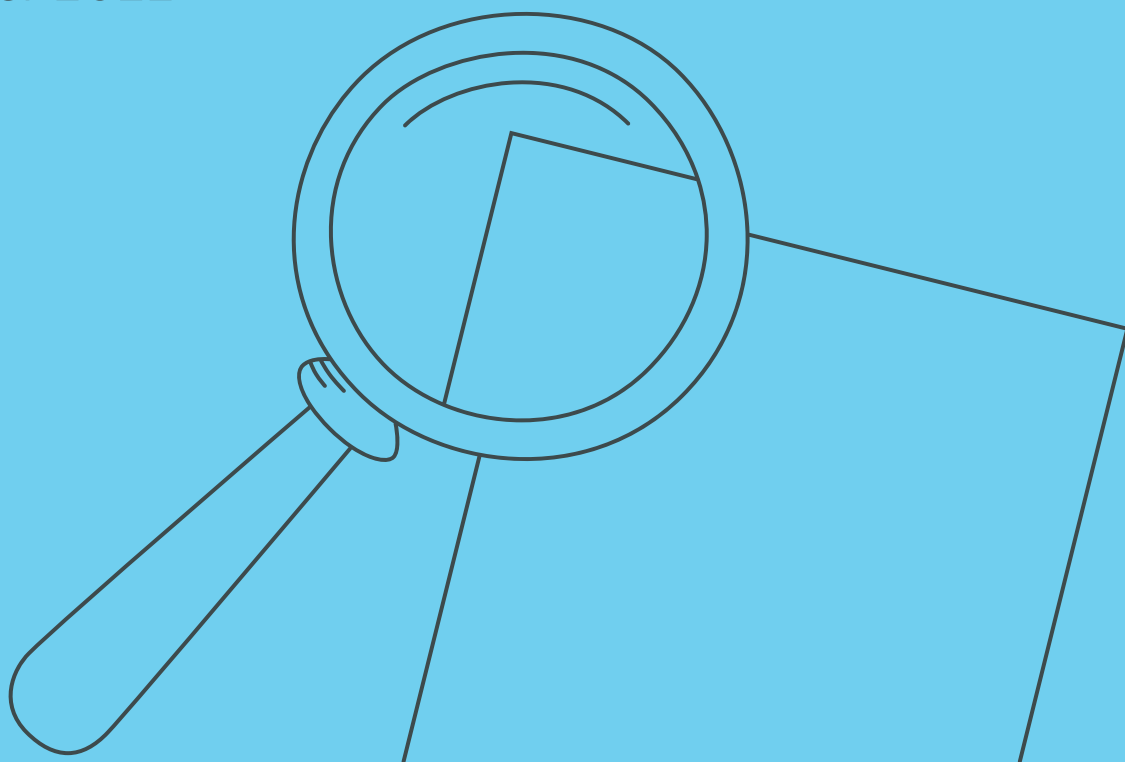


# Solvency and Financial Condition Report

Financial year ending  
31 December 2022



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# A Message from the Chief Executive

The past year has been another highly challenging one with the cost-of-living crisis exacerbated by the war in Ukraine, higher interest rates and spike in inflation. Despite all the challenges, the Society has grown its membership base by 7% and increased its solvency ratio from 166% to 171%. The accomplishments over the year have included:

- Providing our income protection policyholders with health and wellbeing benefits, remote GP consultations and rehabilitation service through our partnership with Nuffield Health;
- We accepted and paid over 96% of Income Protection claims; and
- Achieving carbon neutrality and taking actions to address climate change risks.

We are mindful of the principal and emerging risks affecting the Society and the continuing uncertainty looking ahead into 2023. We will innovate to improve our financial and operational resilience, and invest to ensure the Society has a modern and robust approach to the delivery of our important business services. We will seek to maintain progress with technology, develop new products and forge partnerships that add value to the business. We continue to apply a market-orientated approach to our development.

I hope you find this report informative about our current business and risk management framework. Please do get in touch with us if you wish to discuss any aspect of how the Society is performing.



**Ann-Marie O'Dea**

Chief Executive

# Summary

## About this report

The Prudential Regulation Authority (“PRA”), requires insurers such as The Shepherds Friendly Society Limited (the “Society”) to publish a Solvency and Financial Condition Report (“SFCR”). The SFCR must be provided each year and should:

- Provide information on how the business has performed over the past twelve months.
- Provide information on its system of governance.
- Highlight the main risks to the business.
- Detail its financial strength.
- Set out how its capital is managed.

Information for each of these headings is detailed in this report and a summary is given below.

The appendix to this report provides technical information covering these areas. The information is set out in a prescribed format.

## About the Society

The Society is an insurance company writing a mixture of savings and protection contracts. The savings contracts consist of with-profits conventional and sustainable saving plans, fixed rate bonds and unit-linked investment Child Trust Fund accounts. The protection contracts include guaranteed acceptance whole life assurances (“Over 50s”) and contracts that provide income replacement protection (“IP”) in the event the policyholder falls ill or has an accident so they cannot work.

The Society reduces its mortality and morbidity risks on its protection products through reinsurance arrangements with a selection of reinsurers.

## **Business performance**

This section details the Society's business performance and significant events during the year, as well as noting who regulates the Society and who its auditors are.

Despite the economic and political uncertainty caused by the Ukraine war and cost of living crisis, the Society has been pleased to see membership levels increase by 7% and an increase in total assets, measured for regulatory reporting purposes, by £3.0m to £131.9m as at 31 December 2022. This increase is a function of the growth in the Society's membership offset by the impact of the lower investment returns in the year.

The Society's objective is one of managed and sustainable growth so that the with-profits policyholders can benefit from the value the business is creating. A driver for this growth is new business from protection business, in particular income protection contracts. The technical provision from non-profit income protection contracts has changed from £48.3m to £49.2m. This reflects the combined effect of the growth in the number of in-force policies offset by the movement in interest rates over the year.

## **System of governance**

This section outlines the Society's system of governance and material changes in the year.

The Society is governed primarily by the Friendly Society Act and complies with the Corporate Governance code set by the Association of Financial Mutuals. The Society is also committed to meeting governance standards set by its regulators: the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA").

The Board is responsible for setting the Society's risk appetite and ensuring that an Own Risk and Solvency Assessment ("ORSA") is produced and that it is fit for purpose, embedded and is used in business planning and risk management. This has been an important tool in the management of the business in recent years.

During the year, Joanne Hindle has retired from the Board and Neil Tinegate and Alison McKinna have been appointed to the Board as non-executive directors. The Society also appointed RSM UK Risk Assurance Service LLP (“RSM LLP”) as internal auditors from 1 January 2022, replacing Mazars LLP (“Mazars”). Mazars had completed their three-year internal audit cycle.

The Society’s Board is satisfied that it has the right level of oversight given the nature, scale and complexity of the business.

## **Risk profile**

This section details the key risks in the business, how they are monitored and how the Society might deal with them should those events occur.

The Society uses the standard formula as referred to in the PRA requirements for Solvency II firms to calculate its Solvency Capital Requirement. The Board considers that this approach provides a reasonable basis by which the Society can quantify the risks inherent in its business. The material financial risks are underwriting risk and market risk. Other material risks include product risks, capital risks and operational risks that includes climate change risk.

The oversight of these material risks and other material emerging risks is managed by the Society’s Board Risk Committee.

The Society’s risk management processes have been effective for dealing with the impact of interest rate risks and other material risks throughout the year and ensured it was able to take strong and effective mitigating actions to ensure the Society’s continued resilience.

## **Valuation for solvency purposes**

This section details the bases, methods and assumptions used to value the Society’s assets and liabilities.

The methods used to value the Society’s assets and liabilities are unchanged from those used at the end of the previous year.

The assumptions for technical provisions were updated at 31 December 2022 to reflect the economic conditions and our estimate of future demographic experience at that time.

## Capital management

This section details what capital the Society has to manage its business and the capital needed to cover the risks in the business.

The Society's Solvency Ratio, defined as the ratio of Own Funds to the Solvency Capital Requirement, was 171% (2021: 166%).

The Society has maintained sufficient own funds throughout 2022 and the prior year to cover its Solvency Capital Requirement and its Minimum Capital Requirement.

The Society is able to take appropriate risk mitigating actions to be sure that it can meet policyholder obligations as they fall due.

# Our Responsibility

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

We are satisfied that:

- (A) Throughout the financial year in question, the Society has complied in all material respects with the requirements of the PRA Rules and Solvency II Regulations as applicable; and
- (B) It is reasonable to believe that, at the date of publication of the SFCR, the Society has continued so to comply, and will continue so to comply in future.

On behalf of the Board,



**Ann-Marie O'Dea**

Chief Executive

Dated: 3 April 2023



# Business and Performance

## A.1 Business

The Shepherds Friendly Society Limited (the “Society”) is a friendly society incorporated under the Friendly Societies Act 1992 and registered in the United Kingdom (registered number 240F). The Society’s registered office is at Haw Bank House, High Street, Cheadle, SK8 1AL.

The Society is authorised and regulated by the Prudential Regulation Authority (the “PRA”) and the Financial Conduct Authority (the “FCA”) (registration number 109997). The PRA is the supervisory authority responsible for the financial supervision of the Society. The PRA may be contacted at 20 Moorgate, London, EC2R 6DA.

Our external auditors are BDO LLP. They may be contacted at 55 Baker Street, Marylebone, London W1U 7EU.

The Society is a mutual organisation, owned by its members i.e. its policyholders, and has no shareholders. At General Meetings, all eligible members over the age of 18 have one vote, irrespective of the number or value of policies they hold, and all votes count equally.

The Society has two wholly owned UK registered subsidiaries that do not engage in regulated activity, Financial Advice Network Limited (“FAN”) and Financial Advice Website Limited (“FAW”). FAN’s activities have been discontinued in the prior year. FAW operates as a service company for the Society.

All the Society’s business is carried out in the UK but policyholders are geographically diverse. Its material lines of business are:

- Insurance with-profits participation. This covers the Society’s with-profits regular and single premium life business (with-profits – life).
- Health Insurance with-profits participation. This covers the Society’s Holloway-type business (with-profits – health).
- Other life insurance. This covers the Society’s conventional non-profit life business e.g. Over 50s whole of life, term assurance and fixed rate bonds (non-profit – life).

- Health Insurance. This covers the Society's pure income protection business (non-profit – health).
- Unit-linked. This covers the Society's holdings of Child Trust Funds ("CTF") (unit-linked).

The Society undertakes its activities at a national level with no geographical bias.

The Society has in place various reinsurance arrangements on some of its non-profit business.

As at 31 December 2022 the Society had assets, as reported for regulatory reporting purposes, of £131.9m and own funds of £15.8m.

## **A.2 Underwriting Performance**

Table 1 sets out a summary of the Society's underwriting performance over 2022 and over 2021. All the business is written in the UK. Underwriting performance is defined, for the purposes of this section, as the amount of premiums received over and above claims paid and maintenance expenses. Figures are net of reinsurance. No allowance is made here for the change in liabilities associated with these cashflows.

**Table 1: Underwriting Performance over 2022 and 2021**

Underwriting Performance over 2022 – net of reinsurance				
Line of business	Premiums and Contributions	Claims	Maintenance expenses	Underwriting profit
	£'000	£'000	£'000	£'000
With-profits – life	23,569	10,976	957	11,636
With-profits – health	1,374	1,840	417	(883)
Non-profit – life	9,460	482	442	8,536
Non-profit – health	6,236	3,012	638	2,586
Unit-linked business	389	348	99	(58)
<b>Total</b>	<b>41,028</b>	<b>16,658</b>	<b>2,553</b>	<b>21,817</b>
Underwriting Performance over 2021 – net of reinsurance				
Line of business	Premiums and Contributions	Claims	Maintenance expenses	Underwriting profit
	£'000	£'000	£'000	£'000
With-profits – life	20,977	9,667	887	10,423
With-profits – health	1,477	2,062	394	(979)
Non-profit – life	5,996	161	426	5,409
Non-profit – health	5,815	2,494	505	2,816
Unit-linked business	390	362	99	(71)
<b>Total</b>	<b>34,655</b>	<b>14,746</b>	<b>2,311</b>	<b>17,598</b>

Maintenance expenses above exclude investment expenses.

## A.3 Investment Performance

Table 2 sets out a summary of the Society's annualised investment return over 2022 and over 2021. The returns are shown for the pools of the Society's assets: the assets backing the conventional with-profits fund, the assets backing the sustainable with-profits fund and the assets backing unit-linked liabilities.

**Table 2: Annualised Investment Return over 2022 and 2021**

Fund	2022	2021
Conventional with-profits	-5.6%	6.2%
Unit-linked	0.7%	17.7%
Sustainable with-profits	-16.9%	6.5%
Combined	-3.7%	10.1%

Table 3 summarises the investment returns by income, realised and unrealised gains over 2022 and 2021 split across the Society's different asset types.

Table 3: Annualised Combined Investment Return over 2022 and 2021						
	2022			2021		
Asset type	Income	Realised gains/ (losses)	Unrealised gains/ (losses)	Income	Realised gains/ (losses)	Unrealised gains/ (losses)
	£'000	£'000	£'000	£'000	£'000	£'000
Equity	-	-	-	-	(1,718)	-
Property	-	-	-	-	(215)	-
Cash	-	-	-	3	-	-
Subsidiaries	-	-	-	400	-	-
Collectives	-	301	(4,744)	-	341	11,832
Derivative	-	-	3,680	-	-	-
<b>Total</b>	<b>-</b>	<b>301</b>	<b>(1,064)</b>	<b>403</b>	<b>(1,592)</b>	<b>11,832</b>

The Society's investment expenses for 2022 were £0.2m (2021: £0.2m).

The Society does not have any investments in securitisation.

## A.4 Performance of other activities

The Society's main source of income is premiums from its members. Details of this income are shown in section A.2. The Society's investment income and expenses are detailed in section A.3.

Table 4 summarises the other main item of expenditure. These relate to the costs incurred by the Society in acquiring new business.

Table 4: Acquisition expenses incurred over 2022 and 2021		
Expense type	2022 £'000	2021 £'000
Acquisition costs	12,329	10,925

## A.5 Any other information

There is no additional material information regarding business and performance in this section.

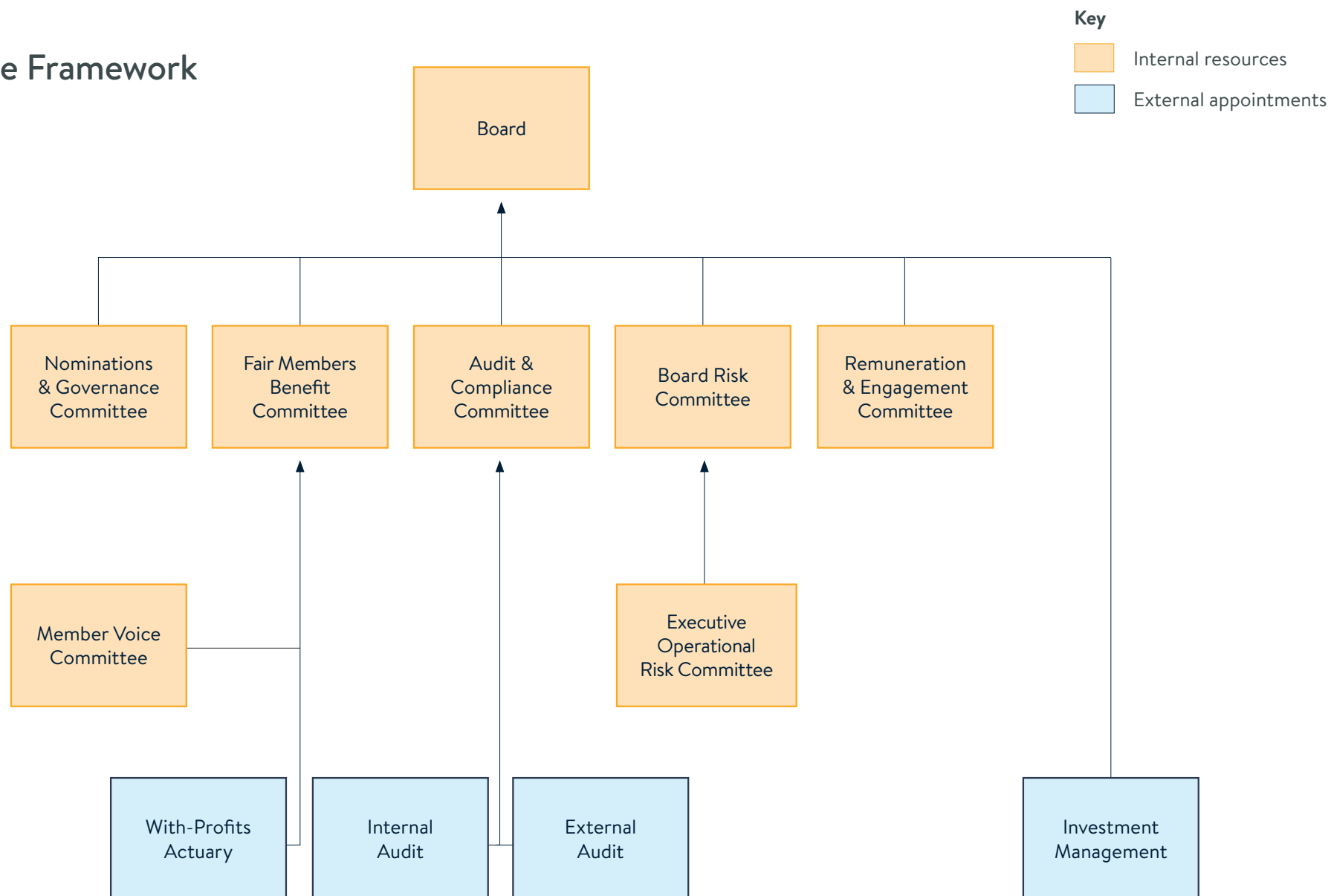
## **B** System of Governance

### **B.1** General information on the system of governance

Ultimate responsibility for the business rests with the Board. The Board comprises a majority of Non-Executive Directors (“NEDs”), and Executive Directors. NEDs are elected annually by the Society’s members at the AGM.

The Board is supported in its activities by five Committees and these committees may, in turn, also be supported by other parties. The following chart illustrates the broad framework of the Society’s system of governance.

## Chart 1: Governance Framework



The Society reviews its governance framework on a half yearly basis to ensure that any changes are recorded and acted upon. The entire system of governance is reviewed on an annual basis which the Board agreed is sufficient given the scale and complexity of risks in the business. No significant changes were made to the governance framework over 2022.

The Executive Directors have authority and operational independence delegated by the Board to deliver the responsibilities and tasks of their key function roles. Additional resources are approved by the Board. This delegation of authority and operational independence is reflected in the Board's organisational structure. There is a system of regular appraisal and feedback.

The NEDs are operationally independent and are not involved in the day-to-day management of the business. The performance, competence and independence of NEDs are reviewed by the Board on a regular basis.

## Key roles of Board and Committees

The following section details the key functions and roles and responsibilities of the Board and Committees.

### The Board

The Board has overall responsibility for the control of the business of the Society to ensure that it achieves its objectives. The Board is responsible for the direction of the Society's current and proposed business, providing oversight of its subsidiaries, and, having regard to its members, acting in the Society's best interests. The primary responsibilities of the Board are:

- to act in the best interests of the Society and its members and accounting to them;
- to provide entrepreneurial leadership;
- to monitor and review performance of the Society, the Board and the Executive Team;
- to monitor key outsourced services, in particular external investment fund managers;
- to set and maintain the highest standards of corporate governance;
- to establish the framework of systems and controls and division of responsibilities;

- to monitor risk via the framework of systems and controls;
- to set the Society's risk appetite and tolerance limits;
- to set the strategic direction and aims of the Society within the agreed risk appetite;
- to set the Society's cultural values and standards of behaviour, including management of conduct risk;
- to ratify and agree the decisions of the Board Committees;
- to make appointments to and evaluate the Board;
- to set out the Society's approach to capital and liquidity management;
- to consider the interests of other relevant stakeholders.

A formal schedule of Matters Reserved to the Board is in place.

The Board Chair is responsible for chairing and overseeing the performance of the Board in accordance with the Society's rules, regulatory and legal requirements to maintain the highest standards of corporate governance. The Chair provides ethical leadership and direction to the Board and ensure that the work of the Board is focussed on meeting the Society's mission, vision and strategic direction.

The Senior Independent Director's role is to ensure the Society places the members at the heart of everything it does. The Senior Independent Director also acts as a channel of communication for any member who believes they have a problem which cannot be resolved through the usual channels. They are also responsible for assessing the Board Chair's performance.

A NED will act as the Board Consumer Duty champion for the Society and oversee that the changes are implemented correctly and in line with the regulation.

## **Nominations and Governance Committee**

The Chair of the Nomination & Governance Committee is responsible for chairing and overseeing the performance of the Committee, which is responsible for all nominations and governance matters. They have oversight responsibility for ensuring that all key function holders are fit, proper and competent on a continuous basis and that the Society has an effective succession planning process in place.

The committee has oversight of the implementation of the Society's



climate change strategy. It works closely with the Board Risk Committee on the risk related aspects of climate change.

## **Fair Members Benefit Committee (incorporating the With-Profits Committee) (“FMBC”)**

The Chair of the FMBC is responsible for chairing and overseeing the performance of the Committee, which is responsible for supporting the Board in discharging its corporate governance obligations in relation to compliance with the PPFM.

The scope of the FMBC covers activities that are normally those of a With-Profits Committee to protect the interests of with-profits policyholders. It also includes the consideration of the fair treatment of non-profit policyholders to ensure that the needs of all the Society’s policyholders are considered.

The FMBC monitors the performance of the Society’s investment managers to ensure with-profits policyholders are securing the returns in line with their reasonable expectations.

The FMBC also has responsibility for monitoring and reviewing the nature of complaints.

The Society’s With-Profits Actuary (“WPA”) attends the FMBC. The WPA advises the Society on key aspects of the discretion to be exercised affecting with-profits policyholders. The WPA is an independent appointment through OAC plc, an external consulting actuarial firm.

The FMBC is supported by an executive committee, the Member Voice Committee. The Committee is responsible for assisting and advising the FMBC in exercising its oversight of good member outcomes in the Society as part of an effective conduct risk strategy. The Member Voice Committee will monitor and review the Society’s performance with regard to the culture element of the Conduct Risk framework in particular member voice, impact of employee interactions with members and external partnerships. A key focus for the FMBC and the Member Voice Committee is the implementation of a new piece of regulation from the FCA on Consumer Duty. This will look at how the Society is best able to deliver fair outcomes for its members.

## Remuneration & Engagement Committee

The Chair of the Remuneration & Engagement Committee is responsible for chairing and overseeing the performance of the Committee, which is responsible for the oversight of the design and implementation of the Society's remuneration policy. They are responsible for ensuring that the Society's remuneration and engagement policy and practices are aligned to business strategy and objectives, its risk appetite, and engage our people by delivering rewards appropriate to their needs and wants.

## Board Risk Committee

The Chair of the Board Risk Committee has the responsibility for the performance of the ORSA process, to ensure the ORSA is reviewed and developed as appropriate (at least annually) and is embedded within the Society as well as to oversee the Society's capital management strategy. They have oversight responsibility for ensuring that the Society has an appropriate ORSA Policy, that the requirements of the Policy are implemented by the Board, and that the Society is fully and effectively using its risk management systems.

The Board Risk Committee is further supported in its activities by an Executive Operational Risk Committee ("EORC") who monitor and report on the Society's operational risk management in the following key categories: Operational resilience, processes reviews, cyber security and the operational aspects of climate change. The EORC also manages a programme of deep dives for specific areas of operational risk concern and oversees the future development and maintenance of the Society's risk management software.

The Board Risk Committee also:

- Monitors the risks attaching to the Society's investments which are currently managed by Royal London Asset Management and Legal and General Investment Management.
- Monitors the financial risks of climate change.
- Monitors market exposures, such as interest rate risk, and implementation of alternative investment strategies to mitigate risk.
- Monitors underwriting risks, such as sickness and lapse risk.
- Reports to the Remuneration Committee on whether management have adhered to risk appetite.

## **Audit & Compliance Committee**

The Chair of the Audit and Compliance Committee is responsible for chairing and overseeing the performance of the Committee, which is responsible for the oversight of internal and external audit. The Committee is responsible for ensuring the independence of the audit functions and monitors the auditors' performance. The Chair has oversight of the independence, autonomy and effectiveness of the whistleblowing policies and procedures, including those for the protection of employees raising concerns.

The Society's Chief Actuary attends the Audit and Compliance Committee to present recommendations on appropriate methodologies and assumptions to use in the valuation of the Society's long-term business provision in its Annual Report and Accounts as well as the Solvency II regulatory valuation.

The Chief Risk & Compliance Officer presents an annual compliance and monitoring plan and the Committee monitors progress and findings against this plan.

The Committee agrees the internal audit plan annually and reviews their reports, and the external auditors also report their findings when the annual financial statements are signed off.

## **Executive Directors**

The following section summarises the key roles and responsibilities of the Executive Directors.

### **Chief Executive**

The Chief Executive provides strategic and operational leadership to ensure the Society's continuing development and financial stability. They are responsible for the delivery of financial objectives of the Society. They are also responsible for ensuring that the Society and its employees act at all times in the best interests of its members and meet the expectations of regulatory bodies.

## **Culture Director**

The Culture Director has overall responsibility for ensuring that the Society creates a quality experience for both our members and employees. They are responsible for designing, implementing and managing people focussed strategies that attract, develop, engage, support and retain high performing employees as well as ensuring that a culture of the highest standard of conduct and values are embedded within the Society.

## **Operations Director**

The Operations Director is responsible for leading the day-to-day operations of the business of the Society in accordance with the overarching strategic plan and the annual operating plan, and overseeing the operational resilience of the Society. They are also responsible for delivery of an IT and systems strategy in line with the Society's corporate objectives, and for outsourced operational functions including systems and technology.

## **Chief Actuary**

The Chief Actuary is responsible for developing, promoting and implementing sound capital and risk management policies and processes within the Society, thereby ensuring that members' interests are protected. In this role they are supported by the Chief Finance Officer and the Chief Risk & Compliance Officer. The Chief Actuary manages all financial related policies, processes, procedures, both accounting and actuarial related, thereby ensuring the integrity of financial data used for reporting the affairs of the Society in line with UK accounting and actuarial standards.

## **Key second line defence functions**

The following section summarises the key second line of defence risk management functions, their roles and brief responsibilities.

## **Risk**

Provides independent oversight and challenge over the identification, assessment and management of all significant risks to ensure the Society is operating within agreed risk appetites. They design and maintain the Risk Management Framework.

## **Compliance**

Oversees and monitors regulatory compliance to ensure that the business is managing its regulatory risk exposures appropriately and that controls are effective.

## **Actuarial**

Coordinates the calculation of technical provisions, provides opinions on underwriting policy and reinsurance arrangements and contributes to the effectiveness of the Risk Management Framework.

## **Third line defence support**

Further third line of defence support is provided to the Committees and Board from:

- Internal audit. The Society outsources internal audit to RSM LLP. This arrangement provides access to wider internal audit capabilities and ensures independent assurance on the adequacy and effectiveness of the Society's systems and controls.
- Additional actuarial oversight. OAC plc provides the Society with additional support overseeing the actuarial activities of the business. This is separate and independent of the With- Profits Actuarial services that OAC plc also provides.
- External audit. BDO LLP are the Society's current independent external auditors.

## Remuneration

The Society bases its remuneration policy on both corporate and individual performance and provides a competitive package to attract and retain quality individuals. It complies fully with corporate governance practices and regulatory requirements. The Society ensures that the policy is consistent with its mission and values. NEDs do not receive any variable performance pay.

Executive Directors are remunerated in both fixed and variable form, with the variable element limited to a maximum potential of 30% of the fixed element.

The Society has an employer sponsored defined contribution pension scheme and a closed defined benefit pension scheme (the “DB pension scheme”). The DB pension scheme has been closed to future accrual and new members since January 2018. The DB pension scheme has its own Board of Trustees and actuarial advisers. None of the Society’s executives are members of the DB pension scheme. The Executives can participate in alternative personal pension arrangements as approved by the Committee.

NEDs receive expenses for travel to and from Board meetings at Head Office.

The design and implementation of the remuneration policy is overseen by the Society’s Remuneration & Engagement Committee. The Committee ensures that the Society complies with good corporate governance practice as well as relevant parts of the appropriate governance codes.

The Board is satisfied that the system of governance described above is appropriate for the nature, scale and complexity of the Society.

## **B.2** Fit and proper requirements

The Nomination & Governance Committee has determined that the essential requirements for each key function role are:

- Technical, professional skills, specialist knowledge;
- Governance experience;
- Behaviours, competencies, experience.

An up-to-date CV is held for each key function holder as well as written records of individual interviews to evidence each key function holder's suitability to fulfil the essential requirements for the relevant key function or functions (including their prescribed responsibilities).

All key function holders and NEDs are required to undertake and maintain appropriate continuing professional development, assessed annually.

In deciding whether a person is fit and proper the Society must be satisfied that the person:

- Has the appropriate personal characteristics (including being of good repute and integrity);
- Possesses the required level of competence, knowledge and experience;
- Has the relevant qualifications, technical skills, professional skills and specialist knowledge in their area of expertise; and
- Has undergone or is undergoing all training required to enable such person to perform their key function effectively.

There were no material transactions between the Society and the Directors or senior management other than remuneration.

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

### **Risk management**

The Society's Risk Management Framework (the "RMF") is designed to sit alongside the strategic plan and be proportional, aligned, embedded and dynamic. The RMF looks to ensure that risk management and risk culture, supports the identification, assessment, management and control of material risks that threaten the achievement of the strategy and fair treatment of members. The principal architecture of identification and culture are risk categories, headline risks, emerging risks, risk ownership and reporting.

To facilitate our RMF, the Society's Risk Database is the central repository for all risks identified by the Society. Risk reporting indicators are used as early warning indicators for each headline risks. They are aligned to the risk appetites and reported to the Board Committees.

### **Own Risk and Solvency Assessment ("ORSA")**

The ORSA, required by regulations, establishes a strong link between business planning, risk assessment and capital management. The Board is responsible for setting the Society's risk appetite which is expressed in the annual ORSA. The ORSA can be produced more frequently if the Society's risk profile has changed materially. One ORSA was produced in 2022 with any scenario analyses undertaken to test the possible impact from the war in Ukraine, higher interest rate, higher inflation and a deterioration in demographic experience.

The Society's overarching risk appetite is to hold a strong capital position and to be able maintain solvency under significant adverse events. The Society's Risk Appetite Statement explains the level of risk that the Society is prepared to accept in pursuit of its strategic objectives and defines the tolerance for each risk category.



## **B.4 Internal control system**

The three lines of defence control system is a key part of the Society's internal control system. This comprises:

- 1st line – the Senior Management team and front line employees;
- 2nd line – the Society's Risk, Compliance and Actuarial function; and
- 3rd line – the outsourced internal audit function.

The three lines of defence approach is considered appropriate for the size and the complexity of its business. It allows flexibility in its approach and this allows management information to be produced quickly and accurately.

An annual Assurance Plan is produced, which considers both risk and compliance requirements. A risk assessment is used to develop the annual Assurance Plan, which considers both internal and external factors, to allow a risk-based approach to assurance activities. This is reviewed and approved by the Audit & Compliance Committee annually and throughout the year the plan is updated in line with the activity and business need.

External audit provides independent assurance on the annual financial statements of the Society.

## **B.5 Internal audit function**

For 2022, the Society's Internal Audit activities were outsourced to an external provider, RSM LLP, and as such they were independent of the Society's management team. A three-year rolling Internal Audit plan is in place to provide continuous assurance to the Audit & Compliance Committee on how well the risks facing Shepherds are being managed. The plan is reviewed annually and agreed with the Audit & Compliance Committee.

The appointment of Internal Audit is on a three-year cycle. At the end of each cycle, their appointment is reviewed, and the Audit & Compliance Committee considers annually the independence and objectivity of the firm.

The Board is satisfied that the Society has an effective internal audit function.

## **B.6 Actuarial function**

The Actuarial Function is co-ordinated internally within the Society by its Chief Actuary. They are supported by the Chief Finance Officer and the Chief Risk & Compliance Officer as well a team of qualified and part-qualified actuaries, and data analysts.

Further support is provided by an external actuarial firm, OAC plc. They review the actuarial function's output and methodologies. They are available for support should the need arise.

The Chief Actuary reports to the Chief Executive.

The Board is satisfied that the Society has an effective actuarial function.

## **B.7 Outsourcing**

The Society assesses all outsourced activities in accordance with its Third-Party Supplier and Outsourcing Risk Policy to decide if any are critical activities to operate the business and to fulfil policyholder expectations. For those identified, a materiality exercise is carried out and out-sourced service agreements are developed, and appropriate providers sourced in line with the Society's Third-Party Management and Outsourcing framework. Sourcing requires a robust process of selection, ensuring due diligence is applied to all criteria. On selection, the provider is subject to on-going fit and proper assessments and follow up due diligence in line with the requirements of the Third-Party Management and Outsourcing framework.

The Society considers that it has two key outsourced services: investment management with RLAM, and the provision of cloud-based infrastructure services by Microsoft. RLAM's services are all provided within the UK, and the Society utilises Microsoft's UK South and UK West data centres.

## **B.8 Any other information**

There is no additional material information regarding system of governance in this section.

# C Risk Profile

## Risk Management Structure

Section B.3 sets out the Society's risk management system.

## Overall risk profile of the Society

The following table analyses the more significant risks (defined as those where the Solvency II SCR risk component before management actions is more than £1m) attaching to the Society's products.

Table 5: Key risks for each of the Society's main lines of business						
Line of Business	Underwriting risk					
	Market risk	Mortality	Longevity	Sickness	Expense	Lapse
With-profits – life	✓					
With-profits – health	✓					
Non-profit – life			✓		✓	✓
Non-profit – health	✓			✓	✓	✓
Unit-linked	✓					

The assessment of risk in the table above takes into account the Society's reinsurance arrangements.

Table 6 sets out the Society's overall risk profile at the end of 2022 with the figures at the end of the prior year shown for comparison. The figures are based on the Society's Solvency Capital Requirement calculations.

Table 6: Solvency Capital Requirement by Risk Module		
Risk Module	31 December 2022	31 December 2021
	£'000	£'000
Market risk	14,067	17,190
Counterparty default risk	896	1,746
Life underwriting risk	3,114	3,742
Health underwriting risk	12,263	12,408
Diversification	(7,997)	(9,441)
Basic Solvency Capital Requirement	22,343	25,645
Operational risk	1,689	1,415
Loss absorbing capacity of technical provisions	(14,828)	(16,783)
Solvency Capital Requirement	9,204	10,277

Health risk continues to represent the primary risk driver of the business. Market risks presented above are before the loss absorbing capacity of technical provisions.

Market risks have reduced reflecting the increases in interest rates and the lower equity stress required as at 31 December 2022. Counterparty default risk has reduced due to lower reinsurance recoverables as at 31 December 2022.

## C.1 Underwriting risk

Underwriting risk relates to the risk that actual rates of mortality, sickness, lapses and expenses are different to those allowed for within the solvency valuation.

Table 7 illustrates the relative significance of these risks on the Society's Own Funds as at 31 December 2022. The figures are based on the Society's undiversified Solvency Capital Requirement before management actions for life and health business combined.

Table 7: Impact of changes in mortality, sickness, lapses and expenses		
Risk	Sensitivity	Estimated impact on Own Funds £'000
Longevity	-20% decrease in mortality rates	(1,795)
Sickness	+25% inceptions, -20% recoveries	(9,487)
Lapses	10% increase in lapse rates	(4,429)
Expenses	+10% increase in maintenance expenses	(3,039)

### Mortality risk

Mortality is not a financially significant risk driver.

### Longevity risk

The Society has an exposure to longevity risk i.e. the risk that policyholders live for longer than expected. This risk applies to the Society's product range with the exception of unit-linked business.

### Sickness risk

This risk applies to all the Society's Holloway and pure income protection contracts of insurance. If inception rates increase or if recovery rates fall (so that claims last for longer), or some combination of the two, then the Society's own funds will reduce.

### Lapse risk

This is the risk that a policyholder lapses or surrenders their policy before the planned maturity date or expected surrender date. This is a material risk facing the Society because its protection contracts are expected to be

profitable assuming a best estimate of future lapse rates. This means that if actual lapses are different to that expected then the value of the Society's existing business will increase or decrease accordingly.

## **Expense risk**

The Society is exposed to the risk that the costs of administering the business are higher than expected. This can arise as a one-off increase to certain expenses and through higher expense inflation.

## **Risk mitigation techniques**

Expenses, lapse and sickness claims experience is closely managed against the Society's risk appetites by Senior Management and monitored by the Board Risk Committee with Board oversight. Action is taken when performance is outside tolerance.

The Society seeks to work with intermediaries with similar values to deliver the quality of new business it expects and to promote member retention. The Society also focuses on member retention initiatives and it has enhanced the benefits provided to IP policyholders to aid recovery from sickness. Reinsurance arrangements help to mitigate sickness risks and IP premiums may be reviewed in line with the terms and conditions of the contracts to adjust for adverse experience.

## **C.2 Market risk**

This is the risk that the Society's own funds are adversely affected by a change in the value of the investments that the Society holds. The risk includes the risk of higher interest rates which reduces the value of future cash flows on the Society's IP contracts.

Table 8 illustrates the relative significance of market risks on the Society's Own Funds as at 31 December 2022. The effect is before any additional management action is applied. The analysis is broken down by the impact of changes in the following market movements: interest rates, equity values, credit spreads and currency risk.

**Table 8: Impact on own funds arising from changes in the market movements, as at 31 December 2022**

<b>Market move- ment</b>	<b>Sensitivity</b>	<b>Estimated impact on Own Funds £'000</b>
<b>Interest rates</b>	Regulatory Insurance interest rate up stress	(1,381)
<b>Equities</b>	Regulatory Insurance stress: 39% fall	(3,313)
<b>Credit spreads</b>	Regulatory Insurance stress	(1,364)
<b>Currency risk</b>	Regulatory Insurance stress	(1,049)

The Society is exposed to the risk of interest rates increasing. This is because higher interest rates have the effect of reducing the value of fixed interest assets and reduce the value of future positive cash-flows on the protection business the Society has sold.

The Society is exposed to the risk of other market movements because the Society is exposed to the risk of:

- The value of the assets backing with-profits liabilities falling. In such an event the cost of guarantees of the with-profits business increases, as does the value of the expense reserve.
- The value of the assets backing unit-linked liabilities falling. This arises only on the equity risk because all the Society's unit-linked assets are invested in equities. There is a fall in own funds because the value of future management charges is lower.
- The value of the assets backing the Society's pension scheme falling. This is because the Society's obligations to the pension scheme increases by the amount of any pension scheme investment losses.

## **Market risk concentrations**

The Society invests the assets backing with-profits liabilities primarily in collective investment schemes. These funds are well-diversified and minimise any ongoing concentration of risk.

The Society's CTF unit-linked liabilities are matched by investment in LGIM's FTSE All-Share tracker fund. This fund is well-diversified and avoids any ongoing concentration of risk.

The Society has no directly held assets as at 31 December 2022 and the prior year.

## **Risk mitigation techniques**

The Society holds investments in actively managed funds that are designed to generate less volatile investment returns in the long term. Investment risk volatility is actively managed by fund managers at RLAM, and LGIM passively tracks appropriate fund indices for the Society's unit-linked funds. The Board has oversight of RLAM as a key outsourced active investment management services provider. Investment performance and emerging experience is monitored by the Board Risk Committee and the Fair Members Benefit Committee. The Society maintains a varied product range and any reduction in the value of IP policies as a result of higher interest rates will be partly offset by a lower value of liability on the Society's with-profit business. The Society has in place a derivative financial instrument to hedge against some of the impact of interest rate movements.

## **Prudent person principle**

The Society invests its assets in accordance with the Prudent Person Principle as defined by the PRA. This requires firms like the Society to invest only in assets and instruments whose risks the firm can properly identify, measure, monitor, manage, control and report, and appropriately consider in the assessment of its overall solvency needs.

The core portfolio of the funds held with RLAM and LGIM are invested primarily in physical assets but the funds may also invest in derivatives for three reasons:

- To implement tactical asset allocation positions.
- To limit volatility by reducing equity exposure.
- To manage liquidity.

The funds operate a conservative derivatives policy. The funds only use derivatives for the purpose of making investment returns and efficient portfolio management. RLAM provide the Society with regular reports on the asset allocation of the collective investment funds as well as ad-hoc reports on demand.

Investment risk is managed and overseen by the Board Risk Committee. The nature of the risks of the Society's investments is reviewed at each meeting to ensure that they align with the Society's risk appetite and that



appropriate steps are being taken by the Society to manage risks with any specific asset or asset class.

The Fair Members Benefit Committee also monitors the nature of the investments backing with-profits business. This Committee exercises independent judgement in advising the Board on the fair treatment of policyholders including investment related matters.

The Society's overall approach to managing its investments is also disclosed in the Society's Principles and Practices of Financial Management ("PPFM").

### **C.3 Credit risk**

Credit risk attaching to the Society's holding of corporate bonds through collective investment funds is covered in section C.2 above. The Society is additionally exposed to the following types of credit risk:

- Risk of default by the Society's reinsurers. The reinsurers were selected based on an assessment of their financial strength and global reputation. The risk of this arising is considered low.
- Risk that intermediaries that sell the Society's products are not able to repay clawback on commissions. The Society's exposure to this risk is not currently significant and varies in line with recently written business volumes. The risk is managed internally through weekly management review of outstanding balances and agreed repayments.
- There is a risk of the Society's banking provider or an investment management services provider counterparty failing. This risk is considered low because the Society invests only with recognised financial institutions and limits exposures to individual firms.
- The Society is exposed to the risk of loss from underlying credit positions, mitigated by diversity within the Society's investment portfolio and active credit assessments by the Society's investment managers.

## Risk mitigation techniques

The Society monitors credit worthiness of all its material counterparties and takes mitigating actions when there are concerns over the credit rating. Material counterparties are selected based on an assessment of their financial strength and global reputation. This means the credit risk is low for the Society's material counterparties that includes its reinsurers, investment management provider and banking providers. Management reviews outstanding balances from intermediaries on a weekly basis and take action to recover overdue payments.

### **C.4** Liquidity risk

Liquidity risk is the risk that the Society, though solvent, is not able to meet its financial obligations as they fall due. Liquidity risk is not quantified as part of the Solvency Capital Requirements.

Short-term liquidity or daily cash management covers the day-to-day cash requirements of the business under normal circumstances. Longer term liquidity is managed through matching liability outflows with expected cash inflows.

Sources of cash arise mainly through premium receipts, sale of investments, reinsurance receipts and any underwriting profits we make on non-profit business.

Liquidity is managed by ensuring that the Society's assets are invested in a way that access to the majority of the Society's assets can be secured within one to three working days. This ensures that the Society has ready access to cash should the need arise. Counterparties are chosen such that the risk of liquidity constraints in times of stress are minimised.

The Society manages the expected profits on future premiums which are not liquid and appropriate ways to mitigate this risk have been developed by the Society such as monitoring the balance of new business mix. These were valued at £57.9m at the end of 2022 (2021: £57.2m).

## **C.5 Operational risk, including strategic risks**

The main operational and strategic risks facing the business include:

### **Operational resilience risk**

This covers the risk that the Society does not have the ability to prevent, adapt, respond to, recover and learn from operational disruptions or cyber threats. There is a risk that the Society is unable to meet its member obligations following the significant degradation of services received which could result in disruption to our operations or loss of financial assets.

The Society has in place an Operational Resilience Framework to manage and stress test operational and technological crises covering various areas such as data and cyber security, and enabling rapid and effective decision making. The Framework identifies the important business services, critical and important suppliers, and critical roles in the business. The Framework sets out the frequency at which the Society reviews key controls and an assessment of how they can be flexed during periods of operational strain. Before entering any outsourcing relationships, the Society conducts due diligence on the organisations and the outsourced activity to ensure any risks are fully considered. The Society recognises that cyber threats constantly evolve in sophistication and it continues to invest in its security systems to ensure the Society remains resilient to cyber threats and other physical threats to business continuity.

### **Strategic development change management risk**

This captures the risks that the Society's strategic development does not benefit members, and the pace of change could lead to uncertainty around the ability of management to deliver the strategy set out by the Board.

The Board Risk Committee and Board monitors the key risk indicators reported by management. The key risk indicators will act as early warning flags on strategic risk. Management have established a management committee to review progress of strategically important projects, manage the project roadmap and manage strains on development resources.

## **Regulatory change risk**

This is the risk that the Society fails to meet its obligation as a result of changes to regulation such as the new Consumer Duty regulation. This may result in poor outcome for the Society's members.

The Board has approved a Consumer Duty implementation plan for the Society and nominated a Board Consumer Duty champion to oversee that the changes are implemented correctly and in line with regulation. The Society is in the process of embedding Consumer Duty across the business and developing key metrics to measure consumer outcomes at key stages of the member journey.

Management, the Fair Members Benefit Committee and the Board regularly review Management Information on complaints, customer communications and sales journeys to maintain oversight.

## **Product development & portfolio risk**

The risk that new business is not in balance with business operations (too much or too little). The risk arises from sales of the Society's with-profits products, non-profit products and products sold through third party relationships.

The Society aims to maintain a varied product range and varied distribution channels to provide continuous flexibility and adaptability to changing market circumstances. The Society sets new business targets in line with the strategic plan, and risk appetite and tolerances. The Board monitors new business volumes against its targets.

## **C.6 Other material risks**

The material risks in the business have been articulated within sections C.1 (underwriting risk), C.2 (market risk), C.3 (credit risk) and C.5 (operational risk, including strategic risks) above. The Society monitors these risks carefully and appropriate controls are in place to take action should one or more of those risks crystallise.

Other material risks to the Society are emerging risks.

Climate change is a key global emerging risk. The Society is taking steps to minimise its carbon footprint as well as ensuring that the risks of climate change are allowed for in its business planning. The ORSA details the scenario analyses undertaken to assess the potential threat of climate change to help inform the Society's longer-term solvency needs. These scenarios have been drawn from the Bank of England's 2021 Climate Biennial Exploratory Scenario ("CBES"), adapted to be appropriate for the nature of the Society's business. There are financial risks associated with climate change. These risks have been quantified within the ORSA through specific late action and no additional action scenarios. The Society is also reviewing other aspects impacted by climate change, including governance, risk management, disclosures and Corporate Social Responsibility. The potential risks associated with climate change are being incorporated into our existing risk categories, rather than a standalone risk category.

The primary focus of activity for this is:

- The Society adopting a carbon neutral footprint;
- Reviewing the nature of the Society's investments to ensure they are aligning with the Society's approach to responsible investment;
- Ensuring the Society makes the relevant disclosures in its Annual Report and Accounts; and
- Developing key MI to assess the Society's maintenance of its net zero emissions, as well as the sustainability credentials of its investments.

## **C.7 Any other information**

There is no additional material information regarding risk profile in this section.

# D Valuation for Solvency Purposes

## D.1 Assets

Table 9 provides a summary of the value of the assets used for solvency purposes.

**Table 9: Value of Assets at the end of 2022 and at the end of 2021**

Asset type	31 December 2022 £'000	31 December 2021 £'000
Collective Investment Undertakings	74,083	71,463
Assets held for unit-linked contracts	39,267	39,587
Reinsurance recoverables	9,556	15,165
Reinsurance receivables	-	66
Cash and cash equivalents	8,353	2,229
Pension scheme surplus	312	-
Other	288	336
<b>Total</b>	<b>131,859</b>	<b>128,846</b>

Collective Investment Undertakings and Assets held for unit-linked contracts are valued based on the bid value of units at the reporting date.

Reinsurance recoverables were valued using the same methods and assumptions that were used to value the technical provisions of the contracts to which the reinsurance relates, taking account of the specific nature of the reinsurance treaty.

Reinsurance receivables were valued at face value based on the amounts owed by the reinsurer.

Cash and cash equivalents are valued at face value.

Other assets relate to amounts payable to Shepherds Friendly from intermediaries and brokers.

The Society values assets for solvency purposes in the same way as used for the Report and Accounts with the following adjustments:

- There are some assets which can be valued for the Report and Accounts but which are not permitted to be valued for solvency purposes. These are tangible assets (property used for the Society's own purposes), intangible assets and prepayments;
- The presentation in the Report and Accounts treats technical provisions in respect of protection benefits as an asset. These are treated as a negative liability for solvency purposes;
- The presentation in the Report and Accounts treats the reinsurance share of technical provisions in respect of protection benefits as a liability. These are treated as a reduction to reinsurance recoverables asset for solvency purposes;

Table 10 reconciles the value of assets set out in the Report and Accounts with the value of assets used for solvency purposes.

Table 10: Reconciliation of Assets in Report and Accounts to those used for solvency purposes		
	31 December 2022 £'000	31 December 2021 £'000
Assets in Report and Accounts	185,074	178,470
Intangible assets	(822)	(576)
Property, plant and equipment held for own use	(353)	(367)
Prepayments	(382)	(303)
Technical provisions for protection benefits	(49,211)	(48,378)
Reinsurers' share of technical provisions for protection benefits	(2,447)	-
Assets for solvency purposes	131,859	128,846

## D.2 Technical provisions

Table 11 provides a summary of the value of technical provisions used for solvency purposes at the end of 2022 and at the end of the prior year.

**Table 11: Technical Provisions at the end of 2022 and 2021**

	31 December 2022			31 December 2021		
Line of business	Best estimate	Risk margin	Total Technical Provisions	Best estimate	Risk margin	Total Technical Provisions
	£'000	£'000	£'000	£'000	£'000	£'000
With-profits – life	71,315	-	71,315	65,518	-	65,518
With-profits – health	14,610	231	14,841	15,254	250	15,504
Non-profit – life	36,675	894	37,569	36,850	582	37,432
Non-profit – health	(53,604)	4,392	(49,212)	(53,139)	4,761	(48,378)
Unit-linked business	37,379	-	37,379	37,296	-	37,296
<b>Total</b>	<b>106,375</b>	<b>5,517</b>	<b>111,892</b>	<b>101,779</b>	<b>5,593</b>	<b>107,372</b>

The following detail the reasons for the change in technical provisions over 2022:

- With-profits – life increased in value following the growth in with-profits contributions over 2022. This sufficiently covered the value of maturing and surrendering business over the year.
- With-profits – health has reduced over the year as this class of business continues to run off.
- Non-profit – life technical provisions have increased over 2022 primarily reflecting sales of the Society's fixed rate bonds and Over50s business in the year.
- Non-profit – health technical provisions have become more negative reflecting better longer-term persistency and sickness experience over 2022 despite the increase in risk-free rates which are used to discount the future cash flows from in force policies.
- Unit-linked technical provisions have increased in value reflecting the investment gains in 2022 on assets held for unit-linked liabilities.



## General description of methodology used to calculate technical provisions

Technical provisions are calculated as the sum of the best estimate liability and the risk margin.

The best estimate liability is the probability-weighted value of future cashflows required to fulfil obligations to policyholders under existing contracts. A negative best estimate liability is allowed if the present value of future premiums exceed the present value of future outgoings.

Best estimate liabilities are calculated without any allowance for reinsurance cashflows.

The best estimate liability for all with-profits (life and health) business is set to be the asset share plus the cost of guarantees reserve plus the expense reserve.

The best estimate liability for all non-profit (life and health) is calculated on a gross premium basis with an explicit allowance for future expenses.

The best estimate liability for unit-linked business is taken to be the face value of unit funds less the present value of future management charges over future expenses for the unit-linked policies.

The risk margin is an addition to the best estimate liability to ensure that the technical provisions are equivalent to the amount that third party insurance undertakings would be expected to require in order to meet the insurance obligations. The risk margin is calculated in accordance with PRA requirements for Solvency II firms and is equal to the product of the cost of capital rate and the sum of current and each future Solvency Capital Requirement discounted to the valuation date using risk-free interest rates. Solvency Capital Requirements are projected in line with the underlying risk driver e.g. sickness risk is based on the projected run-off of the value of future sickness benefits.

## Valuation of the Society's with-profits business

This covers the following types of business:

- With-profits – life: This covers the Society's regular and single premium with-profits (endowments, whole life, with-profits bonds and ISAs) contracts. These are insurance with-profits participating contracts.

- With-profits – health: This covers the Society’s Holloway with-profits contracts. These are health insurance contracts with a profit-participating element.

The technical provisions of with profits business at the valuation date is taken to be the retrospectively calculated asset share plus the present value of the cost of future guarantees plus a reserve (or credit) for maintenance expenses in excess of the charges made for expenses to the asset share.

## **Cost of guarantees**

The cost of guarantees is assessed by projecting forward asset shares and guaranteed benefits and then comparing the two values at the expected benefit payment date. If the projected asset share is higher than the projected guaranteed value then there is no cost of guarantee. If, however, the asset share is lower than the projected guaranteed value then the difference represents a cost, which is then discounted back to the valuation date using the prescribed discount rates.

The levels of future bonus included in the projection of guaranteed benefits are realistic assessments of levels that would be supported on an ongoing basis based on the assumed economic conditions underpinning the valuation (risk free rates).

Future expenses charged to asset share are those set out in the premium basis. Mortality costs, sickness costs and lapse rates are based on a best estimate assessment of the expected future experience.

The cost of guarantees is estimated using a series of deterministic projections. A lognormal distribution is fitted to a range of investment scenarios to make allowance for the range of possible investment outcomes that may occur. The distribution is fitted over the weighted average outstanding duration of the best estimate liabilities in force and the volatility is adjusted accordingly.

Each investment scenario is modelled using the year end solvency methodology and assumptions. Bonus philosophy and management actions are adjusted according to the scenario being modelled.

The cost of guarantees is calculated for each scenario and the probability distribution is applied.

The annual mean return assumed is based on PRA’s published risk-free yield curves.

## Expense reserve

Expenses charged to the asset shares are assumed to be those underlying the illustration basis set out in Key Features Documents or Key Information Documents. An additional expense reserve calculation is done to allow for the difference between the expenses needed to maintain the business and those charged to asset shares. Credit is taken for the excess of expenses charged to the asset share over the actual expenses. The shortfalls and excesses are discounted back to the valuation date using prescribed risk-free yield curves.

## Treatment of Holloway

Holloway income protection business is treated in a similar way to the conventional with-profits business. The asset shares for these contracts are the members' deposits based on their value accrued in line with historic allocations and credited investment returns. No explicit reserve is held for sickness claims as it is assumed that all future premiums, after future expenses and sickness costs, are allocated to members' accounts as they are paid.

## Valuation of the Society's non-profit business (conventional and income protection)

Table 12 sets out the products covered by this section and the type of business they are.

Table 12: Classification of the Society's non-profit contracts		
Line of business	Products	Solvency classification
Non-profit – life	Conventional paid-up endowments	Other life insurance
	Conventional paid up whole life	
	Over 50s	
	Old whole life and other minor classes of conventional non-profit business	
	Fixed rate bonds	
Non-profit – health	Pure income protection	Health (Similar Life Techniques)

A gross premium methodology is used in the valuation of each of these contracts of insurance. None of these policies have any options implicit within the contract terms (e.g. guaranteed surrender values). These reserves allow for the expected cost of all future sickness claims on relevant policies in force at the end of 2022.

## Valuation of unit-linked liabilities

Unit-linked liabilities are taken to be the face value of unit linked funds less the present value of future profits on unit funds. This is the discounted value of future charges over future expenses.

## Currency

All the Society's liabilities are all denominated in GBP.

## Options and guarantees

None of the Society's non-profit or CTF contracts have any options or any material guaranteed surrender values in place as at 31 December 2022 or as at the end of the prior year.

For the Society's with-profits business which have minimum guaranteed payments on death and maturity, the cost of guarantees is estimated using the methodology described above.

Guarantees are assumed to apply on death and maturity only. No guarantees are assumed to apply on contracts lapsing or surrendering. The valuation allows for future charges applied to asset shares to cover the cost of the guarantees provided.

## Assumptions used

The key assumptions used in the valuation of the Society's business are sickness rates, mortality, lapse rates, expenses, inflation and discount rates. Each is discussed further below. The Society has used recent experience to estimate future experience.

## Sickness rates

The Society's sickness experience (inceptions and recoveries) has been analysed separately by reference to CMIR12 tables. The assumptions are

different for each material line of the Society's income protection business (including Holloway).

## **Mortality**

The rates of mortality assumed to apply to the Society's business are split between the Society's conventional business excluding Over50s business, Holloway business and pure income protection business.

No mortality is allowed for in the valuation of the Society's unit-linked business.

## **Lapse and withdrawal rates**

The rates of lapse and withdrawal assumed to apply to the Society's business are split between the Society's main product lines. Rates are set by reference to recent observed experience.

## **Allowance for expenses**

Expenses are allowed for in the valuation of the Society's liabilities by a per policy charge. This is assumed to be payable annually and covers each policy's share of the maintenance and investment related expenses of the Society. The calculation of each policy's share of these costs allows for the expected volumes of new business the Society expects to write. Expected maintenance and investment related expenses and new business volumes are set by reference to the Society's budgets for the next financial year following the valuation date.

## **Inflation**

Future inflation is assumed to be in line with CPI projections in the November 2022 Monetary Policy Report published by the Bank of England, with an adjustment to derive the RPI. Additional allowance is made for elements of the Society's costs linked to wage inflation.

The rates of interest used to discount future cashflows are specified by the PRA.

## Reinsurance

The Society reinsures its Over 50s and part of its IP book of business. The valuation of the Society's assets recognises the value of this arrangement. The same methods and assumptions are used to value the reinsurance arrangement as used to value the technical provisions of the contracts to which the reinsurance relates.

The Society also has an historic reinsurance arrangement in place to cover a de minimis number of term assurance contracts. This is a declining book of business and the cover is not considered material. No credit or allowance is made for this reinsurance in the valuation of the Society's assets and liabilities.

## Material changes in the assumptions used

The Society reviews at least annually the emerging experience of the Society's business and has reflected the sickness and lapse experience over 2022 in the assumptions used as at 31 December 2022.

## Level of uncertainty associated with the value of technical provisions

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

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

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

There is additional uncertainty in the calculation of the risk margin. This is dependent on future interest rates and factors affecting the methodology assumed for the run-off of Solvency Capital Requirement components of the calculation.

## **Differences with the bases, methods and assumptions used with values shown in the Report and Accounts**

The same bases, methods and assumptions are used in calculating the technical provisions for both the Report and Accounts and solvency purposes, with one exception. The exception relates to the valuation of the fixed rate bond where for solvency purposes the value includes allowances for future interest awards; for the Report and Account purposes only interest accrued to the reporting date is allowed for consistency with the FRS102 accounting for investment contracts. The value of this difference at the end of 2022 is a decrease to best estimate liabilities for solvency purposes of £0.91m (2021: £0.46m increase). The decrease to liabilities for solvency purposes is the effect of discounting at higher interest rates as at 31 December 2022.

## **Other required statements**

No use has been made of a matching adjustment.

No use has been made of a volatility adjustment.

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

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

## D.3 Other liabilities

Table 13 sets out a summary of the Society's other liabilities.

Table 13: Other Liabilities at the end of 2022 and at the end of 2021		
Liability type	31 December 2022 £'000	31 December 2021 £'000
Pension scheme	-	370
Claims outstanding	2,009	2,008
Claims outstanding – reinsurance	(688)	(523)
Creditors arising out of direct insurance operations	321	133
Creditors arising out of direct reinsurance operations	18	-
Trade creditors	527	326
Accruals	1,393	1,351
Other creditors	625	776
<b>Total</b>	<b>4,205</b>	<b>4,441</b>

The pension scheme liability is that in respect of the Society's DB pension scheme and has been based on a FRS102 valuation conducted by the pension advisers appointed by the Trustees. The pension scheme was in surplus as at 31 December 2022 and it is presented as an asset.

There is no observable market for the remaining liabilities. Their value is based on an estimate of the expected financial cost to the Society. No account has been taken of discounting these cashflows. Obligations due within the next twelve months have been valued in accordance with the principles used in the Report and Accounts.

## D.4 Alternative methods for valuation

The Society prepares its Report and Accounts using Financial Reporting Standards ("FRS") 102 and FRS 103 as issued by the Financial Reporting Council. The derogation contained in Article 9 of the Solvency II Directive allows firms the option of recognising and valuing assets and liabilities under FRS for solvency purposes as long as certain conditions are fulfilled.



In accordance with supervisory statement SS 38/15 issued by the UK regulator “Solvency II: consistency of UK generally accepted accounting principles with the Solvency II Directive” and after consideration by the Board Risk Committee and the FMBC, the Society considers that these conditions have been fulfilled for the purposes of recognising and valuing assets and liabilities under FRS for solvency purposes.

## **D.5 Any other information**

There is no additional material information regarding the valuation of assets and liabilities for solvency purposes to report in this section.

# E Capital Management

## E.1 Own funds

The Society is an incorporated society within the meaning of the Friendly Societies Act 1992. As such it has no shareholders and its members are the ultimate owners of the business. All its capital is classified as tier 1 and is available to cover its Solvency Capital Requirement and Minimum Capital Requirement.

Table 14 summarises the Society's capital position, defined as its Own Funds at the end of 2022 and at the end of the prior year.

**Table 14: Own Funds at the end of 2022 and at the end of 2021**

	<b>31 December 2022</b> £'000	<b>31 December 2021</b> £'000
<b>Own funds</b>	15,763	17,032

Own funds equal the Fund for Future Appropriations as set out in the Society's Report and Accounts, adjusted for certain valuation differences (as described in section D.1). Table 15 reconciles the two values.

**Table 15: Reconciliation of Fund for Future Appropriations to Own Funds**

	<b>31 December 2022</b> £'000	<b>31 December 2021</b> £'000
<b>Fund for Future Appropriations</b>	16,406	18,735
<b>Intangible assets</b>	(822)	(576)
<b>Property, plant and equipment held for own use</b>	(353)	(367)
<b>Prepayments</b>	(382)	(303)
<b>Valuation difference on fixed rate bonds</b>	914	(457)
<b>Own Funds</b>	15,763	17,032

Own Funds includes an amount of £57.9m (2021: £57.2m) in respect of expected profits in future premiums.

There are no items of ancillary own funds.

The Society's Solvency Ratio, defined as the ratio of Own Funds to the Solvency Capital Requirement was 171% at the end of 2022 (2021: 166%)

The Society manages its capital by reference to a comprehensive capital management plan. This plan is prepared by the Society's actuarial function and reviewed and approved by the Society's Board. The plan sets out a target range for own funds and details the steps the Society would take in the event that the capital position was to breach stated tolerances.

The Society's capital position relative to any targets acts as a guideline for enhancements that can be paid to with-profits policyholders or if alternative management actions need to be applied. These are all subject to Board discretion to allow wider business factors to be considered.

The Society's Own Risk and Solvency Assessment details the expected progression of capital over the next ten years. Monitoring performance against that expected is a key strategic focus for the Society.

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

Table 16 provides a summary of the Solvency Capital Requirement and Minimum Capital Requirement at the end of 2022 and at the end of the prior year.

<b>Table 16: Solvency Capital Requirement and Minimum Capital Requirement</b>		
	<b>31 December 2022</b> £'000	<b>31 December 2021</b> £'000
<b>Solvency Capital Requirement</b>	9,204	10,277
<b>Minimum Capital Requirement</b>	3,445	3,126

Table 17 provides a breakdown of the Solvency Capital Requirement by risk module at the end of 2022 and at the end of the prior year. Figures allow for management actions and allowances against future discretionary benefits.

The Solvency Capital Requirement has been calculated using the standard formula prescribed by the regulations.

<b>Table 17: Solvency Capital Requirement by Risk Module</b>		
<b>Risk Module</b>	<b>31 December 2022</b> £'000	<b>31 December 2021</b> £'000
Market risk	14,067	17,190
Counterparty default risk	896	1,746
Life underwriting risk	3,114	3,742
Health underwriting risk	12,263	12,408
Diversification	(7,997)	(9,441)
Basic Solvency Capital Requirement	22,343	25,645
Operational risk	1,689	1,415
Loss absorbing capacity of technical provisions	(14,828)	(16,783)
Solvency Capital Requirement	9,204	10,277

The Basic Solvency Capital Requirement has decreased over 2022 and this reflects:

- a) lower market risk due to lower holdings in equities and higher holdings in cash equivalent assets held in collective investment funds as at 31 December 2022; and
- b) lower counterparty default risk due to the more diversified holdings in the collective investment funds as at 31 December 2022.

The Solvency Capital Requirement are lower compared to that at the end of the prior year and this reflects the increases in interest rates and the Society's effective capital management.

No simplifications have been used to calculate any of the Solvency Capital Requirement risk modules.

No undertaking-specific parameters have been used to calculate the Solvency Capital Requirement.

The final amount of the Solvency Capital Requirement is subject to supervisory assessment.

QRT S.28.01.01 in the Appendix sets out the information on the inputs used to calculate the Society's Minimum Capital Requirement. Table 18 details the Minimum Capital Requirement.

Table 18: Inputs used to calculate the Minimum Capital Requirement ("MCR")		
	31 December 2022 £'000	31 December 2021 £'000
Minimum Capital Requirement	3,445	3,126

PRA has increased the absolute floor for MCR this year from €3.7m to €4m and this is what contributes to most of the increase in MCR with the remainder down to exchange rates.

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

The regulations allow insurers writing certain types of business to calculate the capital requirement of their equity investments using what is called a duration-based equity sub-module. Its use depends on the regulator having previously approved its use.

The Society does not write any business that can use the duration-based equity risk sub-module.

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

The regulations allow insurers to calculate their Solvency Capital Requirement using a prescribed standard formula. Where the formula is not considered to be appropriate, an internal model may be used instead. The Society considers that the standard formula is appropriate and so has not used an internal model.

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

The Society has maintained sufficient own funds throughout 2022 to cover its Solvency Capital Requirement and its Minimum Capital Requirement.

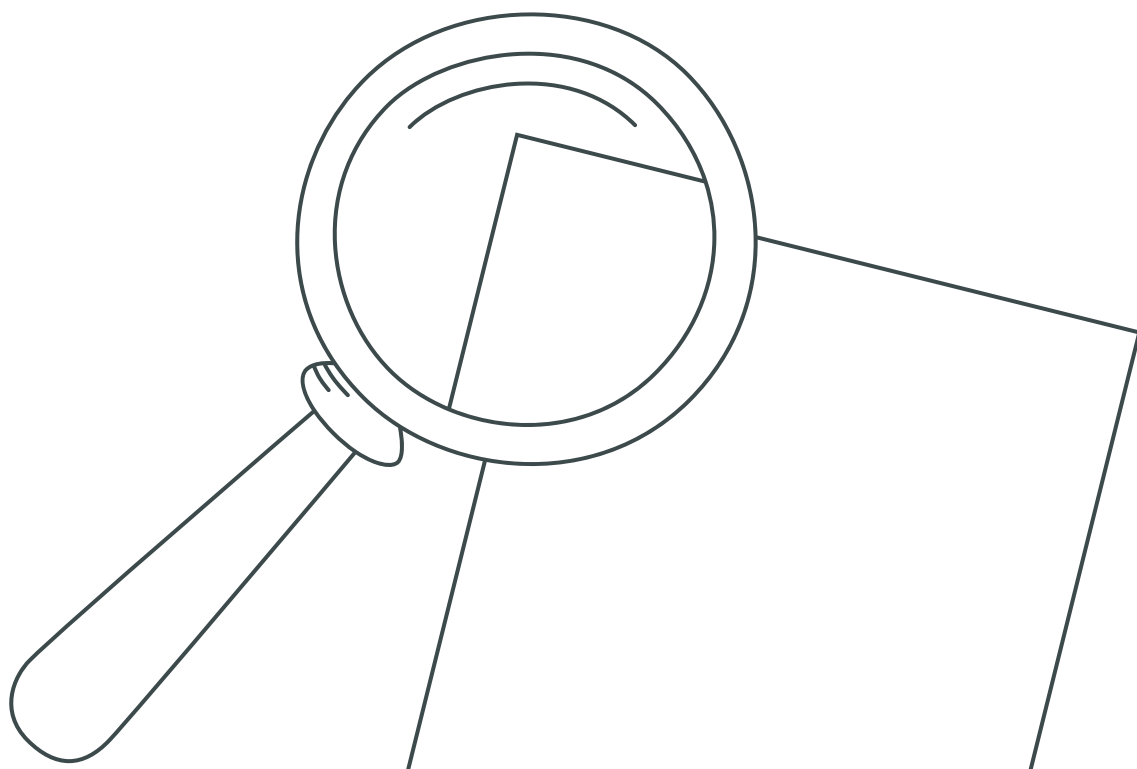
## **E.6 Any other information**

There is no additional material information regarding the capital management of the Society to report in this section.

# Solvency and Financial Condition Report

## Disclosures

31 December 2022



(Monetary amounts in GBP thousands)

## General information

<b>Undertaking name</b>	The Shepherds Friendly Society Ltd
<b>Undertaking identification code</b>	2138008DYCUY8QSADI25
<b>Type of code of undertaking</b>	LEI
<b>Type of undertaking</b>	Life undertakings
<b>Country of authorisation</b>	GB
<b>Language of reporting</b>	en
<b>Reporting reference date</b>	31 December 2022
<b>Currency used for reporting</b>	GBP
<b>Accounting standards</b>	Local GAAP
<b>Method of Calculation of the SCR</b>	Standard formula
<b>Matching adjustment</b>	No use of matching adjustment
<b>Volatility adjustment</b>	No use of volatility adjustment
<b>Transitional measure on the risk-free interest rate</b>	No use of transitional measure on the risk-free interest rate
<b>Transitional measure on technical provisions</b>	No use of transitional measure on technical provisions

## List of reported templates

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



Balance sheet		
	Assets	Solvency II value C0010
R0030	Intangible assets	
R0040	Deferred tax assets	
R0050	Pension benefit surplus	312
R0060	Property, plant & equipment held for own use	0
R0070	Investments (other than assets held for index-linked and unit-linked contracts)	74,083
R0080	Property (other than for own use)	0
R0090	Holdings in related undertakings, including participations	0
R0100	Equities	0
R0110	Equities - listed	
R0120	Equities - unlisted	
R0130	Bonds	0
R0140	Government Bonds	0
R0150	Corporate Bonds	0
R0160	Structured notes	0
R0170	Collateralised securities	0
R0180	Collective Investments Undertakings	74,083
R0190	Derivatives	0
R0200	Deposits other than cash equivalents	0
R0210	Other investments	0
R0220	Assets held for index-linked and unit-linked contracts	39,267
R0230	Loans and mortgages	0
R0240	Loans on policies	0
R0250	Loans and mortgages to individuals	
R0260	Other loans and mortgages	
R0270	Reinsurance recoverables from:	9,556
R0280	Non-life and health similar to non-life	0
R0290	Non-life excluding health	
R0300	Health similar to non-life	
R0310	Life and health similar to life, excluding index-linked and unit-linked	9,556
R0320	Health similar to life	(2,447)
R0330	Life excluding health and index-linked and unit-linked	12,003
R0340	Life index-linked and unit-linked	0
R0350	Deposits to cedants	0
R0360	Insurance and intermediaries receivables	288
R0370	Reinsurance receivables	
R0380	Receivables (trade, not insurance)	
R0390	Own shares (held directly)	
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in	0
R0410	Cash and cash equivalents	8,352
R0420	Any other assets, not elsewhere shown	
R0500	Total assets	131,859

Balance sheet		
	Liabilities	Solvency II value C0010
R0510	Technical provisions - non-life	0
R0520	Technical provisions - non-life (excluding health)	0
R0530	TP calculated as a whole	
R0540	Best Estimate	
R0550	Risk margin	
R0560	Technical provisions - health (similar to non-life)	0
R0570	TP calculated as a whole	
R0580	Best Estimate	
R0590	Risk margin	
R0600	Technical provisions - life (excluding index-linked and unit-linked)	74,514
R0610	Technical provisions - health (similar to life)	(34,370)
R0620	TP calculated as a whole	0
R0630	Best Estimate	(38,993)
R0640	Risk margin	4,623
R0650	Technical provisions - life (excluding health and index-linked and unit-linked)	108,884
R0660	TP calculated as a whole	0
R0670	Best Estimate	107,990
R0680	Risk margin	894
R0690	Technical provisions - index-linked and unit-linked	37,379
R0700	TP calculated as a whole	39,267
R0710	Best Estimate	(1,888)
R0720	Risk margin	0
R0740	Contingent liabilities	
R0750	Provisions other than technical provisions	
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	
R0780	Deferred tax liabilities	
R0790	Derivatives	0
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	
R0820	Insurance & intermediaries payables	321
R0830	Reinsurance payables	
R0840	Payables (trade, not insurance)	363
R0850	Subordinated liabilities	0
R0860	Subordinated liabilities not in BOF	
R0870	Subordinated liabilities in BOF	0
R0880	Any other liabilities, not elsewhere shown	3,520
R0900	Total liabilities	116,096
R1000	Excess of assets over liabilities	15,763

## Premiums, claims and expenses by line of business

Life		Line of Business for: life insurance obligations						Life reinsurance obligations		Total
		Health insurance	Insurance with-profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Annuities stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life reinsurance	
		C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300
Premiums written										
R1410	Gross	7,819	23,569	389	11,284					43,060
R1420	Reinsurers' share	209			1,823					2,032
R1500	Net	7,610	23,569	389	9,460					41,028
Premiums earned										
R1510	Gross	7,819	23,569	389	11,284					43,060
R1520	Reinsurers' share	209			1,823					2,032
R1600	Net	7,610	23,569	389	9,460					41,028
Claims incurred										
R1610	Gross	4,880	10,976	348	1,577					17,781
R1620	Reinsurers' share	28			1,096					1,123
R1700	Net	4,852	10,976	348	482					16,658
Changes in other technical provisions										
R1710	Gross									0
R1720	Reinsurers' share									0
R1800	Net	0	0	0	0					0
R1900	Expenses incurred	7,028	5,937	99	1991					15,054
R2500	Other expenses									
R2600	Total expenses									15,054

Life and Health SLT Technical Provisions																	
		Insurance with-profit participation	Index-linked and unit-linked insurance			Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, including Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)
				Contracts without options and guarantees	Contracts with options or guarantees		Contracts without options and guarantees	Contracts with options or guarantees					Contracts without options and guarantees	Contracts with options or guarantees			
			C0020	C0030	C0040	C0050	C0060	C0070				C0080	C0090	C0100			
R0010	Technical provisions calculated as a whole		39,267								39,267						0
R0020	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole										0						0
Technical provisions calculated as a sum of BE and RM																	
Best estimate																	
R0030	Gross Best Estimate	71,315		(1,888)			7,266	29,409			106,102		(53,604)	14,610			(38,993)
R0080	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default						12,003				12,003		(2,447)				(2,447)
R0090	Best estimate minus recoverables from reinsurance/SPV and Finite Re	71,315		(1,888)	0		(4,737)	29,409			94,098		(51,157)	14,610			(36,546)
R0100	Risk margin	0	0			894					894	4,623					4,623
Amount of the transitional on Technical Provisions																	
R0110	Technical Provisions calculated as a whole										0						0
R0120	Best estimate										0						0
R0130	Risk margin										0						0
R0200	Technical provisions - total	71,315	37,379			37,569					146,262	(34,370)					(34,370)

## Own Funds

		Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
		C0010	C0020	C0030	C0040	C0050
<b>Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35</b>						
R0010	Ordinary share capital (gross of own shares)	0	0		0	
R0030	Share premium account related to ordinary share capital	0	0		0	
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings	0	0		0	
R0050	Subordinated mutual member accounts	0		0	0	0
R0070	Surplus funds	0	0			
R0090	Preference shares	0		0	0	0
R0110	Share premium account related to preference shares	0		0	0	0
R0130	Reconciliation reserve	15,763	15,763			
R0140	Subordinated liabilities	0		0	0	0
R0160	An amount equal to the value of net deferred tax assets	0				0
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above	0	0	0	0	0
R0220	<b>Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds</b>	0				
R0230	<b>Deductions for participations in financial and credit institutions</b>	0	0	0	0	
R0290	<b>Total basic own funds after deductions</b>	15,763	15,763	0	0	0
<b>Ancillary own funds</b>						
R0300	Unpaid and uncalled ordinary share capital callable on demand	0				
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand	0				
R0320	Unpaid and uncalled preference shares callable on demand	0				
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand	0				
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	0				
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	0				
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	0				
R0390	Other ancillary own funds	0				
R0400	<b>Total ancillary own funds</b>	0			0	0

Available and eligible own funds						
R0500	Total available own funds to meet the SCR	15,763	15,763	0	0	0
R0510	Total available own funds to meet the MCR	15,763	15,763	0	0	
R0540	Total eligible own funds to meet the SCR	15,763	15,763	0	0	0
R0550	Total eligible own funds to meet the MCR	15,763	15,763	0	0	
R0580	SCR	9,204				
R0600	MCR	3,445				
R0620	Ratio of Eligible own funds to SCR	171.27%				
R0640	Ratio of Eligible own funds to MCR	457.61%				
Reconciliation reserve		C0060				
R0700	Excess of assets over liabilities	15,763				
R0710	Own shares (held directly and indirectly)	0				
R0720	Foreseeable dividends, distributions and charges					
R0730	Other basic own fund items	0				
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	0				
R0760	Reconciliation reserve	15,763				
Expected profits						
R0770	Expected profits included in future premiums (EPIFP) - Life business	57,938				
R0780	Expected profits included in future premiums (EPIFP) - Non- life business					
R0790	Total Expected profits included in future premiums (EPIFP)	57,938				

Solvency Capital Requirement - for undertakings on Standard Formula				
		Gross solvency capital requirement	USP	Simplifications
		C0110	C0090	C0120
R0010	Market risk	14,067		
R0020	Counterparty default risk	896		
R0030	Life underwriting risk	3,113	9	
R0040	Health underwriting risk	12,263	9	
R0050	Non-life underwriting risk	0	9	
R0060	Diversification	(7,997)		
R0070	Intangible asset risk	0		
R0100	Basic Solvency Capital Requirement	22,343		
Calculation of Solvency Capital Requirement		C0100		
R0130	Operational risk	1,689	<b>USP Key</b>	
R0140	Loss-absorbing capacity of technical provisions	(14,828)		
R0150	Loss-absorbing capacity of deferred taxes		<b>For life underwriting risk:</b>	
R0160	Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC	0	1 – Increase in the amount of annuity benefits	
R0200	Solvency Capital Requirement excluding capital add-on	9,204	9 – None	
R0210	Capital add-ons already set	0	<b>For health underwriting risk:</b>	
R0220	Solvency capital requirement	9,204	1 – Increase in the amount of annuity benefits	
Other information on SCR			2 – Standard deviation for NSLT health premium risk	
R0400	Capital requirement for duration-based equity risk sub-module	0	3 – Standard deviation for NSLT health gross premium risk	
R0410	Total amount of Notional Solvency Capital Requirements for remaining part	0	4 – Adjustment factor for non-proportional reinsurance	
R0420	Total amount of Notional Solvency Capital Requirements for ring fenced funds	0	5 – Standard deviation for NSLT health reserve risk	
R0430	Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios	0	9 – None	
R0440	Diversification effects due to RFF nSCR aggregation for article 304	0	<b>For non-life underwriting risk:</b>	
Approach to tax rate		C0109	4 – Adjustment factor for non-proportional reinsurance	
R0590	Approach based on average tax rate	0	6 – Standard deviation for non-life premium risk	
Calculation of loss absorbing capacity of deferred taxes		LAC DT	7 – Standard deviation for non-life gross premium risk	
		C0130	8 – Standard deviation for non-life reserve risk	
R0640	LAC DT		9 – None	
R0650	LAC DT justified by reversion of deferred tax liabilities	0		
R0660	LAC DT justified by reference to probable future taxable economic profit	0		
R0670	LAC DT justified by carry back, current year	0		
R0680	LAC DT justified by carry back, future years	0		
R0690	Maximum LAC DT	0		

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

Linear formula component for non-life insurance and reinsurance obligations		C0010		
R0010	MCR <sub>NL</sub> Result	0		
			Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
			C0020	C0030
R0020	Medical expense insurance and proportional reinsurance			
R0030	Income protection insurance and proportional reinsurance			
R0040	Workers' compensation insurance and proportional reinsurance			
R0050	Motor vehicle liability insurance and proportional reinsurance			
R0060	Other motor insurance and proportional reinsurance			
R0070	Marine, aviation and transport insurance and proportional reinsurance			
R0080	Fire and other damage to property insurance and proportional reinsurance			
R0090	General liability insurance and proportional reinsurance			
R0100	Credit and suretyship insurance and proportional reinsurance			
R0110	Legal expenses insurance and proportional reinsurance			
R0120	Assistance and proportional reinsurance			
R0130	Miscellaneous financial loss insurance and proportional reinsurance			
R0140	Non-proportional health reinsurance			
R0150	Non-proportional casualty reinsurance			
R0160	Non-proportional marine, aviation and transport reinsurance			
R0170	Non-proportional property reinsurance			
Linear formula component for life insurance and reinsurance obligations		C0040		
R0200	MCR <sub>L</sub> Result	(1,222)		
			Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
			C0050	C0060
R0210	Obligations with profit participation - guaranteed benefits		30,193	
R0220	Obligations with profit participation - future discretionary benefits		55,731	
R0230	Index-linked and unit-linked insurance obligations		37,379	
R0240	Other life (re)insurance and health (re)insurance obligations			
R0250	Total capital at risk for all life (re)insurance obligations			424,177
Overall MCR calculation		C0070		
R0300	Linear MCR	(1,222)		
R0310	SCR	9,204		
R0320	MCR cap	4,142		
R0330	MCR floor	2,301		
R0340	Combined MCR	2,301		
R0350	Absolute floor of the MCR	3,445		
R0400	Minimum Capital Requirement	3,445		





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