure Member benefits are secure in most circumstances over one year. We calculate it using a formula provided by the regulator. It is often shortened to SCR.
Surplus capital	Surplus capital is the capital over and above that needed to meet expected Member benefits and the SCR.
System of governance	This means everything that is in place to make sure that the Society is well governed.
Underwriting	Underwriting is the process by which the Society accepts a new plan and provides cover to a Member in return for agreed premiums. By accepting a new plan, the Society is making assumptions about future sickness, the expense of administration and for how long the Member will continue to pay premiums to keep the plan going.
Valuation	Every year, we are required to calculate the value of the plans that we administer, primarily to make sure that we have enough capital to meet the benefits that are due to Members. This process is called the valuation.

We welcome and invite feedback from you, our Members and owners. You can contact us in a number of different ways, as follows:

In person, by attending the Annual General Meeting.

By email, using hello@holloway.co.uk

By telephone, on 0800 0931 535

By letter, by writing to Holloway Friendly, Holloway House, 71 Eastgate Street, Gloucester, Gloucestershire, GL1 1PW

What the future holds

All through 2020 we've been working on building new systems and developing new services that will help provide our Members with a better support and offer more people the opportunity to protect their income like you.

Into 2021 and beyond we will continue investing in new systems, training our colleagues and improving the service we offer so we can continue to always be there when you, our Members need us the most and help keep lives colourful.