Police Mutual Group

Annual Report & Financial Statements 2018

Company No. 727F

Contents

Chair’s Statement

Introduction and Purpose of the Group

In 1866, serving Police officers formed an organisation run by the Police for the benefit of the Police and their families and this was expanded to the Military in 2014. I have had the privilege of being Chair of Police Mutual since May 2011, and this is the final time I will present the Annual Report before I step down.

We are a financial services mutual with the intent to make it simpler for our Members to obtain financial services that meet their needs, and we give back further to our Members by providing free educational services, health checks and respite care through the Police Mutual Foundation set up in 2011. To deliver the Group’s purpose we need to ensure that the Group can meet its ongoing regulatory capital requirements and that it can fund all ongoing liabilities, as they arise, from the income that it generates, without requiring ongoing funding from its capital reserves. In practice, this means that the Group should cover all its costs whether they are operational costs in running the business, investment and development costs for system and process enhancements and other liabilities such as enhanced payments to the pension scheme to cover any funding deficit.

When I became Chair the Group was much smaller, and over the years we have grown through diversifying our products and acquiring businesses that support our Members’ needs. This diversification strategy was agreed by the Board to support the strategic intent of strengthening the Society’s capital. Benefits for Members were expected through delivering a broader service and lower overall costs which would benefit Members through lower prices or “give back” through the Foundation but also allow investment in the business and ultimately a stronger capital base.

Against these strategic aims the results have been mixed. Whilst benefits have been delivered to Members in providing wider support for their financial needs, the Group has continued to make losses. Some of these losses reflect costs from the diversification strategy, including one off costs in relation to the acquisitions, system developments and investment to strengthen our internal risk capabilities but also reflect unforeseen costs such as The Military Mutual case that we won this year, increased regulatory reviews that required external support and writing off historic project costs that have not delivered the intended benefits. Additionally, with the introduction of the Solvency II capital regime in 2016, the ongoing low base rate environment, the purchase of Abacus in 2016 and higher capital requirements supporting our personal lending proposition, our capital position has not strengthened to a level that we are yet comfortable with.

Performance of the Group and the Economic Environment Impacts

2018 has been another difficult year for the Group. Last year in our report we identified issues that required actions to be taken to reduce costs and write off historic projects that had not delivered the benefits expected, and we committed to continue to simplify the business throughout 2018 recognising that acquisitions and other investments have reduced our capital surplus over the past few years.

This focus on rightsizing the business has resulted in the Group reducing its in year operating loss (pre actuarial adjustments for investment and Life Fund experience and changes in future assumptions) to £2m. The losses have been reduced through lower staff costs, rationalisation of locations, supplier consolidation and retendering of commercial contracts but we need to do more than this to put the Group into a position that allows it to withstand any capital strains from market shocks and to invest to meet our Members’ needs without requiring ongoing capital funding.

Whilst good progress has been made on costs, income growth has been more difficult and we have seen the Military Affinity have a significant reduction in sales in the year. A review has been undertaken and we are taking corrective actions to restructure the business to match the new environment. We will continue this focus into 2019 with further cost savings expected, but also reviewing our Member proposition and products offered as part of a wider strategic review. Further discussion on the financial performance of the Group is included in the Chief Executive’s Statement.

In 2018 the UK and Global macro-economic environment experienced significant volatility reflecting market nervousness on the outcome of Brexit and the threat of a global economic slowdown. As our investment fund is invested across global equities (quoted on the US, UK, Japanese and European Stockmarket indices), UK property, corporate bonds and cash, it was impacted by the equity volatility in the last month of the year which resulted in most equity indices ending lower than at the start of the year. This impacted the 2018 investment returns on our Life fund with the Fund reporting a negative 3.8% return against 2017 positive return of 10.8%. This dampened the 5 year performance return to 4.5% p.a. for our with-profits policies but we have already seen markets bounce back from the year end low.

The drop in equity markets means that we have to hold higher cash reserves in the event that guarantees are required to be paid and this has contributed £9.2m to the reduction in the Fund for Future Appropriations (the FFA) in 2018. The FFA has reduced to £113m and our Solvency Capital Ratio is 156% as at the end of 2018.

Not withstanding all the changes experienced internally in the Group through the acquisitions, cost saving initiatives and changes in the Executive, I’m pleased to report that our Net Promoter Score (a measure of customer loyalty based on the quality of their relationships) has remained very high at 44 (prior year 42). Additionally 83% of our Police Members would recommend us, which is exceptionally high compared to other financial services companies and the industry average.

Risk Management

The regulatory environment in which the Group operates continues to be complex and demanding. The Group expanded its risk and compliance functions during 2017, enabling the Group to improve its risk culture, awareness and reporting as well as being better equipped to respond to requests from our regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Demonstrating financial strength and ongoing controls and oversight will continue to be a key element of our ongoing dialogue with the PRA, in common with other firms in our sector.

During 2018 we successfully implemented the changes required under the General Data Protection Regulation (GDPR) and the Insurance Distribution Directive (IDD) and implemented new Key Risk Indicators across the business, but we need to embed them further in the business during 2019.

Improving Lives

Demonstrating financial strength, ongoing controls and oversight to ensure that the Group delivers its financial and regulatory responsibilities enables us to deliver our purpose, namely to “improve the lives” of the Police and the Military.

We believe we’re able to demonstrate a holistic approach that improves lives and makes a real, tangible difference to the wellbeing of our Police and Military Affinities by focusing on four key areas:

- Financial;
- Physical;
- Mental; and
- Community Wellbeing.

In 2018, we delivered over 900 free financial education courses, helping over 14,700 Police officers and staff to make sense of their finances. We funded around 1,900 health screenings across the UK, helped 85 families with a respite break and made 96 referrals to our Care Line, helping Police employees and their family members with a range of health issues. In addition, we supported 234 community projects through our Force For Good programme, provided funding for major policing events such as the Police Bravery Awards and helped causes including the UK Police Memorial and the Care of Police Survivors (COPS) charity. We were also pleased to continue running our BeFit4Life initiative, delivering 201 events to 127 stations in 34 forces. This activity included our famous Land Rover events, where we provided Police officers and staff with a chance to talk to us about their finances, as well as offering money management courses and mortgage and retirement clinics.

For members of the Military family we delivered 545 free financial education sessions, offering information and guidance through workshops, and both one-to-one and group briefings, helping 3,344 individuals to understand the importance of taking control of their finances to protect their future. We also helped 43 families take much

Chair's Statement (continued)

Improving Lives (continued)

needed time out on respite breaks. In addition, we sponsored over 50 sports teams, events and activities such as the Army Ladies' Hockey Team, Royal Navy Field Gun competition, Royal Navy Rugby League, Royal Navy Boxing and RAF Hockey.

Governance and the Board

The Board continues to operate rigorous oversight of the Business through regular Board meetings and through the sub-committees providing oversight and challenge to ensure the agenda and aims for the Risk, Audit, Investment, Remuneration, Nomination and With-Profits Committees are delivered.

Our Group Chief Executive, Stephen Mann, took the decision to stand down having been in post for almost ten years and left the Group in December. I would like to thank Stephen for the contribution he made both to the Group and for his support of the wider Police family and wish him well for the future.

Mike Kirsch has been appointed as Interim Chief Executive and will remain until April, when John Perks will take the CEO role on a permanent basis. John joins the Group from LV (Liverpool Victoria) where he has been Managing Director, Life & Pensions and his extensive experience will be invaluable in helping shape the future for the Group.

I have also taken the decision to stand down as Chair and this will be effective in May 2019. Julie Hopes, who has been a Non-Executive director since May 2014, will succeed me and I wish her great success.

Looking Ahead and Future Strategic Direction

Whilst we have made significant progress this year in rightsizing our Group, the environment in which we operate has changed significantly in the last few years with the introduction of Solvency II and the capital now required to support a with-profits business. The Board has requested that the Executive undertakes a strategic review of the Group, reviewing options for what the future could look like for our Members, taking into account their needs, our capabilities and our industry environment. The outcomes of this work will be presented to the Board in the first half of 2019 and we will develop and agree the future direction of the Group.

In closing, on behalf of our Board and Committee of Management, I would like to thank colleagues across the Group, our Volunteer Authorised and Force Authorised Officers, along with our distribution and business partners for their support in delivering and contributing to our 2018 results.

I have been honoured to be Chair and I wish all our Members and Police Mutual success in the years to come.

Chief Executive's Statement
2018 Highlights

£717m
Total Assets under management (2017: £827m)

£113m
Fund for Future Appropriations which represents our financial strength (2017: £133m)

491
Number of employees supporting our Affinities (2017: 552)

89%
Annual retention rate on our motor and home insurance products which compares favourably to the industry

£300k
Paid out to support our Police Foundation

£125m
Maturing Policies paid out to Members

19,500
Number of healthcare members who received payouts

1,145
Free educational seminars provided to our Affinities

Chief Executive's Statement (continued)

Our Business Model

Police Mutual is a financial services mutual providing financial services and financial wellbeing support to the Police and has been operating since 1866. It was originally set up for the Police by the Police Service to provide financial and welfare support to colleagues and their families in time of need and we continue to do so. This was expanded in 2014 to offer services to the Military.

Police Mutual is overseen by the Committee of Management who are either serving or former Police officers or Police staff or professionals with relevant life company experience. They provide invaluable support and insight into the issues that our Members are facing and how they impact their financial needs.

Improving the lives of our Members and our customers is at the heart of everything we do and whilst times may have changed that belief is core to everything that we do.

We offer the following products to our Members and customers through our teams who can deliver support face to face or via the telephone or online.

Supporting our Members' and Customers' financial needs by			
Saving for Your Future	**Insurance for you**	**Protection For You**	**Helping you Borrow**
• Regular Savings Plan	• Home insurance	• Mortgage Protection	• Personal Loans
• Fixed Term ISA	• Motor Insurance	• Life Cover	• Residential Mortgages
• Protected Growth ISA	• Travel Insurance	• Critical Illness Cover	• Buy to Let Mortgages
• Anytime Access ISA	• Kit Insurance	• Private Healthcare	**Advice for your Future**
• Stakeholder Pension	• Renters' Insurance	• Personal Accident	• Independent Financial Advice
Supported by the Foundation providing			
• Free financial education sessions			
• Free BeFit4Life health checks			
• Donations and sponsorships supporting Force for Good and Forces Mutual events			

2018 Strategic and Operational Review

As ever, a key priority remains keeping Members' interests and the business interests aligned. It is fair to say that 2018 has been a difficult year for most businesses to navigate with the Brexit uncertainty, the ongoing US political environment and investment market volatility at the end of the year. Whilst the equity markets' volatility impacts the returns for our Members' savings and the economic environment can impact our Members' confidence in saving and investing for their future, the main risks for our business model relate to our ability to be relevant to our Members and ensure that we provide financial products at a fair price.

Throughout 2018 we focused on the strategic aims that we set in 2017, being to simplify and consolidate the business after a period of acquisitions, increase our capital strength and enhance our risk management capabilities. The key progress against these aims in 2018 has been:

- Against our strategic aim of strengthening our capital through reducing losses, good progress has been made in rightsizing the business and we have reduced our underlying operational cost base (excluding write offs in 2017) by 24% year on year. This has been delivered through headcount reduction, consolidating our suppliers and good cost discipline. We continue to seek ways to create efficiencies whilst balancing the focus on maintaining Member services and supporting our Affinities more broadly.
- We also announced our decision to exit our Basingstoke office from 2020 which now sees our office footprint reduced from eight to two in the past two years and further cost savings are expected in 2019.
- Additionally we took further action to enhance our capital strength by purchasing put options (this provides a right to sell a specified amount of an underlying security at a specified price/time) which provided a capital benefit.
- We also reviewed our investment manager mandate and moved from a multi-manager model to a single manager to manage our investments across all sectors and markets. In December 2018, the bulk of the investments in our Life Fund were transferred to Bank of Montreal (BMO) who were awarded the investment mandate and this will reduce costs for our Life Members through lower investment management fees.

We continue to review our products to ensure that they are meeting Member needs and the following are key to note for 2018 and 2019:

- There continues to be much focus on motor and household insurance prices, specifically about the price differential between new and renewal business. We are fully supportive of the FCA investigations and are aligned with the ABI guiding principles and action points (GPAPs) for general insurance pricing. Police Mutual works with our Insurer Partner to ensure that a fair price is offered to Members whether they are new or existing and irrespective of their tenure with us.
- We have built on-line Military insurance products for motor, kit and contents and are offering stand alone protection and young driver insurance products launching in 2019.
- Through our healthcare scheme in 2018 we paid for 19,509 treatments for our Members who receive treatment within an average of 6 to 7 weeks, saving 12 weeks compared to average NHS wait times.
- During 2018 we closed the Children's Bond but are seeking alternatives for our Members.
- For Regular Savings Plan policies that matured in 2018 the return generated was 4.1% p.a., (based on a male, aged 30 next birthday paying £50 per month over a 10 year term).

Chief Executive's Statement (continued)

2018 Strategic and Operational Review (continued)

We have also progressed our internal risk framework to match an ever increasing regulatory and control environment and continue to make progress against delivering within our risk appetite. We continue to have regular and transparent conversations with our key regulators, the PRA and FCA, and there was further good progress in 2018 on embedding and maturing the work begun the year before which included:

- A review of the effectiveness of the Risk Committee and providing the Chair's attestation of skills the Group has in place to meet regulatory expectations;
- Reviews of the progress made against the implementation of the agreed target operating models for the risk and compliance functions and of the Group which indicated strong progress had been made;
- Refreshing and refinement of our risk appetite statements and reporting against our "path to green" initiatives designed to ensure that the Group operates within these risk appetites;
- Improvements in risk reporting and in risk "culture";
- Education and training across the business to underline how risks are managed and better define individuals' roles and responsibilities. A key focus was in ensuring that the Group and key individuals were ready for the introduction of the Senior Managers Certification Regime which is designed to increase standards and individual accountability.
- Our readiness for the possibility of Brexit has also been the subject of requests from regulators. Much of the regulators' interest is now on testing firms' operational resilience particularly in light of the recent TSB IT failures and keeping the organisation safe from cybercrime remains a high profile topic and is an important area for us.

That said, requirements and expectations continue to change and we are focusing on our total financial strength and the level of liquid assets we hold to cover our core regulatory requirements. The latter has been put under pressure given the impact of investments in projects and acquisitions made since 2014 and the ongoing need to hold capital for our guaranteed products which increased with the equity market volatility at the end of the year.

2018 Financial Results

Compared to 2017 we have made progress in reducing losses but posted an operational loss (pre actuarial adjustments for investment and Life Fund experience and changes in future assumptions) of £2m for 2018.

The table below reconciles the group operating loss to the transfer from the Fund for Future Appropriations. The FFA represents the excess of our assets over liabilities and is a measure of our financial strength. The group operating loss reflects the underlying performance of all our products and subsidiaries and is how we measure performance internally. The difference between the two is driven by items that are not reported as part of our operational loss and relates to impacts of investment fluctuations on the asset values held in the Life Fund and on our Balance Sheet, actuarial modelling and assumption changes that calculate our best estimate of liabilities including the cost of guarantees and the Staff Pension Fund valuation. Of the movement in the year c£13.5m relates to the Life fund reflecting impacts of changes to investment and operational experience in running the Fund and future assumptions that impact the current liabilities of the Fund.

Group Operating Loss reconciliation to Movement in FFA - £'m	**2018**
Group Operating Loss for the Year	**(2.2)**
Effect of investment experience including on assets backing FFA and cost of guarantees	(2.9)
Net impact of operating experience including net impact of tax changes, surrenders, maturities and new business strain	(12.1)
Net impact of changes in future assumptions	1.5
Other movements	(2.3)
Transfer from the Group FFA	**(18.0)**

Within these results, income generated was £37m, 5% lower than 2017 but with Police income at £30m reflecting growth of 10% and Military income at £7m reflecting a 40% reduction year on year. Income includes all charges made to the Life policy holders in relation to maintenance and acquisition costs in the year plus commission income received on general insurance sales, IFA advice, healthcare subscriptions after claims and mortgage and personal loan introductions.

The Police Affinity growth reflects increased maintenance charges on our Life products, the benefit from higher commission rates as part of our renegotiated contract with our general insurance strategic partner RSA, increased income from IFA sales and increased healthcare income (net of claims). Offsetting this was the Military Affinity performance which has been impacted by lower recruitment in the Army resulting in fewer briefings and therefore lower sales to recruits. The 2017 income also included a one off profit share of £1.1m whilst in 2018 we booked a provision of £1.2m against income reflecting higher cancellation rates on our Vitality Life product to reflect repayments we expect to make over the next four years. Even taking this into account the year on year reduction on income was 22% which has been disappointing and the Military business is under review.

Our general insurance cover for home and motor continues to have substantially higher retention rates when compared to the market of 87% and 89% respectively and we have seen increased demand for our mortgage, IFA and healthcare offering when compared to 2017.

Total costs at £39m (including operational costs, change costs and investment fees) reduced by 24% when compared to last year (excluding 2017 write offs of historic investments). This has been delivered through the transformation programme which delivered lower headcount and lower third party and change spend. Further savings are expected in 2019 through new initiatives and the benefit of the full year annualised savings from the 2018 initiatives.

Chief Executive's Statement (continued)

2018 Financial Results (continued)

Our capital position as at 31 December 2018 was 156% of our solvency capital requirement and as mentioned earlier, there has been increased focus on the liquidity and quality of our capital with the aim to strengthen both. The drop in equity markets in the last month of the year triggered our internal KPIs as we temporarily breached our internal risk appetite of 150% of Solvency Capital Requirement (SCR) and we subsequently bought further capital protection through the purchase of put options. As well as this, after the year end we temporarily reduced our Equity Backing Ratio (EBR) to 50% which is within the PPFM (Principles and Practices of Financial Management) stated range. Markets have since recovered although further volatility is anticipated with the final Brexit outcome expected in 2019.

At the beginning of 2018, an agreement was reached with the Trustee of the Staff Pension Fund to address the deficit in the pension fund by making an annual capital contribution of £3m for six years.

Our People and Culture

Our colleagues deliver service and support to our Members that consistently receives positive personal feedback. Our people plans across 2018 recognised that our colleagues will need to operate in different ways to meet changing needs but that we need to live and breathe our values through this change.

They also recognised the importance of being an integral and supportive part of the restructuring of the business which completed in the first half of the year and saw a reduction of senior roles by about a third and the closure and/or relocation of other parts of the business.

All of us better than one of us

By working together we can do more for our Members and our colleagues helping all of us do the right thing more often.

Think commercial. Act commercial

We mean business. And by being great at the business of business is the best way of supporting the Police family individually for years to come. It is our job to find ways to help them today, tomorrow, forever.

Be the best

We set our own standard. We are not judged by anyone else. Every day we relentlessly challenge ourselves to be better. Better than we were yesterday. Better than others who seek to serve our Members.

Wired to care

A deep understanding of those we serve and work with is second nature to us. Intuitive. We do the right thing and doing right by those we serve and work with always feels right and worthwhile. We know how to best serve, support and help customers and colleagues.

A big focus was on developing the leadership team through investing in a major programme of task orientation training and support and we hope to see the benefits of this and a more consistent and effective approach to working in 2019, supported by a new learning and development platform.

Our annual engagement survey took place in October, and again we received a high level of participation with 79% of colleagues taking the opportunity to participate. We have maintained our "One to Watch" classification in the Best Companies Engagement Index which is evidence of good levels of engagement. This was a pleasing result in a year when there was a lot of change affecting colleagues including job losses and an office closure and as the survey took place immediately after the announcement of the CEO's resignation.

Headcount has reduced by 11% and at the end of 2018 was 491 on a full time equivalent basis.

Focus for 2019

As our Chair references, we are currently reviewing the strategic direction of the Group and expect to present our recommendations in the first half of 2019. The review will respond to the ongoing challenges that we face with increasing regulatory expectations requiring greater capital strength and being able to demonstrate high standards of conduct and risk management, which ultimately have increased the costs of running the Society.

We need to ensure that the Society can meet these needs and deliver our ultimate purpose, namely to "improve the lives" of the Police and the Military. Whilst this review will inform our strategic direction, in the interim our focus for 2019 will continue to be on serving our Members whilst rightsizing our cost base and strengthening the amount and quality of capital on our Balance Sheet.

After just three months as your interim CEO, I can say that I am sorry to be leaving in early April at such a critical time for the organisation. I would however like to pass on my best wishes for the future to the new permanent CEO John Perks and the Executive team.

Risk Management Report

The Managing Board has over the course of 2018 exercised appropriate governance over the principal risks facing Police Mutual which could impact its financial soundness, Members and customers, or organisational capability. In discharging its governance duties, during 2018 the Managing Board:

- reviewed and approved a revised risk appetite statement setting out which risks it wished to take and avoid;
- discussed and agreed the principal risks as well as the circumstances that could threaten the longer term viability of Police Mutual's business and successful delivery of the annual business plan and strategy;
- monitored and challenged, where appropriate, management of these principal risks, changes in the risk profile of the business and progress of mitigation actions taken to address those risk exceptions identified during the year;
- periodically reviewed Police Mutual's progress towards operating within the desired risk appetite range;
- approved the implementation of a revised investment strategy and operating model commensurate with protecting the interests of our Members;
- approved the business' solvency and capital requirements; and
- reviewed and approved those key risk policies as appropriate for governance of risks and smooth running of the business.

The Managing Board is supported by the work of its sub-committees that include the:

- Investment Committee for oversight and delivery of the investment strategy;
- Audit Committee for oversight of the financial reporting process, the integrity of financial statements and information, and the internal systems of control;
- Risk Committee for oversight of the Chief Executive in managing the business in accordance with risk appetite;
- Remuneration Committee for oversight of the framework and policy for Executive remuneration; and
- With-Profits Committee that provides in the main an independent assessment of compliance with the Principles and Practices of Financial Management.

Police Mutual adopts an enterprise-wide risk management framework to ensure that it manages risks effectively. This is underpinned by the three lines of defence model which ensures independent oversight and audit of risk management carried out by the business. The Managing Board has noted material improvements in the effectiveness of the Risk function and in risk reporting at Executive and Board level have been achieved during the year, which have assisted in addressing the previously recognised shortcomings in the business' overall risk management and internal control systems. Nonetheless, the Managing Board has requested that the Chief Executive continues to make proportionate risk management and internal control improvements so as to ensure that desirable risk outcomes are achieved.

The principal risks facing the business are set out below.

Market Risk (including credit): Risk of fluctuations in values of, or income from, assets or in interest arising from fluctuations in interest rates and other market rates which can affect the value of the Group's investments and therefore the size of its assets and solvency position. This includes the risk of loss arising from the default or failure of third parties to meet their financial obligations or variations in market values against expectations related to these risks.

(Life) Insurance Risk: Risk of fluctuations in the timing, frequency and severity of insured events relative to the expectations at the time of underwriting or when set against the claims settled.

Liquidity Risk: Risk that the Group, whether solvent or not, either does not have available sufficient financial resources to meet its obligations as they fall due, or can secure them only at excessive cost.

Capital Risk: Risk of not maintaining sufficient quality, quantity and liquidity of capital commensurate with the effective delivery of the Group's business strategy.

Conduct Risk: Risk of customer detriment which may occur throughout the customer relationship and that has resulted from the Group's conduct and/or behaviour; and failure to deliver against its values, business strategies and its obligations for the prevention of financial crime.

Operational Risk: Risk of loss resulting from inadequate or failed internal processes, systems, human factors or due to external events.

For each of these principal risks, the Managing Board has determined a formal statement of risk appetite which sets out the levels of risk it is prepared to take in pursuit of achieving Police Mutual's fundamental purpose and established a framework for decision making. Performance is reviewed regularly against this statement to ensure that the business takes appropriate action to operate within its risk appetite.

Internal Audit

During 2018 the Audit Committee reviewed periodically the adequacy, scope and performance of the internal audit function through consideration and endorsement of its target operating model, charter, annual plan and regular updates thereof in addition to the results of its audit activity. The Chief Internal Auditor attends the meetings of the Audit Committee and provides advice on the adequacy of Police Mutual's internal control environment in support of the Committee's challenge of management and its formal, annual control assessment.

Brexit

Police Mutual have been considering the potential outcomes and impacts of Brexit for some time. Whilst the outcome remains uncertain the business analysis shows that it will have a relatively minor impact on the Society's customers, staff and operations.

Risk Management Report (continued)

In addition, Police Mutual manages each of these principal risks through adopting policies, controls and mitigation activities as summarised in the following table:

Risk types	Key aspects of risks	Key controls and risk mitigation activities
Market Risk (including Credit)	• Equity and property market falls • Equity volatility • Bond volatility • Fall and rise in bond yields • Currency movements • Inflation (staff pension fund risk) • Exposures relating to holdings in corporate bonds and cash deposits • Defaults in key strategic partners, • counterparties and reinsurers	• Market Risk (including credit) Policy and risk limits in place. • Diversified portfolio of asset types within which the investment manager operates. • Regular monitoring of markets and solvency triggers including five year gilt yields and unit price. • Currency hedging strategy in place and weekly review and rebalancing of currency hedges. • Agreed (and implemented) Staff Pension Fund deficit funding arrangements. • Due diligence of third parties prior to any agreements and on-going monitoring. • Daily review of credit spreads as part of pricing activity.
(Life) Insurance Risk	• Adverse movements in mortality and persistency rates of policyholders • The possibility that guarantees could acquire a value that affects adversely the finances of a firm and its ability to meet the expectations of policyholders and to treat them fairly • Expense overruns relative to pricing or provisioning assumptions	• Life Insurance Risk Policy and risk limits in place. • Existing risk from term assurance business is limited through reinsurance. • Annual experience analyses of mortality, lapse rates and expenses. • Monthly solvency estimates. • Annual business plan and budget approved by the Board. • Monthly monitoring of business volumes and expense experience. • Financial risk assessment of options and guarantees at product design. • Annual review of guarantee charge.
Liquidity Risk	• Inappropriate cash flows constrain the ability to pay liabilities to policyholders as they fall due or obligations to third parties	• Liquidity Risk Policy and risk limits in place. • Cash flow is closely monitored across key transactions across the Group. • Investment management strategies including levels of liquid and readily marketable assets are closely monitored to allow for timely adjustments to match expected liabilities.
Capital Risk	• Management decisions or external developments impact the appropriateness of the quantity, quality or liquidity of capital	• Capital Risk Policy and associated risk metrics. • Capital management action plan in place. • Regular solvency monitoring processes.

Risk Management Report (continued)

Risk types	Key aspects of risks	Key controls and risk mitigation activities
Conduct Risk	• Business Strategy & Governance • People and culture • Distribution and sales • Post sales administration and complaints handling • Financial crime • Personal data	• Incentive schemes are balanced and monitored to ensure they promote the delivery of good customer outcomes. • Recruitment processes are competence based. • Identify target markets, assess their needs and ensure that the products marketed are suitable for those customers. • Produce transparent marketing and promotional material, ensuring that it meets regulatory requirements and is clear, fair and not misleading. • Monitor Key Performance Indicators (KPIs) such as fund performance to ensure appropriate customer outcomes. • Maintain a robust Training & Competency (T&C) Scheme to ensure colleagues demonstrate competence. • Monitor the quality of sales (whether advised or non-advised) to ensure good customer outcomes continue to be delivered.
Operational Risk	• Customer administration • Systems/technology • Information and data security • Financial processes • People • Premises • Third parties (including outsourcing)	• Operational Risk Policy and risk limits in place. • Key risk frameworks set and operated. • Mandatory training for all staff. • Methodical assessment of risks through the established risk management process. • Clear ownership of risks and controls at Executive and Management levels. • Regular review of people competency and performance to strengthen recruitment strategy, training and people development.

Report of the Committee of Management

The members of the Committee of Management present their report and Group financial statements for the year ended 31 December 2018. The financial statements have been prepared in accordance with the presentation and disclosure requirements of The Friendly Societies (Accounts and Related Provisions) Regulations 1994.

Business Objectives and Activities of the Society

The Society is an incorporated friendly society. Its core business objective continues to be the provision of financial services products to members and retired members of the Police service and the Military and their immediate families. The membership of the Society as at 31 December 2018 was 207,000 (2017: 210,000). The Society has not undertaken any activities during the year which are outside of its powers.

Details of the Society's subsidiaries are included in note 14 to the financial statements.

Results of the Society

Details of the Society's operating performance are set out in the technical accounts and related notes. Group earned premiums for the year were £93,772,000 (2017: £99,082,000) with total technical income (including total investment returns) of £138,374,000 for the year (2017: £224,720,000). Total technical charges before the transfer from the Fund for Future Appropriations were £158,132,000 (2017: £235,846,000). A transfer of £19,758,000 (2017: £11,126,000) was made from the Fund for Future Appropriations.

Solvency

As at 31 December 2018 (and throughout 2017 and 2018), the Group maintained its required margin of solvency as prescribed in regulations made under the Prudential Regulation Authority Rulebook. The management of solvency and the inherited estate is included in the Principles and Practices of Financial Management. This sets out the purposes for which it may be used. Note 19 to the financial statements gives details of the Fund for Future Appropriations, the method of calculation and the reconciliation between 2018 and 2017.

Donations and Sponsorships

Police Mutual takes very seriously its commitment to mutuality and working for the interests of the Police family. Direct support was given in the form of donations, sponsorships and respite contributions of £373,000 (2017: £445,000).

Key Risks and Uncertainties

Details of the key risks to the Society and its approach to risk management are set out in the Risk Management Report on pages 7 to 9. These comprise market risk (including credit), (life) insurance risk, liquidity risk, capital risk, conduct risk and operational risk.

Report of the Committee of Management (continued)

Committee of Management Membership, Directors and Officers

Details of the Committee of Management, directors and officers who were in office as at the date of signing of the annual report and financial statements are as follows:

Committee of Management

President
Sir Hugh Orde OBE QPM, formerly President, Association of Chief Police Officers

Vice Presidents
Simon Cole QPM BA (Hons) MA DipCrim, Chief Constable, Leicestershire Police

Andy Cooke QPM BA (Hons), Chief Constable, Merseyside Police

Mike Cunningham QPM, Chief Executive Officer, College of Policing

Charlie Hall QPM MA (Cantab) MSc, Chief Constable, Hertfordshire Constabulary

Gareth Morgan, Chief Constable, Staffordshire Police

Sir Jon Murphy QPM DL LLB (Hons), formerly Chief Constable, Merseyside Police

Fiona Taylor, Deputy Chief Constable, Police Scotland

Chairman
Julie Spence OBE QPM BEd LLB MA MBA, formerly Chief Constable, Cambridgeshire Constabulary

Claire Beck, Cambridgeshire Constabulary

Paul Bishop MA ACA

David Campbell MSc, West Yorkshire Police

John Edwards, Dyfed Powys Police

Inspector Carwyn Evans, South Wales Police

Detective Constable Martin Guest, Humberside Police

Julie Hopes MBA ACIB

John Lister BSc FIA

Kirsty Norman, Derbyshire Constabulary

Chief Superintendent Simon Ovens BSc (Hons) MSc FCMI, Metropolitan Police

Barry Sanjana MA

Graham Smillie, formerly Police Scotland

Ieuan Watkins, formerly Gwent Police

Other Officers

Interim Chief Executive
Mike Kirsch BA MBA

Executive Directors (on the Managing Board)
Andy Elkington, BA MBA, Group Sales & Marketing Director
Kathryn Winup, FCCA AMCT, Finance Director

Company Secretary
Rachel Kirwan BSc ACIS

Life Vice Presidents
Mick Foster QPM, formerly Chairman
Peter Sharpe MBE FCII, formerly Chief Executive

No members of the Committee of Management, directors or officers have an interest in the shares of the Society's subsidiary undertakings.

The following individuals stood down as members of the Committee of Management (date of leaving in brackets):

Richard Coates BSc (Econ) FCA (4 May 2018)
Stephen Mann LLB FPMI FIoD (31 December 2018)
Andy Rhodes QPM BA (Hons) (21 January 2019)
Robin Hardiman (29 January 2019)

Directors' Remuneration

Details regarding statutory directors' emoluments are set out in note 9 of the financial statements. A remuneration report for Managing Board members including the directors' remuneration policy can be found on our website www.policemutual.co.uk/about-us/corporate-governance.

Report of the Committee of Management (continued)

Total tax contributions (unaudited)

The following tax contributions were generated by the activities of the Group.

	2018 £'m	2017 £'m
Corporation Tax and Income Tax borne	-	-
Irrecoverable Value Added Tax	1.7	2.8
Employment taxes borne – Employer NIC	2.1	2.2
Total taxes borne	**3.8**	**5.0**
Insurance Premium Tax generated	5.6	5.2
Employment taxes collected – Employee PAYE and NIC	5.3	5.6
Total tax contributions	**14.7**	**15.8**

Payments totalling £257,000 (2017: £282,000) were made to local authorities in regard to business rates.

All investment gains made during the year taxable under capital gains tax were offset against investment losses brought forward from previous years.

Corporate Governance

Police Mutual is committed to maintaining high standards of corporate governance and has voluntarily chosen to use the UK Corporate Governance Code for companies quoted on the London Stock Exchange as a guide for reporting on its corporate governance arrangements (the Code). In doing so, we consider its requirements and put them into practice in a way that reflects our business, culture and values and which helps to support the following:

- Transparency; giving Members the information they need to judge whether the Executive team, Board and Committee of Management are doing a good job on their behalf;
- Effective decision-making, risk management and control;
- A proper balance between Executive and Non-Executive directors; and
- Keeping the interests of Police Mutual's Members aligned with, and at the front of the mind of, the people responsible for running the business.

The Committee of Management considers the 2018 annual report & financial statements taken as a whole to be fair, balanced and understandable and provides the information necessary for Members and customers to assess the Group's performance, business model and strategy.

Our complete Corporate Governance report can be found on our website www.policemutual.co.uk/about-us/corporate-governance.

Going Concern Statement

The directors have, at the time of approving the financial statements, a reasonable expectation that the Group and the Society have adequate resources to continue in operational existence for the foreseeable future. Therefore they continue to adopt the going concern basis of preparing the financial statements.

The directors, have made this assessment following review of the Group's performance and the latest forecasts for a period of twelve months from the date of signing the financial statements.

Viability Statement

The Chief Executive's Statement gives details of the Group's business activities, together with the factors likely to affect its future development, performance and position. Notes 16 and 19 to the financial statements and the Risk Management Report give details on the Group's objectives, policies and processes for managing its risks and capital base.

In addition to the directors' responsibilities in respect of going concern, the directors have voluntarily chosen to follow the UK Corporate Governance Code requirement to include a Business Viability Statement in the annual report which states whether there is a reasonable expectation that Police Mutual Group will be able to continue in operation and meet its liabilities as they fall due. The period assessed under the Business Viability Statement is required to be significantly longer than the minimum period of twelve months over which going concern is assessed.

Report of the Committee of Management (continued)

Viability Statement (continued)

In arriving at their assessment, the directors note current levels of market volatility, the economic and political uncertainties associated with the UK's exit from the European Union and the risks arising from the ongoing re-structuring of Police Mutual's business operations.

The directors have based this statement on an assessment of the risks that could threaten the solvency, liquidity and capital adequacy of the Group. In making the assessment, the directors considered a range of information concerning each of the principal risks across a range of scenarios, including but not limited to the current trading performance, the proposed five year business plan, the Own Risk and Solvency Assessment (ORSA) report, as well as current levels of regulatory capital held by the Society. Separately the directors have assessed that all current policyholders liabilities can be met as they fall due and there is no risk of detriment to the in-force business.

Based on the current information there is heightened uncertainty as to whether the Police Mutual Group, in its current form, continues to be viable into the foreseeable future and, as the Chair and Chief Executives' statements reference, the business is undergoing a strategic review. The strategic review includes looking at all options for the Group including reviewing all products and businesses and the legal structure of the Group. This strategic review will inform the future shape and direction of the business but is not yet available for the Board to opine on or confirm the go forward actions. This is expected to be concluded by June 2019.

Statement of Responsibility in Respect of the Financial Statements

The Friendly Societies Act 1992 requires the Committee of Management to prepare financial statements for each financial year which conform with the requirements of Section 70 of the Act and regulations made under it. The Act requires that the financial statements shall give a true and fair view of the state of affairs of the Group and Society at the end of the financial year, and of the results of the Group and Society for that financial year.

In preparing the annual financial statements the Committee of Management is required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

The Committee of Management is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and Society and which enable them to ensure that the financial statements comply with the Friendly Societies Act 1992 and regulations made under the Act. It is also responsible for safeguarding the assets of the Group and Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Committee of Management confirms that, in its view, it has complied with the above requirements in preparing the financial statements.

Statement of Disclosure of Information to Auditors

Each of the persons who is a director at the date of this report confirms that:

- so far as each of them is aware, there is no information relevant to the audit of the Group's financial statements for the period ended 31 December 2018 of which the auditors are unaware; and
- they have taken all steps that they ought to have taken in their duty as a director in order to make themselves aware of any relevant audit information and to establish that the Group's auditors are always aware of that information.

Rachel Kirwan

Company Secretary

19 March 2019

Audit Committee Report

The Audit Committee is a sub-committee of the Managing Board, which in turn is a sub-committee of the Committee of Management. A full description of the work of the Committee of Management and all of its sub-committees is set out in the separate Annual Governance and Directors' Remuneration Reports.

Membership

Paul Bishop (Chair)
Richard Coates (until 4 May 2018)
John Lister
Barry Sanjana

Secretary

Rachel Kirwan

Role

The main role, responsibilities and authority of the Audit Committee, as delegated to it by the Managing Board, are set out in its terms of reference, which are available on the Police Mutual website and summarised below:

- Ensuring the adequacy and effectiveness of internal systems of control that impact on the strategic, financial and operational policies and plans of the Group or financial reporting;
- Reviewing the integrity of financial statements;
- Reviewing significant financial reporting issues and judgements;
- Overseeing the relationship with and appointment of the external auditor, including their remuneration and terms of engagement;
- Assessing the external auditor's independence and objectivity and the effectiveness of the external audit process;
- Developing and implementing the policy on the engagement of the external auditor to supply non-audit services;
- Considering the effectiveness of the external audit;
- Monitoring and assessing the role and effectiveness of the internal audit function;
- Overseeing the appointment of the Chief Internal Auditor;
- Reporting to the Managing Board on how it has discharged its responsibilities;
- Making recommendations to the Managing Board where it considers action or improvement is needed.

As part of the Audit Committee's reporting to the Managing Board, it considers whether the annual report and financial statements taken as a whole are fair, balanced and understandable and provide the information necessary for Members to assess the Group's position and performance, business model and strategy.

How the Audit Committee has discharged its responsibilities

In 2018 the Audit Committee met six times and met the UK Corporate Governance Code requirement to have at least three independent non-executive directors. The Managing Board is satisfied that Paul Bishop brings recent and relevant financial expertise, augmented by the financial and actuarial expertise and experience of the other members of the Audit Committee.

The Audit Committee schedules time annually, without any executive directors or senior management present, to discuss issues with the Chief Internal Auditor and external auditors. The Chairman of the Audit Committee meets the Chief Internal Auditor to review current issues before each Audit Committee meeting.

Financial Reporting

During 2018 the Audit Committee considered in detail the financial statement preparation process and the matters of judgement to be applied. Reports from the external auditor were received before and after the annual statutory audit.

A summary of the significant issues the Audit Committee considered in relation to the 2018 financial statements and how these issues were addressed, together with judgements made and sources of assurance and other evidence used to satisfy itself of the appropriateness of the conclusions reached is as follows:

- Going concern

As part of their oversight of the financial statements, the Audit Committee considers a detailed assessment of the Group and Society's ability to operate as a going concern. The Committee has made this assessment following a review of the Group's performance and the latest forecasts for a period of twelve months from the date of signing the financial statements, which has included the current strategy and business plan and Own Risk and Solvency Assessment (ORSA) information. The Committee has concluded that there is a reasonable expectation that the Group and Society have adequate resources to prepare the financial statements on a going concern basis. A going concern and viability statement are included in the Report of the Committee of Management.

Audit Committee Report (continued)

Financial Reporting (continued)

- Valuation of assets and liabilities

A number of assets in the Group and Society's Balance Sheets are held at fair value, including:

- Investments in subsidiary undertakings and goodwill

  The Society carries its subsidiary undertakings at valuation. This valuation had been prepared by applying an EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) multiple to forecast results for trading companies. Non trading companies are held at net asset value. This methodology is consistent with that adopted in the prior year.

- Carrying value of goodwill
  There have been no additions to goodwill in the year, the balance has reduced by the annual amortisation charge. The valuation of the subsidiary undertakings referred to above has calculated a value greater than the remaining value held in goodwill and related intangible assets, therefore it is considered that there is no impairment charge to record.

- Investment in Pinkerton
  The Pinkerton investment is valued in line with the EBITDA multiple methodology adopted for the subsidiary undertakings as described above. More detail about Pinkerton is given in note 14.

- Alexandra House (held within tangible assets)
  Alexandra House (our head office building) was subject to an external valuation in 2018 by an independent qualified valuer using industry recognised valuation techniques.

- Other financial investments (including valuation of the Neyber shares and bonds)
  The majority of financial investments are valued by external fund managers who hold these investments on the Society's behalf and base valuations on readily available market data. The valuation of Neyber corporate bonds is based on an internally developed discounted cash flow model. The Committee have assessed the appropriateness of the assumptions within this model, compared valuation results to previous years, considered how the future cash flows have been determined and if there are any deviations from the current business plan. The Neyber shares are valued based on recent external transactions.

- Valuation of Long-Term Business Provision
  This area is particularly significant for Police Mutual and involves multiple complex and subjective judgements. The Chief Actuary advised on the methodologies and assumptions to be used and these are reviewed and approved or adjusted by the Audit Committee on behalf of the Managing Board. The Chief Actuary presented the results of those investigations and calculations which include a range of validation measures. The Audit Committee also considered the external auditors' views on the appropriateness of the models, methodologies and assumptions used.

  The subjective judgements required include an assumption for the best estimate of the costs that will be incurred to administer the existing life assurance business. A comprehensive review of the way in which costs are allocated between businesses and products has been completed. The costs anticipated for 2019 and in the future allow for savings anticipated from a recent cost reduction programme. In determining the expense assumptions full allowance for the benefits of the cost reduction programme have been made as they are expected to be realised.

- Deferred Taxation
  Deferred tax assets are recognised to the extent the Society is able to forecast taxable profits against which the deferred tax assets can be offset. A ten year period is used for this forecast which is consistent with prior years.

External Auditors

The independence, objectivity and appointment of the external auditors is subject to regular review. The Senior Statutory Auditor is rotated every five years and 31 December 2018 will be Gary Shaw's first year as the Senior Statutory Auditor.

A tender process took place during 2018 for the appointment of external auditors to undertake the audit for the year ending 31 December 2019. Deloitte LLP were successful in the tender process and will replace PwC who have been in post as external auditor since 2004.

The level of non-audit fees paid to the external auditor is subject to a formal policy to safeguard their independence and objectivity. PwC were engaged to provide additional assurance work in respect of the Police Mutual stakeholder pension scheme, there were no other non audit services provided during the year. Total fees payable to PwC in 2018 were £408,000 (2017: £501,000) excluding VAT of which £8,000 (2017: £27,000) related to non-audit services.

No review of the external auditors' effectiveness was conducted in 2018 due to the tender process which was carried out.

Independent Auditors’ Report to the Members of Police Mutual Assurance Society

Report on the Financial Statements

Opinion

In our opinion, Police Mutual Assurance Society’s Group financial statements and Society financial statements (the “financial statements”):

- give a true and fair view of the state of the Group’s and the Society’s affairs as at 31 December 2018 and of the Group’s and the Society’s income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards comprising FRS 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland” and applicable law); and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

We have audited the financial statements, included within the Annual Report, which comprise: the Consolidated and Society Balance Sheets as at 31 December 2018; the Consolidated and Society Technical Accounts; the Consolidated and Society Statements of Other Comprehensive Income for the year then ended; the accounting policies; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (“ISAs (UK)”) and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors’ responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

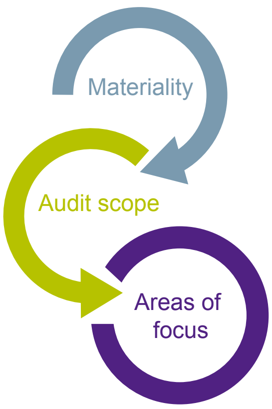
We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC’s Ethical Standard as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC’s Ethical Standard were not provided to the Group or the Society.

Other than those disclosed in note 10 to the financial statements, we have provided no non-audit services to the Group or Society in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview



Materiality

- Overall Group materiality: £5.3 million (2017: £5.3million) based on 11.8% of the Consolidated Fund for Future Appropriations.
- Overall Society materiality: £5 million (2017: £5 million) based on 4.7% of the Society Fund for Future Appropriations.

Audit Scope

- The Group comprises the Society and a number of subsidiaries which provide distinct revenue streams and support functions. A component was deemed to be financially significant and in scope if it contained more than 15% of the Fund for Future Appropriations. A component was also deemed to be a significant risk component if they contained a balance relating to one of the area of audit focus. Additional balance components were selected to ensure sufficient coverage across all material financial statement line items.
- Our audit procedures covered 97.8% of the Group’s gross assets and 84.7% of its total technical income.

Areas of focus

- The expense assumptions used in the valuation of the long term business provision;
- The valuation of the Society’s investment in Pinkerton; and
- The valuation of the Society’s investments in subsidiaries.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Committee of Management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Independent Auditors' Report to the Members of Police Mutual Assurance Society (continued)

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and Society and its industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK and European regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority, and we considered the extent to which non-compliance might have a material effect on the financial statements of the Group and Society. We also considered those laws and regulations that have a direct impact on the financial statements of the Group and Society such as the Friendly Societies Act 1992 legislation, the Prudential Regulation Authority's regulations and UK tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue, reduce expenditure or increase the capital position of the Group and Society, and management bias in accounting estimates and judgemental areas of the financial statements such as the valuation of the Group's and Society's Long-Term Business Provision and the valuation of the Society's investments in Pinkerton and other subsidiaries. Audit procedures performed by the Group engagement team included:

- Discussions with internal audit, senior management involved in the Risk and Compliance function and the Group's and Society's legal function, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Reviewing the results of management's internal controls designed to prevent and detect irregularities, in particular their controls around disclosure of related parties and associated transactions, authorisation of payments to agents and other third parties;
- Reading key correspondence with the Prudential Regulation Authority and the Financial Conduct Authority in relation to compliance with laws and regulations;
- Reviewing relevant meeting minutes including those of the Managing Board, With-Profits Committee, Risk Committee and the Investment Committee;
- Reviewing data regarding policyholder complaints, the Group's and Society's register of litigation and claims, internal audit reports, compliance reports in so far as they related to non-compliance with laws and regulations and fraud;
- Procedures relating to the valuation of the Group's and Society's Long-Term Business Provision and the valuation of the Society's investments in Pinkerton and other subsidiaries described in the related key audit matter below;
- Identifying and testing journal entries, which we have assessed to meet certain risk criteria; and
- Designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing of expenses.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Group & Society - Valuation of the Long-Term Business Provision – expense assumptions Expense assumptions impact the valuation of the Long-Term Business Provision. The Long-Term Business Provision total across the Society and Group was £666.0m as at 31 December 2018 (2017: £719.8m). See note 18 to the financial statements for more information. When valuing the Long-Term Business Provision, assumptions need to be made about the costs that will be incurred in maintaining the in-force policies to their expected maturity. The judgements applied in setting the assumptions for expected expenses are grounded in actual experience but involve an element of subjectivity including the identification of expenses incurred to maintain in force policies, allocation of expenses between Group entities, and to particular long term product types. Planned transformation projects also increase the level of subjectivity in setting future expense assumptions.	Our work to address the expense assumption risk in the valuation of the Long-Term Business Provision was supported by our in-house life actuarial specialists and included the following procedures: - We tested the reasonableness of the expense allocation methodology by reviewing the cost drivers used by management for each significant cost. This included testing a sample of expenses incurred to ensure that the expense allocation has been performed appropriately to the Society; - We tested the completeness and accuracy of the data sets used by management for the expense allocation process; - Reviewed the latest business plan to identify planned transformation savings and challenged managements quantification by seeking supporting project plans for significant savings, and requested evidence for savings achieved in the year to date; and - Reviewed the significant judgements and emerging experience data made in setting the assumptions, in order to conclude on the appropriateness of assumptions and whether there was any evidence of management bias. Based on the work performed we found that the expense assumptions used were supported by the evidence we obtained.

Independent Auditors' Report to the Members of Police Mutual Assurance Society (continued)

Key audit matter	How our audit addressed the key audit matter
Valuation of the Society's investment in Pinkerton Pinkerton is a Bermudan cell to which general insurance business is intermediated via a Group subsidiary. This is then reinsured by a third party insurer. Police Housing Fund Ltd, a subsidiary of the Group, owns 100% of the entity's preference share capital, but does not control the entity. It is held within the Society's Balance Sheet at a valuation of £72.2m (2017: £75.8m), see note 14 to the financial statements. Pinkerton was valued as at 31 December 2018 using an earnings multiple model based on a future discounted EBITDA, plus the value of surplus assets over those required to be held for the cell to continue to operate. The key assumptions within the valuation model are the forecast earnings, the discount factor and the earnings multiple.	Our work to address the valuation of the investment in Pinkerton was supported by our in-house valuation experts and included the following procedures: - We tested the underlying earnings used in the model and the reasonableness of the forecast earnings used by agreeing to the latest business plan as presented to the Board, to contractual arrangements with third party insurers and assessing the reasonableness compared to past performance; - We tested management's discount factors by agreeing the significant inputs to the calculation to supporting evidence; - We tested the appropriateness of management's earnings multiple by independently calculating a range of earnings multiples based on comparator companies; and - We tested the surplus net assets included within the year end valuation to management's supporting calculations and third party confirmations. Based on the work performed, we found that the evidence supporting management's valuation of the investment in Pinkerton was appropriate. We noted no material exceptions from our testing of the valuation.
The valuation of the Society's investments in subsidiaries The Society's investments in subsidiary undertakings are measured at fair value in the Society financial statements. The unlisted illiquid investments are fair valued using an earnings multiple model, plus the value of surplus assets over those required to be held for the entities to continue to operate. The value using this model as at 31 December 2018 is £19.2m (2017: £17.6m), see note 14 to the financial statements. The key assumptions within the valuation model are the forecast earnings, the discount factor and the earnings multiple. In the forecast earnings adjustments are made to derive earnings were the entities to be sold to a willing buyer, specifically Group recharges are adjusted to management's estimate of the cost that would be borne by the entities on a standalone basis.	Our work to address the valuation of the Society investment in subsidiaries was supported by our in-house valuation experts and included the following procedures: - We tested the underlying earnings used in the model and reasonableness of the forecast earnings used by agreeing to the latest business plan as presented to the Board, to contractual arrangements with third party insurers where appropriate, and assessing the reasonableness compared to past performance; - We tested adjustments made to centrally recharged expenses by reviewing the line by line assessment performed by management and agreeing to supporting evidence provided including third party cost estimates; - We tested management's discount factor by agreeing the significant inputs to the calculation to supporting evidence; - We tested the appropriateness of management's earnings multiple by independently calculating a range of earnings multiples based on comparator companies; and - We tested the surplus net assets included within the year end valuation to management's supporting calculations and third party confirmations where possible. Based on the work performed, we found that the evidence supporting management's valuation of the investment in subsidiaries was appropriate. We noted no material exceptions from our testing of the valuation.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group and the Society, the accounting processes and controls, and the industry in which it operates.

A component was deemed to be financial significant and in scope if it contained more than 15% of the Fund for Future Appropriations. A component was also deemed to be a significant risk component if they contained a balance relating to one of the areas of audit focus. Additional balance components were selected to ensure sufficient coverage across all material financial statement line items.

Overall we concluded that this gave us the evidence we needed for our opinion on the financial statements as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Society financial statements
Overall materiality	£5.3 million (2017: £5.3 million).	£5.0 million (2017: £5.0 million).
How we determined it	11.8% of consolidated Fund for Future Appropriations.	4.7% of Society Fund for Future Appropriations.
Rationale for benchmark applied	The Fund for Future Appropriations represents the surplus arising in the Group where the allocation has not been determined at the year end and as such is akin the retained earnings of a company. The Fund for Future Appropriations is therefore of primary interest to the Members of the Group and is the principal Balance Sheet metric against which the performance of the Group is measured. We have also had regard to other measures such as the Group's regulatory capital surplus and other performance metrics and have compared the level of audit work required to be performed over the Consolidated Technical Account using these alternative benchmarks. Materiality for the Group is higher than Society materiality as Group includes the results of the wider subsidiaries.	

Independent Auditors' Report to the Members of Police Mutual Assurance Society (continued)

Materiality (Continued)

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £5 million and £0.1 million. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements for the Society and Group identified during our audit above £250,000 and £265,000 respectively (2017: £250,000 and £265,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Committee of Management's statement in the financial statements about whether the Committee of Management considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Committee of Management's identification of any material uncertainties to the Group's and the Society's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, which is currently due to occur on 29 March 2019, are not clear, and it is difficult to evaluate all of the potential implications on the Group's and Society's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Committee of Management is responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Report of the Committee of Management, we also considered whether it had been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Friendly Societies Act 1992, (FSA92) and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Report of the Committee of Management

In our opinion, based on the work undertaken in the course of the audit, the information given in the Report of the Committee of Management for the financial year for which the financial statements are prepared is consistent with the financial statements and has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it. *(FSA92)*

In light of the knowledge and understanding of the Group and the Society and their environment obtained in the course of the audit, we did not identify any material misstatements in the Report of the Committee of Management. *(FSA92)*

Independent Auditors' Report to the Members of Police Mutual Assurance Society (continued)

Responsibilities for the financial statements and the audit

Responsibilities of the Committee of Management for the financial statements

As explained more fully in the Committee of Management's Responsibilities Statement, the Committee of Management is responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Committee of Management is also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Committee of Management is responsible for assessing the Group's and Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Committee of Management either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's Members as a body in accordance with Section 73 of the Friendly Societies Act 1992 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Friendly Societies Act 1992 exception reporting

Under the Friendly Societies Act 1992 we are required to report to you if, in our opinion:

- we have not received all the information and explanations and access to documents we require for our audit; or
- adequate accounting records have not been kept by the Group or Society, or
- the financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the Committee of Management on 18 October 2004 to audit the financial statements for the year ended 31 December 2004 and subsequent financial periods. The period of total uninterrupted engagement is 15 years, covering the years ended 31 December 2004 to 31 December 2018.

Gary Shaw (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Cornwall Court
19 Cornwall Street
Birmingham
B3 2DT

19 March 2019

Consolidated Technical Account

Long-Term Business for the Year Ended 31 December 2018

	Note	2018 £'000	2017 £'000
Earned Premiums, Net of Reinsurance	2	93,772	99,082
Investment Income	3	107,273	79,609
Unrealised (losses)/gains on Investments	3	(97,876)	6,737
Other Technical Income	4	35,205	39,292
Total Technical Income		**138,374**	**224,720**
Claims Paid - Gross Amount		117,653	125,742
- Reinsurers' Share		(2,099)	(1,922)
Change in Provision for Claims - Gross Amount		(19)	1,288
- Reinsurers' Share		264	(537)
Claims Incurred, Net of Reinsurance		**115,799**	**124,571**
Change in Long-Term Business Provision	6	(44,258)	14,174
Change in Technical Provision for Linked Liabilities		(4,817)	10,900
Change in Other Technical Provisions, Net of Reinsurance		**(49,075)**	**25,074**
Net Operating Expenses	7	19,888	18,380
Investment Expenses and Charges	3	39,397	19,079
Other Charges		**59,285**	**37,459**
Other Technical Charges		32,985	47,883
Taxation Attributable to Long-Term Business	11	(862)	859
Transfer from the Fund for Future Appropriations	12	(19,758)	(11,126)
Total Technical Charges		**138,374**	**224,720**
Balance on the Technical Account		-	-

Consolidated Statement of Other Comprehensive Income

Long-Term Business for the Year Ended 31 December 2018

	Note	2018 £'000	2017 £'000
Actuarial gain on Pension Scheme	24	(2,208)	(1,630)
Deferred tax on actuarial gain on Pension Scheme	11	442	213
Transfer to the Fund for Future Appropriations	12	1,766	1,417
Other Comprehensive Income for the year		**-**	**-**
Total Comprehensive Income for the year		**-**	**-**

The inclusion of unrealised gains and losses in the Technical Account to reflect the marking to market of interests carried on the Balance Sheet is deemed not to be a departure from the unmodified historical cost basis of accounting. Accordingly, a separate note of historical cost profits and losses is not given.

The Group has no recognised gains or losses other than those included in the Technical Account or Statement of Other Comprehensive Income for the year.

The Group has not presented a statement of changes in equity as there are no equity holders in the Group.

Society Technical Account

Long-Term Business for the Year Ended 31 December 2018

	Note	2018 £'000	2017 £'000
Earned Premiums, Net of Reinsurance	2	93,772	99,082
Investment Income	3	107,263	79,607
Unrealised loss on Investments	3	(104,914)	(21,000)
Other Technical Income	4	1,104	1,047
Total Technical Income		**97,225**	**158,736**
Claims Paid - Gross Amount		117,653	125,742
- Reinsurers' Share		(2,099)	(1,922)
Change in Provision for Claims - Gross Amount		(19)	1,288
- Reinsurers' Share		264	(537)
Claims Incurred, Net of Reinsurance		**115,799**	**124,571**
Change in Long-Term Business Provision	6	(44,258)	14,174
Change in Technical Provision for Linked Liabilities		(4,817)	10,900
Change in Other Technical Provisions, Net of Reinsurance		**(49,075)**	**25,074**
Net Operating Expenses	7	13,128	11,649
Investment Expenses and Charges	3	39,397	19,079
Other Charges		**52,525**	**30,728**
Taxation Attributable to Long-Term Business	11	(438)	1,157
Transfer from the Fund for Future Appropriations	12	(21,586)	(22,794)
Total Technical Charges		**97,225**	**158,736**
Balance on the Technical Account		**-**	**-**

Statement of Other Comprehensive Income

Long-Term Business for the Year Ended 31 December 2018

	Note	2018 £'000	2017 £'000
Actuarial gain on Pension Scheme	24	(2,208)	(1,630)
Deferred tax on actuarial gain on Pension Scheme	11	271	213
Transfer to the Fund for Future Appropriations	12	1,937	1,417
Other Comprehensive Income for the year		**-**	**-**
Total Comprehensive Income for the year		**-**	**-**

The inclusion of unrealised gains and losses in the Technical Account to reflect the marking to market of interests carried on the Balance Sheet is deemed not to be a departure from the unmodified historical cost basis of accounting. Accordingly, a separate note of historical cost profits and losses is not given.

The Society has no recognised gains or losses other than those included in the Technical Account or Statement of Other Comprehensive Income for the year.

The Society has not presented a statement of changes in equity as there are no equity holders in the Society.

Consolidated Balance Sheet

As at 31 December 2018

	Note	2018 £'000	2017 £'000
Assets			
Intangible Assets			
Goodwill	13	9,990	15,326
Other	13	2,117	3,684
		12,107	**19,010**
Investments			
Other Financial Investments	15	**617,594**	**726,258**
Assets Held to Cover Linked Liabilities	18(B)	**99,670**	**100,550**
Reinsurers' Share of Technical Provisions			
Long-Term Business Provision	18(A)	8,149	8,205
Claims Outstanding	18(A)	609	873
		8,758	**9,078**
Debtors			
Debtors Arising Out of Direct Insurance Operations		1,874	1,487
Other Debtors	20	30,111	28,392
		31,985	**29,879**
Other Assets			
Tangible Assets	17	8,882	9,783
Cash at Bank and In Hand		87,714	43,297
Deferred Tax	11	3,803	3,328
		100,399	**56,408**
Prepayments and Accrued Income			
Accrued Interest		2,955	2,835
Other Prepayments and Accrued Income		1,915	3,672
		4,870	**6,507**
Total Assets		**875,383**	**947,690**

Consolidated Balance Sheet

As at 31 December 2018 (continued)

	Note	2018 £'000	2017 £'000
Liabilities			
Fund for Future Appropriations	12	**44,751**	**62,743**
Technical Provisions			
Long-Term Business Provision	18(A)	666,018	719,849
Claims Outstanding	18(A)	7,046	7,065
		673,064	**726,914**
Technical Provisions for Linked Liabilities	18(B)	**99,670**	**100,550**
Provisions for other risks and charges			
Provisions for Pensions	24	9,090	14,141
Other Provisions	22	3,228	1,972
		12,318	**16,113**
Creditors			
Creditors Arising out of Direct Insurance Operations		327	380
Other Creditors	21	45,253	40,990
		45,580	**41,370**
Total Liabilities		**875,383**	**947,690**

The financial statements on pages 21 to 55 were approved by the Committee of Management on 19 March 2019 and signed on its behalf by:-

Julie Spence
Chair

Rachel Kirwan
Company Secretary

Society Balance Sheet

As at 31 December 2018

	Note	2018 £'000	2017 £'000
Assets			
Intangible assets	13	**362**	**560**
Investments			
Investments In Group Undertakings	14	91,409	93,447
Other Financial Investments	15	617,594	726,258
		709,003	**819,705**
Assets Held to Cover Linked Liabilities	18(B)	**99,670**	**100,550**
Reinsurers' Share of Technical Provisions			
Long-Term Business Provision	18(A)	8,149	8,205
Claims Outstanding	18(A)	609	873
		8,758	**9,078**
Debtors			
Debtors Arising out of Direct Insurance Operations		1,870	1,468
Other Debtors	20	349	868
		2,219	**2,336**
Other Assets			
Tangible Assets	17	5,809	6,193
Cash at Bank and In Hand		76,454	33,856
Deferred Tax	11	4,119	3,897
		86,382	**43,946**
Prepayments and Accrued Income			
Accrued Interest		2,955	2,835
Other Prepayments and Accrued Income		241	347
		3,196	**3,182**
Total Assets		**909,590**	**979,357**

Society Balance Sheet

As at 31 December 2018 (continued)

	Note	2018 £'000	2017 £'000
Liabilities			
Fund for Future Appropriations	12	**113,263**	**132,912**
Technical Provisions			
Long-Term Business Provision	18(A)	666,018	719,849
Claims Outstanding	18(A)	7,046	7,065
		673,064	**726,914**
Technical Provisions for Linked Liabilities	18(B)	**99,670**	**100,550**
Provisions for other risks and charges			
Provisions for Pensions	24	**9,090**	**14,141**
Creditors			
Creditors Arising out of Direct Insurance Operations		2	13
Other Creditors	21	14,501	4,827
		14,503	**4,840**
Total Liabilities		**909,590**	**979,357**

The financial statements on pages 21 to 55 were approved by the Committee of Management on 19 March 2019 and signed on its behalf by:-

Julie Spence
Chair

Rachel Kirwan
Company Secretary

Notes to the Financial Statements

for the year ended 31 December 2018

1 Accounting Policies

Police Mutual Assurance Society Limited is a friendly society incorporated and domiciled in England and Wales. The address of its registered office is:

Alexandra House
Queen Street
Lichfield
Staffordshire
WS13 6QS

(A) Basis of Presentation

The financial statements have been prepared in compliance with the special provisions relating to Friendly Societies as set out in The Friendly Societies (Accounts and Related Provisions) Regulations 1994. Applicable United Kingdom accounting standards, including the Financial Reporting Standard 102 – 'The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland' ('FRS 102') and Financial Reporting Standard 103 – 'Insurance Contracts' ('FRS 103') have been adopted where those standards do not contradict the 1994 regulations.

The principal accounting policies used in preparing the financial statements are set out below and are in accordance with applicable accounting standards in the United Kingdom with one exception. A requirement of the Friendly Societies Regulations 1994 is to depreciate all properties, however no depreciation has been provided. All of the properties held by the Society are owner occupied which therefore do not satisfy the definition of investment properties in FRS 102, Section 16, and therefore are not exempt from the requirement that they are depreciated. The justification for not applying depreciation however is set out in (N) below.

As a mutual life assurance society, under Financial Reporting Standard 102, Section 7, Police Mutual is exempt from the requirement to prepare a cash flow statement.

(B) Use of Estimates and Judgements

The preparation of the financial statements requires the Committee of Management to make judgements, estimates and assumptions in the process of applying the Group's accounting policies. Although these estimates are based on management's best knowledge of current circumstances and expectations of future events and actions, actual results may differ significantly from those estimates.

The following are the Group's key areas of estimation uncertainty:

Valuation of financial assets – notes 15 and 16 explain the assumptions used in the valuations, particularly in respect of level 3 assets, being those where the valuation is not based on observable market data.

Technical provisions – note 18 explains the assumptions used.

Goodwill – the carrying value of goodwill is assessed where there are indicators of impairment using a discounted future net cash flow model. The significant estimates involved are expected future cash flows and the discount rate used.

Deferred taxation – note 11 sets out the key assumption in the recognition of deferred tax assets as being the likelihood of future taxable profits arising against which the timing differences will reverse. Projections of future profitability and investment asset performance are undertaken to inform the level of deferred tax to be recognised.

Pensions - note 24 sets out the major assumptions used to calculate the surplus or deficit in the defined benefit pension scheme.

Investments in group undertakings – the Society holds its investments in subsidiary companies at fair value. In determining fair value, an EBITDA multiple model is used with assumptions made in respect of cash flows and duration.

Provisions – as a regulated financial services business, the Group has ongoing discussions with external regulators and other authorities in respect of compliance with product and other legislation. Where such issues or other potential exposures arise, the Group evaluates whether or not the matter requires a provision to be recognised or a contingent liability to be disclosed by assessing the likelihood of a constructive or legal obligation to settle a past event and whether the amount can be estimated reliably.

Provisions are also recognised for the estimated level of commission repayable where a customer has the right to cancel a product prior to the end of its term. Estimates are made in respect of the expected level of cancellation.

The amount of provision is determined based on the Group's best estimate of the expenditure required to settle the obligation.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

1 Accounting Policies (continued)

(C) Basis of Consolidation

The consolidated financial statements incorporate the assets, liabilities and results of Police Mutual Assurance Society Limited and its subsidiary undertakings drawn up to 31 December each year. All intra-group transactions, balances, income and expenses are eliminated on consolidation. The financial statements also include the results of Pinkerton segregated account as the activities are conducted on behalf of the Group according to its specific business needs.

Any subsidiary sold or acquired during the year is included up to, or from, the dates of change of control.

(D) Contract Classification

The Society issues contracts that transfer insurance risk or financial risk or both.

Insurance contracts are liabilities with a significant element of insurance risk. The Society has defined a significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event that is at least 10% more than the benefits payable if the event did not occur. A contract that is classified as an insurance contract continues to be treated as such until all rights and obligations under the contract expire.

Contracts that are not classified as insurance contracts are investment contracts. Investment contracts are those contracts that transfer financial risk with no significant insurance risk. Unit linked contracts, where the liability under the contract is dependent on the value of the underlying financial assets, are classified as investment contracts unless the contracts also contain features that transfer significant insurance risk. The Child Trust Fund, Stakeholder Pension, Anytime Access Options ISA and the Fixed Term Options ISA are categorised as investment contracts.

All with-profits contracts contain a discretionary participation feature which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses. These are likely to be a significant portion of the total contractual benefits where the amount or timing is contractually at the discretion of the Society. They will be based contractually on the performance of specified contracts, realised and/or unrealised investment returns on a specified pool of assets held by the Society or the surplus or deficit of the Society.

The Group seeks to reduce its exposure to potential losses by reinsuring certain levels of risk with a reinsurance company. These reinsurance contracts meet the classification requirements for insurance contracts and hence are classified as reinsurance contracts held.

All with-profits contracts are classified as insurance contracts or investment contracts with discretionary participation features. All non-unit linked non-with-profits contracts issued are insurance contracts, except the fixed term options ISA which is a non-participating investment contract.

(E) Premium Receipts – Earned Premiums

Premiums received and reinsurance paid relating to insurance contracts are accounted for as follows:

- Regular premium income is accounted for when due;
- Single premium income is accounted for when received; and
- Reinsurance premiums are charged in line with the income to which they relate.

(F) Payments on Investment Contracts and Investment Contracts with Discretionary Participation Features

Payments received in relation to investment contracts and investment contracts with discretionary participation features are accounted for when received. Payments relating to investment contracts with discretionary participation features are accounted for as earned premiums with movements in the liabilities on such contracts included within technical provisions. Payments on investment contracts are treated as deposits and are included on the Balance Sheet as liabilities.

(G) Investment Return

Investment return comprises all investment income, realised investment gains and losses, net of investment expenses, charges and interest payable on financial liabilities carried at amortised cost.

Dividends are included as investment income on the date that the shares are quoted ex-dividend. Interest and expenses are included on an accruals basis.

Realised gains and losses on investments carried at fair value are calculated as the difference between net sales proceeds and purchase price.

Movements in unrealised gains and losses on investments represent the difference between the fair value at the Balance Sheet date and their fair value at the last Balance Sheet date or if acquired in the current period, their purchase price, together with the reversal of unrealised gains and losses recognised in respect of investment disposals in the current period.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

1 Accounting Policies (continued)

(H) Other Technical Income and Other Technical Charges

Other technical income and other technical charges in the Consolidated Technical Account represent the income and expenditure, recognised on an accruals basis, in respect of subsidiary companies before Group charges and tax.

Management fees arising from investment contracts are recorded in Other Technical Income in the period in which the services are provided.

Income from commission is taken into account on an accruals basis. Commissions earned are subject to claw-back in the event that a policy lapses and the Group is no longer entitled to the commission. Provision is made based on historical levels of claw-back as a percentage of commission earned.

(I) Claims

Claims paid and reinsurers' share shown in the Consolidated Technical Account and Society Technical Account relate to insurance contracts and investment contracts with discretionary participation features. Investment contract claims are included within the movement in liabilities shown on the Balance Sheet and are not treated as a claim in the Technical Account.

Death claims are recorded on the basis of notifications received. Maturities and annuity payments are recorded when due. Surrenders are recorded on the earlier of the date paid or when the policy ceased to be included within the technical provisions or technical provision for linked liabilities. Claims on participating business include bonuses payable. Claims payable include the direct costs of settlement. Reinsurers' share are credited to match the relevant gross amounts.

The provision for outstanding claims represents the total estimated ultimate cost to the Society of settling all incurred insurance contract claims arising from notified events that have occurred up to the end of the financial year, less amounts already paid in respect of such claims.

(J) Business Combinations and Goodwill

Business combinations are accounted for by applying the purchase method. The cost of a business combination is the fair value of the consideration given, liabilities incurred or assumed and of equity instruments issued plus the costs directly attributable to the business combination. Contingent consideration is initially recognised at the estimated amount where the consideration is probable and can be measured reliably.

On acquisition of a business, fair values are attributed to the identifiable assets, liabilities and contingent liabilities unless the fair value cannot be measured reliably, in which case the value is incorporated in goodwill. Where the fair value of contingent liabilities cannot be measured reliably they are disclosed on the same basis as other contingent liabilities.

Goodwill recognised represents the excess of the fair value and directly attributable costs of the purchase consideration over the fair values attributed to the Group's interest in the identifiable net assets, liabilities and contingent liabilities acquired.

Goodwill is amortised over its expected useful life up to a maximum of 20 years. Goodwill is assessed for impairment when there are indicators of impairment and, to the extent that the carrying amount exceeds the recoverable amount, that is the higher of the realisable value and value in use, goodwill is written down to its recoverable amount. The value in use is determined from estimated discounted future net cash flows. Any impairment is recognised immediately in the Technical Account and is not subsequently reversed.

(K) Financial Instruments

The Group has chosen to apply the measurement disclosure requirements of FRS 102 in full respect of financial instruments.

i) Financial Assets

Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date. Financial assets are classified into the following categories:

- Shares, other variable yield securities, units in unit trusts, investments in subsidiaries, debt securities and other fixed-income securities – at fair value through profit or loss, where each year the value of the assets is measured as per section (a) below with all movements taken through the Technical Account;
- Derivatives – held for trading;
- Loans on policies and deposits with credit institutions - loans and receivables.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

1 Accounting Policies (continued)

(K) Financial Instruments (continued)

i) Financial assets (continued)

(a) Shares, other variable yield securities, units in unit trusts, investments in subsidiaries, debt securities and other fixed-income securities – at fair value through profit or loss (FVTPL).

Financial assets are classified into this category at inception if they are acquired principally for the purpose of selling in the short term, if they form part of a portfolio of financial assets in which there is evidence of short term profit-taking, or if so designated by management to minimise any measurement or recognition inconsistency with the associated liabilities.

Fair values are determined by reference to quoted bid prices in their active markets at the Balance Sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Recent market transactions are used to establish fair value where financial instruments are not traded in an active market.

Valuation models are used to establish fair value where financial instruments are not traded in an active market or there are no recent market transactions available for use. These valuation models, which may include, but are not limited to, earnings multiple models, discounted cash flow techniques and underlying net asset value, calculate realisable value using known drivers of value.

Net gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are presented in the Technical Account within unrealised gains or losses on investments in the period in which they arise.

(b) Derivatives – held for trading

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value are recognised immediately in the Technical Account. Fair values are obtained from quoted market prices in active markets or valuation techniques. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

(c) Deposits with credit institutions and other loans - loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. When a financial asset is recognised initially it is measured at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset. Loans and receivables are subsequently measured at amortised cost using the effective interest method.

Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. This basis of valuation is viewed by the directors as having prudent regard to the likely realisable value.

ii) Financial Liabilities

Financial liabilities other than derivatives, which are detailed above, are measured at amortised cost. The amortised cost of these financial liabilities is equivalent to the amount payable on demand without penalty.

(L) Intangible Assets

Intangible assets are stated at cost less accumulated amortisation and any accumulated impairment losses. Amortisation is calculated, using the straight line method, to allocate the depreciable amount of the assets to their residual values over their estimated useful lives as follows:

Customer lists:	5 years
Computer software and licences:	Between 3 and 6 years

The assets are reviewed for impairment if any factors come to light that indicate that the carrying value may be impaired.

(M) Impairment of Assets

For financial assets not at FVTPL, the Group assesses at each Balance Sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be estimated reliably.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and assesses them collectively for impairment. Assets that are assessed individually for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and assesses them collectively for impairment. Assets that are assessed individually for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

1 Accounting Policies (continued)

(M) Impairment of Assets (continued)

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed through the Technical Account for the period.

(N) Tangible Assets and Depreciation

Tangible assets are stated on the Balance Sheet at cost less accumulated depreciation. Cost comprises the purchase price and costs directly incurred in bringing the asset into use. Depreciation is charged on a straight line basis so as to write off the cost of fixed assets over their estimated useful lives or to reduce their carrying value to estimated realisable amount on disposal. The estimated useful lives are:

Office furniture and equipment:	Between 3 and 10 years
Computer equipment:	Between 3 and 6 years
Motor vehicles:	4 years

All property held is freehold and occupied by the Society. Land and buildings are held at fair value. An external valuation of all freehold property is undertaken at least every five years, with an internal directors' valuation undertaken in each of the intervening years. No depreciation has been provided on property as it is considered that the useful lives and residual values are such that depreciation is immaterial.

The carrying value of all assets is reviewed annually to ensure that there has been no change in their expected useful lives. Where necessary additional provisions are made to reflect shortened asset lives.

(O) Surpluses from Long-Term Business and the Fund for Future Appropriations

Surpluses arising from the Society's long-term business, as a result of the annual actuarial valuations of the related assets and liabilities, are subject to appropriation by the Managing Board.

The Fund for Future Appropriations represents the part of the fund where the allocation has not been determined by the end of the financial year.

(P) Long-Term Business Provision

The Long-Term Business Provision is determined by the Managing Board, having taken advice from the Chief Actuary.

The Long-Term Business Provision is calculated using Solvency II methodology (where permitted by FRS 103) which is also used for the Society's regulatory reporting. The Long-Term Business Provision is broadly equivalent to the Society's best estimate of its liabilities.

With-profits (participating) contracts

Actuarial best estimate assumptions are used to determine the amount and timing of future cash flows which make up the best estimate liabilities.

Provision is made for all bonus payments (declared and future, regular and final and planned enhancements) estimated, where necessary, in a manner consistent with the Principles and Practices of Financial Management. The underlying liabilities are based on the aggregate value of asset shares reflecting the premiums, investment return, expenses and charges applied to each contract. No allowance is made for future management actions.

Some with-profits contracts also contain options and guarantees that can increase the benefits payable to the policyholder. The potential liability for these options and guarantees is determined using a market consistent stochastic model, which simulates future investment returns, asset mix and bonuses. The most significant options and guarantees are:

- The sum assured and declared regular bonuses on conventional with-profits policies; and
- Unitised with-profits policies containing a guaranteed increase in the unit price or guarantees that market value reductions will not be applied at specified times.

Non with-profits contracts

For conventional non-profit contracts, the best estimate liability is calculated using a cash flow projection of all future benefit payments, future expenses and future premiums. These are adjusted for tax where applicable and discounted to give a present value.

For unit-linked contracts, the provision is based on fair value. The fair value of a unit-linked financial liability is determined using the current unit values that reflect the fair values of the financial assets contained within the Society's unitised investment funds linked to the financial liability, multiplied by the number of units attributed to the contract holder at the Balance Sheet date.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

1 Accounting Policies (continued)

(Q) Taxation

The current tax charge is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the Balance Sheet date.

Deferred tax is recognised in respect of all material timing differences that have originated but not reversed at the Balance Sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax.

Deferred tax assets are recognised only to the extent that the Group considers that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is calculated at the rates at which it is expected that the tax will arise and is not discounted.

Where tax positions are uncertain, the Group establishes provisions based on reasonable estimates. The amount of provision recorded is based upon various factors, such as interpretation of tax regulations and external professional advice.

(R) Foreign Currencies

The primary economic environment in which the Group and Society operates is the United Kingdom, hence the functional and presentational currency is pounds sterling.

Transactions in foreign currencies are recorded at the rate of exchange prevailing on the date of the transaction and monetary assets and liabilities held in foreign currencies are translated to sterling at the rate of exchange ruling at the end of the year. All resulting foreign exchange gains and losses are recognised in the Technical Account for the year. Non-monetary assets and liabilities are translated using the exchange rate at the date of the transaction.

(S) Operating Leases

Operating leases are leases in which a significant portion of the risks and rewards of ownership are retained by the lessor. Rentals payable under operating leases are charged to the Technical Account on a straight line basis over the period of the lease.

(T) Acquisition Expenses

Acquisition expenses comprise costs of obtaining and processing new business. For business written within the with-profits fund acquisition costs are not deferred.

(U) Staff Pensions

The Group operates both defined benefit and defined contribution pension schemes. In respect of the defined benefit pension scheme, the pension liability recognised on the Balance Sheet is the value of the scheme's assets less the present value of the scheme's liabilities.

The pension cost for the scheme is analysed between past service cost and net return on the pension scheme. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the Technical Account on a straight line basis over the period to which the increase in benefits vest.

Net interest return on the pension liability comprises the expected return on the pension scheme assets less interest on scheme liabilities. The actuarial gains or losses which arise from a valuation, or from updating the latest actuarial valuation to reflect conditions at the Balance Sheet date, are included in the Statement of Other Comprehensive Income for the period.

In respect of the defined contribution schemes operated by the Group, payments made into these schemes are accounted for when due. The assets of the schemes are held separately from the Group and Society in independently administered funds.

(V) Provisions

Provisions are made where an event has taken place that gives a legal or constructive obligation that probably requires settlement by a transfer of economic benefit and a reliable estimate can be made of the amount of the obligation.

Provisions are charged as an expense to the Technical Account in the year that the Group becomes aware of the obligation and are measured at the best estimate at the Balance Sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried on the Balance Sheet.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

2 Premium Analysis

Group and Society

All business is written in the United Kingdom and relates exclusively to individual policy holders.

(A) Earned Premiums

	2018			2017		
	Gross £'000	**Reinsurance £'000**	**Net £'000**	**Gross £'000**	**Reinsurance £'000**	**Net £'000**
Regular premiums						
Insurance contracts	72,829	(1,749)	71,080	73,258	(1,946)	71,312
Investment contracts with discretionary participation features	3,930	-	3,930	4,110	-	4,110
	76,759	**(1,749)**	**75,010**	**77,368**	**(1,946)**	**75,422**
Single premiums						
Investment contracts with discretionary participation features	18,762	-	18,762	23,660	-	23,660
Total earned premiums recognised in the Technical Account	**95,521**	**(1,749)**	**93,772**	**101,028**	**(1,946)**	**99,082**
Earned premiums on linked business	5,021	-	5,021	5,175	-	5,175
Earned premiums on non-participating investment contracts	804	-	804	12,646	-	12,646
Total	**101,346**	**(1,749)**	**99,597**	**118,849**	**(1,946)**	**116,903**

As set out in note 1(F) the Group and Society do not account for premiums received on investment contracts (other than those with discretionary participation features) as premium income. Where these contracts are unit-linked they have been accounted for as deposits and added to the value of linked investment contract liabilities on the Balance Sheet.

Premiums earned on investment contracts without discretionary participation features are treated as deposits and included within technical provisions on the Balance Sheet.

(B) Gross New Business Premiums (Annualised)

Regular premiums are those where there is a contractual obligation or reasonable expectation to pay on a regular basis. Single premiums are those relating to products issued by the Society which provide for the payment of one premium only.

The table below includes the annual premium equivalent for all new regular premiums as well as all single premiums received during the year, including investment contracts.

	2018 £'000	**2017 £'000**
Regular Premiums		
Insurance contracts	10,092	10,344
Investment contracts	35	66
Single Premiums		
Investment contracts	1,923	13,885
Investment contracts with discretionary participation features	18,762	23,660
	30,812	**47,955**

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

3 Investment Income and Expenses

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
Investment income:				
- Income from financial investments	15,292	19,094	15,282	19,092
- Gains on the realisation of investments	95,382	52,889	95,382	52,889
- Net foreign exchange (losses)/gains	(3,401)	7,626	(3,401)	7,626
	107,273	**79,609**	**107,263**	**79,607**
Unrealised (losses)/gains on investments	**(97,876)**	**6,737**	**(104,914)**	**(21,000)**
Investment expenses and charges:				
- Investment management expenses	2,390	5,296	2,390	5,296
- Losses on the realisation of investments	37,007	13,783	37,007	13,783
	39,397	**19,079**	**39,397**	**19,079**
Net investment (losses) / income	**(30,000)**	**67,267**	**(37,048)**	**39,528**

4 Other Technical Income

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
Fee income on investment contracts	1,085	1,021	1,085	1,021
General insurance	19,396	24,073	-	-
Other	14,724	14,198	19	26
	35,205	**39,292**	**1,104**	**1,047**

5 Claims

As set out in note 1(I) the Group and Society do not account for the amounts paid out on investment contracts as a claim expense in the Technical Account. These amounts have been accounted for as deposits repaid and have been deducted from the value of investment contract liabilities on the Balance Sheet. Claims paid out on investment contracts during the year were £12,613,000 (2017: £5,339,000).

6 Long-Term Business Provision

Group and Society

The table below shows the changes in the long-term business provision in the year.

	2018 £'000	**2017 £'000**
Gross amount	(53,831)	23,968
Reinsurers' share	56	(354)
Change in investment contracts	9,517	(9,440)
	(44,258)	**14,174**

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

7 Net Operating Expenses

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Acquisition costs	5,801	2,455	5,801	2,455
Goodwill and intangible asset amortisation	6,903	7,004	198	299
Administration expenses	5,759	4,123	5,704	4,097
Information technology infrastructure	990	4,150	990	4,150
Operating lease costs	435	648	435	648
	19,888	**18,380**	**13,128**	**11,649**

Society

Costs are recharged to the Society via a management recharge from a group entity.

8 Staff Costs

	Group	
	2018 £'000	2017 £'000
Wages and salaries	18,563	23,572
Social security costs	1,837	2,229
Other pension costs	1,122	1,226
	21,522	**27,027**

Average number of employees of the Group by activity (including executive directors) during the year:

	Group	
	2018 No.	2017 No.
Senior management	7	7
Sales and customer services	265	315
Support services	219	230
	491	**552**

The Society has no directly employed staff, all staff are employed by the subsidiary company, PM Central Services PLC.

9 Directors' Emoluments

	Group	
Directors' aggregate remuneration in respect of qualifying services:	2018 £'000	2017 £'000
Aggregate fees	318	298
Aggregate emoluments	478	476
	796	**774**

Pension contributions were made on behalf of one director (2017: one) under defined contribution schemes.

The highest paid director's remuneration was aggregate emoluments of £478,000 (2017: £476,000).

Key management includes directors and members of the executive management team. The compensation of key management personnel for the year was £1,903,000 (2017: £2,054,000) in respect of salaries, pensions and other benefits.

Society

The directors receive emoluments from PM Central Services PLC for services rendered in respect of all Group entities, however, none of the directors receive remuneration specific to the directorship of the Society (2017: £Nil).

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

10 Auditors' Remuneration

During the year the Group obtained the following services from the Society's auditors at costs as detailed below:

	2018 £'000	2017 £'000
Audit Services:		
Fees payable to the Society's auditors for the audit of the Society and Consolidated Financial Statements	319	270
Audit of the Society's subsidiaries	81	74
Audit related assurance services including the audit of insurance related regulatory returns	-	130
	400	**474**
Non Audit Services:		
Fees payable to the Society's auditors for other services:		
Other services supplied pursuant to legislation, including the audit of non-insurance related regulatory returns	8	8
Services relating to corporate finance transactions	-	19
	8	**27**
	408	**501**

The Group's auditors charged fees in respect of the audit of the Police Mutual stakeholder pension scheme of £8,000 (2017: £8,000).

11 Taxation Attributable to Long-Term Business

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
UK corporation tax:				
Current tax on income for the year	-	-	-	-
Adjustment in respect of prior years	55	(99)	55	(54)
Total current tax	**55**	**(99)**	**55**	**(54)**
Deferred tax:				
Origination and reversal of timing differences	(587)	1,120	(334)	1,373
Adjustment in respect of prior years	112	51	112	51
Total deferred tax	**(475)**	**1,171**	**(222)**	**1,424**
Total tax attributable to long-term business	**(420)**	**1,072**	**(167)**	**1,370**

UK corporation tax in the Society Technical Account has been calculated at a rate of 20% (2017: 20%) in accordance with rates applicable to the long-term business of a long-term insurance company.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

11 Taxation Attributable to Long-Term Business (continued)

The tax assessed on the results recorded in the Technical Account for the year differs from the standard rate of tax in the UK of 20% Society / 19% subsidiary companies (2017: 20% - Society / 19.25% - subsidiary companies). The differences are reconciled below:

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
Movement on technical account before tax	(18,412)	(8,637)	(19,816)	(20,007)
Movement multiplied by the standard rate of tax of 19%/20% (2017: 19.25%/20%)	(3,705)	(1,585)	(3,963)	(4,001)
Effects of:				
Adjustment to current tax in respect of prior years	55	(99)	55	(54)
Adjustment to deferred tax in respect of prior years	112	51	112	51
Net non taxable income	(4,351)	1,718	(1,224)	8,789
Depreciation in advance of capital allowances/ (capital allowances claimed in excess of depreciation)	(169)	244	(23)	(10)
Deferred tax on pension liability	412	216	412	216
Deferred tax on capital losses derecognised and capital losses in year	2,444	(6,537)	2,444	(6,537)
Deferred tax on acquisition costs derecognised	211	2,709	211	2,709
Unrelieved pension costs carried forward	221	-	221	-
Losses carried forward in the year	3,328	3,317	1,588	207
Goodwill amortisation not tax deductible	1,022	1,038	-	-
Total taxation	**(420)**	**1,072**	**(167)**	**1,370**

Deferred Tax

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
Deferred tax asset/(liability):				
On acquisition costs	-	267	-	267
On Staff Pension Scheme	1,115	1,846	1,115	1,846
On unrealised losses on investments	3,004	1,784	3,004	1,784
On customer list	(316)	(569)	-	-
	3,803	**3,328**	**4,119**	**3,897**

Movements in net deferred tax asset

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
At 1 January	3,328	4,499	3,897	5,321
Deferred tax credit/(charge) in Technical Account	475	(1,171)	222	(1,424)
At 31 December	**3,803**	**3,328**	**4,119**	**3,897**

At 31 December 2018, the Group had an unrecognised deferred tax asset of £18,007,000 comprising acquisition expenses £2,398,000, capital losses £3,877,000, tax losses £10,038,000, capital allowances £1,473,000 and pension contributions £221,000. At 31 December 2017, the Group had an unrecognised deferred tax asset of £12,493,000 comprising acquisition expenses £2,187,000, capital losses £1,282,000, tax losses £7,431,000 and capital allowances £1,593,000. These assets are not recognised on the grounds that the Group is not expected to generate sufficient suitable taxable profits against which these assets can be relieved.

At 31 December 2018, the Society had an unrecognised deferred tax asset of £8,880,000 comprising acquisition expenses £2,398,000, capital losses £3,877,000, tax losses £2,082,000, capital allowances £302,000, and pension contributions £221,000. At 31 December 2017 the Society had an unrecognised deferred tax asset of £4,343,000 comprising acquisition expenses £2,187,000, capital losses £1,282,000, tax losses £607,000 and capital allowances £267,000. These assets are not recognised on the grounds that the Society is not expected to generate sufficient suitable taxable profits against which these assets can be relieved.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

11 Taxation Attributable to Long-Term Business (continued)

Factors affecting future taxation

Changes to the UK corporation tax rates for the subsidiary companies were substantively enacted as part of the Finance Bill 2016 on 15 September 2016. These include reductions to the main rate of corporation tax to 19% from 1 April 2017 and to 17% from 1 April 2020. Deferred taxes at the Balance Sheet date have been measured and reflected in these financial statements using these enacted tax rates. There are no changes planned to the future corporation tax rate for the Society, which remains at 20%.

12 Fund for Future Appropriations

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
At 1 January	62,743	72,452	132,912	154,289
Transfer from technical account	(19,758)	(11,126)	(21,586)	(22,794)
Transfer from other comprehensive income	1,766	1,417	1,937	1,417
At 31 December	**44,751**	**62,743**	**113,263**	**132,912**

13 Intangible Assets

Group

	Goodwill £'000	Customer List £'000	Software £'000	Total £'000
Cost:				
At 1 January 2018 and at 31 December 2018	**32,916**	**6,846**	**1,501**	**41,263**
Amortisation:				
At 1 January 2018	17,590	3,722	941	22,253
Charge for the year	5,336	1,369	198	6,903
At 31 December 2018	**22,926**	**5,091**	**1,139**	**29,156**
Net book value:				
At 31 December 2018	**9,990**	**1,755**	**362**	**12,107**
At 31 December 2017	15,326	3,124	560	19,010

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

13 Intangible Assets (continued)

Society

	Software £'000
Cost:	
1 January 2018 and 31 December 2018	**687**
Amortisation:	
At 1 January 2018	127
Charge for the year	198
At 31 December 2018	**325**
Net book value:	
At 31 December 2018	**362**
At 31 December 2017	560

14 Investments in Group Undertakings

Society

	Shares in Group undertakings £'000
At 1 January 2018	93,447
Share purchase	5,000
Net revaluation loss	(7,038)
At 31 December 2018	**91,409**

The valuation of group undertakings is sensitive to a number of factors including external economic and market conditions. The elements of the valuation model which are most impacted by these factors are the earnings multiple and forecast future earnings.

A 10% movement in the earnings multiple selected gives a 10.3% movement in the resulting valuation. A 10% movement in the forecast future earnings gives a 9.3% movement in the resulting valuation.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

14 Investments in Group Undertakings (continued)

Set out below are the Society's investments in subsidiary undertakings as at 31 December 2018, all of which are included in the consolidation. All of the subsidiaries are incorporated in England and Wales and are wholly owned.

Name of undertaking	Principal activities	Immediate parent company
PM Central Services PLC (Company number: 08752809)	Service company for the Group.	Police Mutual Assurance Society Limited
PM Holdings Limited (Company number: 09908006)	An intermediate holding company.	Police Mutual Assurance Society Limited
PMGI Limited (Company number: 01073408)	Arranges general insurance policies and acts as an introducer of third party products.	PM Holdings Limited
PM Advisory Limited (Company number: 04560462)	Offers independent financial advice and also acts as an introducer for the Police Mutual Investment Choice platform.	PM Holdings Limited
Police Housing Fund Limited (Company number: 05069158)	An intermediate holding company.	PM Holdings Limited
PMHC Limited (Company number: 03018474)	Provider of discretionary healthcare products.	PM Holdings Limited
Mortgage Excellence PLC (Company number: 03527577)	Provider of mortgage placement and related financial services.	PM Holdings Limited
Abacus Limited (Company number: 04207663)	Arranges general insurance policies and acts as an introducer of third party products.	PM Holdings Limited
Forces Insurance Limited (Company number: 04188402)	A dormant company.	PM Holdings Limited
Abacus Insurance Holdings Limited (Company number: 08313724)	A dormant company.	PM Holdings Limited

PM Advisory Limited, PMGI Limited, Mortgage Excellence PLC, Abacus Limited and Forces Insurance Limited are all regulated by the Financial Conduct Authority.

PM Holdings Limited, Police Housing Fund Limited, PMHC Limited and Abacus Insurance Holdings Limited have all taken the 479A audit exemption for a subsidiary company with the Society providing the parental guarantee.

In addition, the Group owns preference shares in Pinkerton segregated account (within Artex SAC Limited) which is incorporated in Bermuda and is an investment of Police Housing Fund Limited. Pinkerton is included in the consolidated financial statements in accordance with FRS 102, paragraph 9.11 ("Special purpose entities"). Its principal activity is reinsurance of general insurance policies that were arranged by Group companies.

Summary financial information is provided below in relation to Pinkerton segregated account (within Artex SAC Limited) showing each main heading in the primary statements for which there is a material item included within the group financial statements.

Profit and loss account

	2018 £'000	2017 £'000
Other Technical Income	10,334	6,548
Other Technical Charges	(869)	(657)
Net profit	**9,465**	**5,891**

Balance Sheet

	2018 £'000	2017 £'000
Current assets	13,803	7,092
Current liabilities	(3,331)	(85)
Net assets	**10,472**	**7,007**

Included within current assets is £8,091,000 (2017: £4,414,000) of cash, of which £3,790,000 (2017: £3,709,000) is held as collateral.

There are no other gains and losses occurring in the current period. A dividend of £6,000,000 (2017: £4,700,000) was declared during the period and £2,750,000 (2017: £5,500,000) was paid to Police Housing Fund Limited, the immediate parent undertaking.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

15 Other Financial Investments

Due to the nature of the Group and Society, financial investments are held in order to be able to meet obligations to policy holders in the future.

(A) Financial Investments

Group and Society

	2018		2017	
	Carrying Value £'000	**Historical Cost £'000**	**Carrying Value £'000**	**Historical Cost £'000**
Financial investments at FVTPL				
Derivatives (note 15(B) – held for trading)				
- Forward currency	4,011	-	3,567	-
- Listed Options	3,052	4,767	2,429	3,109
- Bond futures	-	70	-	(11)
Financial investments designated upon initial recognition as at FVTPL				
Shares and other variable yield securities:				
- United Kingdom - listed	117,596	111,510	161,224	131,382
- United Kingdom - unlisted	4,175	3,005	4,175	3,005
- Overseas - listed	195,390	206,035	187,581	160,110
Debt and other fixed income securities:				
- United Kingdom - listed	95,132	95,643	161,001	153,538
- United Kingdom - unlisted	20,327	22,198	24,784	25,192
- Overseas - listed	79,310	79,579	9,897	9,939
Total financial investments held at FVTPL	**518,993**	**522,807**	**554,658**	**486,264**
Loans and receivables at amortised cost				
Loans on policies	2,596	2,596	2,929	2,929
Deposits with credit institutions	96,005	93,747	168,671	165,848
Total financial investments	**617,594**	**619,150**	**726,258**	**655,041**

All United Kingdom listed shares and securities are listed on the London Stock Exchange or other recognised investment exchanges. Overseas investments are listed on recognised investment exchanges within the relevant domicile country. Loans and receivables at amortised cost are disclosed at carrying value which is a reasonable approximation of fair value. Investments classified as held as at FVTPL (fair value through profit and loss) are those where fair value is equal to the assets' carrying value with gains or losses being reflected in the Technical Account. In this way these gains and losses will be matched with changes in the related liabilities to policy holders, which are also reflected in the Technical Account.

(B) Derivative Financial Instruments

The Society currently uses derivative financial instruments for efficient portfolio management. The derivatives used are 'exchange-traded' (regulated by an exchange) forward currency contracts with a market quoted price. These derivatives are financial contracts obligating the buyer to purchase a financial instrument at a predetermined future date and price.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value are recognised immediately in the Technical Account. Fair values are obtained from quoted market prices in active markets, including recent market transactions. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. The fair value of derivatives held at 31 December 2018 was £7,063,000 (2017: £5,996,000), commission payable on purchase was £Nil (2017: £Nil).

(C) Collateral

At the Balance Sheet date the Group and Society had pledged £1,542,000 (2017: £796,000) of cash margin collateral in respect of futures. The net cash margin pledged is included within cash on the face of the Balance Sheets of the Group and Society.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

16 Risk Management

(A) Credit Risk

The table below shows the assets of the Group and Society that are subject to credit risk and a reconciliation to the Balance Sheet carrying value for that asset. For derivatives the credit rating reflects the credit rating of the counterparty. Linked assets are not subject to credit risk as this risk is borne by the holders of the contracts concerned. The directors do not consider that there is any credit risk associated with Government gilts. Non-linked assets not subject to credit risk include shares and other variable yield securities that are subject to market risk.

		Group		Society	
		2018	**2017**	**2018**	**2017**
	Rating	**£'000**	**£'000**	**£'000**	**£'000**
Non-linked assets subject to credit risk	Government	1,229	2,431	1,229	2,431
Financial investments - debt and fixed income securities	AAA	2,960	3,091	2,960	3,091
	AA	17,388	16,211	17,388	16,211
	A	42,812	46,109	42,812	46,109
	BBB and below	75,749	100,647	75,749	100,647
	Not rated	20,327	24,784	20,327	24,784
Cash and cash equivalents	AAA	-	-	-	-
	AA	90,849	195,864	90,849	195,864
	A	131,959	11,800	120,699	6,605
	BBB and below	-	4,218	-	-
	Not rated	-	20	-	20
Reinsurers' share of technical provisions	AA	8,149	8,205	8,149	8,205
Linked assets not subject to credit risk		79,476	81,673	79,476	81,673
Linked assets subject to credit risk - cash	AA	8,867	8,736	8,867	8,736
	A	11,327	10,141	11,327	10,141
Non-linked assets not subject to credit risk		384,291	433,760	429,758	474,840
Total assets		**875,383**	**947,690**	**909,590**	**979,357**

In addition to holding collateral, use of an intermediary company reduces Police Mutual's exposure to credit risk by ensuring that the parties involved in the derivatives have sufficient resources to meet payment requirements. This is enhanced by the requirement for parties to provide the intermediary with an additional margin payment which provides further protection against default. The types of derivatives and the terms under which Police Mutual enters into arrangements are given in note 15(B).

No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by these counterparties. Non-linked assets not subject to credit risk include premium debtors all of which are less than three months old. The Society has never experienced a significant loss arising from premium debtors because the Society maintains the right to cancel a policy if premiums are not paid when due. No provision is made for impairment of these assets (2017: £Nil).

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

16 Risk Management (continued)

(B) Liquidity Risk

The analysis below provides a summary of the exposures carried in respect of liquidity risks. The earliest contractual repayment date of investment contracts with discretionary participation features and unit linked investment contracts is on demand and the undiscounted cash flows subject to liquidity risk are £230,926,000 (2017: £235,991,000) and £99,670,000 (2017: £100,550,000) respectively. Other financial liabilities are repayable between 0-5 years as follows:

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
Other financial liabilities	48,808	43,342	14,503	4,840

The tables below show the undiscounted expected maturity analysis of the Group's and Society's insurance contracts and investment contracts with discretionary participation features. These are the amounts that are guaranteed on maturity (or any earlier date where the surrender value is guaranteed).

Group and Society

	2018					
	0-5 years £'000	**5-10 years £'000**	**10-15 years £'000**	**15-20 years £'000**	**Over 20 years £'000**	**Total £'000**
Liabilities subject to liquidity risk						
Insurance contract liabilities						
- guaranteed component	257,064	371,258	106,808	6,323	1,652	743,105
Investment contract with discretionary participation features liabilities						
- guaranteed component	167,936	51,269	778	345	81	220,409
	425,000	**422,527**	**107,586**	**6,668**	**1,733**	**963,514**

	2017					
	0-5 years £'000	**5-10 years £'000**	**10-15 years £'000**	**15-20 years £'000**	**Over 20 years £'000**	**Total £'000**
Liabilities subject to liquidity risk						
Insurance contract liabilities						
- guaranteed component	272,060	365,396	107,817	6,320	1,753	753,346
Investment contract with discretionary participation features liabilities						
- guaranteed component	151,117	54,117	1,089	312	72	206,707
	423,177	**419,513**	**108,906**	**6,632**	**1,825**	**960,053**

Amounts under unit linked contracts are generally repayable on demand and the Group is responsible for ensuring there is sufficient liquidity within the asset portfolio to enable liabilities to unit linked policy holders to be met as they fall due.

(C) Operational, Strategy, Brand and Reputation Risks

Unlike financial risks, the measurement of operational, strategic and reputation risks is largely based on scenario analysis and stress testing that includes reverse stress testing carried out by subject matter experts from key parts of the organisation with the involvement of the Managing Board at appropriate stages. This approach is proportionate to the size and complexity of the business. The Group uses scenario analysis and stress testing to help assess the likelihood and impact of risks on the evolving business model and strategic plans by considering the strength of systems of control and framing appropriate contingency plans and risk mitigating actions to reduce the exposure to within the Group's risk tolerances and appetite. The approach refers to industry and regulatory guidance which emphasises the use of data collected internally and external sources as applicable to the Group.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

16 Risk Management (continued)

(D) Currency Risk

The table below shows the split of denomination currencies and the extent to which there is an exposure to currency risk.

Assets

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Non-linked assets				
Assets denominated in Sterling	573,722	648,233	607,929	679,900
Assets denominated in US Dollars	136,600	154,817	136,600	154,817
Assets denominated in Euros	18,549	25,667	18,549	25,667
Assets denominated in other currencies	46,842	18,423	46,842	18,423
Total non-linked assets	**775,713**	**847,140**	**809,920**	**878,807**
Linked assets not exposed to currency risk	99,670	100,550	99,670	100,550
Total assets	**875,383**	**947,690**	**909,590**	**979,357**

(E) Fair value estimation

FRS 102, under paragraphs 11.41(a) and 11.41(d) requires for financial instruments held at fair value on the Balance Sheet, disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets and liabilities (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2);
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following table presents the Group's investments that are measured at fair value at 31 December 2018.

	Total £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000
Derivatives				
- Forwards	7,063	7,063	-	-
Shares and other variable yield securities:				
- United Kingdom *	182,197	97,974	-	84,223
- Overseas	195,390	195,390	-	-
Debt and other fixed income securities:				
- United Kingdom	115,459	34,305	60,827	20,327
- Overseas	79,310	1,235	78,075	-
Deposits with credit institutions **	115,035	115,035	-	-
Loans on policies	2,596	-	-	2,596
	697,050	**451,002**	**138,902**	**107,146**

* includes £60,426,000 of assets held to cover linked liabilities with the Level 1 category.
** includes £19,030,000 of assets held to cover linked liabilities with the Level 1 category.

The investment in shares in group undertakings held by the Society of £91,409,000 (2017: £93,447,000) is classified as level 3. There are no other differences between the Group and Society's investments.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

16 Risk Management (continued)

(E) Fair value estimation (continued)

The following table presents the Group's investments that are measured at fair value at 31 December 2017.

	Total £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000
Derivatives				
- Forwards	5,996	5,996	-	-
Shares and other variable yield securities:				
- United Kingdom*	247,035	160,763	-	86,272
- Overseas	187,581	187,581	-	-
Debt and other fixed income securities:				
- United Kingdom	185,785	-	161,001	24,784
- Overseas	9,897	-	9,897	-
Deposits with credit institutions**	186,155	186,155	-	-
Loans on policies	2,929	-	-	2,929
	825,378	**540,495**	**170,898**	**113,985**

* includes £81,636,000 of assets held to cover linked liabilities with the Level 1 category.
** includes £17,484,000 of assets held to cover linked liabilities with the Level 1 category.

The Group does not have any financial liabilities that are held for trading.

The fair value of financial instruments traded in active markets is based on quoted bid prices at the Balance Sheet date, as described in note 1(K) to the Financial Statements. These instruments are included in Level 1 and comprise primarily listed equity and debt instruments.

The Group monitors closely the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique. The techniques applied incorporate relevant information available and reflect appropriate adjustments for credit and liquidity risks. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. The relative weightings given to different sources of information and the determination of non-observable inputs to valuation models can require the exercise of significant judgement.

If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2. If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- The use of observable prices for recent arm's length transactions;
- Quoted market prices or dealer quotes for similar instruments. In particular, for corporate bonds for which there is no active market the fair value is based on broker/dealer price quotations. Where possible the Group seeks at least two quotations for each bond and considers whether these are representative of fair value in light of current traded levels. Where this information is not available or where it is considered to be not representative of fair value, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics; and
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

Note that all of the resulting fair value estimates are included in Level 2, except for certain asset backed securities which are included in Level 3.

The following table presents the changes in Level 3 financial instruments for the year ended 31 December 2018.

	Group 2018 £'000	Society 2018 £'000
Opening Balance	113,985	207,432
Net disposals	(12,050)	(7,050)
Unrealised gain/(loss) included in the Technical Account	5,211	(1,827)
Closing Balance	**107,146**	**198,555**

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

16 Risk Management (continued)

(E) Fair value estimation (continued)

The Group has investments in property funds. These have been classified as Level 3 as there is limited observable market data for the valuation of these assets. The fair value of the property funds is based on the net asset values supplied by underlying fund managers using independent firms of valuers. Management has applied a discount factor collated from portfolio managers based on their views of the secondary unlisted market to the net asset values.

The Group has a minority equity holding in and a corporate bond with a financial company. These have been classified as Level 3 as there is limited recent, observable market data in active markets for the valuation of these assets. The fair value of the minority equity holding has been modelled based on external transactions, however these are not in an active market. The fair value of the loan has been calculated using a discounted cash flow model, with assumptions for the level of default, the amount recovered in the event of a default, and the rates of early repayments.

17 Tangible Assets

Group

	Land and Buildings £'000	Computer equipment £'000	Office furniture and equipment £'000	Motor vehicles £'000	Total £'000
Cost or valuation:					
At 1 January 2018	6,768	6,540	1,445	79	14,832
Additions	(1,493)	-	-	-	(1,493)
Transfer to intangible assets	-	291	21	-	312
Disposals	-	(8)	(15)	(50)	(73)
At 31 December 2018	**5,275**	**6,823**	**1,451**	**29**	**13,578**
Depreciation:					
At 1 January 2018	1,438	2,947	620	44	5,049
Charge for the year	-	982	134	4	1,120
Revaluation	(1,438)	-	-	-	(1,438)
Eliminated on disposals	-	(3)	(7)	(25)	(35)
At 31 December 2018	**-**	**3,926**	**747**	**23**	**4,696**
Net book value:					
At 31 December 2018	**5,275**	**2,897**	**704**	**6**	**8,882**
At 31 December 2017	5,330	3,593	825	35	9,783

At the end of the year the Group had a tangible asset capital commitment of £Nil (2017: £Nil).

The land and buildings included above are owned directly by and occupied by the Society.

The value of freehold land, which is not depreciated is £895,000.

All properties held at 31 December 2018 are freehold. The freehold properties were valued at 31 December 2018 by Kingstons Commercial Property Consultants, an independent valuer with a recognised and relevant professional qualification on the basis of fair value in accordance with the provisions of the professional standards of the Royal Institution of Chartered Surveyors. The valuation in 2017 was a directors' valuation.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

17 Tangible Assets (continued)

Society

	Freehold Land and Buildings £'000	Computer equipment £'000	Total £'000
Cost or valuation:			
At 1 January 2018	6,768	1,008	7,776
Additions	(1,493)	-	(1,493)
Disposals	-	(8)	(8)
At 31 December 2018	**5,275**	**1,000**	**6,275**
Depreciation:			
At 1 January 2018	1,438	145	1,583
Charge for the year	-	325	325
Revaluation	(1,438)	-	(1,438)
Eliminated on disposals	-	(4)	(4)
At 31 December 2018	**-**	**466**	**466**
Net book value:			
At 31 December 2018	**5,275**	**534**	**5,809**
At 31 December 2017	5,330	863	6,193

18 Technical Provisions and Technical Provisions for Linked Liabilities

(A) Technical Provisions

Group and Society

	2018			2017		
	Gross £'000	Reinsurers' Share £'000	Net £'000	Gross £'000	Reinsurers' Share £'000	Net £'000
Contract liabilities						
Participating insurance contracts	381,358	-	381,358	424,406	-	424,406
Non-participating insurance contracts	8,697	(8,149)	548	8,103	(8,205)	(102)
	390,055	**(8,149)**	**381,906**	**432,509**	**(8,205)**	**424,304**
Investment contracts with discretionary participation features	243,763	-	243,763	241,041	-	241,041
Non-participating investment contracts	32,200	-	32,200	46,299	-	46,299
Long-term business provision	**666,018**	**(8,149)**	**657,869**	**719,849**	**(8,205)**	**711,644**
Claims outstanding	**7,046**	**(609)**	**6,437**	**7,065**	**(873)**	**6,192**

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

18 Technical Provisions and Technical Provisions for Linked Liabilities (continued)

(B) Technical Provisions for Linked Liabilities and Other Financial Liabilities

Group and Society

	2018	2017
	£'000	£'000
Non-participating investment contracts	99,670	100,550
Total technical provisions for linked liabilities	**99,670**	**100,550**

Financial liabilities in respect of unit-linked investment contracts are carried on the Balance Sheet at amortised cost.

Other financial liabilities of the Group including creditors payable within one year of £43,511,000 (2017: £38,061,000) are measured at amortised cost. The corresponding amounts for the Society are £14,503,000 (2017: £4,840,000).

The carrying value of unit-linked investment contracts and other financial liabilities is a reasonable approximation of fair value.

(C) Assumptions

Key assumptions used to determine insurance contract liabilities are set by the Managing Board based on advice given by the Chief Actuary and are outlined below. These assumptions are updated at least at each reporting date to reflect latest estimates.

In calculating the technical provisions no account has been taken of future management actions.

i) Demographic

- Mortality

Mortality bases are reviewed periodically to ensure that the assumptions remain appropriate, taking into account recent company and industry experience for each class of business. The mortality rates used are given below.

Class of Business	Mortality	
	2018	2017
Term assurance (smoker/non-smoker differentiated)	50% TM/F00 / 100% TM/F00	50% TM/F00 / 100% TM/F00
Term assurance	70% TM/F00	70% TM/F00
Whole of Life business	60% AM/F00	60% AM/F00
Pension business	60% AM/F00	60% AM/F00
Unitised with-profits business	40% AM/F00	40% AM/F00
All other business	40% AM/F00	40% AM/F00
All other business	60% AM/F00	60% AM/F00

The mortality assumptions for 2018 are unchanged from 2017.

If a lower mortality rate were assumed to apply, the Long-Term Business Provision would decrease in respect of assurances and increase in respect of with-profits business.

- Persistency

Persistency is the extent to which policies remain in force and are not for any reason lapsed, made paid-up, surrendered or transferred prior to maturity or expiry.

An allowance has been made for lapse and withdrawal rates based on analysis of the most recent experience. The lapse rates used for 2018 are different from the 2017 assumptions reflecting variations in actual experience.

To the extent that recurring single premiums are paid under a contract, provided the terms of the payment of those single premiums are not fixed contractually, no future allowance will be made.

An increase in lapses would reduce the cost of guarantees, as fewer policy holders remain to receive the guaranteed benefits.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

18 Technical Provisions and Technical Provisions for Linked Liabilities (continued)

(C) Assumptions (continued)

ii) Expenses

Allowance is made for the best estimate of the expenses required to administer the existing life assurance business. A comprehensive review of the way in which costs are allocated between business and products has been undertaken. The assumptions have been updated to reflect both changes in the expected future expense base and the changes in the cost allocation methodology. At 31 December 2017, the cost allocation review had started but not concluded and this, together with the Transformation Programme, introduced some uncertainty to the costs of administering the existing business. As a consequence an additional expense reserve was held at 31 December 2017 to explicitly cover the additional life maintenance costs for the in force book. This additional uncertainty has now been removed and the expense assumptions set out below fully reflect the expected costs of administering the existing business so an additional expense reserve is not required at 31 December 2018.

An increase in expenses would increase the cost of guarantees as the guaranteed benefits are more likely to apply at maturity. It would also increase the technical provisions for the non-profit business.

Class of Business	**Expenses**	
	2018	**2017**
Term assurance	£17.50 pa	£8.50 pa
Annuities	2% of annuity	2% of annuity
Top up pension	£15.00 pa	£14.64 pa
Platinum Bond, GIB, GISA, OISA	£50.00 pa	£65.00 pa
Stakeholder Pension, Group Personal Pension	£75.00 pa	£67.80 pa
Child Trust Fund	£24.00 pa	£18.10 pa
Conventional with-profits	£17.00 pa	£15.25 pa

iii) Economic

For with-profits business, the majority of the liability is calculated as the aggregate asset share for the business in force. This is a retrospective calculation based on the actual experience. Asset shares have been determined in line with our Principles and Practices of Financial Management (PPFM).

The values of financial options and guarantees and future deductions from asset shares are calculated using market consistent techniques. Market consistency is achieved by running a large number of economically credible scenarios through a stochastic valuation model. Each scenario is discounted at a rate consistent with the individual simulation. Economic scenarios achieve market consistency by calibration to observed market data.

Significant assumptions impacting the cost of options and guarantees are investment volatility and correlation. Asset expected returns and volatilities have been calibrated to ensure consistency with market values at an appropriate term for our anticipated liability profile. The cost of guarantees will be higher with higher investment volatility.

The liabilities for non-profit business have been calculated using the risk free term structure as specified by EIOPA. The risk discount rate varies by term. For non-profit business, the long-term business provision is calculated using the gross premium valuation method.

19 Capital Management

All Police Mutual's available capital resources are within the Life Fund. There are no shareholders' funds and there are no borrowings.

The Group and the regulated entities within it are subject to a number of regulatory capital tests. They have all met these requirements throughout the financial year. In reporting financial strength, capital and solvency is measured using the regulations prescribed by the Prudential Regulation Authority (PRA). These regulatory capital tests are based upon required levels of solvency capital and a series of best estimate assumptions in respect of the types of business written.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

19 Capital Management (continued)

The primary uses of Police Mutual's capital are:

- to meet statutory solvency and internal capital requirements;
- to give investment freedom for with-profits policyholders;
- to provide working capital;
- to provide capital support for guarantees;
- to finance other business ventures including providing support for benevolent activities consistent with the Society's purposes and for the overall commercial benefit and/or protection of all current and future Members recognising the support the Society receives from the Police;
- to enable smoothing of investment returns and payouts;
- to meet any excess of costs over charges for business other than conventional with-profits business; and
- to meet exceptional costs in managing the business arising as a result of legislation, taxation or other circumstances which, in the opinion of the Managing Board, should not be directly charged to policyholder benefits.

Police Mutual manages its capital by any of the following or a combination of any of them: pursuing its business plan and attendant revenue and profit targets, amending investment strategy, amending charges and by controlling the addition of regular and final bonuses on with-profits policies, in order to ensure it is adequate to meet both the regulatory requirement and the internal assessment for capital as a buffer against adverse circumstances.

Police Mutual's intention is that the capital should be large enough to support the uses listed above and its risk appetite. However, it will not actively increase the amount of capital beyond the needs of ensuring it is adequate for this purpose.

The table below shows the change in Fund for Future Appropriations (FFA) over the year.

	2018 **£'000**	**2017** **£'000**
Total Society FFA at 1 January	**132,912**	**154,289**
Investment variations – assets not backing the asset shares	627	(328)
Investment variations – liabilities, plus one year ageing of policies	(3,833)	14,139
Change in economic conditions and economic assumptions	2,847	7,457
Effect of subsidiary activity	(7,038)	(30,757)
Effect of demographic experience over the year	(2,758)	(2,314)
Expense variances	(3,519)	(4,942)
Tax variances	(3,312)	2,863
Profits on non-profit business after reinsurance	1,061	646
New business	(3,145)	(3,896)
Change in current liabilities	1,547	3,340
Changes in management policy	-	(33)
Change in non-economic assumptions	(1,203)	(4,541)
Modelling changes	150	(1,140)
Other variances	(1,073)	(1,871)
Total Society FFA at 31 December	**113,263**	**132,912**

The first item in the table includes the investment return earned on assets not backing the asset shares. The second item in the table is due to the investment return on the asset share assets being less than risk free rates in 2018.

The change in economic conditions and economic assumptions reflects changes in interest rates and asset volatility figures, together with any change in future equity backing ratio assumption.

The effect of subsidiary activity reflects the latest business plans for the subsidiaries.

The expense variances include items that the Managing Board agreed would be charged to the estate. It also includes the effect of support provided to products and changes to the cost allocation methodology.

The tax variances are largely due to with-profits policyholders being given the full benefit of the deferred tax asset arising from the equity losses incurred in 2018 but the resulting deferred tax asset only being partially recognised.

The change in capital from new business comes mainly from the strain of writing with-profits business and the Fixed Term OISA product.

The main element included in the change in current liabilities is the non-cash flow item in respect of FRS 102 Pension deficit liabilities.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

19 Capital Management (continued)

Police Mutual has only one with-profits fund, the Life Fund. The FFA for that fund is determined in accordance with the FRS 102 regime. The Long-Term Business Provision is calculated using Solvency II methodology (where permitted by FRS 103) which is also used for the Society's regulatory reporting. The Long-Term Business Provision is broadly equivalent to the Society's best estimate of its liabilities. The FFA includes the value of the estate. The estate represents the surplus in the fund that is in excess of any constructive obligation to policyholders. It represents capital resources of the Life Fund recognisable by Solvency II regulations and is available to meet regulatory and other solvency requirements of the fund including additional liabilities recognisable under the Solvency II regime.

Restrictions on available Own Funds

In addition to the liabilities recognisable in the financial statements, Police Mutual is required to hold sufficient capital to meet the sterling reserves on non-profit business and the 'risk margin' (RM). Under Solvency II, the valuation of subsidiaries and intangible assets is also carried out using different methodology. The excess of assets over liabilities including these adjustments form the Solvency II Own Funds (OF).

Police Mutual is required to hold sufficient OF to meet the 'Solvency Capital Requirement' (SCR) determined in accordance with the PRA's regulatory rules under the Solvency II regime, together with the capital requirement determined under the Solvency II Pillar 2 regime (P2CR) which considers more company bespoke risks. The determination of the SCR and P2CR depends on various actuarial and other assumptions about potential changes in market prices, and the actions management would take in the event of particular adverse changes in market conditions.

Management intends to maintain surplus capital in excess of the SCR and P2CR and to maintain an appropriate additional margin over this to absorb changes in both capital and capital requirements.

The items that will have affected OF are the investment performance over 2018, higher interest rates, changes in investment strategy, expense variances, changes in assumptions used to measure liabilities, effect of subsidiary activity, new business and other variances. These other variances include the effect of investment variations (in particular the investment return on those capital resources over the year) and differences between expected cashflows over the year and actual cashflows (for example expected claim, expense and tax payments compared to actual).

Capital resource sensitivities

The capital position is sensitive to changes in market conditions, due to both changes in the value of the assets and the effect that changes in investment conditions may have on the value of the liabilities. It is also sensitive to assumptions and experience relating to mortality, expenses and persistency.

The most significant sensitivity arises from the market risk in relation to the with-profits business, which would arise if adverse changes in the value of the assets supporting this business could not be reflected in payments to policyholders because of the effect of guarantees and options. The capital position of this business would also deteriorate if increases to the market cost of derivatives resulted in an increase in the liability for guarantees and options on the Balance Sheet.

20 Other Debtors

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Trade debtors	23,097	25,085	-	-
Amounts due from group undertakings	-	-	-	434
Other debtors	6,962	3,124	297	251
Corporation tax recoverable	52	183	52	183
	30,111	**28,392**	**349**	**868**

Included in amounts due from group undertakings is a subordinated loan of £Nil (2017: £434,000) due from PM Advisory Limited. The loan was settled during 2018, prior to settlement interest was payable quarterly in arrears at LIBOR plus 5.22%.

All debtor balances are receivable within one year.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

21 Other Creditors

	Group		Society	
	2018 £'000	**2017 £'000**	**2018 £'000**	**2017 £'000**
Trade Creditors	25,245	25,791	-	80
Amounts due to group undertakings	-	-	3,101	3,680
Other Creditors	4,685	5,120	107	182
Tax and Social Security	522	606	-	-
Accruals and Deferred Income	4,352	9,149	844	561
Unrealised foreign exchange positions	10,449	324	10,449	324
	45,253	**40,990**	**14,501**	**4,827**

All creditor balances above fall due for payment in less than one year except for an amount included within Group Other Creditors of £2,069,000 (2017: £3,309,000) which falls due for payment after more than one year.

22 Other Provisions

	Clawback £'000
Group	
At 1 January 2018	1,972
Utilised in the year	(1,004)
Charged to the Technical Account	2,260
At 31 December 2018	**3,228**

Clawback provisions relate to an expected amount to be repaid to insurers in respect of commission being clawed back on cancellation of life insurance policies by customers. A provision is also established on new business written at the time the gross commission is received. The provision is expected to be utilised within four years.

There are no provisions held in the Society.

23 Operating Leases

The Group has commitments for the following future minimum lease payments under non-cancellable operating leases for each of the following periods:

	Property, plant and equipment	
	2018 £'000	**2017 £'000**
Within one year	477	460
Between two and five years	1,248	1,375
After five years	24	316
	1,749	**2,151**

The Society has no commitments for the future minimum lease payments under non-cancellable operating leases.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

24 Pension Commitments

The Group and Society contribute to defined contribution schemes for employees. In 2018, this contribution amounted to £1,122,000 (2017: £1,226,000).

The Society also operates a funded defined benefit scheme called the Police Mutual Assurance Society Staff Pension Fund ('The Fund'). This provides defined pensions and lump sum benefits payable to members on their retirement or to their dependants on death before or after retirement. All members had been transferred to deferred status by 31 December 2011, and hence there were no active members for the year ended 31 December 2018.

The contributions to The Fund are determined with the advice of independent consulting actuaries, Barnett Waddingham, on the basis of triennial valuations using the projected unit method. The valuation for the financial statements has been based on the most recent actuarial valuation for the period to 31 December 2016 and was updated for FRS 102 purposes at 31 December 2018 by Barnett Waddingham. The next actuarial valuation is due at 31 December 2019.

On 24 March 2018, a schedule of contributions was agreed with the Trustee of The Fund to address the deficit in The Fund by making an annual cash contribution of £3,000,000 for each of the next six years.

The main assumptions used were:

	2018	**2017**
Discount rate	2.95%	2.55%
RPI inflation	3.50%	3.50%
CPI inflation	2.50%	2.50%
LPI 5% pension increases	3.50%	3.50%
Revaluation in deferment	2.50%	2.50%
Life expectancy at age 60 of male aged 45	30.6 years	30.5 years
Life expectancy at age 60 of male aged 60	29.0 years	28.8 years
Life expectancy at age 60 of female aged 45	31.8 years	31.7 years
Life expectancy at age 60 of female aged 60	30.1 years	29.9 years

The actual return of the Fund's assets during the year was 1.8% (2017: 3.4%).

The major categories of assets as a percentage of total assets and the expected long-term rate of return are as follows:

Asset Category	**2018**	**2017**
Equities	38%	64%
LDI	24%	10%
Bonds	32%	25%
Cash	6%	1%

Under FRS 102, the expected return on assets is based on the discount rate used to value the liabilities (i.e. the returns available on high quality corporate bonds) with no allowance made for any outperformance expected from the Fund's actual asset holding. The discount rate (and therefore expected return on assets) used was therefore 2.95% pa (2017: 2.55% pa). The assets do not include any investments in the Group or Society.

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

24 Pension Commitments (continued)

Amounts Recognised on the Balance Sheet at 31 December

	2018 £'000	2017 £'000
Growth assets	12,029	20,341
LDI	7,499	3,112
Bonds	10,238	8,047
Cash	1,842	257
Fair Value of assets	**31,608**	**31,757**
Present value of funded obligations	(40,698)	(45,898)
Deficit in the Fund	**(9,090)**	**(14,141)**

Reconciliation of Present Value of Scheme Liabilities

	2018 £'000	2017 £'000
At 1 January	45,898	48,549
Past service costs	41	-
Interest on liabilities	1,125	1,324
Benefits paid	(2,781)	(2,578)
Actuarial gain on liabilities	(3,585)	(1,397)
At 31 December	**40,698**	**45,898**

Reconciliation of Fair Value of Scheme Assets

	2018 £'000	2017 £'000
At 1 January	31,757	32,518
Return on scheme assets less interest	(1,377)	233
Contributions	3,360	859
Benefits paid	(2,781)	(2,578)
Administration costs	(156)	(159)
Interest on assets	805	884
At 31 December	**31,608**	**31,757**

Analysis of the Amount Charged to Technical Account

	2018 £'000	2017 £'000
Interest on assets	(805)	(884)
Past service costs	41	-
Interest on liabilities	1,125	1,324
Administration costs	156	159
Total	**517**	**599**

Notes to the Financial Statements

for the year ended 31 December 2018 (continued)

24 Pension Commitments (continued)

Amounts recorded in Other Comprehensive Income

	2018 £'000	2017 £'000
Return on scheme assets less interest	1,377	(233)
Actuarial gain on liabilities	(3,585)	(1,397)
Total actuarial gain	**(2,208)**	**(1,630)**

History of Experience of Gains and Losses

	2018 £'000	2017 £'000	2016 £'000	2015 £'000	2014 £'000
Present value of defined benefit obligation	(40,698)	(45,898)	(48,549)	(35,431)	(37,055)
Fund assets	31,608	31,757	32,518	30,590	30,397
Deficit	**(9,090)**	**(14,141)**	**(16,031)**	**(4,841)**	**(6,658)**
Experience gains and losses on Fund liabilities	-	-	-	-	(237)
Changes in assumptions used to value Fund liabilities	(3,585)	(1,397)	13,246	(2,388)	(4,133)
Experience adjustments on Fund assets	1,377	(233)	(1,287)	757	1,204

25 Related Party Transactions

Police Mutual Assurance Society Limited is the ultimate holding company of the wholly owned subsidiaries as listed in note 14. It has, therefore, taken advantage of the exemption contained in Financial Reporting Standard 102, Section 33 - Related Party Disclosures and has not disclosed separately transactions or balances with those companies.

During the year members of the Committee of Management, Managing Board and their immediate families took out products offered by the Group. The annualised premium and claims paid during the year for such products are shown below:

	2018	2017
Life:		
Life products £'000	62	177
Number of members paying premiums in the year	10	18
Balance due to Group £'000	-	-
General Insurance:		
General insurance products £'000	9	12
Number of members paying premiums in the year	10	12
Balance due to Group £'000	5	8
Healthcare subscriptions:		
Healthcare products £'000	5	5
Number of members paying subscriptions in the year	2	2
Balance due to Group £'000	-	-

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