Police Mutual Group

Annual Report & Financial Statements 2019

Company No. 727F

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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 was honoured to be appointed Chair of Police Mutual in May 2019 and this is the first time I will present the Annual Report. Those who attended the 2019 AGM will remember that I said the 2019/20 year was likely to be one where there would be difficult choices to be made. This has proven to be the case. I also promised that I would lead the Board to ensure our choices would always be in Members’ best interests. I hope the statements in this Annual Report and Accounts will evidence that we have done so.

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 as part of the wider support to our Members we provide 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 first joined the Board in 2014 the Group was smaller, but over the years we have continued to grow 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 continue to be mixed. While 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, others relate to our scale with expenses exceeding income as we have suffered directly from reductions in policing numbers and, in particular, new recruitment – critical to our Member interactions and business model. As previously highlighted, following the introduction of the Solvency II capital regime in 2016, and the ongoing low base rate environment, our capital position has continued to deteriorate. The Board has concluded that the Group cannot continue to meet its purpose without further major change and has been actively pursuing broader strategic options with the aim of securing the long term future. The Board is pleased to announce that on 24 April 2020, a transfer agreement was signed with Royal London which will see the Society’s business transfer to Royal London during the second half of this year. In the unlikely event that this transaction fails to complete, the Board has made the decision that the Society will close to new business and the fund will be put into run off, to protect our existing Members’ interests.

Performance of the Group and the Economic Environment Impacts

2019 has been a challenging year for the Group. We have continued to reduce recurring costs to align to our income levels. However, we have also spent money on reviewing our strategy and have suffered an increase in pension liabilities following the annual accounting valuation, which led to an overall loss for 2019.

This focus on rightsizing the business has resulted in the Group reducing its in year operating loss, this has been achieved through ongoing management of expenditure and improved profitability of the subsidiary companies. Income has seen modest increases in Police life, mortgages and IFA income, but this has been offset by lower net healthcare revenue due to higher claims and a falling general insurance book. Military performance has been impacted by additional spend to create a longer term viable business.

In 2019 the UK and Global macro-economic environment experienced significant volatility reflecting market nervousness on the outcome of Brexit, the threat of a global economic slowdown and US trade tariffs. The financial markets ended the year strongly following the result of the UK general election. Our investment fund is invested across global equities (quoted on the US, UK, Japanese and European Stockmarket indices), UK property, corporate bonds and cash. The 2019 investment returns on our Life fund was a positive 7.7% return against 2018 negative return of 3.8%. The 5 year return for our with-profits policies was 4.4% p.a.

Needless to say, the start of 2020 has been very different. The impact of the Covid-19 virus has had and will continue to have a significant adverse effect on financial markets and individuals. Whilst this situation is developing rapidly, we will follow government advice and implement strategies to support our policyholders and Members, as well as safeguarding our workforce. We have also taken significant steps to protect the financial position of the Group and thereby the benefits for our Members. The significance of this pandemic and its impact on markets, demonstrates the importance of financial strength to protect policyholders security and support policy payouts. The agreed transfer to Royal London will lead to greater security for transferring policyholders.

Notwithstanding 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 41 (prior year 44). Additionally 74% of our Police Members would recommend us, which is exceptionally high compared to other financial services companies and the industry average.

Chair's Statement (continued)

Risk Management

In light of our financial position the Group was subject to heightened regulatory scrutiny throughout the year with extensive dialogue with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) on developing and executing appropriate recovery actions. The Group maintains appropriately resourced risk and compliance functions which provide independent oversight of risks facing the business with regular reporting to the Managing Board and its sub-committees on the effectiveness of management's response to these risks. A particular focus for the year was on recognising the key strategic risks facing our business and in supporting management in determining the most appropriate strategic options for consideration by the Managing Board.

Improving Lives

Demonstrating financial strength, ongoing controls and oversight to ensure that the Group delivers its financial and regulatory responsibilities enables us to deliver activity that focuses on improving financial wellbeing in the Police and in the Military.

In 2019:

We delivered 979 free financial education courses, helping over 17,500 Police officers and staff to make sense of their finances. We funded around 1,600 health screenings across the UK, helped 114 families with a respite break and 250 people have contacted our Care Line service regarding various physical, mental health and other concerns helping Police employees and their family Members. In addition, we 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 'Hercules initiative' where we provide refreshments via a mobile facility, delivering 228 events seeing over 18,000 people. Over 1,300 RSPs were taken out on the day of the events.

For Members of the Military family we delivered 703 free financial education sessions, offering information and guidance through both one-to-one and group briefings, helping 17,114 individuals to understand the importance of taking control of their finances to protect their future. We also helped 39 families take much needed time out on respite breaks. In addition, we sponsored over 50 sports teams, events and activities such as the Winning REME Field Gun Team, Royal Navy Rugby League, Royal Navy Boxing, Royal Marines Football, Army Hockey and the Army Cup, Royal Armed Corps Rugby, RAF Hockey and RAF Golf.

We introduced several new initiatives aimed at raising brand awareness including a specific and targeted campaign to increase awareness of our Regular Savings Plans (RSP) and General Insurance offer in Police Staff venues, we launched "Alpha Pup" to support product sales, increased communications to promote advocacy through the Force Authorised Officer (FAO) channel and launched a new mobile enabled website to support our commercial aspirations.

Within Forces Mutual, we engaged with a brand advocate, Ollie Ollerton, to re-think our face to face presentations, we continued with our successful running of canteen events and we launched our new Kit & Personal Possessions Insurance policy and its online application journey. We also added an online application facility for Motor Insurance.

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.

John Perks was appointed Group Chief Executive in April 2019 and took over responsibility from Mike Kirsch who had been in place as interim CEO from December 2018. I would personally like to thank John for the outstanding contribution he has made since joining us.

Looking Ahead and Future Strategic Direction

2020 will be an important year for the Society as it will see the completion of the planned transfer of the Society and its subsidiaries to Royal London's main fund. I fully believe this transaction to be in the best interests of the Society, the wider Group, our Members and our policyholders and will secure the long term future of Police Mutual, our brand and our purpose.

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 2019 results.

Julie Hopes

Managing Board Chair

29 April 2020

Chief Executive's Statement
2019 Highlights

£787m

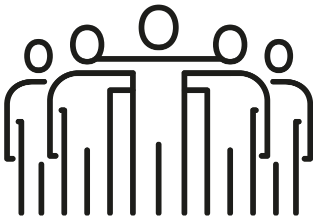
Total Assets under management including cash (2018: £805m)

£47m

Fall in Society Fund for Future Appropriations to £66m (2018: £118m) which represents the reduction in our financial strength

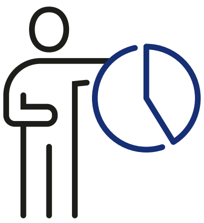
431

Number of employees supporting our affinities (2018: 491)



86%

Annual retention rate on our motor and home insurance products, which compares favourably to the industry (2018: 89%)



£132k

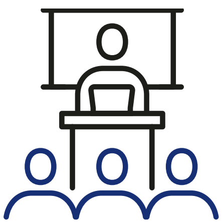
Paid out to support our Police Foundation (2018: £300k)

£138m

Maturing Policies paid out to Members (2018: £125m)

5,129

Number of healthcare claims paid (2018: 4,342)



1,682

Free educational seminars provided to our affinities (2018: 1,145)

Chief Executive's Statement (continued)

I was very honoured to join Police Mutual as its new CEO in early 2019. For me, I have always viewed financial services as something critical to improving people's lives, from the very first insurance companies from the 17th and 18th centuries where people came together to help each other. This is not about making money, this is about serving real people, with real lives and real world challenges. Police Mutual is the epitome of this mindset, continuing to act on a not-for-profit basis for the benefit of our Members and customers. We are privileged to be in a position to support our affinities, and we in the business are proud to be able to do what we can to improve the lives of the Police and Military.

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 these impact their financial needs.

Improving the lives of our Members and our customers is at the heart of everything we do and, while times may have changed over the last 150 years, that belief is core to everything that we do.

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

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			
• Respite care and helplines			
• Donations and sponsorships supporting the Police and Military			

2019 Strategic and Operational Review

One of my immediate tasks as the new CEO was to conduct a strategic review for the business, against the backdrop of a challenging market, with declining Police and Military numbers, and our financial position weakened. Despite those challenges, it was also clear that the underlying business is strong, well-embedded into our affinities, and with this access is able to provide wider services in a way that most commercial organisations cannot. The strategic review was focused on ensuring that current Members remained secure, and that we could create a stronger and sustainable business into the longer term. I am grateful to the many colleagues who worked hard to advance this work, while still maintaining a focus on our Members. The strategic review has now concluded and I am delighted to announce that the Board has signed a transfer agreement with The Royal London Mutual Insurance Society Limited (Royal London), a much larger, financially robust mutual to which the Society will transfer during the second half of 2020, along with our subsidiary businesses. This transaction creates a new chapter in Police Mutual's long heritage and will secure the future of the Group, its Members and policyholders, and will enable the Police Mutual brand and what it stands for to continue to operate in a much more financially secure environment.

As well as this comprehensive strategic review, we also progressed in-flight actions dating from our 2017 and 2018 goals that targeted improvements in cost base, capital strength and risk management capability. The key progress against these aims in 2019 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. 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 moved to a single investment asset manager, BMO, in December 2018 for all investments except our property holdings and are currently working with them to complete the transition to ensure appropriate management of assets on behalf of our Members. Alongside BMO we have worked to maximise investment returns recognising market uncertainties in respect of Brexit, US/China trade war and more recently the devastating social and financial impact of Covid-19 whilst remaining cognisant of our financial position and ability to take investment risk.
- At the beginning of the year the Managing Board's Risk Committee noted the achievement of the risk function's target effectiveness rating and the bolstering of its resources through the establishment of the Financial Risk team from 1 January, with both the Compliance and Finance Risk functions implementing their respective target operating models and maintaining resourcing at an appropriate level throughout the period.
- The closure of the Basingstoke office was completed during 2019, which has reduced our number of offices to two.

Chief Executive's Statement (continued)

2019 Strategic and Operational Review (continued)

- As a consequence of the expense reduction initiatives and extensive strategic options work progressed during 2019, we moderated our ambition for the pace at which we could move towards the desired risk appetite range. Our risk and compliance functions focused on supporting management in improving the operating effectiveness of our internal risk and control frameworks and providing enhanced levels of assurance to the Managing Board. Given this business strategic uncertainty we were subject to heightened scrutiny from our key regulators, the PRA and FCA with regular and transparent conversations being held with the intent of providing confidence over the business's future direction.
- We completed the implementation and associated embedding of the Insurance Distribution Directive (IDD) and extended the requirements of the senior manager and certification regime (SMCR) to the regulated subsidiaries.

We continue to review our products to ensure that they are meeting Member needs and the following are key to note for 2019-2020:

- There continues to be regulatory focus on motor and household insurance prices, specifically about the price differential between new and renewal business and the treatment of vulnerable customers in this context. 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 will consider and make any necessary adjustments to our pricing policy when the FCA release their final report, expected in early 2020.
- We launched a new Military kit product in September that provides a simpler and more cost effective product to our Military customers, combined with digital access. During 2020 we will be looking to widen the protection product range to our Military customers by adding additional insurers.
- Our healthcare scheme handled 5,129 claims in 2019 and our Members receive treatment within an average of 7 weeks, saving 11 weeks compared to average NHS wait times.
- For Regular Savings Plan policies that matured on or after 18 March 2019 the net of tax return generated was 3.6% p.a., (based on a male, aged 30 next birthday paying £50 per month over a 10 year term).

2019 Consolidated Financial Results

	2019	2018
	£m	£m
Premiums, investment income/movements, other income	145.4	104.3
Claims, technical provision movement, investment costs	(147.6)	(106.1)
Net movement on premiums/claims	**(2.2)**	**(1.8)**
Operating costs	(14.4)	(13.1)
Subsidiary net profit	4.4	1.1
Net loss before goodwill, pensions and tax	**(12.2)**	**(13.8)**
Goodwill amortisation	(4.0)	(6.8)
Pension costs	(1.2)	2.2
Tax	(1.9)	0.4
Change in FFA	**(19.3)**	**(18.0)**

The Society only result for the year is a deficit of £47.3 million, £28 million more than the consolidated deficit. This difference relates primarily to a net reduction of £27.5m in the carrying value of subsidiaries less dividends received.

While the Group has achieved its objective of improving operational financial performance as shown above by reducing the net loss before goodwill, tax and pension movements from £13.8m to £12.2m, this is nonetheless a disappointing result and together with the overall unsustainable financial position has led to the Group signing an agreement to transfer its business to Royal London. A number of factors have contributed to this result, with significant losses crystallising on past investments such as Neyber, and costs incurred in addressing issues in the Military business and the strategic position of the Group.

The net underlying loss on the life book of £2.2m has remained similar to the net loss of £1.8m recorded in 2018. Within this balance, the overall value of the life book continued to fall, with a deficit of premiums received less claims paid being £39.3m (2018: £22.0m). Underlying investment performance was stronger during 2019 with a net gain of £42.0m compared to net loss of £27.6m in 2018. Included within the investment gain for the year is a reduction in the carrying value of the debt due from our personal lending product offered through Neyber of £8.4m and a write off of the remaining value of our equity holding in Neyber of £4.2m, further commentary on Neyber is set in note 16. During the year, there was a change in investment manager resulting in a saving of £0.9m on investment management fees. The net movement on the technical provisions was a deficit of £4.4m in 2019 compared to a gain of £49.1m in the prior year.

Operating costs increased by £1.3m from 2018 levels. Whilst strong control has been maintained on day to day expenditure, one off costs relating to strategic work and redundancies of £1.4m contributed to the increase (2018 one offs were £0.1m).

Income generated by the subsidiary companies increased by £0.9m whilst costs decreased by £2.3m generating additional profits of £3.3m compared to 2018. Income includes commission and reinsurance premiums received on general insurance sales, IFA advice, healthcare subscriptions, mortgage and personal loan introductions.

Chief Executive's Statement (continued)

2019 Consolidated Financial Results (continued)

The Police Affinity saw reductions in general insurance commissions of £1.0m and increased healthcare claims, which reduced net health income by £1.5m. Our general insurance cover for home and motor continues to have substantially higher retention rates when compared to the market of 87% and 84% respectively and we have seen increased demand for our mortgage, IFA and healthcare offering when compared to 2018. The 2019 figures also benefitted from a one off profit share receipt of £1.5m relating to our reinsurance business.

Military Affinity performance has continued to be impacted by lower recruitment and restructuring in the Army resulting in fewer briefings and therefore lower sales to recruits. The 2018 income included 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. Whilst we were able to release just over £0.3m of this provision in 2019, underlying income has fallen from £7.7m in 2018 to £6.2m in 2019. A number of actions within the Military business have been taken to address declining income levels and new strategies are being implemented going forward.

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. The pension fund deficit has fallen from £14.1m at 31 December 2017 to £7.7m at 31 December 2019 partly as a result of these additional contributions.

Our capital position as at 31 December 2019 was 146% of our Solvency Capital Requirement (SCR) (2018: 156%) and as mentioned earlier, there has been increased focus on the liquidity and quality of our capital with the aim to strengthen both. The planned transaction with Royal London is the main management action to address this.

Subsequent Events

COVID-19

After the year end, the impact of the Covid-19 virus has created and will continue to create unprecedented social and economic pressure across the globe. At the date of this report, the response to and advice in respect of Covid-19 from the UK government is evolving rapidly and the impact on businesses and individuals is uncertain.

In recent weeks, the financial markets have experienced extreme volatility in equity, bond and commodity prices. In addition to this, the threat of an oil price war has provided further market uncertainty. Significant actions to address economic issues and concerns have already been taken by national governments and central banks and, in the UK, by the Bank of England and through the March 2020 budget.

The impact of these market movements on our with-profits policyholder returns has been limited due to the equity hedging arrangements we have in place and we have also taken investment policy decisions to reduce our equity exposure and overall investment risk.

We have also made an interim bonus declaration which had and will continue to have the impact of reducing maturity and surrender payments to reflect the falls in markets and to reduce the financial impact of our payment smoothing. The maturity values will be reduced by approximately 5%, although will still be above the unsmoothed asset shares, and surrender values by about 10%. Bonus rates will continue to be monitored within the context of stock market movements. The Group will continue to monitor the markets and take appropriate action to protect the interests of our policyholders and Members to the best of our abilities.

Whilst UK government advice in respect of safeguarding individuals and controlling the spread of Covid-19 is emerging and changing rapidly, we have set up an Incident Management Team (IMT) to develop plans in response to this advice and to implement policies to protect our staff. These inevitably involve more home working across our business to support the government's drive to reduce social contact for a period. We have made good progress, and believe that we will be able to support homeworking for almost 100% of our staff without a significant impact on service standards. The directors accept that during a period of exceptional change, focus on the integrity and effectiveness of internal controls must not diminish and where processes have needed to change, these changes have been documented and approved.

The extent and duration of the impact of Covid-19 is very difficult to predict. We do expect there to be disruption to our sales activity. Face to face sales will be impacted by travel and social engagement restrictions, illness can affect both our staff and potential customers, and, perhaps most importantly of all, our customers may well have higher immediate priorities than saving and investing. Equally, home and motor insurance remains important and online and telephony channels mean we will not see a complete cessation in business volumes. In addition, and noting the proposed transfer to Royal London, we do not currently foresee any long term reduction in sales potential. The directors will continue to monitor this situation very closely and take actions where appropriate.

We acknowledge the important role that the Police and Military will need to play in the collective response to Covid-19 and we will endeavour to continue to serve our Members and policyholders. At this stage, the impact to the overall business is not known, however we expect it to impact future business volumes and sales, at least in the short term.

Neyber

It was disappointing to note that our lending partner, Neyber, went into administration after the year end after enduring a period of financial difficulty and failing to secure refinancing or a new investor. Neyber's trade has been purchased by Salary Finance Limited, a competitor business who will assume Neyber's role as our lending partner going forward. As a result of Neyber's administration, we have written down the value of our equity stake in Neyber to £nil and have revised the carrying value of the debt due from Neyber to those amounts we consider recoverable from the administration process. These adjustments have been reflected in the 2019 financial statements.

Chief Executive's Statement (continued)

Our People and Culture

Our colleagues deliver service and support to our Members that consistently receives positive feedback. Our values continue to play a key role in shaping our business culture.

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 challenge ourselves relentlessly 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.

In the first half of 2019 the organisation undertook further restructuring to ensure that the shape and size of our teams were right for our business while at the same time providing a more sustainable cost base. In early 2019 we also implemented online Learning and Performance Management platforms to support our ongoing commitment to the development of our colleagues. These platforms have provided access for all colleagues to an extensive suite of online learning modules, have been utilised to deploy continuing professional development in support of regulatory regimes such as IDD and SMCR, and further enhanced our performance management culture.

We have continued to focus on employee engagement and have implemented a number of initiatives over 2019 to further support this, such as the re-establishment of 'The Voice' (our colleague forum), responding to colleague feedback (and making changes to our policies, such as dress code), hosting colleagues roadshows, and the implementation of a number of colleague wellbeing initiatives such as Mental Health First Aid training. We have refreshed our colleague engagement framework to introduce channels that provide real-time, ongoing feedback, enabling us to recognise and respond to the needs of our colleagues.

Employee Engagement

We are committed to communicating and engaging with our colleagues and have a number of active channels to support communication between colleagues and our Executive team:

- **Team Talk –** all teams have monthly team meetings and we provide a core brief to all managers each month to help ensure consistent messages across the organisation. This includes regular updates on business performance alongside events and/or activities taking place within the business and our affinities.
- **Live & Online –** Live & Online is our monthly online Q&A event. Each month colleagues are invited to put questions to Members of our Executive team anonymously – either live during the session or in advance. Topics range from issues affecting colleagues to more general questions relating to business performance or decisions with immediate responses provided. All colleagues can watch, join the conversation and even visit the chat at a later date to see what was discussed.
- **Intranet –** We use our intranet to share news and information across the Group. This includes a regular Newsfeed and team sites, along with an easily accessible hub for policies and procedures.
- **Regular Email Updates –** Email is one of our main forms of regular communication across the Group and this is used to provide updates on key events, activities and / or decisions.
- **Twitterings –** This is a regular blog by the Executive team, hosted on the intranet. Typically, there will be two or three posts each week, which often now includes guest blogs from colleagues across the business.

In April 2019 we have introduced a number of additional communication channels and activities to provide colleagues with further opportunities to give feedback and to provide mechanisms to keep colleagues updated on progress on the development of our forward looking strategy. This includes colleague roadshows and the re-establishment of our colleague forum – 'The Voice'. This forum is made up of 'champions' from across all business functions and acts as a barometer to the Executive and senior management in relation to colleague engagement and helps drive and shape our engagement agenda. This has been supported by the introduction of our weekly 'Your Say' poll in January 2020, providing real time and anonymous feedback channels. Over 2019 the business also invested significant time in training volunteer Mental Health First Aiders across the Group ahead of the formal launch of this network in January 2020.

Headcount has reduced by 12% and at the end of 2019 was 431 on a full time equivalent basis. During the year, Kathryn Winup resigned as Finance Director as was replaced by David Vallery, previously Chief Risk Officer. Andrew Blackmore formerly Head of Risk within the senior management team was promoted to Chief Risk Officer.

Chief Executive's Statement (continued)

Focus for 2020

As noted earlier in my report, we have recently signed a transfer agreement with Royal London with the target date of transferring the Society and its subsidiaries to Royal London later this year. We are currently engaged with Royal London to consider the practicalities of the transfer, including its impact on Members, policyholders, staff, systems and processes. I am confident that the Royal London transaction is the right course of action for the Group and will secure its long term future and, through our existing strong brand and purpose, will ensure we can continue to provide benefits to our Affinities.

We will continue to manage the impacts of COVID-19 on our colleagues and on our customers, looking to minimise the impacts of the disruption and to continue to meet the needs of our customers to the best of our abilities.

We want to protect our existing customers and continue to attract new customers, with a strong brand and purpose that can continue to provide benefits to our Affinities. We need to ensure that the Society can meet these needs and deliver our ultimate purpose, namely to "improve the lives" of those in the Police and the Military. We remain well-placed to do this in the short term, ahead of the intended transfer, and our focus will remain on completing this transaction while continuing to support our Members and managing the Society's financial position.

John Perks

Chief Executive Officer

29 April 2020

Risk Management Report

The Managing Board has over the course of 2019 exercised appropriate governance over the principal risks facing Police Mutual which could impact its financial soundness, Members and customers, or organisational capability.

As highlighted in the Chair and Chief Executive's Statements, 2019 saw a full strategic review. This review acknowledged the increasingly significant risks to the business' ongoing sustainability and the weakened financial position. The strategic review will respond to the need to create a sustainable business model with sufficient financial strength to protect our Members and the capability to provide and invest in services that meet our customer and regulatory expectations.

In discharging its governance duties, during 2019 the Managing Board:

- confirmed its existing risk appetite statement setting out which risks it wished to take and avoid;
- noted that the Society continued to operate outside of its desired risk appetite range and that the current business model was not viable in the longer term;
- challenged management over performance against the annual business plan;
- monitored and challenged, where appropriate, management of 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;
- in line with regulatory guidance, developed contingency and recovery plans;
- approved the business solvency and capital requirements;
- managed the investment strategy to respond to changes in market conditions and the capital position; 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, changes in employee benefits and performance related pay schemes; and
- With-Profits Committee that provides an independent assessment of both compliance with the Principles and Practices of Financial Management and how the Managing Board has addressed any conflicting interests for policyholders.

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 the continuing effectiveness of the Risk function and in risk reporting at Executive and Board level, 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 and, with the exception of strategic and concentration risk, are consistent with prior year:

Strategic Risk: Risk of determining and pursuing a business strategy which is mis-aligned with the Group's organisational capabilities, financial resources or is not adapted to reflect changes in the business or regulatory environment.

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.

Concentration Risk: Potential for a loss in value of an investment portfolio or a financial institution when an individual or group of exposures move together in an unfavourable direction.

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.

The Managing Board has determined a formal statement of risk appetite for each of its principal risks 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.

Risk Management Report (continued)

Internal Audit

During 2019 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 has been considering the potential outcomes and impacts of Brexit for some time. Business analysis shows that it will have a relatively minor impact on the Society's customers, staff and operations and appropriate preparedness arrangements have been put in place. The Society will continue to monitor the position with Brexit as government policy and related legislation emerges and will respond appropriately.

Neyber

During 2019 Police Mutual continued to hold a small equity stake in the personal lending company Neyber and continued to introduce customers to Neyber for new personal loans. Neyber has experienced issues in securing new funding and this has culminated in their assets being acquired by Salary Finance in March 2020; as a consequence Police Mutual now owns a small equity stake in Salary Finance and a new introducer relationship with Salary Finance is under consideration. Police Mutual customers with existing personal loans will be administered by Salary Finance.

Climate Risk

In response to the regulatory request for businesses to produce an initial plan to address the 'Strategic approach' to managing the financial risks arising from climate change, Police Mutual has assigned Senior Management Function responsibility to the Chief Financial Officer and a high level plan has been approved by the Executive Team. This is an ongoing area of review and further work in this area to enhance management of the financial risks arising will continue during 2020.

LIBOR Transition

Police Mutual has assessed its position for the transition from LIBOR to SONIA in valuing assets and liabilities and the Head of Actuarial has deemed this as low impact. Regarding the quantification of LIBOR exposures; the Head of Actuarial has produced sensitivities and assessed the impact on the Balance Sheet. Further preparation is in progress.

COVID-19

The risks around Covid-19 are set out in the subsequent events section of the Chief Executive's Statement.

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
Strategic Risk	• Mis-match between strategic ambition and organisational capabilities and financial resources • Poorly executed management decisions • Limited recognition of implications of changes in external operating or regulatory environment	• Effective Board governance arrangements • Documented business strategy and plan with robust monitoring arrangements • Regular SWOT analysis • Regulatory horizon scanning and impact assessment process • Competitor analysis and monitoring
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 and market concentrations) 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. • Review and implementation of partial hedging of equity exposure to protect both policyholders' returns and capital position. • Due diligence of third parties prior to any agreements and on-going monitoring. • Daily review of credit spreads as part of pricing activity.

Risk Management Report (continued)

Risk types	Key aspects of risks	Key controls and risk mitigation activities
(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.	• Insurance Risk Policy, Life Underwriting 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 monitored closely across key transactions across the Group. • Investment management strategies including levels of liquid and readily marketable assets are monitored closely 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 Management Policy, Asset & Liability Management (ALM) Policy and associated risk metrics. • Capital management action plan in place. • Regular solvency monitoring processes.

Concentration Risk	• PMAS is aligned to a single affinity (Police). The wider Police Mutual Group transacts with both Police and Military affinities:
	  - Changes to the infrastructure of the Police service/Armed services.
	  - Politically driven changes.
	• Market concentration risk:
	  - Exposure to PMAS' subsidiary companies.
	  - In the past, exposure to Neyber.
		• Controls over market concentrations included in Market Risk Policy.
		• Governance structure with the Committee of Management as ultimate managing body ensures the business remains closely aligned to changes within the Police service.
		• Affinity risks are also closely monitored via our Affinity Risk Dashboard.
		• Diverse nature of the subsidiaries and the activities that they carry out.
		• Careful management and oversight of subsidiaries including annual review to ensure that they are not likely to have an adverse impact on our with-profits policyholders, in line with FCA requirements. This assessment includes a review of the risk exposures and the mitigations in place.

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. • Training & Competency (T&C) Schemes 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.

Andrew Blackmore

Chief Risk Officer

29 April 2020

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 2019. 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 2019 was 231,000 (2018: 235,000). 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 Group

Details of the Group's operating performance are set out in the Technical Accounts and related notes. Group earned premiums for the year were £87,694,000 (2018: £93,772,000) with total technical income (including total investment returns) of £180,428,000 for the year (2018: £138,374,000). Total technical charges before the transfer from the Fund for Future Appropriations were £198,700,000 (2018: £158,132,000). A transfer of £18,272,000 (2018: £19,758,000) was made from the Fund for Future Appropriations.

Solvency

As at 31 December 2019 (and throughout 2018 and 2019), 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 2019 and 2018.

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 £423,000 (2018: £373,000).

Key Risks and Uncertainties

Details of the key generic risks to the Society and its approach to risk management are set out in the Risk Management Report on pages 9 to 12. These comprise strategic risk, market risk (including credit), (life) insurance risk, liquidity risk, capital risk, concentration 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

Mike Cunningham QPM, Chief Executive Officer, College of Policing

Vice Presidents

Simon Cole QPM BA (Hons) MA DipCrim, Chief Constable, Leicestershire Police
Andy Cooke QPM BA (Hons), Chief Constable, Merseyside Police
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

Committee of Management Chair

Vice President, Sir Jon Murphy QPM DL LLB (Hons), formerly Chief Constable, Merseyside Police, is the Chair of the Committee of Management

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
Martin Guest, formerly 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

Chief Executive

John Perks MEng FIA

Executive Directors (on the Managing Board)

Andy Elkington, BA MBA, Group Sales & Marketing Director
David Vallery BSc FFA, Chief Financial Officer

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):
Andy Rhodes QPM BA (Hons) (21 January 2019)
Robin Hardiman (29 January 2019)
Sir Hugh Orde OBE QPM (3 May 2019)
Julie Spence OBE QPM BEd LLB MA MBA (12 June 2019)

Report of the Committee of Management (continued)

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.

Total Tax Contributions

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

	2019 £'m	2018 £'m
Irrecoverable Value Added Tax	1.2	1.7
Employment taxes borne - Employer NIC	1.7	2.1
Total taxes borne	**2.9**	**3.8**
Insurance Premium Tax generated	5.4	5.6
Employment taxes collected - Employee PAYE and NIC	4.3	5.3
Total tax contributions	**12.6**	**14.7**

Payments totalling £238,000 (2018: £257,000) 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 chosen voluntarily 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 2019 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

The 2018 financial statements referenced doubt as to whether the Police Mutual Group, in its current form, continued to be viable into the foreseeable future. As a consequence of this, a strategic review was initiated that considered a range of future options for the Group, including retaining the existing structure and business model. Following the completion of this review, the Managing Board concluded that the Group was unsustainable in its current form and certain of the viable strategic options were pursued. On 24 April 2020, the Board signed a transfer agreement with Royal London, a much larger and financially secure mutual, with a view to transfer our business to them during the second half of this year. The directors are very confident that this transaction will proceed as intended and will safeguard the long term future of the business, its Members and policyholders. On the basis that the directors consider the outcome of this transaction has a high probability of success, the directors are confident that the Group and Society will be able to meet their liabilities as they fall due for payment for a period of at least one year (the time period referenced in the going concern basis) following the signature date of these financial statements. Consequently, the directors consider it appropriate that the financial statements are prepared on a going concern basis. Should the transaction with Royal London not proceed the directors have decided that the Society's fund would close to new business and be put into run off. As a standard requirement for a regulated insurance business, the Group has long term financial, capital and solvency forecasts in place that demonstrate it is expected to be able to remain viable in a run off situation over at least a ten year term and meet all liabilities of its policyholders in the event that it closed to new business. The Board recognises that the run-off plan incorporates a number of key assumptions over the planning period and that there is inherent uncertainty in long term projections of this nature, and therefore recognise the risks in such a run-off. The Board has considered that management actions may need to be taken to manage the solvency of the business in run-off and that any such action may impact policyholders returns.

Report of the Committee of Management (continued)

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 the going concern basis is assessed.

The going concern statement above references the expected transaction with Royal London, which the directors are confident will secure the future of the Group, its Members and policyholders into the long term (considered to be a period of at least five years). As also referenced in the going concern statement, should the transaction with Royal London not proceed the directors have decided that the Society's fund would close to new business and be put into run off where forecasts demonstrate viability over at least a ten year period.

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. The directors have prepared the Group and Society financial statements in accordance with United Kingdom Accounting Standards, including FRS102, the Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland.

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 2019 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

29 April 2020

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)

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; and
- 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 2019 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 2019 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 2019 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 has considered 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, the latest forecasts, the likely outcome of the strategic review and the subsequent expected transaction with Royal London. The Committee has concluded that there is a reasonable expectation that the Group and Society have appropriate action plans in place to safeguard the long term future of the business, its Members and policyholders, and therefore will 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 & 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. Following a review of external property indices, the Committee concluded that the valuation had not changed significantly since this date and consequently, no amendment was made to the value on the 2019 Balance Sheet.

- 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. After the year end, Neyber, who operate our personal lending offering went into administration and following a corporate restructure, the trade was acquired by Neyber's competitor Salary Finance. The corporate bond we held with Neyber has been valued at the level of cash receipts the Society expects to receive as part of the restructure contract. The shares held by the Society in Neyber have been written down to £nil in the year.

- 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.

- 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.

Internal Auditors

The Audit Committee oversee the work of Group Internal Audit and monitor and assess the effectiveness, performance, resourcing, independence and standing of the function.

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 2019 will be David Heaton'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 have completed their first audit of the Police Mutual Group.

The level of non-audit fees paid to the external auditor is subject to a formal policy to safeguard their independence and objectivity. There were no non audit services provided during the year. Total fees payable to Deloitte in 2019 were £339,000 excluding VAT.

Total fees payable to PwC (the previous auditors) in 2018 were £408,000) excluding VAT of which £8,000 related to non-audit services in connection with assurance work in respect of the Group's stakeholder pension scheme.

A review of the external auditor's effectiveness will be conducted during 2020.

Paul Bishop

Audit Committee Chair

29 April 2020

Independent Auditor’s Report to the Members of Police Mutual Assurance Society

Report on the audit of the financial statements

1 Opinion

In our opinion the financial statements of Police Mutual Assurance Society Limited (the Society) and its subsidiaries (The Group):

- give a true and fair view of the state of the Group’s and of the Society’s affairs as at 31 December 2019 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, including Financial Reporting Standard 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland”; and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

We have audited the financial statements which comprise:

- the consolidated Technical Account and Statement of Other Comprehensive Income;
- the Society Technical Account and Statement of Other Comprehensive Income;
- the consolidated and Society Balance Sheets; and
- the related notes 1 to 26.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland” (United Kingdom Generally Accepted Accounting Practice).

2 Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor’s responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council’s (the ‘FRC’s’) Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC’s Ethical Standard were not provided to the Group or the Society.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3 Summary of our audit approach

Key audit matters	Materiality	Scoping
The key audit matters that we identified in the current year were: • Valuation of the long term business provision; • Valuation of the Society’s investment in group undertakings; and • Committee of Management’s assessment of going concern.	The materiality that we used in the current year was £2,900,000 which was determined on the basis of adjusted Technical Income.	The group comprises the Society and a number of subsidiaries. Our audit covered 86% of the group’s adjusted technical income and 98% of the group’s total assets.

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

4 Conclusions relating to going concern, principal risks and viability statement

Going concern	
We have reviewed the directors' statement in note 1A to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and the Society's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.	**Going concern is the basis of preparation of the financial statements that assumes an entity will remain in operation for a period of at least 12 months from the date of approval of the financial statements.** We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement	
Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the Society's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to: • the disclosures on pages 10 to 12 that describe the principal risks, procedures to identify emerging risks, and an explanation of how these are being managed or mitigated; • the directors' confirmation on page 15 that they have carried out a robust assessment of the principal and emerging risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or • the directors' explanation on page 15 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	**Viability means the ability of the Group and society to continue over the time horizon considered appropriate by the directors.** We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Independent Auditor’s Report to the Members of Police Mutual Assurance Society (continued)

5 Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our 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) that we identified. These matters included 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 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.

5.1 Valuation of long term business provision

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
The Long Term Business Provision (“LTBP”) is calculated using a number of assumptions and valuation techniques. The use of inappropriate assumptions could have a material impact on the valuation. The economic and expense assumptions have been identified as being the most significant assumptions. This has been identified as a potential risk of fraud. Specifically, we focus our audit effort on management’s expense allocation process, which requires a high degree of judgement in allocating costs between group entities and also in determining which costs are acquisition related compared to those which are maintenance expenses; these in turn drive the assumptions used in reserving. The key audit matter on economic assumptions is specifically focused on yield curves, investment returns and equity volatility due to their sensitivity and current level of market uncertainty. The nature of these assumptions, which are subject to significant management estimates and due to the size of the balance of £654m (2018: £666m) as set out in note 18 of the financial statements, could materially affect the financial statements if incorrectly or inconsistently determined or applied. The Group Audit Committee refers to this key audit matter in its report on page 18.	In order to address the key audit matter we have, in conjunction with our actuarial specialists, performed the following procedures: • obtained an understanding of the relevant controls around the valuation of the LTBP pertaining to the expense allocation process and the setting of economic assumptions; • understood the key drivers of the expense assumptions used in reserving and compared these to management’s prior year approach to understand the rationale for any changes; • reviewed management’s assumptions underpinning the allocation of group expenses between entities and between acquisition and maintenance costs and by then agreeing a sample of management’s assumptions to internal supporting evidence; • agreed the expense assumptions used in the LTBP valuation to board approved basis papers; • agreed that the yield curve rates used in the models are consistent with those published by the European Insurance and Occupational Pensions Authority; • tested the assumed investment returns against benchmarked actual returns over the period; • agreed assumptions input into the models are consistent with those stated in the valuation basis document; • evaluated whether the financial impact of changing the assumption is consistent with expectations based on sensitivities; • evaluated the reasonability of the movement in the asset shares due to investment returns by assessing the assumed investment returns against external sources; and • validated the equity volatility through replication using market data from Bloomberg.	The actuarial assumptions applied and the resulting technical provisions presented in the financial statements are considered to be within an acceptable range and the valuation of the long term business provision is reasonable.

5.2 Valuation of the Society’s investment in group undertakings

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
The Society values its investments in group undertakings at fair value. Under FRS 102 Section 2, fair values for such investments are to be calculated using valuation techniques and models to estimate the realisable value. There are key inputs to the valuation calculations such as discount rates, business forecasts and use of earnings multiples and net assets, which reflect the judgement of the directors. The application of an inappropriate valuation methodology and the use of inappropriate assumptions could have a material impact on the valuation of the Group undertakings. This has been identified as a potential fraud risk. The investments are held within the Society’s Balance Sheet at a valuation of £57.9m (2018: £91.4m) - see note 14 to the financial statements. The Group Audit Committee refers to this key audit matter in their report on page 18.	In order to address the key audit matter we have performed the following procedures: • obtained an understanding of the relevant controls around the valuation of the Society’s investment in group undertakings; • involved our valuation specialists in assessing the key assumptions underpinning the valuation; • performed sensitivity analysis on the assumptions used in the valuation; • evaluated the data inputs used to assess for reasonableness and completeness; • assesed the cash flows and the adjustments made to the subsidiaries’ underlying cost base; and • agreed the surplus net assets included within the year end valuations to audited figures.	The assumptions applied in the valuation are considered to be within an acceptable range and the valuation of the Society’s investment in group undertakings is reasonable.

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

5 Key audit matters (continued)

5.3 Committee of Management's assessment of going concern

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
The prior year financial statements, referenced doubt as to whether the Police Mutual Group, in its current form, could continue to be viable into the foreseeable future. As a consequence of this, a strategic review was initiated that considered a range of future options for the Group, including retaining the existing structure and business model. Following the completion of this review, the Managing Board concluded that the Group was unsustainable in its current form and certain of the strategic options were pursued. As disclosed in the Chief Executive's statement on page 4, on 24 April 2020, the Group signed a transfer agreement with another mutual society (the "transfer"), with a view to transferring its fund and the subsidiary undertakings to it during the second half of 2020. The Managing Board is confident that this transfer will proceed as intended and consequently considers it appropriate to recommend to the Committee of Management that the financial statements are prepared on a going concern basis. In addition, subsequent to the balance sheet date a global pandemic of a new strain of Coronavirus ("COVID-19", "the virus") has emerged. The virus, and responses taken by organisations and governments to manage its spread in markets to which the Group is exposed, have led to increased volatility and economic disruption. The matter is a non-adjusting event since it is indicative of conditions that arose after the reporting period. The Committee of Management's going concern assessment, as recommended by the Managing Board and management, has necessitated the use of significant judgement, exacerbated by non-adjusting post balance sheet events relating to the Coronavirus pandemic. We view the judgements related to the likely future direction as part of the larger mutual society within its new ownership structure a key audit matter. Refer to page 15 of the annual report for detail regarding management's going concern assessment and note 26 for management's post balance sheet events disclosure.	In order to address the key audit matter, we have assessed the going concern assessment included in the Committee of Management's Report by performing the following procedures: • reviewed contractual documentation relating to the transfer to challenge the basis on which the going concern assessment has been made; • reviewed regulatory correspondence relating to the transfer and checked this was consistent with management's analysis; • challenged management's Covid-19 risk assessment by assessing the potential impact on the transfer agreement and considered its impact on the going concern assumption; and • assessed management's disclosure within the annual report and checked it was consistent with papers presented to the Managing Board.	The judgements applied and the resulting going concern assessment presented in the financial statements are considered appropriate.

Independent Auditor’s report to the Members of Police Mutual Assurance Society (continued)

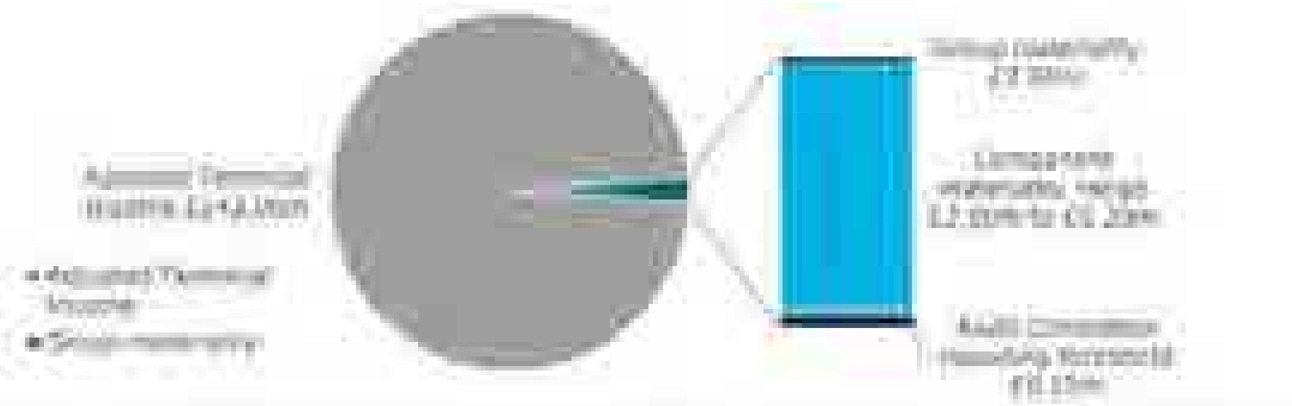
6 Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

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

	Group financial statements	Society financial statements
Materiality	£2,900,000	£2,800,000
Basis for determining materiality	2% of adjusted technical income Technical income was adjusted to remove unrealised and realised gains / losses that are volatile and are dependent on market performance.	The Society’s materiality equates to 2% of adjusted technical income which has been capped at 97% of group materiality.
Rationale for the benchmark applied	Adjusted Technical income was considered the most stable benchmark that represents the underlying activities of the Group and what the users of the financial statements will be interested in.	



6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Group performance materiality was set at 70% of group materiality for the 2019 audit. In determining performance materiality, we considered our risk assessment, including our assessment of the Group’s overall control environment and a low number of corrected and uncorrected misstatements identified in prior periods.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.145m, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

Independent Auditor's report to the Members of Police Mutual Assurance Society (continued)

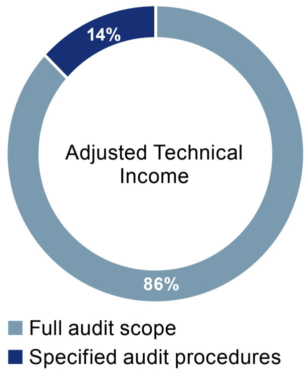
7 An overview of the scope of our audit

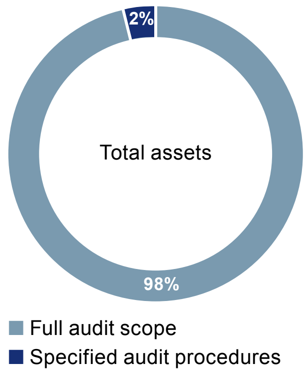
7.1 Identification and scoping of components

Our group audit was scoped by obtaining an understanding of the Group and its environment through discussions with finance, IT and commercial teams and performing walkthroughs of processes across these areas, including group wide controls, and assessing the risks of material misstatement at a group level.

The Group consists of the Society and a number of subsidiaries. The majority of the subsidiaries were audited at their local statutory materiality, capped at a percentage of group materiality. Our full scope audit covered 86% of adjusted technical income and 98% of total assets in the current year.

All of the work was performed by the Group audit team.





8 Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion 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 such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in 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.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of these matters.

9 Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors 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 directors are responsible for assessing the Group's and the 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 directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

10 Auditor's 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 auditor's 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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud and non-compliance with laws and regulations are set out below.

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 auditor's report.

Independent Auditor’s report to the Members of Police Mutual Assurance Society (continued)

11 Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

11.1 Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group’s remuneration policies, key drivers for directors’ remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit and the Audit Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Group’s documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and involving relevant internal specialists, including tax, valuations, pensions, IT, actuarial and real estate specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: valuation of the long term business provision and the valuation of the Society’s investment in group undertakings. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the Friendly Societies Act 1992, tax legislation and pension legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group’s ability to operate or to avoid a material penalty. These included the Group’s regulatory solvency requirements.

11.2 Audit response to risks identified

As a result of performing the above, we identified the valuation of the long term business provision and the valuation of the Society’s investment in group undertakings as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Prudential Regulation Authority and the Financial Conduct Authority; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members, including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Independent Auditor's report to the Members of Police Mutual Assurance Society (continued)

12 Report on other legal and regulatory requirements

12.1 Opinions on other matters prescribed by the Friendly Societies Act 1992

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Society and their environment obtained in the course of the audit, we have not identified any material misstatements in the Report of the Committee of Management.

12.2 Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have nothing to report in respect of these matters.

13. Other matters

13.1 Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by the Committee of Management on 3 May 2019 to audit the financial statements for the year ending 31 December 2019 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is one year, covering the year ending 31 December 2019.

13.2 Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

14. Use of our report

This report is made solely to the Society's members, as a body, in accordance with section 73 of the Friendly Societies Act 1992. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

David Heaton (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

Manchester, UK

29 April 2020

Consolidated Technical Account

Long-Term Business for the Year Ended 31 December 2019

	Note	2019 £'000	2018 £'000
Earned Premiums, Net of Reinsurance	2	87,694	93,772
Investment Income	3	52,888	107,273
Unrealised Gain/(Loss) on Investments	3	3,733	(97,876)
Other Technical Income	4	36,113	35,205
Total Technical Income		**180,428**	**138,374**
Claims Paid - Gross Amount		127,444	117,653
- Reinsurers' Share		(817)	(2,099)
Change in Provision for Claims - Gross Amount		520	(19)
- Reinsurers' Share		(171)	264
Claims Incurred, Net of Reinsurance		**126,976**	**115,799**
Change in Long-Term Business Provision	6	(4,725)	(44,258)
Change in Technical Provision for Linked Liabilities		9,146	(4,817)
Change in Other Technical Provisions, Net of Reinsurance		**4,421**	**(49,075)**
Net Operating Expenses	7	18,358	19,888
Investment Expenses and Charges	3	16,188	39,397
Other Charges		**34,546**	**59,285**
Other Technical Charges		30,717	32,985
Taxation Attributable to Long-Term Business	11	2,040	(862)
Transfer from the Fund for Future Appropriations	12	(18,272)	(19,758)
Total Technical Charges		**180,428**	**138,374**
Balance on the Technical Account		**-**	**-**

Consolidated Statement of Other Comprehensive Income

Long-Term Business for the Year Ended 31 December 2019

	Note	2019 £'000	2018 £'000
Actuarial loss/(gain) on Pension Scheme	24	1,244	(2,208)
Deferred tax on actuarial loss/(gain) on Pension Scheme	11	(149)	442
Transfer (from)/to the Fund for Future Appropriations	12	(1,095)	1,766
Other Comprehensive Result for the year		**-**	**-**
Total Comprehensive Result 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 2019

	Note	2019 £'000	2018 £'000
Earned Premiums, Net of Reinsurance	2	87,694	93,772
Investment Income	3	58,843	107,263
Unrealised losses on Investments	3	(29,792)	(104,914)
Other Technical Income	4	1,155	1,104
Total Technical Income		**117,900**	**97,225**
Claims Paid - Gross Amount		127,444	117,653
- Reinsurers' Share		(817)	(2,099)
Change in Provision for Claims - Gross Amount		520	(19)
- Reinsurers' Share		(171)	264
Claims Incurred, Net of Reinsurance		**126,976**	**115,799**
Change in Long-Term Business Provision	6	(4,725)	(44,258)
Change in Technical Provision for Linked Liabilities		9,146	(4,817)
Change in Other Technical Provisions, Net of Reinsurance		**4,421**	**(49,075)**
Net Operating Expenses	7	14,356	13,128
Investment Expenses and Charges	3	16,188	39,397
Other Charges		**30,544**	**52,525**
Taxation Attributable to Long-Term Business	11	2,181	(438)
Transfer from the Fund for Future Appropriations	12	(46,222)	(21,586)
Total Technical Charges		**117,900**	**97,225**
Balance on the Technical Account		**-**	**-**

Society Statement of Other Comprehensive Income

Long-Term Business for the Year Ended 31 December 2019

	Note	2019 £'000	2018 £'000
Actuarial loss/(gain) on Pension Scheme	24	1,244	(2,208)
Deferred tax on actuarial loss/(gain) on Pension Scheme	11	(149)	271
Transfer (from)/to the Fund for Future Appropriations	12	(1,095)	1,937
Other Comprehensive Result for the year		**-**	**-**
Total Comprehensive Result 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 2019

	Note	2019 £'000	2018 £'000
Assets			
Intangible Assets			
Goodwill	13	6,770	9,990
Other	13	1,130	2,117
		7,900	**12,107**
Investments			
Other Financial Investments	15	**582,001**	**617,594**
Assets Held to Cover Linked Liabilities	18(B)	**112,779**	**99,670**
Reinsurers' Share of Technical Provisions			
Long-Term Business Provision	18(A)	8,980	8,149
Claims Outstanding	18(A)	780	609
		9,760	**8,758**
Debtors			
Debtors Arising Out of Direct Insurance Operations		1,121	1,874
Other Debtors	20	29,650	30,111
		30,771	**31,985**
Other Assets			
Tangible Assets	17	7,776	8,882
Cash at Bank and In Hand		92,013	87,714
Deferred Tax	11	1,731	3,803
		101,520	**100,399**
Prepayments and Accrued Income			
Accrued Interest		2,768	2,955
Other Prepayments and Accrued Income		1,452	1,915
		4,220	**4,870**
Total Assets		**848,951**	**875,383**

Consolidated Balance Sheet

As at 31 December 2019 (continued)

	Note	2019 £'000	2018 £'000
Liabilities			
Fund for Future Appropriations	12	**25,384**	**44,751**
Technical Provisions			
Long-Term Business Provision	18(A)	654,182	666,018
Claims Outstanding	18(A)	7,566	7,046
		661,748	**673,064**
Technical Provisions for Linked Liabilities	18(B)	**112,779**	**99,670**
Provisions for Other Risks and Charges			
Provisions for Pensions	24	7,680	9,090
Other Provisions	22	1,943	3,228
		9,623	**12,318**
Creditors			
Creditors Arising out of Direct Insurance Operations		2	327
Other Creditors	21	39,415	45,253
		39,417	**45,580**
Total Liabilities		**848,951**	**875,383**

The financial statements on pages 27 to 63 were approved by the Committee of Management on 29 April 2020 and signed on its behalf by:-

Rachel Kirwan
Company Secretary

Society Balance Sheet

As at 31 December 2019

	Note	2019 £'000	2018 £'000
Assets			
Intangible assets	13	**157**	**362**
Investments			
Investments In Group Undertakings	14	57,884	91,409
Other Financial Investments	15	582,001	617,594
		639,885	**709,003**
Assets Held to Cover Linked Liabilities	18(B)	**112,779**	**99,670**
Reinsurers' Share of Technical Provisions			
Long-Term Business Provision	18(A)	8,980	8,149
Claims Outstanding	18(A)	780	609
		9,760	**8,758**
Debtors			
Debtors Arising out of Direct Insurance Operations		1,121	1,870
Other Debtors	20	453	349
		1,574	**2,219**
Other Assets			
Tangible Assets	17	5,571	5,809
Cash at Bank and In Hand		82,095	76,454
Deferred Tax	11	1,906	4,119
		89,572	**86,382**
Prepayments and Accrued Income			
Accrued Interest		2,768	2,955
Other Prepayments and Accrued Income		-	241
		2,768	**3,196**
Total Assets		**856,495**	**909,590**

Society Balance Sheet

As at 31 December 2019 (continued)

	Note	2019 £'000	2018 £'000
Liabilities			
Fund for Future Appropriations	12	**65,946**	**113,263**
Technical Provisions			
Long-Term Business Provision	18(A)	654,182	666,018
Claims Outstanding	18(A)	7,566	7,046
		661,748	**673,064**
Technical Provisions for Linked Liabilities	18(B)	**112,779**	**99,670**
Provisions for Other Risks and Charges			
Provisions for Pensions	24	**7,680**	**9,090**
Creditors			
Creditors Arising out of Direct Insurance Operations		2	2
Other Creditors	21	8,340	14,501
		8,342	**14,503**
Total Liabilities		**856,495**	**909,590**

The financial statements on pages 27 to 63 were approved by the Committee of Management on 29 April 2020 and signed on its behalf by:-

Rachel Kirwan
Company Secretary

Notes to the Financial Statements

For the year ended 31 December 2019

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 financial statements are prepared under the historical cost convention as modified by the recognition of financial instruments and certain non financial assets at fair value.

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. All of the properties held by the Society are owner occupied and therefore do not satisfy the definition of investment properties in FRS 102, Section 16, consequently, are not exempt from the requirement that they are depreciated. In addition, a requirement of the Friendly Societies Regulations 1994 is to depreciate all properties. 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.

On 24 April 2020, the Board signed a transfer agreement with Royal London, a much larger and financially secure mutual, with a view to transferring its business to them during the second half of this year. The directors are very confident that this transaction will proceed as intended and will safeguard the long term future of the business, its Members and policyholders. On the basis that the directors consider the outcome of this transaction has a high probability of success, the directors are confident that the Group and Society will be able to meet their liabilities as they fall due for payment for a period of at least one year (the time period referenced in the going concern basis) following the signature date of these financial statements. Consequently, the directors consider it appropriate that the financial statements are prepared on a going concern basis. Should the transaction with Royal London not proceed the directors have decided that the Society's fund would close to new business and be put into run off. As a standard requirement for a regulated insurance business, the Group has long term financial, capital and solvency forecasts in place that demonstrate it is expected to be able to remain viable in a run off situation over at least a ten year term and meet all liabilities of its policyholders in the event that it closed to new business.

(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 by comparison to 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 the level of EBITDA expected to be generated and the EBITDA multiple to be used.

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 estimate of the expenditure required to settle the obligation.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

1 Accounting Policies (continued)

(B) Use of Estimates and Judgements (continued)

The following are the Group's key areas of judgement:

Investments in group undertakings – the Society holds its investments in subsidiary companies at fair value on the grounds that the directors believe this gives a more up to date and relevant carrying value than using historic cost.

Contract classification - the classification of contracts as insurance or investment contracts on initial recognition requires an assessment of whether significant insurance risk has been transferred to the Society. 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. Contracts that are not classified as insurance contracts are investment contracts.

Control over an entity - This decision requires the consideration of a number of factors. These include if the activities of the entity are being conducted on behalf of the Society, if the Society has ultimate decision-making powers, if the Society has the rights to obtain the majority of the benefits from entity and if the Society retains the majority of the residual or ownership risks related to the entity.

(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.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

1 Accounting Policies (continued)

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

Payments received in relation to investment contracts with discretionary participation features are accounted for as earned premiums within the Technical Account when received. Movements in the liabilities on such contracts are included within technical provisions.

Payments received in relation to non-participating investment contracts are treated as deposits and are included on the Balance Sheet as liabilities when received. Payments received are not recorded in the Technical Account, but are disclosed in note 2.

(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.

(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 recognised 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 recoverable shown in the Consolidated and Society Technical Accounts relate to insurance contracts and investment contracts with discretionary participation features.

Non-participating 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 provision or technical provision for linked liabilities. Claims on participating business include bonuses payable. Claims payable include the direct costs of settlement. Reinsurance recoveries 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 recognised initially 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 reviewed for impairment if any factors come to light that indicate that the carrying value may not be recoverable.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

1 Accounting Policies (continued)

(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.

(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 recognised initially 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 by using 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 measured subsequently 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.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

1 Accounting Policies (continued)

(L) Impairment

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 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 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.

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.

For non-financial assets, an impairment loss is recognised whenever the carrying amount exceeds the recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

(M) Intangible Assets and Amortisation

Intangible assets are stated on the Balance Sheet at cost less accumulated amortisation. 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:	Between 3 and 6 years

Intangible assets are reviewed for impairment if any factors come to light that indicate that the carrying value may not be recoverable.

(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 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:

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, occupied by the Society and is 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 is provided on property as it is considered that the useful lives and residual values are such that depreciation is immaterial.

Tangible assets are reviewed for impairment if any factors come to light that indicate that the carrying value may not be recoverable.

(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.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

1 Accounting Policies (continued)

(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) 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.

(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.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

1 Accounting Policies (continued)

(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 fair value of the scheme's assets less the present value of the scheme's liabilities.

The defined benefit liability is calculated by projecting the expected benefit payments using the chosen assumptions and then discounting the resulting cashflows back to the review date. The present value of the liability is determined by discounting the estimated future payments using market yields on high quality corporate bonds that are denominated in sterling and that have terms approximating the estimated period of the future payments.

The fair value of plan assets is measured in accordance with the Group's policy for similarly held assets and includes the use of appropriate valuation techniques.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions together with the return on plan assets less interest, are disclosed in the Statement of Other Comprehensive Income.

The pension cost for the scheme as recorded in the Technical Account is analysed between past service cost and net interest on assets and liabilities. Past service costs, relate to changes in pension liabilities arising from benefit changes, curtailments or settlements. The net interest is calculated by applying the discount rate to the net balance of the defined benefit liability and the fair value of plan assets.

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 2019 (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

	2019			2018		
	Gross £'000	**Reinsurance £'000**	**Net £'000**	**Gross £'000**	**Reinsurance £'000**	**Net £'000**
Regular premiums						
Insurance contracts	72,924	(1,571)	71,353	72,829	(1,749)	71,080
Investment contracts with discretionary participation features	3,731	-	3,731	3,930	-	3,930
	76,655	**(1,571)**	**75,084**	**76,759**	**(1,749)**	**75,010**
Single premiums						
Investment contracts with discretionary participation features	12,610	-	12,610	18,762	-	18,762
Total earned premiums recognised in the Technical Account	**89,265**	**(1,571)**	**87,694**	**95,521**	**(1,749)**	**93,772**
Earned premiums on linked business	5,118	-	5,118	5,021	-	5,021
Earned premiums on non-participating investment contracts	2,876	-	2,876	804	-	804
Total	**97,259**	**(1,571)**	**95,688**	**101,346**	**(1,749)**	**99,597**

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.

	2019 £'000	**2018 £'000**
Regular Premiums		
Insurance contracts	10,703	10,092
Investment contracts	51	35
Single Premiums		
Investment contracts	4,121	1,923
Investment contracts with discretionary participation features	12,610	18,762
	27,485	**30,812**

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

3 Investment Income and Expenses

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Investment income:				
- Income from financial investments held at fair value through profit or loss	18,961	15,292	24,916	15,282
- Gains on the realisation of investments held at fair value through profit or loss	34,297	95,382	34,297	95,382
- Net foreign exchange losses	(370)	(3,401)	(370)	(3,401)
	52,888	**107,273**	**58,843**	**107,263**
Unrealised gains/(losses) on investments	**3,733**	**(97,876)**	**(29,792)**	**(104,914)**
Investment expenses and charges:				
- Investment management expenses	1,535	2,390	1,535	2,390
- Losses on the realisation of investments	14,653	37,007	14,653	37,007
	16,188	**39,397**	**16,188**	**39,397**
Net investment income/(losses)	**40,433**	**(30,000)**	**12,863**	**(37,048)**

4 Other Technical Income

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Fee income on investment contracts	1,155	1,085	1,155	1,085
General insurance	19,777	19,396	-	-
Other	15,181	14,724	-	19
	36,113	**35,205**	**1,155**	**1,104**

5 Claims

As set out in note 1(l) 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 £12,641,000 (2018: £12,613,000).

6 Long-Term Business Provision

Group and Society

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

	2019 £'000	**2018 £'000**
Gross amount	(11,836)	(53,831)
Reinsurers' share	(831)	56
Change in investment contracts	7,942	9,517
	(4,725)	**(44,258)**

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

7 Operating Expenses

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Acquisition costs	4,717	5,801	4,717	5,801
Goodwill and intangible asset amortisation	4,207	6,903	205	198
Administration expenses	7,418	6,194	7,418	6,139
Information technology infrastructure	2,016	990	2,016	990
	18,358	**19,888**	**14,356**	**13,128**

8 Staff Costs

	Group	
	2019 £'000	**2018 £'000**
Wages and salaries	18,184	18,563
Social security costs	1,768	1,837
Other pension costs	1,052	1,122
	21,004	**21,522**

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

	Group	
	2019 No.	**2018 No.**
Senior management	5	7
Sales and customer services	217	265
Support services	209	219
	431	**491**

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:	**2019 £'000**	**2018 £'000**
Aggregate fees	285	318
Aggregate emoluments	391	478
	676	**796**

Pension contributions were made on behalf of one director (2018: One) under defined contribution schemes.

The highest paid director's remuneration was aggregate emoluments of £391,000 (2018: £478,000).

Key management includes directors and members of the executive management team. The compensation of key management personnel for the year was £2,215,000 (2018: £1,903,000) 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 (2018: £Nil).

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

10 Auditor's Remuneration

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

	2019 £'000	2018 £'000
Audit Services:		
Fees payable to the Society's auditors for the audit of the Society and Consolidated Financial Statements	210	319
Audit of the Society's subsidiaries	129	81
	339	**400**
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**
	339	**408**

The 2019 figures relate to the current auditors, Deloitte. The 2018 figures relate to the former auditors, PwC. In 2018, the Group's auditors charged fees in respect of the audit of the Police Mutual stakeholder pension scheme of £8,000.

11 Taxation Attributable to Long-Term Business

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
UK corporation tax:				
Current tax on income for the year	(87)	-	(87)	-
Adjustment in respect of prior years	(94)	55	(94)	55
Total current tax	**(181)**	**55**	**(181)**	**55**
Deferred tax:				
Origination and reversal of timing differences	1,973	(587)	2,114	(334)
Adjustment in respect of prior years	99	112	99	112
Total deferred tax charge/ (credit)	**2,072**	**(475)**	**2,213**	**(222)**
Total tax attributable to long-term business	**1,891**	**(420)**	**2,032**	**(167)**

UK corporation tax in the Society Technical Account has been calculated at a rate of 20% (2018: 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 2019 (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 (2018: 20% – Society / 19% – subsidiary companies). The differences are reconciled below:

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Movement on Technical Account and SOCI before tax	(17,476)	(18,412)	(45,285)	(19,816)
Movement multiplied by the standard rate of tax of 19%/20% (2018: 19%/20%)	(3,499)	(3,705)	(9,057)	(3,963)
Effects of:				
Adjustment to current tax in respect of prior years	(94)	55	(94)	55
Adjustment to deferred tax in respect of prior years	99	112	99	112
Net non taxable expenditure/(income)	5,306	(4,351)	12,868	(1,224)
(Capital allowances claimed in excess of depreciation)/Depreciation in advance of capital allowances	(79)	(169)	53	(23)
Tax movement on pension liability	(25)	412	(25)	412
Deferred tax on capital losses derecognised and capital losses in year	(1,740)	2,444	(1,740)	2,444
Deferred tax on acquisition costs derecognised	-	211	-	211
Unrelieved pension costs carried forward	-	221	-	221
Losses carried forward/(utilised) in the year	1,304	3,328	(72)	1,588
Goodwill amortisation not tax deductible	619	1,022	-	-
Total taxation charge/ (credit)	**1,891**	**(420)**	**2,032**	**(167)**

Deferred Tax	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Deferred tax asset/(liability):				
On Staff Pension Scheme	920	1,115	920	1,115
On unrealised losses on investments	986	3,004	986	3,004
On customer list	(175)	(316)	-	-
	1,731	**3,803**	**1,906**	**4,119**

Movements in net deferred tax asset	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
At 1 January	3,803	3,328	4,119	3,897
Deferred tax (charge)/credit in Technical Account and SOCI	(2,072)	475	(2,213)	222
At 31 December	**1,731**	**3,803**	**1,906**	**4,119**

At 31 December 2019, the Group had an unrecognised deferred tax asset of £17,692,000 comprising acquisition expenses £2,536,000, capital losses £2,085,000, tax losses £11,187,000, capital allowances £1,741,000 and pension contributions £143,000. 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. 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.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

11 Taxation Attributable to Long-Term Business (continued)

At 31 December 2019, the Society had an unrecognised deferred tax asset of £7,107,000 comprising acquisition expenses £2,536,000, capital losses £2,085,000, tax losses £1,994,000, capital allowances £349,000 and pension contributions £143,000. 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. 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.

Substantively enacted changes to the UK corporation tax rates include reductions to the main rate of corporation tax to 17%. The unrecognised deferred taxes at the Balance Sheet date have been measured and reflected in these financial statements using these substantively enacted tax rates.

12 Fund for Future Appropriations

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
At 1 January	44,751	62,743	113,263	132,912
Transfer to Technical Account	(18,272)	(19,758)	(46,222)	(21,586)
Transfer (to)/from other comprehensive income	(1,095)	1,766	(1,095)	1,937
At 31 December	**25,384**	**44,751**	**65,946**	**113,263**

13 Intangible Assets

Group

	Goodwill £'000	**Customer List £'000**	**Software £'000**	**Total £'000**
Cost:				
At 1 January 2019 and 31 December 2019	**32,916**	**6,846**	**1,501**	**41,263**
Amortisation:				
At 1 January 2019	22,926	5,091	1,139	29,156
Charge for the year	3,220	782	205	4,207
At 31 December 2019	**26,146**	**5,873**	**1,344**	**33,363**
Net book value:				
At 31 December 2019	**6,770**	**973**	**157**	**7,900**
At 31 December 2018	9,990	1,755	362	12,107

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

13 Intangible Assets (continued)

Society

	Software £'000
Cost:	
At 1 January 2019 and 31 December 2019	**687**
Amortisation:	
At 1 January 2019	325
Charge for the year	205
At 31 December 2019	**530**
Net book value:	
At 31 December 2019	**157**
At 31 December 2018	**362**

14 Investments in Group Undertakings

Society

	Shares in Group undertakings £'000
At 1 January 2019	91,409
Net revaluation loss	(33,525)
At 31 December 2019	**57,884**

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 9.2% movement in the resulting valuation. A 10% movement in the forecast future earnings gives an 8.3% movement in the resulting valuation.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

14 Investments in Group Undertakings (continued)

Set out below are the Society's investments in subsidiary undertakings as at 31 December 2019, 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.	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.	PM Holdings Limited
Forces Insurance Limited (Company number: 04188402)	A dormant company.	PM Holdings Limited

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

PM Holdings Limited, Police Housing Fund Limited, PMHC Limited and Forces Insurance 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.

	Technical Account			**Balance Sheet**	
	2019 £'000	**2018 £'000**		**2019 £'000**	**2018 £'000**
Other technical income	11,955	10,334	Current assets	11,394	13,803
Other technical charges	(1,101)	(869)	Current liabilities	(68)	(3,331)
Net profit	**10,854**	**9,465**	Net assets	**11,326**	**10,472**

Included within current assets is £7,837,000 (2018: £8,091,000) of cash, of which £3,808,000 (2018: £3,790,000) is held as collateral.

There are no other gains and losses occurring in the current year. A dividend of £10,000,000 (2018: £6,000,000) was declared during the year and £13,250,000 (2018: £2,750,000) was paid to Police Housing Fund Limited, the immediate parent undertaking.

Notes to the Financial Statements

For the year ended 31 December 2019 (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		2019		2018
	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	891	-	4,011	-
- Listed Options	(8,764)	2,514	3,052	4,767
- Bond futures	-	67	-	70
- Stock futures	-	(164)	-	-
Financial investments designated upon initial recognition as at FVTPL				
Shares and other variable yield securities:				
- United Kingdom - listed	83,944	78,071	117,596	111,510
- United Kingdom - unlisted	-	3,005	4,175	3,005
- Overseas - listed	213,089	195,245	195,390	206,035
Debt and other fixed income securities:				
- United Kingdom - listed	104,372	102,866	95,132	95,643
- United Kingdom - unlisted	6,224	16,859	20,327	22,198
- Overseas - listed	105,749	103,698	79,310	79,579
Total financial investments held at FVTPL	**505,505**	**502,161**	**518,993**	**522,807**
Loans and receivables at amortised cost				
Loans on policies	2,101	2,101	2,596	2,596
Deposits with credit institutions	74,395	73,774	96,005	93,747
Total financial investments	**582,001**	**578,036**	**617,594**	**619,150**

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 re-measured subsequently 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 2019 was £7,873,000 – negative, (2018: £7,063,000 – positive), commission payable on purchase was £Nil (2018: £Nil).

(C) Collateral

At the Balance Sheet date the Group and Society had pledged £33,119,000 (2018: £1,542,000) 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. The amount pledged is payable on demand.

Notes to the Financial Statements

For the year ended 31 December 2019 (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	
	Rating	**2019 £'000**	**2018 £'000**	**2019 £'000**	**2018 £'000**
Financial investments - debt and fixed income securities	AAA	4,799	3,524	4,799	3,524
	AA	23,266	18,053	23,266	18,053
	A	56,949	42,812	56,949	42,812
	BBB and below	79,678	75,749	79,678	75,749
	Not rated	6,224	20,327	6,224	20,327
Cash and cash equivalents	AA	71,033	90,849	63,196	90,849
	A	63,719	131,959	61,753	120,699
Reinsurers' share of technical provisions	AA	8,980	8,149	8,980	8,149
Linked assets not subject to credit risk		90,041	79,476	90,041	79,476
Linked assets subject to credit risk - cash	AA	9,236	8,867	9,236	8,867
	A	13,502	11,327	13,502	11,327
Non-linked assets not subject to credit risk		421,524	384,291	438,871	429,758
Total assets		**848,951**	**875,383**	**856,495**	**909,590**

In addition to holding collateral, the 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 (2018: £Nil).

(B) Interest Rate Risk

Interest rate risk is the risk that the fair value or cash flows of a financial instrument will vary as market rates of interest vary. Interest rate risk arises from holding assets and liabilities with different maturity or re-pricing dates, creating exposure to changes in the level of interest rates, whether real or notional. It mainly arises from the Society's investments in debt and fixed income securities, which are exposed to changes in interest rates. It also arises in certain products sold by the Society, which include guarantees as they can lead to the liabilities increasing by more than the value of the backing assets where interest rates change.

Exposure to interest rate risk is measured as part of the Society's stress and scenario testing and is considered as part of the capital management of the Society.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

16 Risk Management (continued)

(C) 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 £234,443,000 (2018: £230,926,000) and £112,779,000 (2018: £99,670,000) respectively. Other financial liabilities are repayable between 0-5 years as follows:

	Group		Society	
	2019 £'000	2018 £'000	2019 £'000	2018 £'000
Other financial liabilities	41,360	48,808	8,342	14,503

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

	2019					
	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	242,960	373,085	112,684	5,444	2,278	736,451
Investment contract with discretionary participation features liabilities						
- guaranteed component	168,954	48,030	671	325	65	218,045
	411,914	**421,115**	**113,355**	**5,769**	**2,343**	**954,496**

	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**

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.

(D) Operational, Strategy, Brand and Reputation Risks

Unlike financial risks, the measurement of operational, strategic and reputation risks is based largely 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 from external sources as applicable to the Group.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

16 Risk Management (continued)

(E) 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	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Non-linked assets				
Assets denominated in Sterling	520,336	573,722	527,880	607,929
Assets denominated in US Dollars	152,008	136,600	152,008	136,600
Assets denominated in Euros	15,201	18,549	15,201	18,549
Assets denominated in other currencies	48,627	46,842	48,627	46,842
Total non-linked assets	**736,172**	**775,713**	**743,716**	**809,920**
Linked assets not exposed to currency risk	112,779	99,670	112,779	99,670
Total assets	**848,951**	**875,383**	**856,495**	**909,590**

(F) 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 2019.

	Total £'000	**Level 1 £'000**	**Level 2 £'000**	**Level 3 £'000**
Derivatives				
- Forwards and options	(7,873)	(7,873)	-	-
Shares and other variable yield securities				
- United Kingdom*	173,895	99,617	-	74,278
- Overseas	213,089	213,089	-	-
Debt and other fixed income securities				
- United Kingdom	110,596	45,430	58,943	6,223
- Overseas	105,749	2,378	103,371	-
Deposits with credit institutions**	95,850	95,850	-	-
Loans on policies	2,101	-	-	2,101
	693,407	**448,491**	**162,314**	**82,602**

* includes £89,951,000 of assets held to cover linked liabilities with the Level 1 category.

** includes £21,455,000 of assets held to cover linked liabilities with the Level 1 category.

The investment in shares in group undertakings held by the Society of £57,884,000 (2018: £91,409,000) 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 2019 (continued)

16 Risk Management (continued)

(F) Fair value estimation (continued)

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 and options	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 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 2019.

	Group 2019 £'000	Society 2019 £'000
Opening balance	107,146	198,555
Net disposals	(16,591)	(16,591)
Unrealised loss included in the Technical Account	(7,953)	(41,478)
Closing Balance	**82,602**	**140,486**

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

16 Risk Management (continued)

(F) 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 held a minority equity holding in and a corporate bond with a financial company which went into administration post year end. Both of these assets were 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 was modelled previously based on external transactions, however these are not in an active market. The equity holding was written down to £nil at the Balance Sheet date as it has no value following the administration. The fair value of the loan had been calculated previously 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. At the Balance Sheet date, the loan was valued at amounts expected to be recoverable from the administration.

(G) Sensitivity analysis

The impact on the Society's Technical Account and FFA are shown in the table below. For each sensitivity, the impact of a change in a single variable with all other assumptions left constant is considered. In reality, it is unlikely that only one factor will change in isolation and the sensitivities used do not take into account consideration of active management by the Society of its assets and liabilities.

The percentage changes shown below are designed to show the sensitivity of the Society's Balance Sheet to a range of illustrative market movements and do not in any way reflect management's expectation of future market performance.

	2019					
	Fixed interest yields		Equity		Property	
	+1%	-1%	+10%	-10%	+10%	-10%
% Impact on Technical Account (£'000)	(3.1)	3.4	1.0	(1.3)	0.9	(0.8)
% Impact on FFA (£'000)	9.7	(13.1)	1.6	(3.4)	3.4	(3.7)

	2018					
	Fixed interest yields		Equity		Property	
	+1%	-1%	+10%	-10%	+10%	-10%
% Impact on Technical Account (£'000)	(2.9)	3.2	2.7	(2.5)	0.9	(0.9)
% Impact on FFA (£'000)	5.9	(7.7)	4.9	(6.2)	2.2	(2.3)

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

17 Tangible Assets

Group

	Freehold land and buildings £'000	Computer equipment £'000	Office furniture and equipment £'000	Motor vehicles £'000	Total £'000
Cost or valuation:					
At 1 January 2019	5,275	6,823	1,451	29	13,578
Additions	-	27	25	60	112
Disposals	-	-	(124)	(24)	(148)
At 31 December 2019	**5,275**	**6,850**	**1,352**	**65**	**13,542**
Depreciation:					
At 1 January 2019	-	3,926	747	23	4,696
Charge for the year	-	1,006	122	14	1,142
Eliminated on disposals	-	-	(54)	(18)	(72)
At 31 December 2019	**-**	**4,932**	**815**	**19**	**5,766**
Net book value:					
At 31 December 2019	**5,275**	**1,918**	**537**	**46**	**7,776**
At 31 December 2018	5,275	2,897	704	6	8,882

At the end of the year the Group had a tangible asset capital commitment of £Nil (2018: £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 (2018: £895,000).

All properties held at 31 December 2019 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 directors have considered the valuation of the freehold properties as at 31 December 2019 and do not consider it to have differed materially from that stated at 31 December 2018.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

17 Tangible Assets (continued)

Society

	Freehold land and buildings £'000	Computer equipment £'000	Total £'000
Cost or valuation:			
At 1 January 2019 and 31 December 2019	**5,275**	**1,000**	**6,275**
Depreciation:			
At 1 January 2019	-	466	466
Charge for the year	-	238	238
At 31 December 2019	**-**	**704**	**704**
Net book value:			
At 31 December 2019	**5,275**	**296**	**5,571**
At 31 December 2018	5,275	534	5,809

18 Technical Provisions and Technical Provisions for Linked Liabilities

(A) Technical Provisions

Group and Society

	2019			2018		
	Gross £'000	Reinsurers' Share £'000	Net £'000	Gross £'000	Reinsurers' Share £'000	Net £'000
Contract liabilities						
Participating insurance contracts	371,156	-	371,156	381,358	-	381,358
Non-participating insurance contracts	9,937	(8,980)	957	8,697	(8,149)	548
	381,093	**(8,980)**	**372,113**	**390,055**	**(8,149)**	**381,906**
Investment contracts with discretionary participation features	248,569	-	248,569	243,763	-	243,763
Non-participating investment contracts	24,520	-	24,520	32,200	-	32,200
Long-term business provision	**654,182**	**(8,980)**	**645,202**	**666,018**	**(8,149)**	**657,869**
Claims outstanding	**7,566**	**(780)**	**6,786**	**7,046**	**(609)**	**6,437**

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

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

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

Group and Society

	2019 £'000	2018 £'000
Non-participating investment contracts	112,779	99,670
Total technical provisions for linked liabilities	**112,779**	**99,670**

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 £38,353,000 (2018: £43,511,000) are measured at amortised cost. The corresponding amounts for the Society are £8,342,000 (2018: £14,503,000).

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	
	2019	2018
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	40% AM/F00	40% AM/F00
Unitised with-profits business	40% AM/F00	40% AM/F00
All other business	60% AM/F00	60% AM/F00

The mortality assumptions for 2019 are unchanged from 2018.

If a lower mortality rate were assumed to apply, the long-term business provision would decrease in respect of assurances.

- **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 2019 are different from the 2018 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 policyholders remain to receive the guaranteed benefits.

Notes to the Financial Statements

For the year ended 31 December 2019 (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 and future expense inflation. The assumptions have been updated to reflect changes in the expected future expense base.

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	
	2019	2018
Term assurance	£23.00 pa	£17.50 pa
Top up pension	£15.24 pa	£15.00 pa
Platinum Bond, GIB, GISA, OISA	£60.00 pa	£50.00 pa
Stakeholder Pension, Group Personal Pension	£75.00 pa	£75.00 pa
Child Trust Fund	£26.50 pa	£24.00 pa
Conventional with-profits	£18.25 pa	£17.00 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 the Society's 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 the Society's 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 the Society's 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 by the Society.

Notes to the Financial Statements

For the year ended 31 December 2019 (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 or a combination of any of the following:

- 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.

	2019 £'000	2018 £'000
Total Society FFA at start of year	**113,263**	**132,912**
Investment variations – assets not backing the asset shares	(11,737)	627
Investment variations – liabilities, plus one year ageing of policies	10,241	(3,833)
Change in economic conditions and economic assumptions	(3,099)	2,847
Effect of subsidiary activity	(33,525)	(7,038)
Effect of demographic experience over the year	(2,581)	(2,758)
Expense variances	(5,516)	(3,519)
Tax variances	811	(3,312)
Profits on non-profit business after reinsurance	476	1,061
New business	(2,164)	(3,145)
Change in current liabilities	(281)	1,547
Change in non-economic assumptions	(2,103)	(1,203)
Modelling changes	-	150
Other variances	2,161	(1,073)
Total Society FFA at end of year	**65,946**	**113,263**

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 significantly positive in 2019.

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.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

19 Capital Management (continued)

The tax variances are a result of reduced recognition of the deferred tax asset, offset by the fact that with-profits policyholders were given a net of tax return (in particular in respect of equity gains) despite no tax being payable. This is because they had previously been given the full benefit of the deferred tax asset arising from the equity losses incurred in earlier years.

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 actuarial loss in respect of FRS 102 Pension deficit liabilities. This item also includes a £1m benefit resulting from the change in reserving in respect of outstanding claims.

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 2019, lower interest rates, changes in investment strategy, expense variances, changes in assumptions used to measure liabilities, changes in subsidiary valuations, 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	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Trade debtors	25,240	23,097	-	-
Other debtors	4,229	6,962	272	297
Corporation tax recoverable	181	52	181	52
	29,650	**30,111**	**453**	**349**

All balances are recoverable within one year.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

21 Other Creditors

	Group		Society	
	2019 £'000	**2018 £'000**	**2019 £'000**	**2018 £'000**
Trade creditors	29,557	25,245	208	-
Amounts due to group undertakings	-	-	6,559	3,101
Other creditors	3,754	4,685	311	107
Tax and social security	452	522	-	-
Accruals and deferred income	4,932	4,352	542	844
Unrealised foreign exchange positions	720	10,449	720	10,449
	39,415	**45,253**	**8,340**	**14,501**

All creditor balances above fall due for payment in less than one year except for an amount included within Other Creditors (Group only) of £1,064,000 (2018: £2,069,000) which falls due for payment after more than one year.

22 Other Provisions

	Clawback
Group	**£'000**
At 1 January 2019	3,228
Utilised in the year	(1,834)
Charged to the Technical Account	549
At 31 December 2019	**1,943**

Clawback provisions relate to an expected amount to be repaid to insurers in respect of commission clawed back on cancellation of life insurance policies by customers. A provision is established on new business written at the time the gross commission is received. The provision is expected to be utilised within four years and whilst the timing of cash outflows is inherently uncertain, it is assumed that 61% of the provision will be utilised in 2020, 27% in 2021, 10% in 2022 and 2% in 2023.

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	
	2019 £'000	**2018 £'000**
Within one year	436	477
Between two and five years	1,227	1,248
After five years	24	24
	1,687	**1,749**

The Society has no commitments for the future minimum lease payments under non-cancellable operating leases. The Group had net operating lease costs of £750,000 (2018: £435,000) during the year. The Society had net operating lease costs of £Nil (2018: £Nil) during the year.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

24 Pension Commitments

The Group and Society contribute to defined contribution schemes for employees. In 2019, this contribution amounted to £1,052,000 (2018: £1,122,000).

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 2019.

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 credit 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 2019 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:

	2019	**2018**
Discount rate	2.10%	2.95%
RPI inflation	3.05%	3.50%
CPI inflation	2.05%	2.50%
LPI 5% pension increases	3.05%	3.50%
Revaluation in deferment	2.05%	2.50%
Life expectancy at age 60 of male aged 45	30.7 years	30.6 years
Life expectancy at age 60 of male aged 60	29.1 years	29.0 years
Life expectancy at age 60 of female aged 45	31.9 years	31.8 years
Life expectancy at age 60 of female aged 60	30.2 years	30.1 years

The actual return of the Fund's assets during the year was 11.9% (2018: 1.8%).

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

Asset Category	**2019**	**2018**
Equities	41%	38%
LDI	21%	24%
Bonds	31%	32%
Cash	7%	6%

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 2.10% pa (2018: 2.95% pa). The assets do not include any investments in the Group or Society.

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

24 Pension Commitments (continued)

Amounts Recognised on the Balance Sheet at 31 December

	2019 £'000	2018 £'000
Growth funds	14,915	12,029
LDI	7,862	7,499
Bonds	11,549	10,238
Cash	2,567	1,842
Fair value of assets	**36,893**	**31,608**
Present value of funded obligations	(44,573)	(40,698)
Deficit in the Fund	**(7,680)**	**(9,090)**

Reconciliation of Present Value of Scheme Liabilities

	2019 £'000	2018 £'000
At 1 January	40,698	45,898
Past service costs	17	41
Interest on liabilities	1,181	1,125
Benefits paid	(1,367)	(2,781)
Actuarial loss/(gain) on liabilities	4,044	(3,585)
At 31 December	**44,573**	**40,698**

Reconciliation of Fair Value of Scheme Assets

	2019 £'000	2018 £'000
At 1 January	31,608	31,757
Return on scheme assets less interest	2,800	(1,377)
Contributions	3,030	3,360
Benefits paid	(1,367)	(2,781)
Administration costs	(133)	(156)
Interest on assets	955	805
At 31 December	**36,893**	**31,608**

Analysis of the Amount Charged to Technical Account

	2019 £'000	2018 £'000
Interest on assets	(955)	(805)
Past service costs	17	41
Interest on liabilities	1,181	1,125
Administration costs	133	156
Total	**376**	**517**

Amounts recorded in Other Comprehensive Income

	2019 £'000	2018 £'000
Return on scheme assets less interest	(2,800)	1,377
Actuarial loss/(gain) on liabilities	4,044	(3,585)
Total actuarial loss/(gain)	**1,244**	**(2,208)**

Notes to the Financial Statements

For the year ended 31 December 2019 (continued)

24 Pension Commitments (continued)

History of Experience of Gains and Losses

	2019 £'000	2018 £'000	2017 £'000	2016 £'000	2015 £'000
Present value of defined benefit obligation	(44,573)	(40,698)	(45,898)	(48,549)	(35,431)
Fund assets	36,893	31,608	31,757	32,518	30,590
Deficit	**(7,680)**	**(9,090)**	**(14,141)**	**(16,031)**	**(4,841)**
Experience gains and losses on Fund liabilities	-	-	-	-	-
Changes in assumptions used to value Fund liabilities	4,044	(3,585)	(1,397)	13,246	(2,388)
Experience adjustments on Fund assets	(2,800)	1,377	(233)	(1,287)	757

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 paid during the year for such products are shown below:

	2019	2018
Life:		
Life premiums £'000	16	62
Number of members paying premiums in the year	10	10
Balance due to Group £'000	-	-
General insurance:		
General insurance premiums £'000	6	9
Number of members paying premiums in the year	7	10
Balance due to Group £'000	3	5
Healthcare subscriptions:		
Healthcare subscriptions £'000	4	5
Number of members paying subscriptions in the year	2	2
Balance due to Group £'000	-	-

26. Subsequent Events

On 24 April 2020, the Board signed a transfer agreement with The Royal London Mutual Insurance Society Limited (Royal London), a much larger, financially robust mutual to which the Society's business and its subsidiary undertakings will transfer during the second half of 2020. At the date of signing these financial statements, discussions are ongoing with Royal London to consider the practicalities of the transfer, including its impact on Members, policyholders, staff, systems and processes. No changes to the carrying value of assets or liabilities have been made in these financial statements as a result of the signature of this agreement.

The Group's lending partner, Neyber, went into administration after the year end, following a period of financial difficulty which was apparent in 2019. Neyber's trade has been purchased by Salary Finance Limited, a competitor business who will assume Neyber's role as the Group's lending partner going forward. As a result of Neyber's financial situation as at the year end, which was further evidenced by its administration in early 2020, the value of the equity stake in Neyber has been written down from £4.2m to £nil. The carrying value of the debt due from Neyber, including a working capital loan, has been written down to those amounts that were anticipated as being recovered through, as at the year end, an anticipated administration or restructuring event resulting in a write down of £8.4m. These adjustments have been reflected in the 2019 financial statements.

After the year end, the Covid-19 virus has created unprecedented social and economic pressure across the globe. The extent and duration of the impact of Covid-19 is very difficult to predict, but disruption to sales activity is expected through travel and social distancing restrictions, changes to immediate customer priorities and potential illness to staff and customers. Procedures have been put in place to enable almost 100% of staff to work from home and service to members and customers is expected to be largely unaffected. No impact to the transfer to Royal London is anticipated and neither is any reduction to long term sales potential foreseen. The directors consider the impact of Covid-19 to be a non-adjusting subsequent event and therefore no changes to the carrying values of assets or liabilities have been recorded in these financial statements. At present, the longer term impact of Covid-19 on the carrying value of assets and trading performance is unknown and it is not certain whether the impact will be material or persistent.

Police Mutual Assurance Society Limited

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