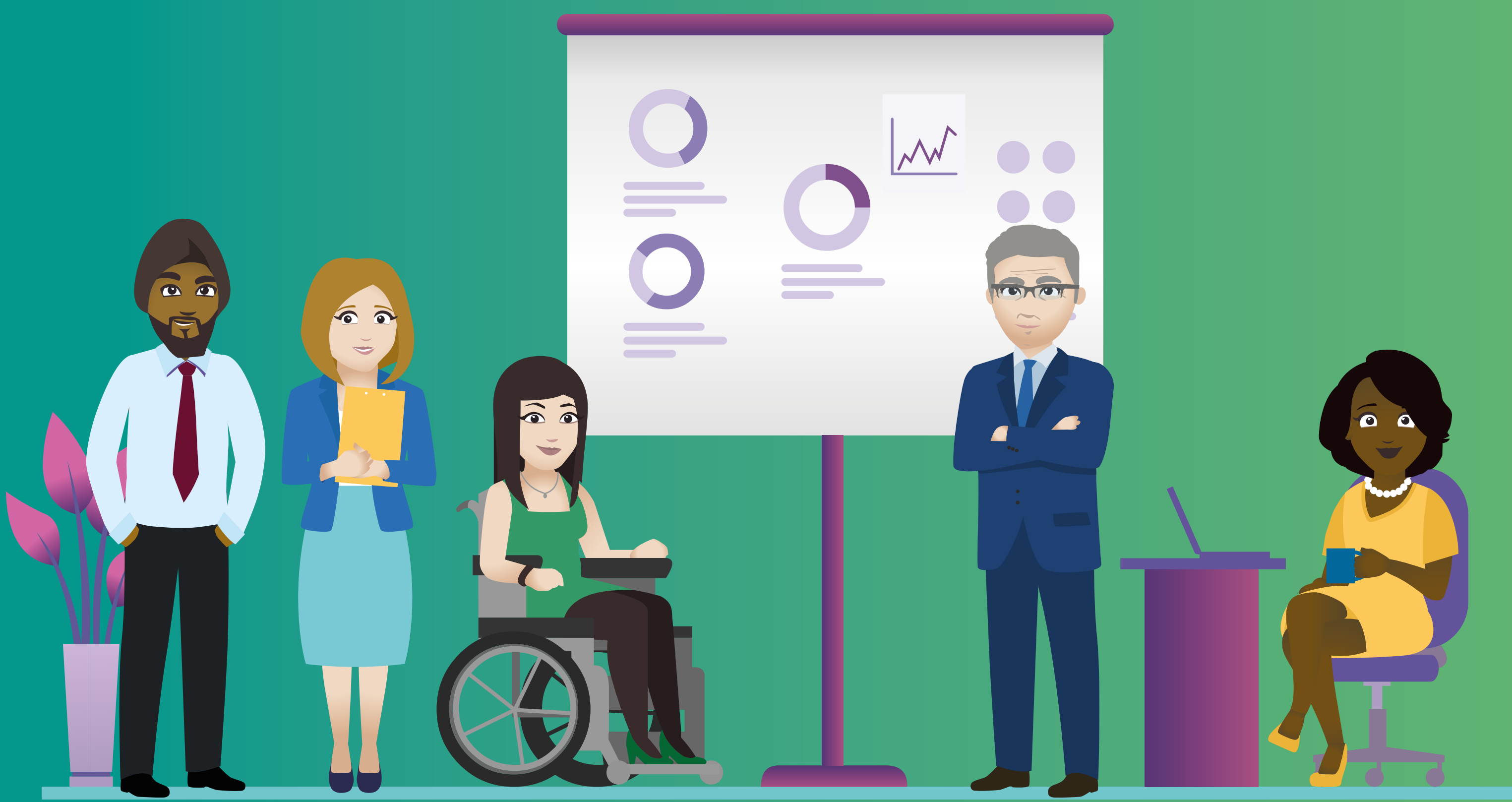
Scottish Friendly

www.scottishfriendly.co.uk

Annual Report & Accounts 2021

A warm welcome



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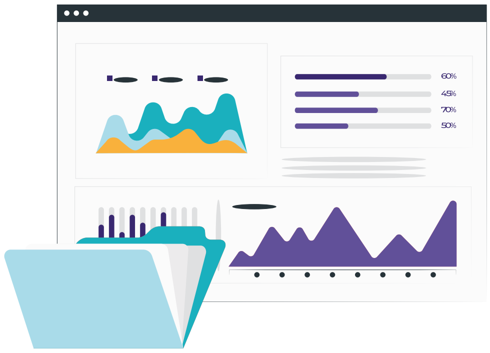

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For more information on Scottish Friendly and its products visit www.scottishfriendly.co.uk

Overview

"In what has been one of the most extraordinary years in recent history I am pleased to report that we have demonstrated our resilience."

2021 Highlights

Scottish Friendly's status as a mutual means that we are not driven by the needs of shareholders. Instead we are owned by, and run for, the benefit of our members and profits are reinvested in the interest of those members.

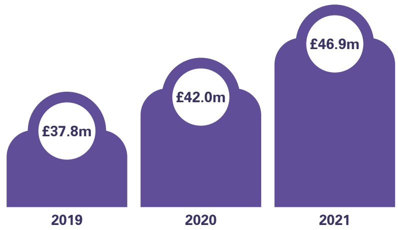
Scottish Friendly firmly believes that saving and investing should be for everyone, which is why we have a commitment to offer understandable and accessible products, helping to secure a better financial future for individuals and their families.

We are proud to be one of the largest mutual life offices in the UK, with a history reaching back 160 years.

New business sales

£46.9m (APE)[1]

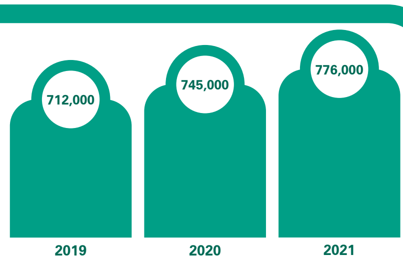
New business sales are up 12% versus 2020 driven by increases in both savings products sold direct to customers and protection products sold through partnerships. This represents the highest sales figures in Scottish Friendly's history.



Number of members

776,000

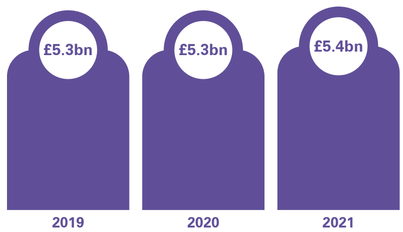
Everyone who has a qualifying policy with Scottish Friendly becomes a member and 2021 saw the total number of members increase by 31,000 from 745,000 in 2020. This reflects the continued success of attracting new customers to Scottish Friendly and retaining existing customers.



Assets under management[2]

£5.4bn

Total assets under management at 31 December 2021 were £5.4bn, up slightly from 2020 (£5.3bn). This reflects positive market movements during the year and the combined impact of premiums received from policyholders and claims paid out.

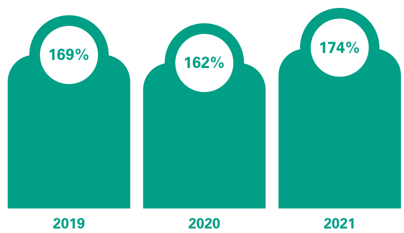


Financial strength

174%

(Solvency II Pillar 1 capital)

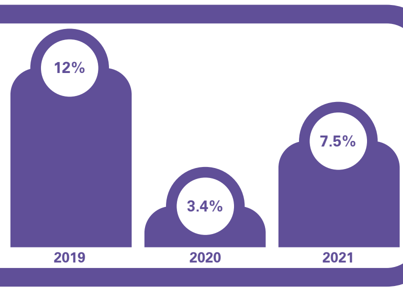
The solvency position (as measured by Solvency II Pillar 1 capital) of Scottish Friendly remains strong with a solvency ratio at 31 December 2021 of 174%, up by 12% from the previous year. The level is well above regulatory requirements and demonstrates continued financial strength.



Investment return

7.5%

The return on asset shares within the Scottish Friendly Main With-Profits fund was 7.5%. These investment returns contribute to bonuses we pay to our with-profits policyholders. Investment return during the year was boosted by positive returns on UK equities offset to some extent by negative returns in the fixed interest market. The total return for with-profits members is further increased by enhancements in respect of the Special Members' Share of 1.2%. This takes the total return for those policies to 8.7%.



[1] Annual Premium Equivalent is an alternative performance measure and is gross of reinsurance (APE = Annual Premium Equivalent, calculated as the annual amount of regular premiums plus one tenth of the single premiums on business written during the year).

[2] Assets under management is an alternative performance measure and includes assets in the Scottish Friendly Investment Funds ICVC.

[3] Investment return is the return in 2021 gross of charges and includes realised and unrealised gains. It is an alternative performance measure.

Chair's Statement

"Our priority from the outset of Covid-19 has been on serving and supporting our members, colleagues, and the wider community."

David Huntley
Chair

Jim Galbraith

Last April, we were all deeply saddened by the news that Scottish Friendly's Chief Executive and long serving colleague, Jim Galbraith had passed away. For over 30 years, Jim had devoted himself to strengthening and driving forward Scottish Friendly and was integral to the success of the business.

His commitment, drive and sheer grit and determination to ensure the success of our mutual life office was truly inspirational. Jim was at the heart of our success for the best part of his career and is deeply missed by everyone.

Covid-19

Our priority, from the outset of Covid-19 has been on serving and supporting our members, colleagues, and the wider community. Many of our colleagues continued to work from home during the year, showing great resilience under difficult circumstances that have lasted longer than any of us could have imagined.

While we experienced some difficulties during the latter part of the year in providing our normal levels of customer service, primarily due to absence levels due to Covid-19, I'm pleased to report that service levels are now much improved.

Following the successful rollout of vaccines across the UK, we are now entering a new set of challenges that lie ahead with UK household budgets being squeezed as rising costs of living are starting to make an impact. We will continue to help support and protect individuals and their families during this continued period of uncertainty.

Purpose and Strategy

Here at Scottish Friendly, we are a purpose-led organisation providing products and services that cater for everyone, regardless of age, income or previous financial experience.

Our defined strategy, to Diversify and Grow, is comprised of three core elements:

- Organic growth through our own brand product range and distribution channels;
- Forming new partnerships and launching new products with existing partners; and
- Acquisition and consolidation activity.

This continued focus has resulted in a year of record-breaking sales totalling £46.9 million APE (2020: £42.0 million). Assets under management increased to £5.4 billion with solvency capital remaining strong 174% while member numbers increased from 745,000 to 776,000.

Environmental, Social & Governance

At COP 26 in Glasgow, world leaders met to make important commitments to tackle climate change.

In turn, we developed our own internal Environmental, Social and Governance (ESG) framework with a focus on ensuring sound corporate governance, responsible investing, and working to improve the communities of which we are part. We also made a commitment to achieving net zero for our own direct scope 1 and 2 (these are direct and indirect greenhouse gas emissions) by 2030 and fully across the business and our supply chain by 2050, in line with government targets.

We aim to invest your funds in a responsible manner and continue to develop our capabilities in this area, working with our investment managers to ensure the stewardship of our investments is consistent with our ESG aspirations.

The Scottish Friendly Children's Book Tour, organised by Scottish Book Trust, continued to deliver a full programme of virtual activity, live streaming engaging and educational content into classrooms and living rooms across the UK. Working with some of the UK's most popular authors and illustrators, the production of fun and exciting video content has been viewed over 100,000 times through social media and a purpose built on demand library hub.

We also continued our relationship with Action for Children raising £23,500 which will provide support to some of the most vulnerable children, young adults and their families across Scotland.

Alzheimer Scotland was our chosen charity, with fundraising activities including a Memory Walk and Wear Your Pyjamas to work day.

Corporate Governance

The strength and flexibility of our governance processes help us to respond to regulatory changes and developments in best practice. We are a member of the Association of Financial Mutuals and support its governance standards. Specific details are included in the Report on Corporate Governance on pages 28 to 45 of this Annual Report.

We remain committed to maintaining best practice and to driving continued improvements in our key processes. I am delighted to report that this has been positively reflected both in the re-certification of ISO 22301 in December 2021 and also in maintaining ISO 27001, the International Standards for Business Continuity Management and Information Security respectively.

The regulatory environment

Throughout 2021, enhancements to policies, processes and systems have been made to ensure continued compliance with requirements of our regulators the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

Particular areas of focus have included:

- Operational resilience;
- Climate change; and
- The fair treatment and protection of vulnerable customers

Corporate recognition

Our achievements were once again recognised with a number of prestigious industry awards. These included Best UK Mutual Insurer at the Capital Finance International Awards and Best Junior ISA Provider at the Investment Life and Pensions Moneyfacts awards, both of which were won for the third consecutive year. In addition, Scottish Friendly won Best Junior ISA Provider UK and Most Innovative Mutual Insurer UK at the Global Brands Magazine awards and was highly commended for Best Financial Protection Provider at the What Mortgage awards.

Our media profile continued to increase with double the volume of press coverage compared to the previous year across national, trade, regional and online media outlets, in addition to targeted exposure across social media channels. This was achieved through a tailored programme of press activity, including corporate news, consumer thought leadership research, and regular commentary on industry topics affecting everyday lives.

The Board

Following Jim Galbraith's passing, Martin Pringle was appointed Chief Executive (Acting) and performed an excellent job in ensuring the business remained on track during a very difficult period. On behalf of myself and the rest of the Board I would like to express our sincere thanks to Martin for his efforts during this period.

Stephen McGee has accepted the role of Chief Executive Officer and will join us from 18th April, continuing to serve until then as a Non-Executive Director. Mark Laidlaw joined as a Non-Executive Director to further strengthen the Board and will become the Chair of the Audit Committee. Dermot Jenkinson retires from the Board at the AGM and Kerr Luscombe will assume the role of Vice-Chair and Senior Independent Director while Gillian Watson will become Chair of the Remuneration Committee. Each of these changes is subject to regulatory approval.

Finally, Neil Lovatt, Commercial Director formally resigned from the Board on 18 January 2022 for health reasons. His last Board meeting was in December 2021. Neil has been instrumental in developing and delivering on our strategy with relentless passion and enthusiasm. On behalf of myself and the Board we would like to thank Neil for his immense contribution.

Our people and our delegates

2021 was another year of uncertainty during which our colleagues remained fully committed to supporting our customers. The Board is extremely grateful and appreciative of each of them and will continue to prioritise their wellbeing and safety in the coming year.

Our delegate system is central to the efficient governance of the company and I would personally like to thank all of the delegates for their continued support throughout the past year.

Outlook

As a purpose-led organisation, each and every one of us at Scottish Friendly remain fully committed to serving our members and supporting their financial aspirations and needs. The economic outlook for the coming year is very difficult to forecast with any degree of certainty. Stubbornly high inflation and rising interest rates are going to be a feature and, the conflict in Ukraine is bringing about a fresh set of concerns and uncertainties geopolitically. Notwithstanding these troubling times, at Scottish Friendly, we have entered 2022 in a strong position and look forward to continuing to deliver on our commitments to our customers, our colleagues and the wider community.

David Huntley
Chair
7 April 2022

> "Our achievements were once again recognised with a number of prestigious industry awards."

Chief Executive's Review

"Our solvency position has remained strong, at 174%, despite a challenging economic environment. This means that our customers can be confident in our ability to meet our promises to them today and in the future."

Martin Pringle
Chief Executive
(Acting)

Jim Galbraith

Last year was extremely difficult for everyone at Scottish Friendly following the passing of Jim Galbraith. He led our mutual society with unparalleled enthusiasm, drive and purpose for such a long time. No one would want to take on the leadership of an organisation under such circumstances. However, having known Jim over the years, I know he would have wanted us to keep on driving the Society forward, and for us to make him proud. Therefore, that has been both my focus and that of all my colleagues during the course of 2021.

We have included a stand-alone tribute to Jim Galbraith to sit alongside this report.

2021 Highlights

Despite the challenges we've faced, I'm delighted to report a record-breaking year for sales of new business while ensuring our financial strength is maintained, once again demonstrating that our strategy continues to deliver for our customers. We continue to diversify and innovate our product range so we can continue to offer products that our members need and value.

Throughout the year we have worked well as a team and I am immensely proud that, in our colleague engagement survey results, 86% of colleagues stated that they are proud to work for Scottish Friendly with more than 9 in 10 saying they enjoy working with their team. To maintain our focus on the wellbeing of our colleagues, we have further strengthened our HR function, launched our company values and introduced a new colleague recognition scheme.

We have made further appointments in our contact centre to mitigate any adverse effects our customers have experienced in our service levels. There is always room for improvement, and we haven't always got this right, but I am very pleased that we are making good strides to enhance and improve the service we offer to our members, through a focus on recruitment and automation of processes, backed by enhancements to our IT and security infrastructure.

Our solvency position has remained strong, at 174%, despite a challenging economic environment. This means that our customers can be confident in our ability to meet our promises.

During the year we entered into a strategic investment relationship with both JP Morgan Asset Management and abrdn plc. These relationships will provide us with access to market insight, support the delivery of investment returns for our customers and provide additional flexibility in a time of volatile investment markets.

We continue to invest in our business, looking to improve how we operate. We invested in new technology to strengthen our Risk Management Framework and are focused on delivering further enhancements to our business operations by use of automation, technology and continual cost management efficiencies.

Through innovation, efficient customer services and responsible capital management, Scottish Friendly is well placed to achieve our objective to provide long-term sustainable growth in value for our members.

Business Performance

Scottish Friendly has a three strand approach to our Diversify and Grow Strategy; Organic growth through our own brand product range and distribution channels; Forming new partnerships and launching new products with existing partners; and acquisition and consolidation activity.

"I am delighted to announce a strong set of results and the highest sales in our 160 year history."

Organic growth

Scottish Friendly's e-business and direct marketing activity delivered strong sales growth despite the continued economic uncertainty, resulting in a 17% increase in own brand sales to over £18.4 million APE; with a quarter of the business coming from our mobile app, as we move ever closer to becoming an app-first financial services provider.

Paper-based marketing activity reduced again this year, in line with our commitment to lowering our carbon footprint. Continuing to invest more in digital marketing, developing our website and the mobile app experience for our customers means that we will keep moving forward to deliver the best experience for our customers, now and in the future.

Partnerships

While some partners continued to find the new environment challenging and uncertain, Scottish Friendly continued to support them through this difficult period. Funeral partners experienced the most disruption during the year, with ongoing restrictions making it difficult for our partners to be able to have in person contact; albeit this improved toward the end of the year. Term life sales, on the other hand, experienced some growth with more people continuing to realise the importance of having life insurance cover in place.

Combined, this led to partnership sales that were relatively flat in comparison to previous years. However, sales remained above expectation, which is testimony to our diverse approach and flexibility in the light of an ever changing environment.

Acquisitions and consolidation

Scottish Friendly has a long and proven track record of acquiring and integrating books of insurance business. We have successfully integrated and embedded a number of acquisitions and in 2021 our focus was on completing the integration of the Canada Life business into Scottish Friendly. We are selective in our activity in this space, requiring all opportunities to be clearly consistent with our strategic objective to provide long-term sustainable growth in value for our members.

Results

Scottish Friendly delivered the strongest set of results in its history despite continued market uncertainty. Total sales were £46.9 million APE, compared to £42 million in 2020.

Of the 2021 total, protection sales were £25.0 million (2020: £24.1 million) and savings and investments, which includes Scottish Friendly own brand, whole of life and savings partners, amounted to £21.9 million (2020: £17.9 million). Included within savings and investments, Scottish Friendly own brand sales increased in 2021 to £18.4 million (2020: £15.7 million).

Earned premiums increased to £155.4 million (2020: £146.2 million). Net premium income (after reinsurance) from insurance contracts increased to £87.8 million (2020: £84.4 million). The ratio of administration expenses to total renewal premiums increased to 8.7% (2020: 8.4%). The Net Transfer to the Fund for Future Appropriations for the year was £24.0 million (2020 restated: £8.8 million) – increasing the surplus available to distribute to our with profits customers and to use to grow the business.

Customer membership increased from 745,000 in 2020 to 776,000 in 2021. Scottish Friendly administers more than one million policies across more than 350 product lines.

Financial position

The return attributed to the asset shares within the Scottish Friendly Main with-profits fund for 2021 was 7.5%, compared to 3.4% in 2020. With-profits policies in that fund also benefited from enhancements in respect of the Special Members Share of 1.2% (2020: 1.2%), taking the total return to 8.7%.

The investment performance reflects a year of continued volatility across financial markets, which saw the FTSE All Share Total Return Index increase by 18.3% and the FTSE Actuaries Government Securities All Stocks Total Return index decrease by 5.2%. The performance of the fund supports the current and future ability to pay bonuses to our with-profits policyholders. Scottish Friendly assets under management increased to £5.4 billion during the year, reflecting market movements and the run-off of the existing business.

In response to the continued increase in customer enquiries into our contact centre, we have made further appointments to mitigate any adverse effects our customers have experienced in our service levels. I fully accept that there is always room for improvement, and we haven't always got this right. However, I am very pleased and can report that we are making good strides to enhance and improve the service we offer to our members through a focus on recruitment and automation of processes backed by enhancements to our IT and security infrastructure.

Our solvency position has remained strong, at 174%, despite a challenging economic environment. This means that our customers can be confident in our ability to meet our promises to them today and in the future.

Scottish Friendly's Fund for Future Appropriations is £226 million at the year end with a surplus of £24 million being generated in the year. The Fund for Future Appropriations represents funds that have not been allocated to specific policyholders and free assets.

Outlook

We are now entering a new level of uncertainty due to the impact of the war in Ukraine and as we emerge from the worst of the pandemic. With a rising cost of living affecting many UK households we are under no illusion that difficult times lie ahead. One certainty during this period is that Scottish Friendly will continue to focus on servicing our members and supporting our colleagues.

Despite this level of uncertainty, we continue to remain well capitalised, with 2021 results yet again demonstrating our agility, drive and determination to successfully navigate through difficult times. Scottish Friendly takes strength from its mutual status. We have experienced many economic cycles over our 160 year history and have a proven track record of being flexible and agile and always taking the long-term view. This has served us well, enabling us to protect value during short term turbulence while planning measures to enhance our asset base in the future.

We fully recognise the challenges that lie ahead and our priority remains on servicing our members during these times. The future may remain uncertain, however we are confident in our ability to steer through the struggles that lie ahead.

On a personal level, I would like to pass on my thanks to our Chair, the rest of the Board, the Executive and our colleagues for their continued commitment and support during this period.

Finally, I would like to add my personal congratulations to Stephen McGee on his appointment as our new Chief Executive Officer. It has been a privilege to lead Scottish Friendly during the difficult circumstances of 2021 and I very much look forward to working with Stephen going forward.

Martin Pringle
Chief Executive (Acting)
7 April 2022

"Scottish Friendly is well placed to achieve our objective to provide long-term sustainable growth in value for our members."

Delivering value to our members

Scottish Friendly as a mutual means that we are not driven by the needs of shareholders. Instead, we are owned by, and run for, the benefit of our members. Profits we make are distributed to our members or reinvested to generate further value in future years.

- **Our mutual ethos –** we aim to serve the full breadth of the market and make it easy for people to engage with financial services. We aim to offer products that are simple and accessible even for those with smaller amounts to invest

- **Focus on our members –** as a mutual we don't pay shareholder dividends. Therefore, we're able to focus on providing value for our members

- **Effective governance –** there are around 30 delegates who represent all our 776,000 members. They meet regularly with the Board and Executive to discuss company performance and strategy. They are empowered to approve key company decisions on behalf of all members

- **Long standing –** we have been helping people plan for their futures since 1862 and are proud to be one of the largest mutual life offices in the UK.

- **Award winning –** in 2021 we won Best UK Mutual Insurer at the Capital Finance International Awards and Best Junior ISA Provider at the Investment Life and Pensions Moneyfacts awards, both for the third consecutive year. In addition, we won Most Innovative Mutual Insurer and Best Junior ISA Provider at the Global Brands Magazine awards and were highly commended for best financial protection provider at the What Mortgage awards

- **Digital technologies -** we continue to invest more in digital marketing and developing our website in addition to continuing to add new functionality to our mobile app, ensuring our members can manage their investments on the move, wherever they are, 24 hours a day.

Governance

Scottish Friendly continues to embrace best practice in corporate governance and is committed to the principles of the AFM Corporate Governance Code for Mutual Insurers

Directors

David C Huntley BA, FIA

Chair

Appointed as a Director in January 2013. Chair of the Nomination Committee and member of the Remuneration Committee, Investment Committee and Risk Committee. Chair of the Scottish Friendly Assurance subsidiary companies: Scottish Friendly Asset Managers Limited, Scottish Friendly Insurance Services Limited, S.L. Insurance Services Limited, SFIS (Nominees) Limited, M&GM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited. Chair of FIL Life Insurance Limited and Non-Executive Director of FIL Life Insurance (Ireland) DAC and Hampden & Co plc. Former Senior Independent Director of Loughborough Building Society, Managing Director of Pearl Life, CEO of Scottish Re and Swiss Re Life and Health Australia.

Dermot J Jenkinson

Vice-Chair and Senior Independent Director

Appointed as a Director in November 2011. Chair of the Remuneration Committee and member of the Audit Committee and Nomination Committee. Appointed Vice-Chair and Senior Independent Director in April 2015. Over 30 years' commercial executive and Non-Executive experience in developing and managing a wide range of businesses in the UK, USA and EU, covering services, distribution, corporate finance and advice. Scottish Entrepreneur of the Year 2009. Executive Chairman of Ascensos Limited and other private companies.

Kerr Luscombe BSc, FFA

Appointed as a Director in June 2015. Chair of the Audit Committee and member of the Risk Committee, Remuneration Committee and With-Profits Committee. Director of the Scottish Friendly Assurance subsidiary companies: Scottish Friendly Asset Managers Limited, Scottish Friendly Insurance Services Limited, S.L. Insurance Services Limited, SFIS (Nominees) Limited, M&GM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited. Fellow of the Institute and Faculty of Actuaries with extensive experience at Board level in the life insurance industry. Previously a Director of Royal London Group and also held finance Directorships at both Lloyds Banking Group and Santander's life insurance businesses. Currently an Independent Member of the With-Profits Committee at Aegon UK and Chairman of the With-Profits Committees at Phoenix Group and Standard Life.

Directors (cont)

Anja M Balfour BSc (Hons), ASIP

Appointed as a Director in April 2018. Chair of the Investment Committee and member of the Risk Committee and With-Profits Committee. Currently Chair of Schroder Japan Growth Fund plc and BMO Global Smaller Companies Plc and Non-Executive Director of AVI Global Trust plc.

Gillian Watson

Appointed as a Director in April 2018. Member of the Audit Committee and Remuneration Committee. Currently Managing Director and Head of Energy & Renewables at Noble & Co and Chair of DC25 Ltd and Char.gy Ltd. Also holds Non-Executive Director positions in Meallmore Ltd, Martin Currie Global Portfolio Trust and Stratera Energy Ltd and is a Trustee of the Boswell Trust.

Susan Beckett BSc (Hons)

Appointed as a Director in September 2020. Chair of Risk Committee and member of the Audit Committee. Chief Risk Officer for Brewin Dolphin, joining the firm in 2014 having held similar senior leadership positions at global firms including Schroders, JP Morgan, Barclays Global Investors, BlackRock, Kleinwort Benson, and the BT Pension Scheme. Non-Executive Director and Chair of the Board Risk Committee for Brewin Dolphin Wealth Management, Dublin. Appointed as Director of Scottish Friendly Asset Managers Limited in September 2020.

Mark Laidlaw BSc (Hons), FFA

Appointed as Director in September 2021. A qualified actuary with over 30 years' experience in the insurance sector across life insurance, general insurance, pensions and asset management. Held a number of roles in the UK and in Europe including CFO of Aegon UK, Global Head of Solvency II for Aegon nv and Corporate Strategy Director of LV. Now retired from full time executive work and is focused on Non-Executive Directorships and is currently a director of Kilter Finance, Omnilife, London CIV, as well as being a Trustee of the LV pension scheme.

Stephen McGee BSc, FFA

Appointed as a Director in September 2021. Fellow of the Institute and Faculty of Actuaries with extensive experience at Board level in the life insurance industry. Previously the CFO at Aegon UK from 2016 and also held senior positions at a number of financial institutions including Chief Actuary at Lloyds Banking Group and Head of Actuarial at Phoenix Group.

Directors (cont)

Jim Galbraith BSc, MBA, FFA

Chief Executive (deceased April 2021)

Appointed as a Director in April 2006. A qualified actuary with over 30 years' experience in the life insurance industry. Joined Scottish Friendly in 1988. Member of the Nomination Committee, Investment Committee and Risk Committee. Director of the Scottish Friendly Assurance subsidiary companies: Scottish Friendly Asset Managers Limited, Scottish Friendly Insurance Services Limited, S.L. Insurance Services Limited, SFIS (Nominees) Limited, M&GM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited. Trustee of the MGM Assurance Staff Pension Plan.

Neil E Lovatt BA (Hons), MSc (Dip), ACII

Commercial Director

Appointed as a Director in January 2017. A marketing and product design professional with nearly 30 years' experience in the life, pensions and investments industry, including senior positions at Scottish Life and Royal London. Joined Scottish Friendly in June 2006. Neil formally resigned on 18 January 2022 for health reasons, with his last Board attendance in December 2021.

Martin Pringle BSc, FCA

Chief Executive (Acting) (from April 2021)

Joined Scottish Friendly in June 2016. Appointed as a Director in February 2018 and assumed the role of Chief Executive (Acting) in April 2021, following the passing of Jim Galbraith. A qualified chartered accountant with over 20 years' experience in the financial services industry. Member of the Nomination Committee, Investment Committee, Risk Committee. Appointed as a Director of Scottish Friendly Asset Managers Limited in January 2021 and as a Director of the Scottish Friendly subsidiaries Scottish Friendly Insurance Services Limited, S.L. Insurance Services Limited, SFIS (Nominees) Limited, M&GM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited in May 2021.

Executive

Jim Galbraith BSc, MBA, FFA
(until 7 April 2021)
Chief Executive

Stuart Macpherson BSc (Hons)
Head of Infrastructure and Security

Neil E Lovatt BA (Hons), MSc (Dip), ACII
Commercial Director

Ian Neilson
Operations Director

Martin Pringle BSc, FCA
(from 7 April 2021)
Chief Executive (Acting)

Stephen Percival BSc (Hons), FFA
(from 25 August 2021)
Interim Finance Director

Aileen Abernethy BSc, MSci
Head of Customer Experience

Alan Rankine BSc, FFA
Head of Actuarial

Gen Humphreys BSc, FFA, CERA
Chief Risk Officer

Pam Simmons BA, FCIPD
Head of HR and Company Secretary

Jill Mackay BA (Hons)
Head of Marketing

Directors' Report

The Directors have pleasure in submitting their Annual Report and Accounts for the year ended 31 December 2021. This report should be read in conjunction with the Strategic Report on pages 8 to 15.

Business objectives and activities

The principal activity of Scottish Friendly Assurance Society Limited ("Scottish Friendly") is the transaction of long-term insurance business in the United Kingdom. In accordance with the Friendly Societies Act 1992, the Directors confirm that all activities carried on during the year by Scottish Friendly are believed to have been within its powers.

Scottish Friendly is authorised by the Prudential Regulatory Authority and regulated by the Financial Conduct Authority and the Prudential Regulatory Authority. It has six wholly owned subsidiaries, (collectively with Scottish Friendly "the Group"): Scottish Friendly Asset Managers Limited, Scottish Friendly Insurance Services Limited, S.L. Insurance Services Limited, SFIS (Nominees) Limited, M&GM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited.

Scottish Friendly Asset Managers Limited is authorised and regulated by the Financial Conduct Authority and conducts the business of managers for transactions in Scottish Friendly ISAs, Junior ISAs and Child Trust Funds. The principal activity of Scottish Friendly Insurance Services Limited is the provision of administration services and it is authorised and regulated by the Financial Conduct Authority. S.L. Insurance Services Limited conducts the business of agents for the transaction of general branch insurance. SFIS (Nominees) Limited is currently dormant.

MGM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited are the trustee entities for the oversight of certain closed pensions schemes.

Scottish Friendly Investment Funds ICVC, an OEIC (Open Ended Investment Company), provides the stocks and shares component of the Scottish Friendly ISA and Child Trust Fund.

All of the above are registered in Scotland, other than MGM Assurance (Trustees) Limited and SF Pension Managers & Trustees Limited which are registered in England and Wales.

Governance and Business review

In 2021, a Board effectiveness review was completed by Grant Thornton which concluded that, while governance was good, a number of changes could be made to ensure we are operating in the most efficient way and these actions have all been implemented. A review of the performance of the business during the year and the future outlook, including key performance indicators, is included in the Strategic Report on pages 8 to 15.

Directors and Chief Executive

The current Directors of Scottish Friendly, including the Chief Executive (Acting), are listed on page 19 to 21.

Further information on the Board is set out in the Report on Corporate Governance on pages 28 to 45.

Statement of solvency

In the opinion of Scottish Friendly's Head of Actuarial and the Board, Scottish Friendly had the required margin of solvency as prescribed in the Solvency II regulatory requirements as at 31 December 2021 and throughout the year.

Going concern basis

The Board is satisfied that it is appropriate for Scottish Friendly to draw up financial statements on the going concern basis. The Board considers that Scottish Friendly has adequate resources to continue in business for the foreseeable future. In making this assessment, the Board has considered the above statement of solvency from the Head of Actuarial, which is further supported by actuarial valuation and solvency reporting made to the Board on a regular basis, including the Own Risk and Solvency Assessment (ORSA). It is also noted that the Group maintains substantial cash reserves to cover anticipated policy outflows and further contingency is available in that the majority of the investments on both balance sheets are held in readily realisable unit funds.

Longer term viability statement

Scottish Friendly invests for long term capital growth and as such members rely on the stability of the Group over the longer term. This is reflected in the analysis of the principal risks within the Corporate Governance section of this report. Key risks have been analysed and disclosed, as well as the framework in place to manage and mitigate these risks.

The Risk Management Framework is integrated within the solvency and capital management activity, in particular the ORSA. The ORSA requires Scottish Friendly to consider the risks arising from the agreed strategic priorities, how much capital is needed to protect the business against those risks over the business planning period in the context of the agreed risk appetite, and how resilient the Scottish Friendly business model is under stressed conditions.

This analysis involves testing a number of projections of the capital position under a range of severe but plausible adverse scenarios covering a period of five years. These include economic and demographic scenarios as well as specific scenarios covering climate change, operational failures and counterparty defaults. This enables management to take any necessary actions to manage risks and ensure the adequate level of capital is held, in line with Scottish Friendly's risk appetite.

Overall, this allows the Board to make an assessment of Scottish Friendly's viability to continue operations and meet its obligations over a five year time period. This period reflects the Scottish Friendly planning cycle. The Board has also considered the ongoing continued impact of Covid-19, on the business and its day to day operations.

Based on the robust assessment of the principal risks, the Directors have a reasonable expectation that Scottish Friendly will be able to continue in operation and meet its liabilities as they fall due over that five year period.

Tax strategy

Scottish Friendly has published its tax strategy on its website and this can be found at: https://www.scottishfriendly.co.uk/tax-strategy

Colleagues

For 160 years we have been here for everyone; it is important no barriers exist for our people too. Our colleagues come from all walks of life and experiences and we like it that way. We recruit and reward individuals based on their skills, performance and potential — regardless of race, gender, sexual orientation, gender identity or expression, lifestyle, age, educational background, nationality, religion or physical ability.

Our People function facilitates an overall framework that ensures colleague conversations take place frequently between managers and their teams, however, we reinforce and supplement this with independently chaired monthly people ambassador meetings attended by a network of representatives from across the business. In addition, regular anonymous colleague surveys are issued throughout the year and are independently reviewed. The results are then shared locally with functional teams, supported by the people ambassadors, to agree action plans for improvements. All of this is overseen by the people function to ensure there is a continuous loop of feedback.

Modern Slavery Act

The Modern Slavery Act 2015 (Slavery Act) requires a commercial organisation over a certain size to publish a slavery and human trafficking statement for each financial year. This statement can be found on Scottish Friendly's website. Scottish Friendly is committed to the eradication of human trafficking and slavery. Slavery and human trafficking are abuses of a person's freedom and rights. We are totally opposed to such abuses in our direct operations, our indirect operations and our supply chain as a whole. We consider that the greatest risk of slavery and human trafficking would be in our supply chain, where operational and managerial oversight is out of our direct control and we expect our partners to operate in line with our corporate values.

Policy on complaints by customers

Scottish Friendly's complaints procedures, detailing the action to be taken in the event of a complaint being received from a member, are documented in Scottish Friendly's Memorandum and Rules, Complaints Manual and Compliance Manual. There is provision for an arbiter to be appointed. In the event that Scottish Friendly is unable to resolve a complaint to the member's satisfaction, the member is made aware of the option to refer to the Financial Ombudsman Service.

Policyholders and members

As at 31 December 2021, Scottish Friendly had 1,413,000 (2020: 1,399,000) policies and estimated the number of members to be 776,000 (2020: 745,000).

Post balance sheet events

The Directors do not consider there to be any post balance sheet events that need to be disclosed.

Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are aware, there is no relevant audit information of which Scottish Friendly's auditors are unaware, and each Director has taken all the steps he or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that Scottish Friendly's auditors are aware of that information.

Statement of Directors' responsibilities in respect of the Directors' Report and the accounts

The Directors are responsible for preparing the Strategic Report, the Directors' Report, the Report on Corporate Governance and the accounts in accordance with applicable law and regulations.

Friendly Society law requires the Directors to prepare accounts for each financial year. Under that law, they have elected to prepare the accounts in accordance with United Kingdom Accounting Standards and applicable law (United Kingdom Generally Accepted Accounting Practice).

The accounts are required by law to give a true and fair view of the state of affairs of the Group and of Scottish Friendly as at the end of the financial year, and of the income and expenditure of the Group and of Scottish Friendly, for the financial year.

In preparing these accounts, the Directors are required to:

(a) Select suitable accounting policies and then apply them consistently;

(b) make judgements and estimates that are reasonable and prudent;

(c) state whether applicable United Kingdom Accounting Standards have been followed, subject to any material departures disclosed and explained in the accounts; and

(d) prepare the accounts on the going concern basis unless it is inappropriate to presume that the Group and Scottish Friendly will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and of Scottish Friendly and enable them to ensure that the accounts comply with the Friendly Societies Act 1992 and the regulations made under it.

The Directors are also responsible for preparing a Directors' Report in accordance with the Friendly Societies Act 1992 and the regulations made under it.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Directors’ Report (cont)

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on Scottish Friendly’s website. Legislation in the United Kingdom governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

The Board confirms that, in its view, it has complied with the above requirements in preparing the Report and Accounts and that it considers the Report and Accounts, taken as a whole, are fair, balanced and understandable.

Auditors

In accordance with Scottish Friendly’s Rules, and following an audit tender exercise in 2021, PricewaterhouseCoopers LLP will offer themselves for appointment as auditors at the forthcoming Annual General Meeting.

The Strategic Report and Directors’ Report are approved by order of the Directors.

Martin Pringle
Chief Executive (Acting)
7 April 2022

Report on Corporate Governance

As a mutual organisation, Scottish Friendly is committed to maintaining accountability to its members. All members are represented by elected Delegates and the Board meets with the Delegates at least twice a year. In addition, members can raise matters directly via the Member Relations function.

As a further part of that commitment to accountability, Scottish Friendly continues to embrace best practice in corporate governance and is committed to the principles of the AFM Corporate Governance Code for Mutual Insurers ("the Code").

In line with the principle of 'apply and explain' set out in the Code, this report describes Scottish Friendly's compliance throughout the period with the principles and provisions of the Code.

The Directors consider that, throughout the period under review, Scottish Friendly has applied the relevant principles and complied with the relevant provisions of the Code as amplified by guidance published by the Association of Financial Mutuals (AFM) in response to the Code.

The AFM asks members to demonstrate in their annual reports how they applied the Code's six high level principles and how that has contributed to better corporate governance. These are detailed below:

AFM Corporate Governance Code Principles	How Scottish Friendly applies to the Principles
Principle One - Purpose and Leadership *"An effective Board promotes the purpose of an organisation, and ensures its values, strategy and culture align with that purpose."*	• A Business Plan is developed each year by the Executive which is reviewed and approved annually by the Board as part of the Business Planning Away Day. At the same time, the broader and longer term strategic plan is also reviewed to ensure alignment, with any necessary updates being incorporated. • With the introduction of a Human Resources department in 2020 and the additional frameworks and controls in place the Board routinely review these via executive reporting across the year. Anonymous colleague surveys since launch in 2019 have consistently reported in excess of 80% of respondents being proud to work for Scottish Friendly. Through all of these mechanisms the Board is satisfied it is able to ensure values, strategy and culture align to the purpose
Principle Two - Board Composition *"Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual Directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the organisation."*	• A succession and skills review of the Board takes place on an annual basis and recruitment of any new members prioritises any gaps. In 2021 Scottish Friendly commissioned Grant Thornton to undertake an external review of Board effectiveness, which reported strong results. Any gaps and recommendations identified in this independent report were addressed throughout the remainder of 2021. Each Board member has a detailed and personalised induction as well as an annual review of individual performance and effectiveness by the Chair. The Chairs performance is reviewed by the SID with contribution sought from the Non Executive Directors.

Report on Corporate Governance (cont)

AFM Corporate Governance Code Principles	How Scottish Friendly applies to the Principles
Principle Three - Director Responsibilities *"The board and individual Directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge."*	• The individual statements of responsibilities as well as performance as a Director are assessed by the Chair as part of the Senior Manager certification regime annual review, for any new appointments a comprehensive induction is undertaken with a review of completion at the end of this by the Chair. • The Memorandum and Rules set out the policies and practices which apply to Scottish Friendly, in accordance with the Friendly Societies Act 1992 and these are all shared and understood by the Board. Additionally in 2021 we undertook some external governance training with the Board to ensure they understood their accountabilities and responsibilities. • There are a number of corporate governance documents which are reviewed annually, including the management responsibilities map and manual, conflicts of interest policy, Board and Committee terms of reference and the Board Diversity policy.
Principle Four - Opportunity and Risk *A board should promote the long-term sustainable success of the organisation by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks."*	• Scottish Friendly has established a framework of internal controls for the management of risk within its business and to safeguard the interests of its members. The system is designed to manage the risk of failure to achieve business objectives, and to the provide reasonable assurance against material mis-statement or loss. • A strategic plan detailing how the organisation creates and preserves value over the next five years is prepared annually and approved by the Board. This, along with the Business Plan and ORSA, details how opportunities are assessed in line with our long-term strategy and risk appetite.
Principle Five – Remuneration *"A board should promote executive remuneration structures aligned to the long-term sustainable success of an organisation, taking into account pay and conditions elsewhere in the organisation."*	• Our Remuneration Committee and policy defines our remuneration strategy and ensures that it is aligned to the sustainable success of the business. An annual review takes place of both the terms of reference for the committee and the policy and external benchmarking reviews are included in order to determine whether any regulatory or best practice updates should be made.
Principle Six - Stakeholder Relationships and Engagement *"Directors should foster effective stakeholder relationships aligned to the organisation's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions."*	• Engagement with our internal and external stakeholders is undertaken through a variety of mechanisms for example, staff engagement surveys, focus groups, dedicated partnership and functional liaison team and outsourcing services meetings. Any issues from these would flow upwards into the regular Executive and Board reporting. • Our Members Relations section on the website provides customers with information on areas such as fund prices, investments and takeovers and acquisitions.

Scottish Friendly is subject to the Senior Managers & Certification Regime (SM&CR) operated by the PRA and FCA to improve culture, governance and accountability within financial services firms.

The Board is satisfied that individual responsibilities have been reviewed, documentation updated and certification of relevant staff undertaken to ensure compliance with the SM&CR.

Report on Corporate Governance (cont)

The Board

The Board met formally on ten occasions in 2021 and informally on two occasions (a meeting in June to discuss a legal matter and the November strategy session). There is a schedule of regular reports which the Board considers and which is agreed at least annually. Reports are provided to Board members in advance of the Board and Board Committee meetings. Apologies were received from Directors on three occasions.

The Directors' attendance at Board and Committee meetings is set out in the table below (figures in brackets are the total number of meetings held during each Director's tenure). In addition to the Board meetings, the Non-Executive Directors met in June to discuss a legal matter and also met with Executive Management in November to review strategic objectives and the business plan for the forthcoming year.

The matters considered by the Board, and on which it receives regular reports, cover financial, business conduct, operational and risk matters, including:

- financial performance against budget, data and analysis relating to business volumes, and reports on investment strategy and performance;
- risk management, through the Risk Management Framework; (see Risk Management, below);
- actuarial matters including solvency and capital requirements;
- operational reports on customer service and staff matters; and
- business conduct information, including performance on the six outcomes of the Treating Customers Fairly initiative.

	Board Meetings	Audit Committee	Risk Committee	Remuneration Committee	Investment Committee	Nomination Committee	With-Profits Committee
David C Huntley	10 (10)	-	-	4 (4)	5 (5)	4 (4)	-
Dermot J Jenkinson	10 (10)	3 (3)	-	4 (4)	-	4 (4)	-
Kerr Luscombe	10 (10)	3 (3)	4 (4)	4 (4)	-	-	4 (4)
Anja Balfour	9 (10)	-	4 (4)	-	5 (5)	-	4 (4)
Gillian Watson	9 (10)	3 (3)	-	4 (4)	-	-	-
Susan Beckett	10 (10)	3 (3)	4 (4)	-	-	-	-
Jim Galbraith	2 (2)	-	1 (1)	-	1 (1)	1 (1)	-
Neil Lovatt	8 (9)	-	-	-	-	-	-
Martin Pringle	9 (9)	-	3 (3)	-	5 (5)	1 (1)	-
Mark Laidlaw	4 (4)	-	-	-	-	-	-
Stephen McGee	3 (3)	-	-	-	-	-	-

Report on Corporate Governance (cont)

Although many of the powers regarding business conduct, operational management and day-to-day activities of Scottish Friendly are delegated to Executive Management, through the Chief Executive, there is a formal schedule of matters reserved to the Board for approval which includes: the authorisation regime for bank accounts, changes to investment parameters and deals outwith those parameters, transfers of engagement, the budget and the distribution of surpluses and bonuses.

The Board also retains responsibility for a number of statutory duties relating to the prudent management of Scottish Friendly's activities; these include responsibility for maintaining required solvency and liquidity levels as well as maintenance of requisite accounting records and systems of control. The powers retained by the Board, and those delegated to the Chief Executive and to Board Committees, are reviewed at least annually by the Board.

The roles of the Chair and Chief Executive are separate and their respective responsibilities have been agreed and documented.

Scottish Friendly has established a framework of internal controls for the management of risk within its business and to safeguard the interests of members. The framework is designed to manage the risk of failure to achieve business objectives, and to provide reasonable assurance against material misstatement or loss. Further information on Scottish Friendly's approach to Risk Management is set out below.

Risk management

Scottish Friendly maintains a robust Risk Management Framework (RMF) that creates an effective risk management capability across the business. The operation of the RMF underpins both strategic aspects of risk management, such as the use of stress testing to inform strategic decision making, as well as the more operational aspects such as risk assessment and assurance.

Risk Management Framework

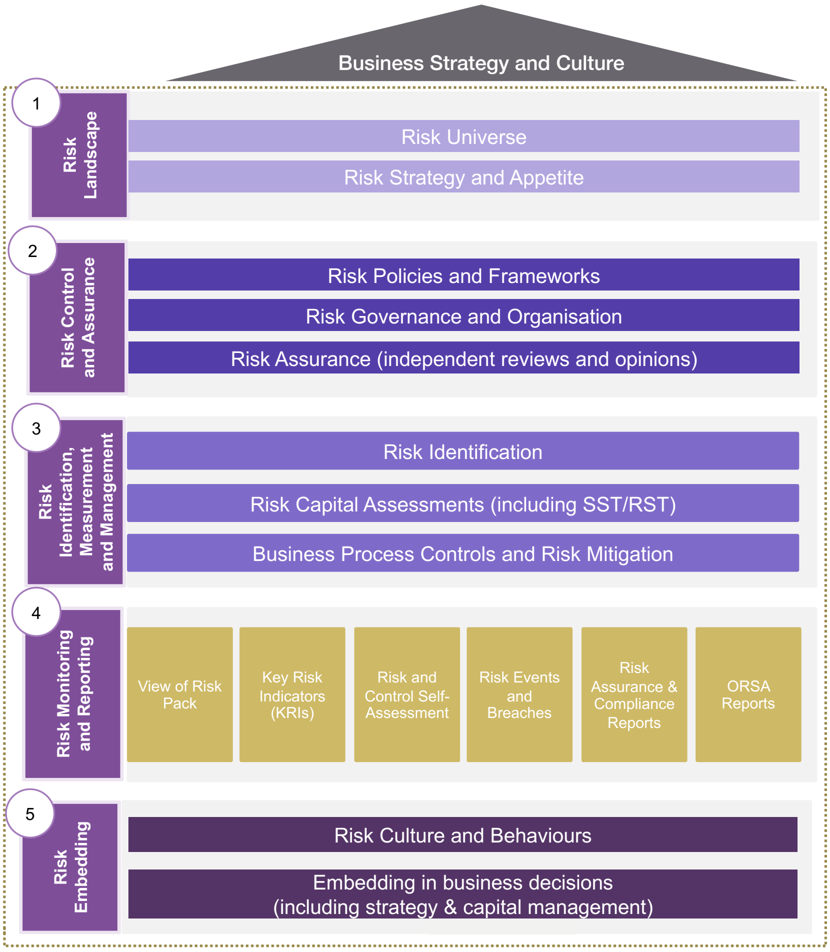
Risk Landscape

The Risk Universe categorises all the risks to which the business is exposed, providing a common language for risk across the business and a structure for assessing and reporting risk. There are three risk categories within the Risk Universe, with level 1 being the highest.

Board approved Risk Appetite Statements (RAS) are in place for each level 1 risk category; these set out the type and amount of risk which Scottish Friendly is willing to accept in pursuit of its strategic objectives and business strategy. When setting risk appetite the Board considers not only the strategic priorities at that point in time, but also what is proposed over the five year business planning period.

The RAS also include a number of metrics, which allow the business to measure its position against risk appetite. For each of these metrics, a trigger and tolerance level has been defined; these are used to guide the extent to which management action is required, should the risk exposure change, based on an intervention ladder set out within the RMF.

Risk Management Framework



SST = Stress and Scenario Testing
RST = Reverse Stress Testing

Risk Control and Assurance

A number of risk policies and risk frameworks are in place and owned by the Chief Risk Officer; these define the principles and standards for managing key risks across the business.

Each risk policy has been allocated an Executive Risk Owner (ERO) who is responsible for demonstrating compliance with the standards across the company on an ongoing basis. The Risk Function provide oversight and challenge of this process.

Risk Identification, Measurement and Management

Current and emerging risks are identified using a variety of techniques, including business risk self-assessments, risk workshops, horizon scanning and forward looking Key Risk Indicators (KRIs).

A key component in the measurement of risk is the Pillar 2 capital assessment, which ensures Scottish Friendly has sufficient capital to reflect the risks to its business. Solvency appetite is primarily assessed with reference to the Pillar 2 solvency coverage ratio.

The annual ORSA cycle involves a forward looking projection of the business' capital resources and capital requirements over a five year time horizon, with consideration given to strategic and business plans. This projection also involves an assessment of whether the level of capital coverage is within Scottish Friendly's solvency risk appetite as well as the associated limits/ triggers. Stress and scenario testing is used to test the impact of adverse scenarios on the capital coverage and business viability. Reverse stress testing is also completed as part of the annual ORSA cycle.

An ongoing process of Risk Controls Self-Assessment (RCSA) is in place for monitoring and managing inherent and residual risk exposures. A key element of the RCSA process is the identification of current and forward looking risks and the management of risk through the assessment of the performance of key controls. This process is performed at both a functional and at a consolidated corporate wide level and is the mechanism for identifying, assessing and reporting the key risks from a strategic perspective. The output of the RCSA process is captured in the Functional and Corporate Risk Registers.

Risk management and mitigation measures are determined (e.g. reinsurance, capital management plans) by EROs to maintain risk exposure within appetite. The measures in place are in accordance with relevant Risk Policies with oversight from the Risk Function.

Risk Monitoring and Reporting

As part of the regular cycle of risk reporting, the Risk Function is responsible for consolidation of information from the preceding components of the risk management framework. This is used to inform a number of regular risk reports are communicated through appropriate governance structures.

The reports include reporting on the Risk Function's view of the position against risk appetite, as well as other relevant data points such as risk events and breaches. This is risk reporting is used to inform decision making, facilitate risk monitoring and ensuring pro-active action is taken to remain within risk appetite.

Risk Embedding

A strong firm-wide risk culture is a key element of effective risk management. Scottish Friendly aims to deliver a culture of risk awareness through desired behaviours, key business decisions, day-to-day operations and change management.

Risk Governance:

The overall accountability for risk within the business ultimately rests with the Board.

The Board has delegated some responsibilities for risk to the Audit Committee of the Board, to assist the Board in reviewing the systems of internal controls and the external financial reports of the business, and to the Risk Committee of the Board (BRC), to provide focused support and advice on risk governance and to assist the Board in reviewing the systems for managing all aspects of the risk universe. On behalf of the Board, the BRC also conducts an annual assessment of the effectiveness of the Risk function.

In addition, the Executive Risk Committee (ERC) is the primary forum for Executive oversight and challenge of the risk and control environment across the business and is chaired by the Chief Risk Officer. All

Executives are responsible for the identification, assessment, management and control of risks in their respective areas, delegating such parts of this responsibility to appropriate managers or other individuals where appropriate. Each Executive is required to report on their respective area to the ERC on at least a quarterly basis.

Three lines of defence model

Scottish Friendly operates a 'three lines of defence model' in the management of risk so that there are clearly defined roles and responsibilities within our Risk Management Framework:

- The First Line of Defence is the operational areas across Scottish Friendly which are responsible for the identification and management of day-to-day risks and controls across the business. The management of risks, monitoring of risks and the reporting of breaches of risk appetite are the responsibility of each Executive Risk Owner.

- In addition, the governance structure includes first line oversight committees. These meetings are chaired by the relevant Executive and membership includes the Risk and Compliance function.

- The Risk Function is part of the Second Line of Defence, reporting to the Chief Risk Officer, Executive Risk Committee and Board Risk Committee. The Risk Function has a clear mandate which is set by the Board and reviewed annually. The primary activities of the Risk Function include the design and oversight of the Risk Management Framework, oversight of the identification and management of risk by the business, independent risk reviews, ownership of the quarterly risk and control self-assessment process, the ORSA methodology and ORSA processes, and promotion a risk-aware culture across the organisation.

- The Chief Risk Officer is responsible for the Compliance Function (SMF16) supported by the Senior Compliance and Financial Crime Manager. Responsibilities of the Function include preparing and delivering of the Board Risk Committee annual compliance plan, assessing the system and controls in place to prevent non-compliance with the regulatory requirements including financial crime and other provisions applicable to the business, monitor and track regulatory developments and to provide policy guidance and support to the first line.

- The Third Line of Defence is independent assurance of the adequacy and effectiveness of our risk and control environment and this is provided by the Internal Audit Function which delivers a cyclical and prioritised programme of risk based audits covering all aspects of work undertaken in the First and Second Line business areas over a period of years.

Report on Corporate Governance (cont)

Principal risks

Once a risk exposure has been identified it is recorded within Scottish Friendly's Risk Universe. The Risk Universe categorises all risks which Scottish Friendly is exposed to into seven broad categories (termed a "Level 1 risk"), and each category contains a number of sub-risks.

The seven Level 1 risks are described below, alongside a description of the key activities undertaken by Scottish Friendly to mitigate and manage the risk:

	Risk	Description	Mitigation and Management
1	Strategic, Business Environment and Reputation ('SBER')	The risk of failing to manage resources, or make business decisions, in a manner appropriate to the business and external environment such that this damages Scottish Friendly's reputation and / or stops Scottish Friendly from being able to deliver its business strategy.	We mitigate SBER risks through a combination of strategic and operational measures. Scottish Friendly sells a wide and varied range of products, and these are sold through a number of channels to multiple target markets. In addition, operational controls are used to minimise the impact of events that could harm reputation as well as continued investment in people, systems and processes to strengthen the business' resilience to internal and external events. Strategic risks are monitored through KRIs and horizon scanning.
2	Market	The risk that market movements or fluctuations results in adverse impacts to the value of assets and/or liabilities leading to financial loss to Scottish Friendly	We adopt a relatively low risk investment strategy, which provides stability against market risk. The specifics of investment strategy are set by the Investment Committee, and the risk exposure is closely monitored by the Risk Committee. In addition, over 2021 a project was completed to appoint two new asset managers; this significantly enhances our ability to undertake specific asset and liability management ('ALM') focused activities, and has also enabled an extended use of derivatives to hedge out undesired risk exposures. Capital is held to protect policyholders against market risk.

	Risk	Description	Mitigation and Management
3	Insurance	The risk of loss or adverse consequence for the business resulting from a failure to predict or respond to changes in the level, trend, or volatility of demographic, policyholder action and expense experience.	We closely monitor emerging experience data, in order to identify possible changes in long-term experience. In addition, in 2021 we increased our data analytics capability, and this provides more detailed information, which allows us to make better informed long-term decisions. A key focus over 2021 was assessing whether there was evidence of any changes in lapse assumptions as a result of potential hardship caused by Covid-19. This had been identified in the 2020 ORSA as a possible emerging risk, particularly when the furlough scheme was unwound. In addition, throughout 2021 we have continued to monitor emerging data to allow us to assess the potential impact of Covid-19 on mortality, morbidity and longevity assumptions. Evidence to date has suggested that there is no reason to believe any long-term assumptions will be significantly impacted as a result of the effects of Covid-19, although there is still considerable uncertainty over the long-term impact. Capital is held to protect policy holders against demographic risk.
4	Liquidity	The risk of failing to have sufficient cash to meet financial obligations when they fall due	Liquidity risk is mitigated by holding adequate liquid resources. The liquidity positioned is monitored closely as part of day-to-day activity, with formal reporting based on a forward looking projection of liquidity needs. Scottish Friendly currently holds significant resources in cash and highly liquid assets, and so liquidity risk is significantly mitigated at present through this investment strategy.
5	Operational	The risk that inadequate or failed internal processes, systems, people or from external events result in financial loss or non-financial impact, including reduced operational resilience, customer and reputational impacts	Operational risk is primarily mitigated and managed through the control environment which is operated across the business. Each Function is required to assess the design and operation of their key controls as part of a quarterly controls self-assessment submission, which is challenged by the Risk Function with further oversight from the Risk Committees. In 2021, in recognition that cyber risk is continually evolving - as hostile attacks adapt to existing tools and become more sophisticated - the business has focused on continuing to invest and strengthen its cyber defences, including training staff on cyber security awareness and continuing to invest in new technology solutions. Over 2021 work was completed to enhance the oversight of operational risk, with development of specific quantitative risk appetite metrics and triggers. There was a strengthening of the operational controls within finance and investment functions and Scottish Friendly has also focused on maturing the processes in place to support staff development. In addition, a new Governance, Risk and Compliance (GRC) tool has been licensed and a project is in progress to roll out the new system across the business, which should further improve the availability of data to measure the exposure to operational risk. Although controls are the best mitigant against operational risks, capital is also held.

	Risk	Description	Mitigation and Management
5	Operational	The risk that inadequate or failed internal processes, systems, people or from external events result in financial loss or non-financial impact, including reduced operational resilience, customer and reputational impacts	A key source of operational risk for Scottish Friendly arises from "model risk". Scottish Friendly uses a number of models to project policy cash flows and value its actuarial liabilities. By necessity, these models are complex and have been iterated over many years. The risk that these models contain errors is a source of operational risk for the business. The first-line operates an extensive suite of controls over the operation of these models, as well as ensuring that the output produced is in line with its expectations. In addition, the business undertakes an annual rolling cycle of review to validate that the models are performing calculations correctly. This is led by the Actuarial Function, with the Risk Function performing independent review of the testing. Over 2021 this work has identified a number of errors within legacy models. These errors have now been corrected and this has resulted in restatements to the prior year results. Please refer to Note 37 for full details of all prior year restatements, including those arising out of ongoing improvements to the Finance control environment.
6	Credit	The risk of loss or adverse consequences for the business resulting from default or failure of third parties to meet their payment obligations, or change in the credit standing of key counterparties	Over 2021 the reporting and oversight of key credit exposures has been further enhanced. A formal credit report is provided monthly to the relevant management committee, allowing timely action to be taken on key credit exposures if required. Scottish Friendly's most significant credit exposures are to highly rated banking and reinsurance counterparties, and collateral is used to further mitigate a number of these key exposures. In addition, capital is held to protect policyholders against credit risk.
7	Conduct	The risk of poor outcomes for customers resulting from the acts of Scottish Friendly, associated third parties and/or individuals within the firm	Measures to mitigate conduct risks are embedded through the product lifecycle and customer journey. Building on the enhancements to product governance, culture and accountability in 2020, a new Conduct Committee was established in 2021 to provide oversight of customer outcomes and the steps taken to manage conduct risk. In addition, a new Executive led Customer Experience function was established, which will focus on how Scottish Friendly delivers on our promises to customers. We have also strengthened our first and second line teams, and are focused on ensuring we continue to meet evolving regulatory expectations in this area. Although strong culture and controls are the best mitigant against conduct risks, capital is also held as part of the operational risk capital.

Key Emerging Risks

Emerging risks are typically characterised by a high degree of uncertainty and generally fall into two categories. They are either 1) new risks which may develop in the future into a material exposure for Scottish Friendly; or 2) existing risks which begin to present in a new or different way from previously understood. Emerging risks may be known to some extent, but they may never materialise, or might not have an impact for several years. Alternatively, they might crystallise rapidly, with little time to respond. Scottish Friendly operates an emerging risk process to identify new emerging risks, as well as to determine whether existing emerging risks have become more or less likely to crystallise in the future.

This process is used to ensure that timely action can be taken, as necessary, to mitigate the risk prior to it impacting Scottish Friendly.

The top five emerging risks which were identified in the 2021 ORSA process are described below. Subsequent to completion of the 2021 ORSA process, the war in Ukraine has emerged. It is recognised as a key emerging risk which is being closely monitored.

	Emerging Risk	Description	Mitigation and Management
1	Failure to keep pace with next wave technology	Failing to keep pace with the rapid developments in technology, or late to embrace opportunities offered. As a result this leads to inefficiencies or loss of competitive advantage.	A strategic project is ongoing to investigate utilising emerging technology across the business, in order to improve customer experience.
2	Impact of long-Covid-19/ missed diagnosis and treatment delays	The impact of Covid-19 on long-term health – as a result of long-Covid-19, as well as missed diagnoses and delayed treatments - remains unknown. If this results in poorer health outcomes and shorter life expectancies, this would increase claims and reduce profitability – particularly for the whole of life business which is not reinsured	Emerging experience is being closely monitored. Management is also engaging with industry working groups to understand emerging data on wider societal impact. At present there is no reason to consider experience will be materially different in the future, although this will continue to be closely monitored and assumptions will be updated as appropriate.
3	Insufficient pace in implementing climate change strategy	Scottish Friendly fails to take sufficient action to implement its climate change strategy, leading to significant additional transition costs and disruption to delivery of other strategic initiatives.	Climate change strategy has been discussed extensively by the Board in 2021, and long-term objectives have been agreed for own operations and investments. An ESG working group has been established and is leading progress on developing more detailed operational plans and targets.
4	Scottish independence	Constitutional change may have an impact on Scottish Friendly's ability to deliver services to some of its customers.	Developments are monitored by the Board. Appropriate contingency options have been identified to ensure continuity of customer service.
5	Regulatory change has unintended consequence for Scottish Friendly	There is a significant programme of financial services regulatory reform taking place following the UK's exit from the EU, and other changes are planned to the tax regime in the UK, as well as the approach to provision for long-term social care. There is a risk that a change is made which has a negative unintended consequence for Scottish Friendly, or friendly societies more generally.	Management is closely monitoring proposed regulatory changes. To date, all proposals are assessed to have a minimal impact, or could be marginally beneficial for Scottish Friendly. Management will continue to engage with industry bodies, such as Investment and Life Assurance Group and the ABI, and plans to respond to any consultation papers to highlight the impact on Scottish Friendly if necessary.

Key risk management developments in 2021

- In addition to the developments incorporated above, key focus for 2021 was enhancing the Risk Management Framework to embed the management of the financial risks of climate change and to meet the expectations set by the PRA. In 2021 a number of specific actions were taken, including:
  - Climate change has been recognised as a specific risk within the Risk Universe;
  - Climate change risk appetite statements were approved by the Board. These set Scottish Friendly's strategic ambitions in relation to reducing its carbon emissions.
  - A climate change risk management policy has been developed and approved by the Risk Committee. This sets out the expectations for management of climate change risk across all three lines of defence
  - Climate change risk is now incorporated within the Corporate Risk Register. The ERO is required to provide an assessment of the position against appetite on a quarterly basis.
  - External consultants were engaged to complete an exercise of calculating the business' carbon emissions, and to assist in developing a plan for reducing the carbon emitted from Scottish Friendly's own business operations;
  - Further enhancements were made to the climate change scenario modelling, including completion of the PRA's Climate Biennial Exploratory Scenario exercise on a best efforts basis for inclusion in the ORSA report.

Directors

Brief biographies of the current Directors are set out on pages 19 to 21.

In addition to the Chair and Senior Independent Director, the Board comprised, as at 31 December 2021, five other Non-Executive Directors and the Chief Executive (Acting). The Commercial Director stepped down from the Board in January 2022.

This composition is considered to provide an effective and balanced mix of skills and experience to meet the Board's remit.

The Nomination Committee has reviewed the length of service of the Non-Executive Directors and considers that they all meet the criteria of independence.

Dermot Jenkinson continued as the Senior Independent Director; as such, he may, as necessary, lead meetings of the independent Non-Executive Directors (with/without the Chair being present), be available to members through the Member Relations function to understand their concerns (in the event that other contacts within Scottish Friendly are inappropriate or have failed) and to present these views to the Board as a whole, and to lead the performance evaluation of the Chair. He is also the whistleblowing champion.

Scottish Friendly's rules provide for all Directors to stand for re-election at least once every three years. If any member of the Board who does not also hold or has not held an executive position with Scottish Friendly has been a member of the Board for nine years or more, that member of the Board is subject to annual re-election at the Annual General Meeting.

In line with the Code, the submission of any Non-Executive Director for re-election for a term which means they would serve more than six years is subject to particular review, taking into account the need for progressive refreshing of the Board.

Particulars of Directors' remuneration are given in the Directors' Remuneration Report on pages 46 to 47.

Performance evaluation

On at least an annual basis, the Chair conducts a performance evaluation of each Director in order to verify that each continues to contribute effectively and demonstrate commitment, including time commitment, to the role.

Feedback from the evaluation is communicated individually to the Director by the Chair. The performance of the Chair is reviewed by the Non-Executive Directors, led by the Senior Independent Director, taking into account the views of the Executive Directors. Executive Directors are appraised in respect of their Directorial duties.

The performance of the Board and its Committees is also considered on at least an annual basis and the results shared with the Board as a whole.

Board Committees

The terms of reference of the current Committees of the Board – Audit, Risk, Remuneration, Nomination, Investment and With-Profits Committee – are available on the Scottish Friendly website https://www.scottishfriendly.co.uk/about-us/board-committee-terms-reference

Membership of the Committees of the Board is intended to make best use of the skills and experience of the Directors. The work carried out during 2021 by the Audit, Risk, Nomination, Investment and With-Profits Committees in discharging their responsibilities is summarised below. The work carried out by the Remuneration Committee is described within the Directors' Remuneration Report on pages 46 to 47.

Report on Corporate Governance (cont)

Audit Committee

- **Kerr Luscombe (Chair)**
- **Dermot J Jenkinson**
- **Gillian Watson**
- **Susan Beckett**

The terms of reference of the Audit Committee include all matters indicated by the Code. The Committee consisted of four independent Non-Executive Directors, at least one of whom has recent and relevant financial experience, in line with the Code. The Company Secretary acted as Secretary to the Committee. In addition the Chair, CEO, CRO and Head of Actuarial all attend the Audit Committee meetings.

During 2021 the Committee met formally on three occasions. The Committee:

- reviewed the internal control systems, including internal financial controls and ensured that these continued to be effective; advised the Risk Committee as appropriate of any concerns regarding the effectiveness of the current control framework;

- considered the External Audit Plan which highlighted key judgement areas and summarised changes in reporting requirements;

- reviewed the annual financial statements and annual regulatory returns including Solvency II reporting and the Solvency and Financial Condition Report (SFCR) and approved them for submission to the Board. The Committee focused particularly on major judgemental areas and compliance with accounting standards and legal requirements, including the regulations and guidance of the PRA. The Committee reviewed thoroughly the external auditor's detailed report on the draft documents and obtained satisfactory explanations where necessary. The Committee also reviewed the external auditor's final report on internal controls and ensured that follow up action was appropriate and completed where necessary;

- Approved the internal audit programmes and received regular progress reports from internal audit and ensured that recommendations made were followed up by management. Individual internal audit reviews are scheduled both according to regular assessments of key risk areas on a cyclical approach supplemented with matters of a topical nature. The Committee also monitored co-ordination between the internal and external auditors and ensured that the internal audit function was adequately resourced and had appropriate standing within the organisation;

- reviewed the internal audit charter which follows guidance from the Chartered Institute of Internal Auditors;

- undertook an external audit tender exercise, reflecting the requirement to put this out to tender every 10 years. A Request For Proposal was circulated, with a number of bids received and interviews were held with the shortlisted firms throughout September. The Committee considered the final two participants at the September 2021 meeting and recommended to the Board that PwC were appointed as the new external auditors. Formal approval is expected at the AGM in April 2022;

- assessed the effectiveness of the current external and internal audit processes through the reporting that it receives from the respective auditors who were present at each Committee meeting.

As part of the review of the 2021 annual financial statements, the Committee considered and approved the prior year restatements. Please refer to Note 37 for full details of the restatements.

The Committee meets with each of internal and external audit in the absence of management at least once a year; and reviewed and ensured the fulfilment of the terms of reference of the Committee and examined Committee effectiveness

In planning its work and reviewing the audit plan of the external auditors, the Committee took account of the most significant issues and risks, both operational and financial, likely to impact on the Group's financial statements. The two areas which have most impact on the financial statements and returns are:

- the calculation of life insurance technical provisions and reinsurance valuation on a Solvency II basis. The Audit Committee reviews these on behalf of the Board including reports from the Head of Actuarial covering methodology, assumptions, significant judgements and other factors impacting the provisions and recommends their approval to the Board. Over 2021, this included detailed consideration of the potential impact of the Covid-19 pandemic on future experience; and

- the appropriate recording and valuation of the investment portfolio, particularly the valuation of less liquid and more complex investments. Approximately 99% of the investment portfolio by value can be verified against daily market prices. Scottish Friendly uses appropriate independent safeguarding and custodian arrangements. The Committee has reviewed the control environment as relates to investments, including relevant internal or external audit activity.

Both the Board and the external auditor have safeguards in place to prevent the auditor's independence and objectivity being compromised. The external auditor reports regularly to the Committee on the actions that it has taken to maintain its independence. Deloitte was first appointed as auditor following a tendering exercise in 2012. No issues with the independence of Deloitte were identified.

Investment Committee

- **Anja Balfour (Chair)**
- **Jim Galbraith (until 7 April 2021)**
- **Martin Pringle**
- **David Huntley**
- **Alan Rankine**

During 2021 the Committee met on five occasions. The Company Secretary acts as Secretary to the Committee. The Investment Committee oversees Scottish Friendly's investment holdings and performance on behalf of the Board.

The terms of reference of the Committee include setting asset allocation and investment strategy of the Scottish Friendly funds in line with the liability profile, relevant risk appetite and parameters established by the Board or by the relevant fund objective, and also monitoring risk appetite, investment parameters and fund objectives, making recommendations to the Board as appropriate.

Report on Corporate Governance (cont)

External fund managers were invited to present to the Committee at an investment away day and investment advisors are invited to give regular updates on an ongoing basis.

During the year the Committee oversaw the implementation of a new Investments Target Operating Model.

Following a robust selection process, JP Morgan and abrdn were selected as the two preferred fund managers and as of early August 2021 the management of all non-linked funds had been transitioned to them, with quarterly reporting provided to the Committee.

The Committee continued its work to support Scottish Friendly's wider ESG development, reviewing and approving an updated ESG Policy for investments.

During 2021, the Committee also reviewed and ensured the fulfilment of the terms of reference and examined Committee effectiveness.

Nomination Committee

- **David Huntley (Chair)**
- **Jim Galbraith (until 7 April 2021)**
- **Martin Pringle (from 7 April 2021)**
- **Dermot J Jenkinson**

The Committee ensures that plans are in place for orderly succession for appointments to the Board. It leads the process for such appointments and makes recommendations to the Board, taking into consideration the time commitments required of Non-Executive Directors as well as their independence. The Committee considers the overall balance of skills, diversity, experience and knowledge to ensure that, collectively, the Directors bring informed and independent judgement across the full range of matters either impacting or having the potential to impact the Company.

During 2021 the Committee met formally on four occasions. The Company Secretary acts as Secretary to the Committee. Following the sudden passing of Chief Executive Jim Galbraith in April 2021 the Committee recommended to the Board that Martin Pringle take on the role of Chief Executive (Acting). Under the direction of the Board, it then retained the services of an external search firm to identify candidates for the longer term succession to the role of Chief Executive, subsequently recommending to the Board in November 2021 that Stephen McGee be offered the position. In addition, the Committee also recommended to the Board the appointment of two new non-executive directors during the year.

Risk Committee

- **Susan Beckett (Chair)**
- **Jim Galbraith (until 7 April 2021)**
- **Martin Pringle (from 7 April 2021)**
- **Kerr Luscombe**
- **David Huntley**
- **Anja Balfour**

The Risk Committee provides focused support and advice on risk governance, assisting the Board in reviewing the systems for managing all aspects of business risk. The Committee takes account of the most significant issues and risks, both operational and financial, likely to impact on the Group's financial statements.

During 2021 the Committee met on four occasions. The Company Secretary acts as Secretary to the Committee.

The Committee:

- reviewed, challenged and approved the revised Risk Appetite Methodology and recommended Risk Appetite Statements for Board approval, including oversight of the limits and triggers that are the basis for regular ORSA reporting;

- shaped the design and content of the Annual ORSA report to meet the requirements of the Board in terms of risk insights and forward-looking risks and threats. In particular reviewing through the lens of the Solvency II regulations, with specific focus on risks inherent in the strategy, the overall solvency needs assessment, and the adequacy of the stress and scenario testing;

- received regular reports from the second- line teams outlining the key prudential, operational and conduct risks facing Scottish Friendly and the controls and actions being taken to mitigate their impacts. The Committee reviewed various 'deep dives' in to areas of risk such as the continued threat from Cybercrime as well as projects in place to meet upcoming regulatory change such as Operational Resilience.

This included updates on the Compliance Monitoring plan and any actions arising from Compliance Reviews and Risk Assurance reviews during the period;

- oversaw risk exposure relative to appetite and the actions taken by management to manage principal risks; and

- reviewed and ensured the fulfilment of the terms of reference of the Committee and examined Committee effectiveness.

Report on Corporate Governance (cont)

With-Profits Committee

- **David Gulland (Chair)**
- **Anja Balfour**
- **Lorna Blyth**
- **Kerr Luscombe**

During 2021 the Committee met formally on four occasions and also supported an additional ad-hoc meeting to consider the wider with-profits market. The Company Secretary acts as Secretary to the Committee.

The role of the Committee is, as relevant, to assess, report on, and provide clear advice and, where appropriate, recommendations to the Board on:

- the way in which each With-Profits fund is managed by Scottish Friendly and, if a PPFM is required, whether this is properly reflected in the PPFM;
- if applicable, whether the firm is complying with the principles and practices set out in the PPFM;
- any proposed changes which would result in revisions to the PPFM;
- whether the firm has addressed effectively the conflicting rights and interests of with-profits policyholders and other policyholders or stakeholders in a way that is consistent with Principle 6 of the FCA Handbook (treating customers fairly);
- reviewed and ensured the fulfilment of the terms of reference of the Committee and examined Committee effectiveness; and
- any other issues with which the Board or Committee considers with-profits policyholders might reasonably expect the Committee to be involved.

Member Relations

Scottish Friendly's Delegate system has proven to be an effective model for communication with members and will continue to be the cornerstone around which Scottish Friendly fulfils its responsibilities to engage with, and be accountable to, its members. There are currently 30 Delegate positions (29 filled), elected to represent geographic constituencies and Delegate positions are advertised annually for the one third retiring by rotation.

The Annual General Meeting provides an opportunity to inform the Delegates on business performance and future strategy. This is supplemented by additional Delegates' meetings held at least annually.

Delegate attendance at meetings has always been very good. Due to Covid-19 some of these meetings have had to move to virtual events, with every effort made to ensure these are easily accessible for our Delegates.

Scottish Friendly's member relations strategy includes hosting a dedicated members' area at www.scottishfriendly.co.uk/customer-centre on the Scottish Friendly website which promotes two-way communication by providing access to information of particular relevance to members and through a dedicated email link which members can use to provide feedback. This members' area also includes dedicated areas for those members joining as a result of transfers of business.

Directors' Remuneration Report

Remuneration Committee

- **Dermot J Jenkinson (Chair)**
- **David Huntley**
- **Kerr Luscombe**
- **Gillian Watson**

The terms of reference of the Remuneration Committee include reviewing the remuneration of the Chair, the Non-Executive Directors, and Solvency II and Material Risk Takers, as well as determining appropriate levels of Executive Management remuneration.

The Committee consists of three independent Non-Executive Directors, as well as David Huntley, who was considered independent on appointment, in line with the Code.

Scottish Friendly's remuneration policy forms part of the risk management strategy, and is intended to ensure Scottish Friendly attracts and retains competent, experienced and skilled resources.

Executive Director salaries are reviewed annually. A range of data is taken into account to inform the review including comparable positions in other organisations, remuneration trends in the financial services sector, as well as wider economic influences. Any change to salary is effective from 1 January. The Remuneration Committee ensures that it remains appraised of these factors and of best practice, taking external advice where appropriate.

The remuneration package for Executive Directors incorporates a performance element which is targeted at delivering growth and cost efficiencies while generating longer term value for members. Payments are capped at 100% of salary as per Solvency II requirements for ad hoc discretionary bonuses e.g. as a result of acquisitions. 40% of bonus payments may be deferred for three years, if applicable.

The Executive Directors' benefits comprise a company car or car allowance where applicable, as well as the provision of pay in lieu of pension contributions and healthcare insurance.

Non-Executive Directors' duties and responsibilities are set out in Scottish Friendly's Governance and Control Procedures Manual. Non-Executive Directors initially hold office until the conclusion of the Annual General Meeting following their appointment, at which they are eligible for election without nomination. The circumstances in which a Board member would be required to vacate office are set out in the Rules of Scottish Friendly.

Fees for the Chairman are set by the Committee in his absence and for Non-Executive Directors are set by the Executive Directors and the Chairman. Changes are effective from 1 January. Fees are designed to recognise the responsibilities of Non-Executive Directors and to attract individuals with the necessary skills and experience to contribute to the future development of Scottish Friendly.

Directors’ Remuneration Report (cont)

Employment Contracts

The Executive Directors have employment contracts with 6 months notice on either side. In the event of termination, any payments made would be based on individual circumstances including the reason for termination and contractual obligations and would be reviewed and approved through the Remuneration committee. Scottish Friendly has directors’ and officers’ liability insurance and maintains such cover for the full term of their appointment.

Directors’ emoluments

	Salary and Fees £000	Performance pay £000	Entitled performance pay deferred £000	Benefits[1] £000	Year ended 31 Dec 2021 £000	Year ended 31 Dec 2020 £000
Chair						
David C Huntley	100	-	-	7	107	79
Executive Directors						
Jim Galbraith (deceased April 2021)	191	-	-	32	223	737
Neil Lovatt	188	88	-	37	313	277
Martin Pringle	275	119	-	36	430	300
Non-Executive Directors						
Anja Balfour	72	-	-	-	72	60
Dermot J Jenkinson	62	-	-	-	62	53
Kerr Luscombe	72	-	-	-	72	60
Gillian Watson	50	-	-	-	50	45
Susan Beckett	62	-	-	2	64	15
Mark Laidlaw (joined Sept 2021)	17	-	-	-	17	-
Stephen McGee (joined Sept 2021)	17	-	-	-	17	-

[1] For Executive Directors, benefits comprise the provision of pension contributions, a company car or car allowance where applicable, as well as the provision of pay in lieu of pension contributions and healthcare insurance. For the Non-Executive Directors, figures in the benefits column comprise travel and accommodation cost reimbursements.

Fees are made up of an annual fee covering Board and Committee membership. Additional fees are payable to the Vice-Chair and to the Chairs of the Audit, Risk, Remuneration, and Investment Committees, as well as With-Profits Committee members, in respect of the additional responsibilities relating to those roles. Fees are neither performance-related nor pensionable and Non-Executive Directors do not receive any additional benefits.

Non-Executive Directors receive reimbursement of travel and accommodation costs where required for attending meetings.

Accounts

Independent Auditor's Report To The Members Of Scottish Friendly Assurance Society Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Scottish Friendly Assurance Society ("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 2021 and of the group's and 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 group and society income and expenditure accounts;
- the group and society balance sheets; and
- the related notes 1 to 37, excluding the sections within the capital disclosures in note 30 calculated in accordance with the solvency II regime which are marked as unaudited.

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).

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 we have not provided any non-audit services prohibited by the FRC's Ethical Standard 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.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Actuarial Assumptions – assumptions and methodology judgements for determining Cost of Guarantees reserves and setting of assumptions around future mortality and morbidity in the protection business; • Valuation of illiquid and complex investments; • Specification of model changes; and • Evaluation of prior year errors identified in the current year Within this report, key audit matters are identified as follows: Newly identified Similar level of risk
Materiality	The materiality that we used for the group financial statements was £6.80m which was determined on the basis of Funds for Future Appropriation ("FFA").
Scoping	In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts we determined that the society would be subject to a full scope audit. The society represents the largest component of the group with 99.99% (2020: 99.97%) of the total asset position being composed of society held assets. For the remaining entities within the group we performed other specific procedures for balances with higher materiality or deemed risk.
Significant changes in our approach	There were two significant changes to our audit approach: • A material prior period error was identified which led to us increasing our risk assessment level on model changes to significant, and identifying a Key Audit Matter; and • As described in note 37, errors were identified and corrected in the financial statements through a prior year restatement of comparatives. The assessment of these errors is a Key Audit Matter. There were no other significant changes to our audit approach during the year.

Independent Auditor's Report (cont)

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the Directors' assessment of the group's and society's ability to continue to adopt the going concern basis of accounting included the following:

- evaluated management's assessment of the risks across the group, including: solvency risk, liquidity risk, and operational matters;
- In conjunction with our internal actuarial specialists we evaluated management's stress and scenario testing of future liquidity and solvency ratios, including inspecting the own risk and solvency assessment ("ORSA"), and challenged management's key assumptions. We also reviewed the governance over, and the production of, solvency monitoring information, and considered its consistency with other available information and our understanding of the business; and
- assessed the going concern disclosures made by management in the financial statements, based on our knowledge gained throughout the audit.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and society's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

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

Actuarial Assumptions – The assumptions and methodology judgements for determining Cost of Guarantees reserves and setting of assumptions around future mortality and morbidity in the protection business

Key audit matters description

The group's technical provisions represent an assessment of the liabilities arising from insurance and investment contracts. These include:

- Protection policies that contain a guaranteed payment on death, disability or illness, depending on the terms of the contract;
- Other insurance contracts with guarantees that can increase the benefits payable to the policyholder.

The calculation of technical provisions for insurance contracts requires management to make significant judgements about assumptions and methodology. Judgements include estimates of future deaths, future sickness, voluntary contract terminations, investment returns and administration expenses. In addition, these balances are some of the most significant in the group's financial statements; with-profit insurance contracts valued at £765m (2020 restated: £816m) and non-profit insurance contracts at £896m (2020 restated: £838m), comprising the total output from various actuarial models for the group's insurance products.

Our key audit matter is pinpointed to two specific areas of significant judgement:

- The assumptions and methodology judgements for determining costs of guarantee reserves. These costs of guarantees ('CoG') are complex and material, calculated using a stochastic model based on a variety of possible economic scenarios.
- The valuation of technical provisions related to the protection business is highly sensitive to the setting of the mortality and morbidity assumptions, which require the application of significant judgement.

Due to the significant assumptions and judgements involved, we determined that there was a potential for fraud through possible manipulation of key assumptions and judgements in these balances.

The technical provisions and related accounting policy are set out in Note 26. Management's consideration of significant judgements and estimates is disclosed in Note 2.

How the scope of our audit responded to the key audit matter

We obtained an understanding of the relevant internal controls put in place by management for the setting of technical provision assumptions.

We worked closely with our actuarial specialists to test the economic assumptions and calibration of the stochastic models that determine CoG reserves. We challenged the key movements in the reserve over the period, as well as changes in methodology. In particular, we challenged management's actuarial function on the testing of the Economic Scenario Generator ("ESG") model output, used as an input to the CoG model, by assessing the inputs to the model and the outputs of the ESG model. We also tested the movements in the CoG 'analysis of change' by considering market and policy value movements in 2021.

Together with our actuarial specialists, we challenged management's mortality and morbidity assumptions applied to the protection business by assessing the results of management's experience data analyses and understanding the rationale for any significant changes in assumptions. In particular, we assessed how management had taken account of the additional uncertainty that exists as a result of Covid-19 on the setting of the mortality and morbidity assumptions in the protection business.

We tested the underlying experience data for completeness and accuracy and evaluated that it was used appropriately in establishing these assumptions.

Key observations

The reserves held for future CoG were considered to be appropriately calculated using a stochastic model based on a variety of possible economic scenarios, with appropriate assumptions and methodology judgements.

The mortality and morbidity actuarial assumptions applied to the protection business and the resulting technical provisions presented in the financial statements were considered to be reasonable.

Valuation of liquid and complex investments

Key audit matter description

Investments represent the society's most significant asset balance, £3,624m at 31 December 2021 (£3,409m at 31 December 2020), and are key to matching insurance liabilities. The investments held are concentrated in collective investment schemes, with prices quoted in active markets.

We identified a key audit matter relating to the material asset types with an increased level of management judgement and inherent complexity, being:

- Investments in property funds of £58.2m, which are primarily open-ended and therefore carry a higher liquidity risk; and
- Swaption contracts valued at £17.7m, which are complex derivative contracts that provide the society with an option to enter into an interest rate swap at the expiry date.

Due to the level of judgements involved and the inherent complexity, we determined that there was a potential for fraud through possible manipulation of key assumptions in these balances.

Further details are included within the critical accounting judgements and sources of estimation uncertainty section in Note 2 and financial investments disclosures in Note 17 to the financial statements.

How the scope of our audit responded to the key audit matter

We obtained an understanding of the relevant internal controls put in place by management to verify the valuation of investments held.

For the investments in property funds, we independently tested a sample of the market prices used to value these investments to third party sources. We reviewed the recent performance of the property funds, on both an absolute basis and against peers or benchmark indices, and performed targeted research using independent sources. We assessed the appropriateness of management's assumptions in valuing any property funds that were suspended from trading at the balance sheet dates.

For the swaption contracts, we worked with our complex pricing derivative specialists to calculate a point estimate fair value for 100% of the swaptions as at the year end for the population of £17.7m. We derived our valuation based on inspection of the underlying contracts and other inputs that were independently sourced. In addition, we determined an acceptable range of fair values for each swaption contract, varying market data assumptions to the extent that they are deemed reasonable, and assessed management's valuation against this range.

Key observations

From the work that was performed the property fund investments and the swaption valuations were considered to be within an acceptable tolerance.

Specification of model changes

Key audit matter description

The actuarial models calculate the technical provisions for each product held by Scottish Friendly. The policy terms and conditions differ between products, and the model is calibrated accordingly for these differences. In the current period, as part of the implementation of changes to the models to update certain products, it was identified that the specification of the model change was incorrectly determined, which resulted in the model changes not appropriately reflecting the underlying terms and conditions of the products.

Management subsequently performed an analysis to identify if the terms and conditions within the impacted portfolio of policies were appropriately reflected in the model and made additional adjustments to the technical provisions accordingly.

This analysis resulted in a prior year restatement in the financial statements which resulted in a decrease to the non-profit contract liabilities of £23.7m and reduction in the Fund for Future Appropriation of £0.5m, as described in note 37. The technical provisions disclosures and accounting policies are shown in note 26

How the scope of our audit responded to the key audit matter

We have obtained an understanding of the control on specification of model changes.

We have assessed whether there were any similar model changes implemented, which could indicate other material errors exist.

Together with our actuarial specialists, we performed a number of audit procedures on the model changes. We assessed the model code changes against the specification set out in supporting documentation to establish completeness of the model changes and challenged the work performed by management to compare the valuation model results against those produced by management’s replicator model for a sample of policies. We inspected the calculations performed by the replicator model to confirm that these were being performed in line with our understanding of the product features and the appropriate valuation approach.

We inspected the additional model code changes made to address the re-specification, inspected calculation of manual reserves for those issues addressed outside the model and inspected the calculations performed in the revised version of the replicator model, to compare sample policy level results with those from the updated valuation model.

We inspected a sample of key features documents related to the change in modelling of the product associated with the material error and tested that the terms and conditions were included in the revised replicator model.

We assessed whether the error required restatement in the prior year under the requirements of FRS 102.

Key observations

Based on the work performed we are satisfied that management has incorporated the relevant material terms and conditions within the model. We determined the error was appropriately restated under the requirements of FRS 102.

Evaluation of prior year errors identified in the current year ⓘ

Key audit matter description

During the year end reporting process six material prior year errors were identified.

The adjustments are as follows:

Adjustment One: The pension scheme surplus attracts taxation at 35% on its surplus which has been omitted in error. This adjustment has amounted to an increase to the provisions for liabilities of £7,240k, with an equal reduction in the transfer to the Fund for Future Appropriations.

Adjustment Two: In the non-profit contract liabilities, an error was identified in a model simplification. This adjustment has amounted to a decrease in the non-profit contract liabilities of £67,521k and, as these contracts are fully reinsured, a decrease in the reinsurance asset for non-profit contracts of £67,521k.

Adjustment Three: In the non-profit contract liabilities, an error was identified relating to the use of data and assumptions which did not accurately reflect a range of product features. This adjustment has amounted to an decrease to non-profit contract liabilities of £23,728k and, as the majority of these contracts are reinsured, an decrease to the reinsurance asset for non-profit contracts of £24,275k.

Adjustment Four: In the non-profit contract liabilities an error was identified relating to an incorrect modelling approach being applied. This adjustment has amounted to an increase to non-profit contract liabilities of £3,739k.

Adjustment Five: In the unit-linked contract liabilities an error was identified in the accounting treatment of taxation on investment gains on assets in a portfolio of onshore bonds. This correction has amounted to a reduction to unit-linked contract liabilities of £10,213k.

Adjustment Six: Amounts recognised as annual management charges on investment contracts was overstated in the 2020 Accounts. The correction amounts to a reduction of £10,625k from Other Technical Income with a corresponding reduction to Change in other Technical Provisions.

As a result of these errors identified, management prepared a paper with their consideration as to whether these items were errors and which were changes in accounting estimates. The paper also evaluated whether each error identified required restatement under FRS 102.

FRS 102 requires only material prior year errors to be corrected through a prior year restatement, assessed on both a quantitative and qualitative basis. Due to the significance of the errors, and the judgement required in determining the restatements required, we have identified the evaluation of the prior year errors as a key audit matter.

The prior year restatements are set out in Note 37.

Independent Auditor's Report (cont)

How the scope of our audit responded to the key audit matter

We obtained and assessed the paper management prepared, and challenged the completeness of the errors identified. We assessed the completeness of the model errors identified by assessing the simplifications made by management in the modelling process and assessing the key terms of product features relevant to the modelling process, such as reinsurance contracts, treaties and other key agreements.

We assessed each error to determine whether the value of the error calculated was appropriate and whether the proposed correcting accounting entry was accurate.

We assessed whether each error was correctly classified as a material prior year error under FRS 102, including whether the error would be qualitatively material to the users of the financial statements.

We tested the disclosure in note 37 to determine if it was sufficient and appropriate.

Key observations

Based on the testing performed we are satisfied that the corrections are materially accurate and appropriately disclosed in the financial statements.

Our application of materiality

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	£6.80m (2020: £5.90m)	£6.46m (2020: £5.60m)
Basis for determining materiality	3% of Funds for Future Appropriation ('FFA')	3% of Funds for Future Appropriation ('FFA')
Rationale for the benchmark applied	FFA represents funds not yet allocated to policyholders and is considered an equivalent to a net asset figure in accounting for Friendly Societies.	FFA represents funds not yet allocated to policyholders and is considered an equivalent to a net asset figure in accounting for Friendly Societies. The society represents the largest component of the group with 99.99% (2020: 99.97%) of the total asset position being composed of society held assets. As such, a component materiality threshold cap of 95% of group materiality (2020: 95%) has been applied to reflect the significance of the society to the group structure.

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 financial statements	Society financial statements
Performance materiality	60% (2020: 60%) of group materiality	60% (2020: 60%) of society materiality
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the quality of the control environment and whether we were able to rely on controls, the prior period errors identified in the current year and the nature, volume and size of misstatements identified in the prior period.	

Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £136,000 (2020: £118,000), 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.

An overview of the scope of our audit

Scoping

Our audit scope has been based on the materiality of each element of the income and expenditure account and the balance sheet, taking into account both qualitative and quantitative factors in our assessment. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

A full scope audit of the society was performed. For the remaining entities within the group we performed other specific procedures for balances with higher materiality or deemed risk.

Society materiality was set at £6.46m (2020: £5.60m) after consideration of the significance of the society to the group structure. The specific procedures which were performed on the other components within the group were performed to the lower statutory performance materiality of these entities which ranged between £18k and £112k. All of the audit work to respond to the risks of material misstatement was performed directly by the group audit engagement team.

Our consideration of the control environment

We performed walkthroughs to gain an understanding of the control environment and assessed the design and implementation on controls for significant risks. As described on page 37, internal controls within the financial reporting environment are subject to ongoing improvement. We have not taken reliance over any business processes in the current year, which is consistent with the prior year, and we altered the timing, nature and extent of our procedures accordingly.

We have involved our IT audit specialists in obtaining an understanding of general IT controls in the year. IT controls require further improvement before operating effectiveness of those controls can be tested and we have altered the timing, nature and extent of our procedures accordingly.

Our consideration of climate-related risks

The group continues to develop its assessment of the potential impacts of environmental, social and governance ("ESG") related risks, including climate change. As part of our audit, we held discussions with management to understand the process of identifying climate-related risks, and its strategy for managing climate risk.

We performed our own qualitative risk assessment of the potential impact of climate change on the group's account balances and classes of transactions.

We have also reviewed the group's climate change financial statement disclosures to evaluate consistency with the information obtained during the audit.

Other information

The other information comprises the information included in the annual report, and the section of the capital disclosures in Note 30 which are marked as unaudited, and our auditor's report thereon. The Directors are responsible for the other information contained within the annual report.

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.

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 course of 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 this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

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.

Independent Auditor’s Report (cont)

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.

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.

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

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

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 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;
  - 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 relevant internal specialists, including tax, valuations, pensions, IT, and actuarial 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: (i) actuarial assumptions and methodology judgements related to cost of guarantee reserves and assumptions for future mortality and morbidity in the protection business, (ii) valuation of illiquid and complex investments, (iii) specification of model changes, and (iv) in recording of premiums for the protection business. 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 frameworks 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, and tax and pensions 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 applicable rules set by the Financial Conduct Authority ('FCA') and the Prudential Regulation Authority ('PRA').

Audit response to risks identified

As a result of performing the above, we identified two key audit matters related to the potential risk of fraud (i) actuarial assumptions and methodology judgements related to cost of guarantee reserves and assumptions for future mortality and morbidity in the protection business, and (ii) the valuation of illiquid or complex investments. 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 external 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 HMRC, the PRA and the FCA; and
- in addressing the risk of fraud in revenue recognition, substantiating premiums recorded for the protection business by tracing third party invoices/data, tracing cash flows through bank statements and determining that all 12 months of third party invoices in the year had been appropriately recorded; 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.

Report on other legal and regulatory requirements

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 Strategic Report or the Directors' Report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Friendly Societies Act 1992 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; 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.

Other matters which we are required to address

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the society's Board on 7 August 2012 to audit the financial statements for the year ending 31 December 2012 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 10 years, covering the years ending 31 December 2012 to 31 December 2021.

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).

Use of our report

This report is made solely to the society's members, as a body, in accordance with Chapter 3 of Part 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.

Andrew Holland (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

Bristol, United Kingdom

7 April 2022


30
20
0
2
3
4
5
6
7
40%

Income and Expenditure

Technical Account – Long Term Business

For year ended 31 December

	Note	Group 2021 £000	Group 2020 (restated) £000	Scottish Friendly 2021 £000	Scottish Friendly 2020 (restated) £000
Earned Premiums		155,442	146,136	155,442	146,136
Reinsurance Premiums		(67,692)	(61,694)	(67,692)	(61,694)
Earned Premiums, Net of Reinsurance	3	87,750	84,442	87,750	84,442
Investment Income	4	236,354	119,245	237,354	119,498
Unrealised Gains on Investments	5	100,456	27,576	100,411	27,916
Other Technical Income	6	32,790	36,008[1]	30,698	34,343[1]
Amortisation of Negative Goodwill	13	6,060	6,062	6,060	6,062
		463,410	273,333	462,273	272,261
Claims Incurred		236,072	222,705	236,072	222,705
Reinsurance Claims		(98,955)	(90,010)	(98,955)	(90,010)
Net Claims Incurred	7	137,117	132,695	137,117	132,695
Change in Other Technical Provisions	26	219,018	71,208[1]	219,018	71,208[1]
Operating Expenses	8	78,159	62,224	78,159	62,224
Investment Expenses & Charges	10	3,255	3,054	3,255	3,054
Other Technical Charges	11	1,766	1,701	861	794
Tax attributable to Long Term Business	12	16,826	1,126[1]	16,594	961[1]
Actuarial Gain re Pension Scheme	24	(16,742)	(7,524)	(16,742)	(7,524)
Transfer to the Fund for Future Appropriations	25	24,011	8,849[1]	24,011	8,849[1]
		463,410	273,333	462,273	272,261

[1] Details on the restatement is included in note 37.

Except as disclosed above, there are no recognised gains or losses for the year. All results are derived from continuing operations.

The inclusion of unrealised gains and losses reflects the marking to fair value of investments in the balance sheet.

The notes on pages 69 to 106 form an integral part of these accounts

Balance Sheet

ASSETS As at 31 December	Note	Group 2021 £000	Group 2020 (restated) £000	Scottish Friendly 2021 £000	Scottish Friendly 2020 (restated) £000
Intangible Assets					
Negative Goodwill	13	(47,475)	(53,535)	(47,475)	(53,535)
Investments					
Land and Buildings	14	3,250	3,500	3,250	3,500
Investment in Group Undertakings	15	-	-	3,879	3,910
Derivative Financial Instruments	16	20,110	27,253	20,110	27,253
Other Financial Investments	17	1,152,556	1,148,134	1,152,556	1,147,837
Total Non-Linked Financial Investments		1,175,916	1,178,887	1,179,795	1,182,500
Assets Held to Cover Linked Liabilities	17	2,340,346	2,230,570	2,340,135	2,230,570
Total Financial Investments		3,516,262	3,409,457	3,519,930	3,413,070
Reinsurers' share of Technical Provisions					
With-Profit Insurance Contracts	26	408,741	404,947	408,741	404,947
Non-Profit Insurance Contracts	26	651,061	563,082[1]	651,061	563,082[1]
Investment Contracts	26	501,485	491,502	501,485	491,502
		1,561,287	1,459,531	1,561,287	1,459,531
Debtors					
Deposits held for Reinsurers	19	10,939	9,398	10,939	9,398
Debtors arising out of Direct Insurance Operations	20	16,561	12,264	16,561	12,264
Other Debtors	21	7,491	39,762	8,779	40,622
		34,991	61,424	36,279	62,284
Other Assets					
Tangible Assets	22	753	853	753	853
Cash at Bank and In Hand	23	106,305	108,852	100,573	103,684
		107,058	109,705	101,326	104,537
Prepayments and Accrued Income					
Prepayments & Accruals		103	279	103	279
Pension Scheme Surplus	24	40,147	20,685	40,147	20,685
		5,212,373	5,007,546	5,211,597	5,006,851

[1] Details on the restatement is included in note 37.

The notes on pages 69 to 106 form an integral part of these accounts

LIABILITIES As at 31 December	Note	Group 2021 £000	Group 2020 (restated) £000	Scottish Friendly 2021 £000	Scottish Friendly 2020 (restated) £000
Fund for Future Appropriations	25	226,293	202,282[1]	226,293	202,282[1]
Technical Provisions					
With-Profit Insurance Contract Liabilities	26	765,383	816,030	765,383	816,030
Non-Profit Insurance Contract Liabilities	26	896,118	838,414[1]	896,118	838,414[1]
Unit-Linked Insurance Contract Liabilities	26	288,413	296,912	288,413	296,912
Investment Contract Liabilities	26	2,897,362	2,743,649[1]	2,897,362	2,743,649[1]
Claims Outstanding	28	48,778	32,500	48,641	32,365
		4,896,054	4,727,505	4,895,917	4,727,370
Creditors					
Derivative Financial Instruments	16	106	-	106	-
Deposits Received from Reinsurers	31	36,085	40,550	36,085	40,550
Creditors arising out of Direct Insurance Operations	32	7,508	7,982	7,508	7,982
Other Creditors	33	11,820	11,876	11,365	11,507
		55,519	60,408	55,064	60,039
Accruals and Deferred Income		3,172	1,767	2,988	1,576
Provisions for Liabilities	34	31,335	15,584[1]	31,335	15,584[1]
		5,212,373	5,007,546	5,211,597	5,006,851

[1] Details on the restatement is included in note 37.

Approved by the Directors and signed on 7 April 2022 on their behalf by

K Luscombe
Director

M Pringle
Director and (Acting) Chief Executive

The notes on pages 69 to 106 form an integral part of these accounts

Notes to the Accounts

Group and Scottish Friendly

1. GENERAL INFORMATION

Scottish Friendly Assurance Society Limited ("Scottish Friendly") is an incorporated friendly society authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. It is incorporated in the United Kingdom under the Friendly Societies Act 1992, and its principal place of business is its registered office: Galbraith House, 16 Blythswood Square, Glasgow, G2 4HJ.

It has six wholly owned subsidiaries, together "the Group". The principal activities of each company in the Group are detailed in the Directors' report.

2. ACCOUNTING POLICIES

The Group's significant accounting policies are included at the beginning of the relevant notes to the Accounts. This note sets out the basis of preparation, a summary of the Group's critical accounting estimates and judgements in applying accounting policies, and other significant accounting policies which have been applied to the financial statements as a whole.

Basis of preparation

The Accounts have been prepared in accordance with "The Financial Reporting Standard 102 ('FRS 102') and The Financial Reporting Standard 103 ('FRS 103')" issued by the Financial Reporting Council. They have also been prepared in accordance with The Friendly Societies Act 1992 and The Friendly Societies (Accounts and Related Provisions) Regulations 1994.

The Accounts have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with FRS 102. The accounts have also been prepared on a going concern basis, as confirmed in the Directors' Report. As outlined in the Directors' Report, after making enquiries, including consideration of the impact of Covid-19 on the Group's operations and financial position and prospects, the Directors have reviewed financial projections across a five-year period and have a reasonable expectation that the Group has adequate resources to continue in operational existence for this period.

As a mutual life assurance society, under FRS 102, Scottish Friendly is exempt from the requirement to prepare a Statement of Cash Flow. The other companies in the Group are not entitled to this exemption on the basis that they are not mutual societies and therefore a Statement of Cash Flow has been disclosed in the individual accounts of each company.

The Accounts are prepared in sterling which is the functional currency of the Group and rounded to the nearest £000.

2. ACCOUNTING POLICIES (continued)

Basis of consolidation

The Group Accounts consolidate the assets, liabilities and income and expenditure account transactions of Scottish Friendly together with its subsidiary undertakings. A subsidiary is an entity controlled by the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The activities of Scottish Friendly and the Group are accounted for in the Income and Expenditure Technical Account – Long Term Business. All intra-group transactions, balances, income and expenses are eliminated on consolidation. The classification of transactions and balances included in the Accounts of the Society have been reviewed in the current period to enhance the understandability to the users of the Accounts. Where transactions and balances have been presented differently in the current period the prior period comparative has been updated to ensure consistency with the current period classification.

Business combinations and goodwill

Business combinations are accounted for under 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. The accounting policies in relation to the acquired assets and liabilities are harmonised with those of the Group.

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight-line basis over its useful economic life, which is 10 years. Provision is made for any impairment.

Negative goodwill is similarly included in the balance sheet and is credited to the technical account in the periods in which the acquired non-monetary assets are recovered through depreciation or sale.

Contract classification

Scottish Friendly classifies its products for accounting purposes as insurance or investment contracts. The product range includes conventional and unitised with-profits business, unit-linked and index-linked business, and other non-profit business. Life product types include endowments, whole of life, and term assurance, as well as personal pensions accumulation and decumulation products, including annuities.

Insurance contracts are defined as those containing significant insurance risk if, and only if, the value of benefits payable under the contract varies significantly as the result of the occurrence of an insured event. This assessment is undertaken at the inception of the contract and excludes consideration of scenarios that lack commercial substance. Such contracts which may also transfer financial risk, remain insurance contracts until all rights and obligations are extinguished or 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.

Significant judgements and estimates

In preparing the Accounts in line with FRS 102 and 103, the Group uses judgement in applying its accounting policies and estimates where uncertainty exists that affect the reported amounts of assets and liabilities. The more critical areas, where accounting judgements and estimates are made, are set out below.

2. ACCOUNTING POLICIES (continued)

Critical accounting judgements

The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Classification of long-term contracts

The Group has exercised judgement in its classification of long-term business between insurance and investment contracts, which fall to be accounted for differently in accordance with our accounting policies. Insurance contracts are those where significant risk is transferred to the Group under the contract and judgement is applied in assessing whether the risk so transferred is significant.

Key sources of estimation and uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Investments
The fair value measurement note 18 explains the assumptions used in the valuation, particularly in respect of level 2 and 3 assets.

Valuation of insurance and investment contract liabilities
The technical provisions note 26 explains the main assumptions used in relation to mortality, morbidity, longevity, expenses, lapse and surrender rates, investment returns and discount rates. Note 35 provides information on the sensitivities of key assumptions.

A significant proportion of the insurance claims arising are ceded to reinsurers. The value placed on the associated reinsurance contracts are based on appropriate valuation assumptions, which are consistent with those used in the evaluation of the relevant insurance contract liabilities.

Insurance claim reserves – reinsurance recoverable
The reinsurance asset is highly sensitive to assumptions around future mortality and morbidity experience, which are set based on observed experience and rely on judgements about how to interpret that experience and how that experience may change in the future. In preparing the Accounts the Directors have made an assessment as to whether claims ceded to reinsurers are recoverable. Note 35 provides information on the sensitivities on this assumption.

Valuation of pension benefit obligations
The valuation includes assumptions about discount rates, expected returns on assets and mortality rates. Note 24 includes more details on the assumptions used and sensitivities thereon.

Outstanding claims
Outstanding claims reserve is based on observed experience and relies on judgements about how to interpret that experience and how that experience may change in the future. Note 35 provides information on the sensitivities on this assumption.

Prior year restatement

During the year the Society restated its prior year Accounts to reflect material restatements in its assets and liabilities. Details on the prior year restatement is shown in Note 37.

2. ACCOUNTING POLICIES (continued)

Foreign currencies

Transactions in foreign currencies are recorded at the average rate for the period. Monetary assets and liabilities denominated in foreign currencies are translated at the rate ruling at the balance sheet date. All differences are taken to the technical account.

3. EARNED PREMIUMS

Accounting for premiums

Insurance contracts

Gross regular premiums on insurance contracts are recognised when the policy liability is set up and the premium becomes due for payment; reinsurance premiums are accounted for when they come payable.

Investment contracts

Premiums relating to investment contracts are not recognised in the technical account but are recorded as contributions to and deductions from the investment contract liabilities recorded in the balance sheet.

Earned premiums, all of which relate to direct insurance on individual contracts, can be analysed as follows:

	Ordinary Assurance		Industrial Assurance		Total	
	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000
Annual	149,469	143,197	681	843	150,150	144,040
Single	5,292	2,096	-	-	5,292	2,096
	154,761	145,293	681	843	155,442	146,136

Comprising		
Premiums for participating contracts	14,193	20,612
Premiums for non-participating contracts	131,588	114,559
Premiums from linked contracts	9,661	10,965
Gross Earned Premiums	155,442	146,136
Reinsurance Premiums on Insurance Contracts	(67,692)	(61,694)
Earned Premiums, net of reinsurance	87,750	84,442

Where policyholders have the option of investing premiums in either linked funds or accumulating With-Profits funds, these premiums are included above as premiums from linked contracts.

Consideration received in respect of investment contracts of £75,718k (2020: £50,967k) is treated as customer deposits and taken directly to the technical provisions, see Note 26.

4. INVESTMENT INCOME

Accounting for investment income

Investment income includes dividends, interest, rents, and gains and losses on the realisation of investments. Dividends are included as investment income on the date on which the shares are quoted "ex-dividend interests". Realised gains and losses on investments are calculated as the difference between net sales proceeds and the original cost.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Income from land and buildings	71	135	71	135
Income from financial investments held at fair value through profit and loss	57,815	64,136	58,815	64,389
Net realised gains on financial investments held at fair value through profit and loss	178,468	54,974	178,468	54,974
Investment Income	236,354	119,245	237,354	119,498

5. UNREALISED GAINS AND LOSSES ON INVESTMENTS

Accounting for unrealised gains and losses on investments

Unrealised investment gains and losses are calculated as the difference between the valuation at the balance sheet date and the valuation at the last balance sheet date or purchase price, if acquired during the year. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier years in respect of investment disposals in the current period. All unrealised gains and losses are included in the Technical Account.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Unrealised gains on investments	100,456	27,576	100,411	27,916

6. OTHER TECHNICAL INCOME

Accounting for other technical income

Other technical income comprises fee income and, at Group level, the income of the subsidiaries. Fee income is charged to policyholders for administration services, investment management services and surrenders. These fees are recognised in the period over which the services are performed.

	Group		Scottish Friendly	
	2021 £000	**2020 £000**	**2021 £000**	**2020 (restated) £000**
Annual management charges	28,133	27,328[1]	28,133	27,328[1]
Policy charges	4,527	4,457	4,527	4,457
Income from Subsidiaries	-	-	804	804
Foreign exchange gain/loss	(2,769)	1,493	(2,769)	1,493
Other income	2,899	2,730	3	261
	32,790	36,008	30,698	34,343

[1] Details on the restatement is included in note 37.

7. CLAIMS INCURRED

Accounting for claims

Insurance contracts

Claims incurred, which include related claims handling expenses, are accounted for, in the case of death claims and surrenders, when they are notified to Scottish Friendly and, in the case of maturities and annuities, when they become due. Claims on participating business include bonuses payable.

Reinsurance recoveries are credited to match the relevant gross amounts

Investment contracts

Gross claims on non-participating investment contracts are deducted from investment contract liabilities and are accounted for as deductions from investments in the Balance Sheet.

Outstanding claims

Please refer to note 28 for accounting treatment.

7. CLAIMS INCURRED (continued)

	Ordinary Assurance		Industrial Assurance		Total	
	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000
Gross claims paid	214,803	206,481	4,994	3,630	219,797	210,111
Change in provision for claims outstanding at the year-end	15,868	11,816	407	303	16,275	12,119
	230,671	218,297	5,401	3,933	236,072	222,230
Claims handling expenses					-	475
					236,072	222,705
Aggregate recoveries received from reinsurers					(98,955)	(90,010)
Net Claims Paid on Insurance Contracts					137,117	132,695

Policies defined as investment rather than insurance contracts are accounted for on a deposit basis.

The claims analysis above excludes £253,094k (2020: £185,769k) of payments made in relation to investment contracts, see Note 26.

8. OPERATING EXPENSES

Accounting for acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of sales. The costs are not split between insurance and investment contracts because the business model manages the sales and marketing function on an integrated basis.

Operating Costs

There were no exceptional costs in 2021 (2020: nil)

	2021 £000	2020 £000
Acquisition costs	20,813	14,080
Administration costs	19,989	17,711
Renewal commission	39,057	30,433
Bad debt reversal	(1,700)	-
	78,159	62,224

Remuneration of Auditors (included within administration expenses above)

	2021 £000	2020 £000
Fees payable to the auditor for audit of annual accounts	382	301
Fees payable to the auditor for other services:		
The audit of subsidiary companies pursuant to legislation	31	18
Other	93	89

9. STAFF COSTS

Staff numbers and costs

The average number of persons, excluding Directors, employed by Scottish Friendly during the year was 225 (2020: 204). The aggregate payroll costs of these persons were as follows:

	2021 £000	2020 £000
Wages and salaries	8,564	7,525
Social security costs	763	696
Other pension costs	660	570
	9,987	8,791

Remuneration of Directors

During the year there was £966k remuneration incurred for Executive Directors and £461k of fees for Non-Executive Directors. Details of Directors' remuneration are included in the Directors' Remuneration Report on pages 46 to 47.

10. INVESTMENT EXPENSES AND CHARGES

Accounting for investment expenses

Investment expenses includes expenses paid to external fund managers and custody fees. Expenses are accounted for on an accruals basis. Other investment fees and charges includes money paid to third parties for investment administration.

	2021 £000	2020 £000
External fund manager fees	1,410	1,356
Custody fees	176	159
Other investment fees and charges	1,669	1,539
	3,255	3,054

11. OTHER TECHNICAL CHARGES

Accounting for other technical charges

Other technical charges are recognised as they are incurred. Amounts include interest on collateral, OEIC administration fees and overhead expenses.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Other Technical Charges	1,766	1,701	861	794

12. TAXATION

Accounting for taxation

The charge for taxation in respect of business that falls outside the tax-exempt limit is based on the rules for the taxation of friendly societies, as applied to items included in the long-term business technical account for the year. It also takes into account deferred taxation arising from timing differences between the recognition of gains, losses and certain items of expenditure in the financial statements and recognition for tax purposes. Deferred tax assets are recognised to the extent that they are judged to be recoverable in future periods.

	Group		Scottish Friendly	
	2021 £000	**2020 (restated) £000**	**2021 £000**	**2020 (restated) £000**
Current tax charge	3,748	4,540	3,516	4,375
Deferred tax liabilities movement	15,751	(1,618)[1]	15,751	(1,618)[1]
Under/(Over) provided in earlier years	(623)	(1,361)	(623)	(1,361)
Other	(2,050)	(435)	(2,050)	(435)
Corporation Tax and irrecoverable income tax	16,826	1,126	16,594	961

[1] Details on the restatement is included in note 37.

UK corporation tax in the technical account has been calculated at a rate of 20% (2020: 20%) in accordance with rates applicable to the long-term business of a friendly society.

	2021 £000	**2020 (restated) £000**
Transfer to fund for future appropriations	24,011	8,849[1]
Income tax using the policyholder tax rate of 20%	4,803	1,770[1]
Tax effect of accounting profit not subject to tax	(1,287)	2,605[1]
Movement in deferred tax (I-E method of taxation)	8,941	(5,205)
Tax applied to pension surplus at 35%	6,810	3,587[1]
Differences due to policyholder tax items	(2,050)	(435)
Under/(Over) provided in earlier years	(623)	(1,361)
Current tax year	16,594	961

[1] Details on the restatement is included in note 37.

Corporation tax is charged at the standard rate of 19% on the profit on ordinary activities of the subsidiary SFAM £232k (2020: £166k) with adjustments in respect of prior years being £nil (2020:£nil).

13. NEGATIVE GOODWILL

	2021 £000	2020 £000
Carrying amount at the beginning of the period	(53,535)	(59,597)
Amortisation	6,060	6,062
Carrying amount at the end of the period	(47,475)	(53,535)

14. LAND AND BUILDINGS

Accounting for land and buildings

Land and buildings occupied by Scottish Friendly are revalued to fair value every three years with the surplus or deficit on book value being included in the technical account. It is Scottish Friendly's practice to maintain these assets in a continual state of sound repair and to extend and make improvement thereto from time to time; accordingly, the Directors consider that the lives of these assets are so long and the residual values, based on prices prevailing at the time of acquisition or subsequent revaluation, are so high that any depreciation would be insignificant.

	2021 £000	2020 £000
Owner Occupied Land and Buildings:		
Fair Value at 1 January	3,500	3,500
Revaluation adjustment	(250)	-
Fair Value at 31 December	3,250	3,500

Land and buildings relates to freehold property at 14-16 Blythswood Square. The most recent valuation has been completed for 31 December 2021. The revaluation deficit of £250k in the year has been recognised in the Technical Account.

15. INVESTMENT IN GROUP UNDERTAKINGS

Accounting for investments in Group undertakings

Investments in Group undertakings are valued at the excess of assets over liabilities within the balance sheet of the undertaking, which the Directors believe is an approximate fair value which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

Set out on the next page are the Group's investments in subsidiary undertakings as at 31 December 2021, all of which are included in the consolidation; the carrying value of these subsidiaries cancel out on consolidation. All subsidiaries are wholly owned by the Group.

15. INVESTMENT IN GROUP UNDERTAKINGS (continued)

Name of Subsidiary Undertaking	Nature of Business	Country of Incorporation and Registered Address
Scottish Friendly Asset Managers Limited	Child Trust Fund, ISA, and Junior ISA management and Authorised Corporate Director to operate OEICs	Scotland 16 Blythswood Square, Glasgow G2 4HJ
Scottish Friendly Insurance Services Limited	Administration services	Scotland 16 Blythswood Square, Glasgow G2 4HJ
SL Insurance Services Limited	Dormant general insurance agents	Scotland 16 Blythswood Square, Glasgow G2 4HJ
MGM Assurance (Trustees) Limited	Trustee	England and Wales 78 Cannon Street, London, England, EC4N 6AF
SF Pension Managers & Trustees Limited	Trustee	England and Wales 78 Cannon Street, London, England, EC4N 6AF
Scottish Friendly Insurance Services (Nominees) Limited	Nominee	Scotland 16 Blythswood Square, Glasgow G2 4HJ

16. DERIVATIVE FINANCIAL INSTRUMENTS

Accounting for derivatives

The Group uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The Group does not hold or issue derivative financial instruments for speculative purposes, and does not designate any derivatives as hedging instruments. A small portfolio of derivatives is held for efficient portfolio management. Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value of derivatives are recognised in the technical account in finance costs or income as appropriate.

	2021			2020		
	Contract Amount £000	Fair Value Assets £000	Fair Value Liabilities £000	Contract Amount £000	Fair Value Assets £000	Fair Value Liabilities £000
Futures	27,576	343	50	-	-	-
Forwards	108,159	2,061	56	-	-	-
Swaptions	30,600	17,706	-	39,300	27,253	-
	166,335	20,110	106	39,300	27,253	-

At 31 December 2021, the outstanding contracts all mature within 6 years of the year end (2020: 7 years).

17. FINANCIAL INVESTMENTS

Accounting for financial investments

Financial assets are recognised when the Group becomes a party to the contractual obligations of the instrument. Upon initial recognition, financial investments are classified as either financial assets at fair value through profit or loss, or at transaction price.

Financial assets at fair value through profit or loss

Financial assets measured at fair value through profit or loss are initially measured at fair value, normally the transaction price excluding transaction costs. Subsequent changes of fair value are recognised in profit or loss. Financial investments at fair value through profit or loss include derivatives, listed and unlisted investments, debt securities and bonds, and units in authorised unit trusts, Open Ended Investment Companies (OEICs) and other investments.

Loans and Receivables

Instruments classified as 'basic' financial instruments are initially measured at transaction price excluding transaction costs and subsequently at amortised cost using the effective interest method. Debt instruments that have no stated interest rate (and do not constitute a financing transaction) and are classified as payable or receivable within one year, are initially measured at an undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment.

Property

Directly held investment properties are measured at fair value annually with any change recognised in the technical account. Independent external valuers, having an appropriate recognised professional qualification, undertake the valuation of the portfolio.

Derecognition of financial assets

A financial asset is de-recognised when Scottish Friendly's right to receive cash flows from the asset has expired, and where Scottish Friendly has transferred to a third party its right to receive cash flow from an asset, or substantially all the risks and rewards of ownership or control of the asset.

Impairment of assets

Assets, other than those measured at fair value, are assessed for indicators of impairment; any impairment loss is recognised in operating expenses in the technical account.

17. FINANCIAL INVESTMENTS (continued)

Other non-linked and linked financial investments

	Group				Scottish Friendly			
	Carrying Value		Cost		Carrying Value		Cost	
	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000
Financial investments designated at fair value;								
Shares, other variable yield securities and units in OEICs and unit trusts	511,371	821,972	500,443	664,481	511,371	821,675	500,443	664,184
Debt securities and other fixed income securities	641,105	326,090	645,867	313,443	641,105	326,090	645,867	313,443
Private equity investments	80	72	658	658	80	72	658	658
Investments in Group Undertakings	-	-	-	-	3,879	3,910	3,115	3,115
Total non-linked financial investments	**1,152,556**	**1,148,134**	**1,146,968**	**978,582**	**1,156,435**	**1,151,747**	**1,150,083**	**981,400**

Linked financial investments

	Group				Scottish Friendly			
	Carrying Value		Cost		Carrying Value		Cost	
	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000	2021 £000	2020 £000
Financial investments designated at fair value;								
Shares, other variable yield securities and units in OEICs and unit trusts	2,339,915	2,230,119	1,768,075	1,925,423	2,339,704	2,230,119	1,767,865	1,925,423
Debt securities and other fixed income securities	165	164	303	321	165	164	303	321
Land and buildings		-		-		-		-
	2,340,080	2,230,283	1,768,378	1,925,744	2,339,869	2,230,283	1,768,168	1,925,744
Loans and receivables								
Deposits with credit institutions	266	287	266	287	266	287	266	287
Total linked financial investments	**2,340,346**	**2,230,570**	**1,768,644**	**1,926,031**	**2,340,135**	**2,230,570**	**1,768,434**	**1,926,031**

18. FAIR VALUE MEASUREMENT

Scottish Friendly applies the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: unadjusted prices quoted in active markets for identical assets or liabilities.

Prices are obtained from pricing service providers where there is clear evidence that the valuations are based on traded prices in an active market. The prices for assets in this category are received daily from Thomson Reuters, or are provided by third parties based on active market prices.

Level 2: inputs other than quoted prices that are observable either directly (as prices) or indirectly (as derived from prices).

Where it is not possible to determine prices based on actual transactions in an active market, the fair value is based on broker quotes and information from fund managers. Assets in this category include the investment property held by Scottish Friendly and derivatives.

18. FAIR VALUE MEASUREMENT (continued)

Level 3: the inputs are not based on observable market data (unobservable inputs).

In a minority of cases, there are no market observable inputs and therefore the fair value is determined using a valuation technique based on assumptions that are not supported by observable market transactions nor based on market data. Such assets include Scottish Friendly's investment in private equity funds and the subsidiary companies.

Each financial instrument is categorised according to the lowest level of input that is significant to the fair value measurement of the financial instrument. Both price volatility and market information on assets are reviewed periodically to see if there is any indicator that an asset may require classification due to liquidity or impairment.

Fair Value Hierarchy

	Group				Scottish Friendly			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial instrument assets 2021								
Financial instruments designated at fair value;								
Shares, other variable yield securities and units in OEICs and unit trusts	2,789,800	61,486	-	2,851,286	2,789,589	61,486	-	2,851,075
Debt securities and other fixed income securities	574,325	63,206	3,739	641,270	574,325	63,206	3,739	641,270
Private equity investments	-	-	80	80	-	-	80	80
Investments in Group Undertakings	-	-	-	-	-	-	3,879	3,879
Land and buildings	-	3,250	-	3,250	-	3,250	-	3,250
	3,364,125	127,942	3,819	3,495,886	3,363,914	127,942	7,698	3,499,554
Derivative Financial Instruments	343	19,767	-	20,110	343	19,767	-	20,110
Financial assets measured at fair value through profit and loss	3,364,468	117,709	3,819	3,515,996	3,364,257	117,709	7,698	3,519,664
Loans and receivables;								
Deposits with credit institutions	-	266	-	266	-	266	-	266
Total financial assets	3,364,468	147,975	3,819	3,516,362	3,364,257	147,975	7,698	3,519,930
Financial instrument liabilities 2021								
Derivative Financial Instruments	50	56	-	106	50	56	-	106
Investment contract and liabilities (see Note 26)	-	-	2,897,362	2,897,362	-	-	2,897,362	2,897,362
Total financial liabilities	50	56	2,897,362	2,897,468	50	56	2,897,362	2,897,468

At 31 December 2020 Scottish Friendly had an investment in the M&G Property Fund (Level 2 assets) which was suspended and is currently actively trading again. Last year the price was not considered to be a stale price, and therefore the valuation was considered appropriate by the Directors. The suspension of this Fund had no impact on the liquidity of the unit holders at the previous year end. In addition, we note that at the year end Scottish Friendly had an investment in a Level 3 security that is the subject of a class action.

18. FAIR VALUE MEASUREMENT (continued)

Fair Value Hierarchy

	Group				Scottish Friendly			
	Level 1 £000	Level 2 £000	Level 3 £000	Total (restated) £000	Level 1 £000	Level 2 £000	Level 3 £000	Total (restated) £000
Financial instrument assets 2020								
Financial instruments designated at fair value;								
Shares, other variable yield securities and units in OEICs and unit trusts*	2,964,737	87,354	-	3,052,091	2,964,439	87,355	-	3,051,794
Debt securities and other fixed income securities	286,490	35,465	4,299	326,254	286,490	35,465	4,299	326,254
Private equity investments	-	-	72	72	-	-	72	72
Investments in Group Undertakings	-	-	-	-	-	-	3,910	3,910
Land and buildings	-	3,500	-	3,500	-	3,500	-	3,500
	3,251,227	126,319	4,371	3,381,917	3,250,929	126,320	8,281	3,385,530
Derivative assets	-	27,253	-	27,253	-	27,253	-	27,253
Financial assets measured at fair value through profit and loss	3,251,227	153,572	4,371	3,409,170	3,250,929	153,573	8,281	3,412,783
Loans and receivables;								
Deposits with credit institutions	-	287	-	287	-	287	-	287
	-	287	-	287	-	287	-	287
Total financial assets	3,251,227	153,859	4,371	3,409,457	3,250,929	153,860	8,281	3,413,070
Financial instrument liabilities 2020								
Investment contract and liabilities (see Note 26)				2,743,649[1]				2,743,649[1]

[1] Details on the restatement is included in note 37.

Financial instruments have been categorised between Levels 1, 2 or 3 for the fair value hierarchy on a consistent basis between 2020 and 2021. There have been no changes to the valuation methods of Levels 1, 2 or 3 in 2021 and no change in the nature of the financial instruments. All changes in fair value of financial instruments have resulted directly from trading in 2021 and market movement. On this basis, no reconciliation for movements between Level 1, 2 and 3 is required.

Derivative financial instruments

Derivatives are measured at fair value, which is determined using valuation techniques that utilise observable inputs. The key assumptions used in valuing the derivatives are interest rate curve data and interest rate volatility data.

19. DEPOSITS HELD FOR REINSURERS

Accounting for deposits held for reinsurers

Debtors arising out of deposits held for reinsurers are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method.

Reinsurance arrangements are in place for the "Standard" and "Select" annuity products written in the past under treaties with Pacific Life Re and Hannover Re respectively, and includes an overlay treaty with RGA providing 100% reinsurance in total.

The reinsurance treaties include appropriate collateral arrangements, in deposits with Scottish Friendly as collateral security for their liabilities and obligations under the contracts.

	2021 £000	2020 £000
Collateral deposits for:		
Longevity Swap (Pacific Life Re)	10,939	9,398
	10,939	9,398

20. DEBTORS ARISING OUT OF DIRECT INSURANCE OPERATIONS

Accounting for debtors arising out of direct insurance operations

Debtors arising out of insurance operations are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method.

	2021 £000	2020 £000
Amounts due from policyholders/intermediaries	7,680	4,503
Amounts due from reinsurance operations	8,881	7,761
	16,561	12,264

21. OTHER DEBTORS

Accounting for other debtors

Other debtors are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method. The current tax asset is income tax recoverable in respect of the taxable surplus or deficit in the year.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Amounts due from brokers	5,111	38,651	5,111	38,651
Amounts due from Group entities	-	-	1,600	1,375
Other receivables	2,103	834	1,791	319
Current tax asset	277	277	277	277
	7,491	39,762	8,779	40,622

22. TANGIBLE ASSETS

Accounting for tangible assets

Tangible fixed assets are stated at cost net of any depreciation and provision for impairment. Depreciation is provided on tangible fixed assets to write off the cost less the estimated residual value of tangible assets on a straight-line basis over the estimated useful economic lives as follows:

Computer Equipment	4 years
Fixtures & Fittings	10 years

	Computer equipment £000	Fixtures & fittings £000	Total £000
Cost			
At 1 January 2021	867	466	1,333
Additions	93	5	98
Disposals	-	-	-
At 31 December 2021	960	471	1,431
Depreciation			
At 1 January 2021	426	54	480
Charge for the year	151	47	198
Disposals	-	-	-
At 31 December 2021	577	101	678
Net Book Value at 31 December 2021	383	370	753
Net Book Value at 31 December 2020	441	412	853

23. CASH AND CASH EQUIVALENTS

Accounting for cash and cash equivalents

Cash and cash equivalents comprise cash at bank and cash in hand as well as short-term deposits with a maturity of three months or less and known redemption values which are held to manage short-term operational cash requirements on origination.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Cash and Cash Equivalents	106,305	108,852	100,573	103,684

24. PENSION SCHEME SURPLUS

Accounting for pension schemes

For the defined contribution scheme, the amount charged to the technical account in respect of pension costs and other retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

For the defined benefit scheme, the amounts charged to the technical account are the costs arising from employee services rendered during the period, and the cost of plan introductions, benefit changes, settlements or curtailments. Remeasurement, comprising actuarial gains and losses and the return on the scheme assets, is recognised in the technical account.

The defined benefit scheme is funded, with the assets of the scheme held separately from those of the Group, in a separate trustee administered fund. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit credit method. The actuarial valuations are obtained at least triennially and updated at each balance sheet date.

Money purchase Group personal pension scheme

Scottish Friendly operates a money purchase Group personal pension scheme. For the year ended 31 December 2021, the charge included in the technical account relating to the employer's contributions to this scheme was £680,477 (2020: £589,568). There were no outstanding or prepaid contributions at the date of the balance sheet.

MGM Assurance Staff Pension Plan

Scottish Friendly sponsors the MGM Assurance Staff Pension Plan, a funded defined benefit pension plan in the UK. The Plan is set up on a tax relieved basis as a separate trust independent of Scottish Friendly.

The Trustees are responsible for ensuring that the correct benefits are paid, that the Plan is appropriately funded and that Plan assets are appropriately invested. Scottish Friendly pays the balance of the cost as determined by regular actuarial valuations. The Trustees are required to use prudent assumptions to value the liabilities and costs of the Plan whereas the accounting assumptions must be best estimates. Under the current Recovery Plan, dated 6 September 2019, Scottish Friendly is paying contributions of £226,667 per month for a period of 2 years and 9 months from 1 October 2019 to 30 June 2022.

The last formal actuarial valuation was carried out as at 31 December 2018. A valuation is currently in progress and due to complete in 2022. The liabilities at the reporting date have been calculated by using the same membership data as that used for the 2018 actuarial valuation, but adjusted to allow for the passage of time, benefits paid out of the Plan and changes in actuarial assumptions over the period from 31 December 2018 to 31 December 2021. The figures in the following disclosure were measured using the projected unit method.

The amounts recognised in the statement of financial position are as follows:	2021 £000	2020 £000
Defined benefit obligation	(104,321)	(121,232)
Fair value of plan assets	144,468	141,917
Net defined benefit asset	40,147	20,685

The amounts recognised in comprehensive income are the current and past service costs, settlements and curtailments, together with the net interest expense for the year as included in profit or loss. Remeasurements of the net defined benefit liability are included in comprehensive income.

24. PENSION SCHEME SURPLUS (continued)

	2021 £000	2020 £000
Service cost:		
Administration expenses	-	-
Loss/(gain) on plan introductions, changes, curtailments and settlements	-	56
Net interest expense/(credit)	(276)	(242)
Charge/(credit) recognised in profit and loss	(276)	(186)
Remeasurements of the net liability:		
Return on Plan assets (excluding amount included in net interest expense)	(3,829)	(18,794)
Actuarial (losses)/gains	(12,637)	11,456
Credit recorded in profit and loss	(16,466)	(7,338)
Total defined benefit credit	(16,742)	(7,524)

Scheme administration expenses of £485k (2020: £385k) has been included in the operating expenses of Scottish Friendly.

	2021	2020
Liability discount rate	1.80%	1.25%
Inflation assumption – RPI	3.45%	3.05%
Inflation assumption – CPI	2.80%	2.30%
Revaluation of deferred pensions:		
GMP	Fixed rate	Fixed rate
Excess over GMP	2.80%	2.30%
Increases for pensions in payment:		
Pre 88 GMP	0.00%	0.00%
Post 88 GMP	3.00%	3.00%
Excess over GMP (RPI capped at 5%)	3.30%	3.00%
Proportion of employees opting for early retirement	0%	0%
Proportion of pension commuted for cash at retirement	20%	20%
Expected age at death of current pensioner at age 65:		
Male aged 65 at year end	87.4	88.1
Female aged 65 at year end	89.2	90.3
Expected age at death of future pensioner at age 65:		
Male aged 45 at year end	89.0	89.8
Female aged 45 at year end	90.3	91.5

Analysis was carried out in 2020 into the proportion of employees commuting their pension for cash. Reflective of this new information, an assumption that 20% of pension benefit is commuted to cash (2020: 20%) has been allowed for in the amounts recognised in the statement of financial position.

Reconciliation of Plan assets and liabilities	Assets £000	Liabilities £000	Total £000
At start of period	141,917	(121,232)	20,685
Benefits paid	(5,753)	5,753	
Contributions from the employer	2,720	-	2,720
Interest income/(expense)	1,755	(1,479)	276
Return on assets (excluding amount included in net interest expense)	3,829	-	3,829
Actuarial gains	-	12,637	12,637
At end of period	144,468	(104,321)	40,147

24. PENSION SCHEME SURPLUS (continued)

The return on Plan assets was:	2021 £000	2020 £000
Interest income	1,755	2,473
Return on plan assets (excluding amount included in net interest expense)	3,829	18,794
Total return on plan assets	5,584	21,267

The major categories of Plan assets are as follows:	2021 £000	2020 £000
UK Equities	-	2,796
Overseas Equities	-	10,337
Corporate Bonds	14,194	11,009
Gilts	12,631	17,502
Index Linked	-	6,633
Property	-	3,535
Commodities	-	2,674
Hedge Funds/Diversified Growth Funds	-	8,439
Cash	75,197	26,257
Liability Driven Investment (LDI)	42,446	41,230
Alternatives	-	11,505
Total market value of assets	144,468	141,917

Projected P&L cost items for year ending:	2022 £000	2021 £000
Service cost – inc. current & past service costs, settlements	-	-
Service cost – administrative cost	150	485
Net interest on the net defined benefit liability	(735)	(276)
	(585)	209

If the discount rate was 0.5 percent higher (lower), the Fund liabilities would decrease by £9,300k (2020: £11,727k) (increase by £10,703k (2020: £13,618k)) if all the other assumptions remained unchanged.

If the inflation assumption was 0.5 percent higher (lower), the Fund liabilities would increase by £7,614k (2020: £9,841k) (decrease by £6,836k (2020: £9,423k)). In this calculation all assumptions related to the inflation assumption have been appropriately adjusted, that is the deferred pension increases and pension in payment increases, if all the other assumptions remain unchanged.

If life expectancies were to increase by 1 year, the Fund liabilities would increase by £5,374k (2020: £6,499k) if all the other assumptions remained unchanged.

25. FUND FOR FUTURE APPROPRIATIONS

Accounting for fund for future appropriations

The balance on this account represents funds that have not been allocated to specific policyholders. Transfers to and from the fund reflect the excess of income over outgoings in each accounting year arising from participating business.

	2021 £000	2020 (restated) £000
Value at start of the year	202,282	193,433[1]
Transfer to the Fund for Future Appropriations in the year	24,011	8,849[1]
Value at the end of the year	226,293	202,282[1]

[1] Details on the restatement is included in note 37.

26. TECHNICAL PROVISIONS

Accounting for technical provisions

The technical provisions are determined in accordance with the requirements of the PRA rulebook: Solvency II Firm Technical Provisions Instrument 2015. They are calculated as the expected future cash flows (claims and expenses less premiums) plus a risk margin. The risk margin allows for the cost to a third party of holding the Solvency II risk capital for non-hedgeable risks until all contracts are settled.

The liability calculations are undertaken on a Solvency II basis and are based on demographic and expense assumptions that reflect Scottish Friendly's best estimate of future experiences at the time of calculation. The economic assumptions used are market consistent, in line with the requirements of Solvency II, and are set using current market data.

For with-profits the underlying liabilities are based on "asset shares" and reflect the accumulated premiums, investment return, expenses and charges applied to each contract. Where appropriate, the cost of meeting future expected cash flows relating to the with-profits policies, including cash flows resulting from embedded options and guarantees, is evaluated using a stochastic approach. For 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. Credit is only taken for future premiums to the extent that they fall within the boundary of the contract, as defined under Solvency II.

The main assumptions used relate to mortality, morbidity, longevity, expenses, lapse and surrender rates, investment returns and discount rates. Scottish Friendly bases mortality, morbidity and longevity rates on standard industry or reinsurers' tables, adjusted where necessary to reflect Scottish Friendly's own experience. Expense, lapse and surrender rates assumptions are based on product characteristics and relevant claims experience. Investment returns and discount rates are based on current risk-free market rates, as prescribed under Solvency II.

26. TECHNICAL PROVISIONS (continued)

Guarantees

Some participating contracts contain guarantees that can increase the benefits payable to the policyholder. A market consistent stochastic model is used to determine the potential liability for the following guarantees:

- the sum assured and declared reversionary bonuses on with-profits policies; and
- unitised with-profits plans containing guarantees that the market adjustments will not be applied at specific times.

Reinsurance

A significant proportion of the insurance claims arising are ceded to reinsurers. The value placed on the associated reinsurance contracts are based on appropriate valuation assumptions, which are consistent with those used in the evaluation of the relevant insurance contract liabilities.

Reinsurance premiums payable are recognised when the underlying contract premiums become receivable or the underlying contract becomes effective. Reinsurance recoveries are recognised as a deduction to claims and are recognised when the underlying contract claims become payable.

Certain reinsurance assets that were acquired from Mobius Life and Canada Life are backed by investments in Collective Investment schemes and directly held property.

The underlying collective investment schemes are recognised at fair value through profit or loss.

Any irrecoverability from these policies would flow through the surplus generated in the year.

Investment Contracts

Under deposit accounting, investment contract premiums and claims are not treated as income or expense and instead are treated as deposits which are received and paid directly to investment contract liabilities in the Balance Sheet. As there is no significant transfer of risk, these deposits are treated as fully under the trust of Scottish Friendly and are not required to be recognised in the technical account. Related investment contract charges and expenses are treated as profit or loss items within the technical account.

A breakdown of technical provisions on a gross and net basis is shown below.

	2021			2020		
	Gross £000	Reinsured £000	Net £000	Gross (restated) £000	Reinsured (restated) £000	Net (restated) £000
With-Profits Insurance	765,383	(408,741)	356,642	816,030	(404,947)	411,083
Non-Profits Insurance	896,118	(651,061)	245,057	838,414[1]	(563,082)[1]	275,332[1]
Unit Linked Insurance	288,413	-	288,413	296,912	-	296,912
Investment Contracts	2,897,362	(501,485)	2,395,877	2,743,649[1]	(491,502)	2,252,147[1]
	4,847,276	(1,561,287)	3,285,989	4,695,005	(1,459,531)	3,235,474

[1] Details on the restatement is included in note 37.

26. TECHNICAL PROVISIONS (continued)

Reconciliation of movement in technical provisions:	2021 £000	2020 (restated) £000
Movement in net technical provisions	50,515	(60,276)
Return on reinsurance assets	(16,576)	(12,317)
Amounts received in respect of investment contracts	(75,718)	(50,967)
Reinsurance of amounts received in respect of investment contracts	4,137	3,263
Payments made on investment contracts	253,094	185,769
Reinsurance received in relation to payments on investment contracts	(23,358)	(20,477)
Investment contract fees deducted	26,924	26,213[1]
Change in other technical provisions per technical account	219,018	71,208[1]

[1] Details on the restatement is included in note 37.

The movements on the technical provisions during the year are as follows:

With-Profits Insurance Contracts	Gross 2021 £000	Reinsured 2021 £000	Gross 2020 (restated) £000	Reinsured 2020 £000
1 January	816,030	(404,947)	872,042	(426,301)
Premiums received	14,193	-	20,612	(24)
Liabilities paid by claims	(84,431)	49,053	(100,059)	49,120
New Business	1,934	-	1,163[1]	-
Fees deducted	(1,305)	-	(1,267)[1]	-
Experience Variance and assumption changes	18,962	(52,847)	23,539	(27,742)
31 December	765,383	(408,741)	816,030	(404,947)

[1] Details on the restatement is included in note 37.

Non-Profits Insurance Contracts	Gross 2021 £000	Reinsured 2021 £000	Gross 2020 (restated) £000	Reinsured 2020 (restated) £000
1 January	838,414	(563,082)	750,751[1]	(500,843)[1]
Premiums received	131,587	(67,599)	114,559	(61,670)
Liabilities paid by claims	(93,393)	48,911	(83,912)	40,890
New Business	72,280	(75,977)	63,164	(60,738)
Experience Variance and assumption changes	(52,770)	6,686	(6,148)[1]	19,279[1]
31 December	896,118	(651,061)	838,414[1]	(563,082)[1]

[1] Details on the restatement is included in note 37.

Unit Linked Insurance Contracts	Gross 2021 £000	Reinsured 2021 £000	Gross 2020 (restated) £000	Reinsured 2020 £000
1 January	296,912	-	316,968	-
Premiums received	9,661	-	10,965	-
Liabilities paid by claims	(58,247)	-	(38,259)	-
Fees deducted	(4,451)	-	(4,444)[1]	-
Experience Variance and assumption changes	44,538	-	11,682[1]	-
31 December	288,413	-	296,912	-

[1] Details on the restatement is included in note 37.

26. TECHNICAL PROVISIONS (continued)

Investment Contracts	Gross 2021 £000	Reinsurance 2021 £000	Gross 2020 (restated) £000	Reinsurance 2020 £000
1 January	2,743,649	(491,502)	2,822,579[1]	(539,441)
Premiums received	75,718	(4,229)	50,967	(3,263)
Liabilities paid by claims	(253,094)	24,350	(185,769)	20,477
New Business	19,093	(384)	12,462	137
Fees deducted	(17,913)	-	(17,467)[1]	-
Experience Variance and assumption changes	329,909	(29,720)	60,877[1]	30,588
31 December	2,897,362	(501,485)	2,743,649[1]	(491,502)

[1] Details on the restatement is included in note 37.

The investment contract technical provisions above show the position after allowing for the positive contribution made from the value of the in-force business. Excluding this would increase the liability by the amounts shown in the next table, with the creation of an equal and opposite asset on the balance sheet.

	Gross 2021 £000	Reinsurance 2021 £000	Gross 2020 (restated) £000[1]	Reinsurance 2020 £000
Technical provisions (Excluding Value In Force)	2,895,107	(501,485)	2,751,106	(491,502)
Value of in-force investment business	2,255	-	(7,457)[1]	-
Technical provisions	2,897,362	(501,485)	2,743,649	(491,502)

[1] Details on the restatement is included in note 37.

27. COST OF BONUSES

Accounting for bonuses

Vested reversionary bonuses, including the current declaration, are dealt with in the technical account under "change in other technical provisions". Terminal bonuses paid during the year are included as part of claims incurred.

Total bonuses attributable to the year are as follows:

	2021 £000	2020 £000
Year end reversionary bonus declared) (included in change in other technical provisions)	2,113	2,604
Reversionary and terminal bonuses paid (included in claims)	7,982	9,474
	10,095	12,078

28. OUTSTANDING CLAIMS

Accounting for claims outstanding

Claims outstanding on insurance contracts represents the best estimate of the expected cashflows resulting from all outstanding obligations which have not as yet been paid to policyholders as at year end.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Outstanding Claims	48,778	32,500	48,641	32,365

29. WITH-PROFITS ACTUARY

Mr S Makin of Hymans Robertson LLP served as the With-Profits Actuary for the period between 1 January 2021 and 31 December 2021. The following information has been provided in response to a request made by Scottish Friendly as required by section 77 of the Friendly Societies Act 1992. Mr Makin has confirmed that neither he nor his family were members of Scottish Friendly, nor had they any financial or pecuniary interest in Scottish Friendly, with the exception of fees paid to Hymans Robertson LLP for professional services which amounted to £379,044 (2020: £429,299) (this figure includes fees payable for work carried out by Hymans Robertson LLP not related to Mr Makin's role as With-Profits Actuary).

30.CAPITAL MANAGEMENT

(a) Capital management policies and objectives

Scottish Friendly's capital management objectives are:

- to protect Scottish Friendly's financial strength, providing security to policyholders;
- to comply with the PRA's capital requirements; Scottish Friendly has not breached these requirements at any point in the current or prior years;
- to enable smoothing of investment returns and payouts; and
- to ensure that Scottish Friendly's capital position is sufficient to enable it to invest in the development of the business in order to fulfil its stated core strategic objectives as determined by the Board.

The capital position of Scottish Friendly is monitored on a regular basis and reviewed formally by the Board.

(b) Solvency II balance sheet

A Solvency II available capital balance sheet is shown below, split between the Main Fund, which is open to new business, and its sub-funds that are closed. The closed sub-funds are the Rational Shelley sub-fund, LANMAS (London Aberdeen and Northern Mutual Assurance Society) sub-fund, the Scottish Legal sub-fund, the M&GM sub-fund and the Manulife sub-fund.

Solvency II available capital for both the open and closed funds of Scottish Friendly is determined in accordance with the Solvency II balance sheet methodology. This can be broadly described as placing a fair value on both the assets and the liabilities, including both benefits already guaranteed and future discretionary benefits.

With-profits liabilities comprise asset shares, plus the costs of smoothing, and the value of guarantees and options which have been granted to policyholders. Unit-linked liabilities comprise of a unit reserve plus a non-unit reserve, which is calculated based on the expected future management charges less future expected expenses. Non-profit non-linked liabilities are based on the expected future benefit payments plus expenses less premiums to be received.

30.CAPITAL MANAGEMENT (continued)

When calculating the with-profits liabilities, allowance has been made for actions that management would be expected to undertake on key assumptions, for example future bonus or investment policy in varying market conditions, in line with the PPFMs (Principles and Practices of Financial Management). The cost of financial options and guarantees are measured using a market-consistent stochastic model.

(c) Capital Statement (unaudited)

	2021			2020 (as reported)		
	Main Fund £000	Closed Sub-funds £000	Total £000	Main Fund £000	Closed Sub-funds £000	Total £000
Total available capital resources	140,411	23,325	163,736	130,857	32,755	163,612

The capital resources in 2020 are calculated under the Solvency II regulatory requirements and the total capital resources presented represents Solvency II own funds. The analysis of total available capital resources is unaudited.

The 2020 values are per the regulatory return and, for the reasons set out in note 30(e), have not been restated for the prior year restatements explained in note 37.

(d) Movement in available capital resources

	2021 £000	2020 (as reported) £000
Opening capital resources	163,612	168,838
Prior year adjustments	7,180	-
Increase/(decrease) in Current Assets	68,569	(54,539)
(increase)/decrease in Technical Provisions	(50,514)	54,457
(Increase)/decrease in Current Liabilities	(21,655)	(3,328)
Total	167,192	165,428
(Decrease) in ring-fencing of available capital	(3,456)	(1,816)
Closing capital resources	163,736	163,612

The 2020 values are per the regulatory return and, for the reasons set out in note 30(e), have not been restated for the prior year restatements explained in note 37.

(e) Solvency position

	2021 £000	2020 (as reported) £000
Own Funds	163,736	163,612
SCR	94,106	101,112
Solvency Ratio	174%	162%

The 2020 amounts are as per the stated amounts in the 2020 regulatory return, and the impact of prior year restatements as outlined in note 37 does not have a material impact on the solvency position. The updated 2020 values for own funds is £170,792k, the updated SCR is £104,733k and solvency ratio is 163%. Due to the immaterial impact on solvency the Accounts continue to refer to values submitted in the 2020 regulatory returns.

30.CAPITAL MANAGEMENT (continued)

(f) Capital resource sensitivities

The capital position is sensitive to changes in market conditions and to a lesser extent to assumptions and experience relating to mortality, expenses and persistency.

Economic assumptions are set consistent with market prices. The liability valuation will include assumptions about interest rates and investment returns. An adverse change in either variable will increase liabilities and, to the extent that assets are impacted, this may increase or decrease the available capital. For example, a reduction in long-term interest rates would increase the amount of Scottish Friendly's liabilities and could therefore reduce its available capital, depending upon the extent to which the liabilities are matched by assets with similar anticipated cash flows. Currently, the available capital of Scottish Friendly will decrease if interest rates fall.

Similarly, an adverse change in the markets for Scottish Friendly's investment assets could increase or decrease the available capital of Scottish Friendly to the extent that equity falls cannot be reflected in reductions in payments to policyholders because of the presence of guarantees and options in the underlying contracts, and any change in assets within the working capital. Currently, a fall in equity/property values would reduce available capital for the Scottish Friendly main fund.

Non-economic assumptions are set at best estimate levels based on historic experience. Scottish Friendly monitors actual experience in mortality; morbidity and persistency rates against the assumptions used, and applies that outcome to refine its long-term assumptions. Amounts paid will inevitably differ from estimates, particularly when the expected payments do not occur until well into the future. Liabilities are evaluated at least quarterly, allowing for changes in the assumptions used, as well as for the actual claims experience. If actual claims experience is less favourable than the underlying assumptions, or it is necessary to increase provisions in anticipation of a higher rate of future claims, then available capital will be reduced.

Scottish Friendly has provided guarantees in respect of sums assured and reversionary bonus guarantees on with-profits contracts. Under the Solvency II balance sheet basis, these are explicitly calculated using a stochastic valuation model.

31. DEPOSITS RECEIVED FROM REINSURERS

Accounting for deposits received from reinsurers

Creditors arising out of deposits received from insurers are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method.

The "Standard" and "Select" annuity products written in the past by M&GM are reinsured under treaties with Pacific Life Re and Hannover respectively, with an overlay treaty with RGA providing 100% reinsurance in total.

The reinsurance treaties include appropriate collateral arrangements, including the following deposits with Scottish Friendly as collateral security for their liabilities and obligations under the contracts.

	2021 £000	**2020 £000**
Collateral deposits for:		
"Select" annuity (Hannover Re)	30,266	34,378
"Standard" annuity (RGA)	5,819	6,172
	36,085	40,550

32.CREDITORS ARISING OUT OF DIRECT INSURANCE OPERATIONS

Accounting for creditors arising out of direct insurance operations

Creditors arising out of insurance operations are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method.

	2021 £000	2020 £000
Due to reinsurers	1,906	1,971
Due to intermediaries	5,602	6,011
	7,508	7,982

33. OTHER CREDITORS

Accounting for other creditors

Other creditors are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method. Taxation is calculated in line with HMRC guidelines and is payable within a year.

	Group		Scottish Friendly	
	2021 £000	2020 £000	2021 £000	2020 £000
Taxation	3,152	4,480	3,151	4,375
Trade Creditors	427	1,450	427	1,450
Investment Creditors	3,182	2,202	3,182	2,202
Other payables	4,385	2,710	3,931	2,446
HMRC payments PAYE and VAT	674	1,034	674	1,034
	11,820	11,876	11,365	11,507

34. PROVISIONS FOR OTHER LIABILITIES

Accounting for provisions for other liabilities

Provisions for deferred taxation are recognised at cost and relate to amounts of tax which is expected to be paid at a future date. Deferred taxation on the pension scheme surplus is payable only when the Society receives a payment of surplus on the pension scheme which is not expected to occur whilst there are members in the scheme. Deferred taxation on s212 deemed disposals are payable over the next seven years.

	2021 £000	2020 (restated) £000
Deferred taxation on pension scheme surplus	14,051	7,240[1]
Deferred taxation under s212 deemed disposals	17,304	8,344
	31,335	15,584

[1] Details on the restatement is included in note 37.

The deferred tax on the pension scheme surplus impacts the with-profits fund, whereas the deferred tax on s212 deemed disposals impacts unit-linked policyholders.

The deferred tax liabilities expected to be settled after 12 months is £31.3m (2020: £15.6m).

35. RISK MANAGEMENT

The principal risks to which Scottish Friendly is exposed are strategic (business environment), market, credit, insurance, solvency, liquidity, operational and conduct risks. Scottish Friendly's approach to risk management is detailed in the Report on Corporate Governance on pages 28 to 45, and this includes a description of the key, controls and risk mitigants operated details in relation to the principal risks to which Scottish Friendly is exposed.

A key tool used in the identification and management of risks is completion of the Own Risks and Solvency Assessment ('ORSA') process. The ORSA report is approved annually by the Board. As part of Scottish Friendly's 2021 ORSA process, the impact of a range of different future scenarios have been considered, including consideration of the potential impact on the business from three different climate change temperature transition scenarios. Consideration was also given within the 2021 ORSA to a number of market and credit events occurring concurrently, as well as the impact of higher inflation prevailing for a prolonged period of time.

Further details are included here of insurance risk, credit risk and liquidity risk, and a sensitivity analysis of each type of market risk.

Insurance risk

Insurance risk refers to the risk of failure to predict or respond to changes in demographic experience, policyholder actions and level of expenses incurred in administering the in-force business.

The exposure of Scottish Friendly depends on the value of claims to be paid in the future, relative to the assets accumulated to the date of claim. The value of such future obligations is assessed using best estimate assumptions, which include future mortality and/or morbidity rates, persistency rates, expenses, investment returns, interest rates and tax rates.

The level of insurance risk assumed by Scottish Friendly varies with the type of business written. Additional 1
risks also arise from the financial options and guarantees within contracts. The Board, having taken advice from the Head of Actuarial and based on its risk appetite, may set limits on new business volumes, including restricting the extent to which specific products with particular risks are written.

Scottish Friendly is not exposed to significant concentrations of insurance risk. A diverse mix of life insurance business is written and has been written (or acquired) in the past through a range of distribution channels. The Group's business is virtually all in the UK and therefore the results are subject to demographic and economic changes arising in the UK.

With-profits contracts

With-profits contracts (including both conventional and unitised with-profits policies) usually contain a guaranteed benefit on maturity, death or surrender at certain specified dates.

This guaranteed benefit may be increased by the addition of annual bonuses and a final bonus may also be
applied when the policy becomes a claim. Scottish Friendly can vary the amount of future bonuses paid, 1
including reducing future bonus additions to zero. Scottish Friendly also has contractual discretion to vary the amount payable on early surrender of the contract. The setting of bonus rates and surrender terms are subject to the relevant PPFM. All discretionary actions must be consistent with the overriding principle that customers be treated fairly.

The key risk factors of with-profits contracts are:

- **mortality:**
  The guaranteed payments on death generally exceed the value of the assets held to back the policy, giving rise to mortality risk. Assumptions regarding the rate of mortality are taken into account when determining the bonus payments to be added to with-profits contracts. The level of these bonus additions can be varied to mitigate differences between expected and actual mortality experience.

35. RISK MANAGEMENT (continued)

- **guarantees:**

  With-profits contracts are subject to the risk that the market value of assets held to back the liabilities is depressed at the time that the guaranteed payments specified in the contract fall due to be paid. Scottish Friendly's contractual right to vary future bonus additions can be used to partly mitigate this risk. A number of with-profits contracts include guarantees relating to the minimum level of income received at retirement. These risks are mitigated by Scottish Friendly's use of appropriate investment strategies that match changes in the value of these liabilities under market movements.

- **persistency and expenses:**

  The most significant costs associated with writing insurance contracts are the costs incurred to acquire the policy. These expenses, together with the ongoing costs of administration, are recovered over the policy's lifetime. If the policy is terminated early, the expense deductions made to the point of termination may be less than the costs incurred. For some product types, this risk is partly mitigated by Scottish Friendly's contractual ability to vary the amount payable on surrender. Scottish Friendly also controls its administration expenses on an ongoing basis, and Scottish Friendly's right to vary future bonus additions can be used to partly mitigate this risk.

Protection contracts

Protection policies contain a guaranteed payment on death or disability or illness depending on the terms of the contract. These contracts may also be attached to with-profits or unit-linked policies. In addition, there are also a small number of income protection policies which pay policyholders a defined income when they are unable to work due to sickness for an extended period of time.

For most policies, the level of benefits payable is determined at the start of the contract and so the ability of Scottish Friendly to reduce the level of insurance risk accepted by varying terms and conditions is very limited. However, some contracts include a premium review clause and for some contracts the policyholder has the option to reduce benefits in lieu of a premium increase.

The key insurance risk factors of protection contracts are:

- **mortality and morbidity:**

  Scottish Friendly has largely mitigated these risks through the use of reinsurance to transfer most of the mortality and morbidity risk to third-party reinsurers.

- **persistency and expenses:**

  Scottish Friendly manages these risks by monitoring persistency experience, including through discussions with our partners and actively controlling and monitoring expense levels.

Non-participating insurance contracts – non-profit annuities

For non-profit annuities, the level of annuity payments is determined at the start of the contract and these payments continue until the death of the annuitant and in certain cases the later death of their dependants. Hence the ability of Scottish Friendly to reduce the level of insurance risk accepted by varying terms and conditions is very limited.

The key insurance risk factors of annuity contracts are:

- **longevity:**

  The contractual stream of payments made until the death of the annuitant gives rise to longevity risk.

  An increase in life expectancy will increase the payments that have to be made. Scottish Friendly mitigates this risk by the extensive use of third-party reinsurers.

35. RISK MANAGEMENT (continued)

Non-participating investment contracts – unit-linked policies

For unit linked investment business most of the risks (particularly market and credit risk) are borne by the policyholders. The principal benefit payable is the value of the underlying assets and therefore Scottish Friendly generally has limited ability to apply penalties on early surrender or early cessation of regular premiums. The ability to increase charges or apply penalties may be constrained by regulatory or market pressures and by the obligation to treat customers fairly.

The key insurance risk factors of unit-linked contracts are:

- **persistency and expenses:**
  Acquisition and administration costs are recovered by management charges deducted over the policy's lifetime. If the policy is terminated early, the expense deductions made to the point of termination may be less than the costs incurred. The administration expenses may also exceed the level of management charges deducted from policies which remain in force. These risks are mitigated by Scottish Friendly's ability to increase management charges. Scottish Friendly also controls its administration expenses on an ongoing basis.

- **embedded guarantees:**
  A small number of unit-linked contracts include guarantees relating to the minimum level of income that can be purchased at retirement using the proceeds of the policy or guarantees related to the term of that purchase. In addition, some unit-linked contracts also offer a loyalty bonus, whereby policyholders are awarded additional units for remaining in force. The risks arising from these guarantees are primarily mitigated by Scottish Friendly's use of appropriate investment strategies that match changes in the value of these liabilities under market movements.

Insurance risk sensitivity analysis

The following table illustrates the impacts on the Scottish Friendly Main Fund of applying stress scenarios prescribed under the Solvency II regulations, which are believed to be good approximations of the sensitivities under UK GAAP.

Impact on the FFA:	2021 £m	2020 (restated) £m
Increase in expenses by 10%	(19.8)	(17.4)[1]
Increase in assurance mortality rates by 15%	(4.1)	(3.5)[1]
Reduction in persistency by 10%	(13.6)	(12.3)[1]

[1] Details on the restatement is included in note 37.

For the purposes of the scenarios shown above, it has been assumed that the negative goodwill recognised in respect of the transfer from Canada Life Limited would be written down to absorb the impact of the scenario, adjusted as appropriate to allow for amortisation at that point.

Credit risk

Credit risk is the risk of loss arising from third parties failing to meet their financial obligations. Scottish Friendly's key exposures includes holdings in corporate bonds, cash deposits, and reinsurance assets. Scottish Friendly manages this risk by setting clear limits and tolerances on exposures to a single counterparty, or groups of counterparties, holding treaties with several different reinsurers and using only reinsurers with appropriate credit ratings.

The potential financial exposure is in the table on page 100, showing the assets of the Group and Scottish Friendly that are subject to credit risk and the Balance Sheet carrying value for that asset. For derivatives the credit rating reflects the credit rating of the counterparty.

35. RISK MANAGEMENT (continued)

Linked assets are not subject to credit risk as this risk is borne by the holders of the contracts concerned These assets are therefore not included in the following tables. The Board does not consider that there is any appreciable credit risk associated with UK Government gilts. Non-linked assets not subject to credit risk include shares and other variable yield securities that are subject to market risk.

Group 2021	AAA £000	AA £000	A £000	BBB and below £000	Not rated £000	Not subject to credit risk £000	Value in the balance sheet £000
Non-linked investments – debt and fixed income securities	26,876	574,944	29,243	10,042	-	-	641,105
Cash and cash equivalents	-	-	106,305	-	-	-	106,305
Derivatives	-	-	-	-	2,063	18,047	20,110
Reinsurers' share of technical provisions:							
With-profit Insurance Contracts	-	408,741	-	-	-	-	408,741
Non-profit Insurance Contracts	-	638,570	-	-	12,491	-	651,061
Investment Contracts	-	184,244	-	-	317,241	-	501,485
Other assets	-	10,939	-	-	-	24,052	34,991
Total	26,876	1,817,438	135,548	10,042	331,795	42,099	2,363,798

Group 2020	AAA £000	AA (restated) £000	A £000	BBB and below £000	Not rated (restated) £000	Not subject to credit risk £000	Value in the balance sheet (restated) £000
Non-linked investments – debt and fixed income securities	16,665	282,479	17,693	23,646	2,084	-	342,567
Cash and cash equivalents	-	-	108,852	-	-	-	108,852
Reinsurers' share of technical provisions:							
With-profit Insurance Contracts	-	404,947	-	-	-	-	404,947
Non-profit Insurance Contracts	-	547,316[1]	-	-	15,766[1]	-	563,082[1]
Investment Contracts	-	188,644	-	-	302,858	-	491,502
Other assets	-	9,398	-	-	-	52,026	61,424
Total	16,665	1,432,784	126,545	23,646	320,708	52,026	1,972,374

[1] Details on the restatement is included in note 37.

Scottish Friendly holds certain derivative positions for the purposes of currency hedging and efficient portfolio management. The derivative investments portfolio generally require third parties to pledge collateral for the derivative assets. The collateral is in the form of cash and, to help protect against credit risk, all collateral is to be held by an intermediary company.

Collateral pledged by Scottish Friendly in respect of exchange traded derivatives amounted to £1,072k (2020: £nil), and collateral received in respect of exchange traded derivatives amounted to £104k (2020: £nil). The net market value of derivatives in respect of which cash margin is held for both group and Scottish Friendly at the year-end is £292,489 (2020: £nil).

35. RISK MANAGEMENT (continued)

For cash collateral received and pledged the risks and rewards of ownership are transferred. Cash collateral received is recognised as an asset with a corresponding liability to repay the collateral. For cash collateral pledged, the cash asset is derecognised and an equivalent debtor for the repayment of the collateral is recognised.

Scottish Friendly also holds a portfolio of fully collateralised swaptions, held as an asset on the balance sheet, with a year-end market value of £17.7m (2020: £27.3m). These positions are held to mitigate the interest rate risk associated with certain contractual options on Scottish Friendly's unit-linked business. Cash collateral received in respect of swaptions of £17.6m (2020: £26.8m) is held off-balance sheet.

No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by counterparties.

Other assets include premium debtors all of which are less than three months old. Scottish Friendly has never experienced a significant loss arising from premium debtors because it maintains the right to cancel a policy if premiums are not paid when due. No provision is made for impairment of these assets (2020: £nil).

Liquidity risk

Liquidity risk is the risk that a firm, even if solvent, either does not have sufficient financial resources to meet its obligations as they fall due. This risk could arise if the timing of premium receipts, maturity payments, claim payments, expense payments, and the receipt of investment proceeds and amounts due from reinsurers were not appropriately managed. Scottish Friendly manages this risk by monitoring cash flow across key transactions in the business, and setting investment strategies with consideration to the level of liquid and readily marketable assets, in order to allow for timely adjustments to match expected liabilities, if required.

The analysis below summarises the exposures the Group and Scottish Friendly carry in respect of liquidity risks. The earliest contractual repayment date of investment contracts with discretionary participation features and unit-linked investment contracts is repayment on demand and therefore the undiscounted cash flows subject to liquidity risk are £222,911k (2020: £205,680k) and £2,560,084k (2020: £2,420,982k) respectively.

Other financial liabilities are repayable between 0-5 years as follows:

	Group		Scottish Friendly	
	2021 £000	2020 (restated) £000	2021 £000	2020 (restated) £000
Other financial liabilities	138,698	110,259[1]	137,922	109,564[1]

[1] Details on the restatement is included in note 37.

The following table shows the undiscounted expected maturity analysis of the Group's and Scottish Friendly's liabilities, including 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).

35. RISK MANAGEMENT (continued)

Group 2021	0-5 years £000	5-10 years £000	10-15 years £000	15-20 years £000	Over 20 years £000	Total £000
Non-Profit (insurance)	64,758	116,803	165,304	193,953	513,898	1,054,716
With-Profits (insurance)	305,128	236,103	123,955	77,008	85,154	827,348
Unit Linked	276,213	-	-	-	-	276,213
Investment	2,861,833	-	-	-	-	2,861,833
Derivative Financial Instruments	108,209	-	-	-	-	108,209
Other Liabilities[2]	138,698	-	-			138,698
Total	3,754,839	352,906	289,259	270,961	599,052	5,267,017

Group 2020	0-5 years (restated) £000	5-10 years (restated) £000	10-15 years (restated) £000	15-20 years (restated) £000	Over 20 years (restated) £000	Total (restated) £000
Non-Profit (insurance)	77,175[1]	144,819[1]	196,438[1]	207,872[1]	259,804[1]	886,108[1]
With-Profits (insurance)	317,682[3]	246,550[3]	121,222[3]	72,444[3]	81,635[3]	839,533[3]
Unit Linked	293,218	-	-	-	-	293,218
Investment	2,710,608	-	-	-	-	2,710,608
Other Liabilities[2]	110,259[1]	-	-	-	-	110,259[1]
Total	3,508,942	391,369	317,660	280,316	341,439	4,839,726

[1] Amounts have been restated as a consequence of the restatements included in note 37.

[2] Other liabilities in the liquidity risk tables consists of outstanding claims, deposits received from reinsurers, creditors arising out of direct insurance operations, other creditors, accruals and deferred income, and provisions for liabilities.

[3] The 2020 table above unintentionally included With-Profit investment cashflows in the With-Profits (insurance) line of £273,866k. The reported comparatives have been updated to remove these cashflows. There is no related impact on the primary statements or other notes within these Accounts.

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.

Fair value estimation

Disclosure of the fair value measurements for financial instruments held at fair value in the balance sheet by level of the fair value measurement hierarchy is detailed at Note 18.

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. These instruments are included in Level 1 and comprise primarily listed equities, OEICs and debt instruments.

The Group closely monitors 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.

35. RISK MANAGEMENT (continued)

If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2. If one or more significant inputs are 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.

Market risk sensitivity analysis

The following table illustrates the impacts on the available capital resources of the Scottish Friendly Main Fund of applying stress scenarios in line with the Standard Formula under Solvency II which are believed to be good approximations of the impact on the UK GAAP FFA.

- The equity price sensitivity considers the changes in prices of UK and other type 1 equities as defined under Solvency II. This is a change in equity prices of ± 39% plus the symmetric adjustment of the equity capital charge as published by the PRA.
- The property value sensitivity considers a 25% reduction in property values.
- The interest rate sensitivities are based on the Solvency II Standard Formula interest rate stresses, which are expressed as a duration dependent multiplicative factor applied to the base curve.

	2021 Impact £m	2020 Impact £m
Equity Fall	(34.9)	(21.4)
Property Fall	(1.2)	(1.6)
Interest Rate Fall	0.3	0.1
Interest Rate Rise	2.1	(0.6)

Outstanding Claims

Increasing the experience of making payments to customers by 10% would increase outstanding claims by approximately £1.3m and a decrease in the experience of making payments to customer by 10% would reduce outstanding claims by approximately £1.2m.

Derivative financial instruments

The company holds interest rate swaptions to mitigate the interest rate risk associated with its non-linked business. At 31 December 2021, the outstanding contracts all mature within 6 years of the year end.

35. RISK MANAGEMENT (continued)

The interest rate swaptions are measured at fair value, which is determined using valuation techniques that utilise observable inputs. The key assumptions used in valuing the derivatives are interest rate curve data and interest rate volatility data.

During the year, the Society entered into new Forwards contracts to reduce exposure to foreign currency movements in overseas in bonds. None are held for speculative purposes.

Further, a very small exposure to new Futures contracts were entered into during the year for efficient portfolio management.

36. TRANSACTIONS WITH RELATED PARTIES

The aggregate premiums payable for the year by eleven Directors in respect of Scottish Friendly's products amounted to £71,926 (2020: £70,321).

At the year end, no Director of Scottish Friendly had any beneficial interest in shares of Scottish Friendly's subsidiary companies.

37. PRIOR YEAR RESTATEMENT

During 2021 work was undertaken to enhance the operational controls within the financial reporting processes, and following a detailed review of the balance sheet, errors have been identified in a number of the line items in the 2020 Accounts. The errors principally relate to adjustments in the balance sheet, with less significant adjustments required to the Fund for Future Appropriation ("FFA"). The adjustments described in this note are the same for both the Society and Group.

The following table sets out the adjustments to the Society's balance sheet for the year ended 31 December 2020:

Impact on the 2020 Balance Sheet	2020 as previously reported £000	Adjustment One £000	Adjustment Two £000	Adjustment Three £000	Adjustment Four £000	Adjustment Five £000	Adjustment Six £000	2020 restated £000
Reinsurers' share of Technical Provisions:								
Non-profit Insurance Contracts	654,878		(67,521)	(24,275)				563,082
Total Assets	5,098,647		(67,521)	(24,275)				5,006,851
Fund for Future Appropriations	203,595	(7,240)		(547)	(3,739)	10,213		202,282
Technical Provisions:								
Non-profit Insurance Contract Liabilities	925,924		(67,521)	(23,728)	3,739			838,414
Investment Contract Liabilities	2,753,862					(10,213)		2,743,649
Provision for liabilities	-	7,240						7,240
Total Liabilities	5,098,647	-	(67,521)	(24,275)	-	-		5,006,851

37. PRIOR YEAR RESTATEMENT (continued)

Explanation of adjustments to the Technical Account for the year ended 31 December 2020:

Impact on the 2020 Technical Account	**2020 as previously reported £000**	**Adjustment One £000**	**Adjustment Two £000**	**Adjustment Three £000**	**Adjustment Four £000**	**Adjustment Five £000**	**Adjustment Six £000**	**2020 restated £000**
Other Technical Income	44,968						(10,625)	34,343
Change in other Technical Provisions	81,566			59	411	(203)	(10,625)	71,208
Tax attributable to Long Term Business	(2,626)	3,587						961
Transfer to the Fund for Future Appropriations	12,703	(3,587)		(59)	(411)	203		8,849

Explanation of adjustments to the balance sheet for the year ended 31 December 2019:

Impact on the 2019 Balance Sheet	**2019 as previously reported £000**	**Adjustment One £000**	**Adjustment Two £000**	**Adjustment Three £000**	**Adjustment Four £000**	**Adjustment Five £000**	**Adjustment Six £000**	**2019 restated £000**
Reinsurers' share of Technical Provisions:								
Non-profit Insurance Contracts	557,805		(44,898)	(12,064)				500,843
Total Assets	5,115,382	-	(44,898)	(12,064)	-	-	-	5,058,420
Fund for Future Appropriations	190,890	(3,653)		(486)	(3,328)	10,010		193,433
Technical Provisions:								
Non-profit Insurance Contract Liabilities	803,899		(44,898)	(11,578)	3,328			750,751
Investment Contract Liabilities	2,832,589					(10,010)		2,822,579
Provision for liabilities	-	3,653						3,653
Total Liabilities	5,115,382	-	(44,898)	(12,064)	-	-	-	5,058,420

37. PRIOR YEAR RESTATEMENT (continued)

The details of adjustments are summarised as follows:

Adjustment One: The pension scheme surplus attracts taxation at 35% on its surplus which has been omitted in error. This adjustment has amounted to an increase to the provisions for liabilities of £7,240k, with an equal reduction in the transfer to the Fund for Future Appropriations.

Adjustment Two: In the non-profit contract liabilities, a regular review of actuarial models calculating the technical provisions identified an error relating a model simplification for a personal injury insurance benefit, which on calculation has proved to be materially inaccurate. This adjustment has amounted to a decrease in the non-profit contract liabilities of £67,521k and, as these contracts are fully reinsured, a decrease in the reinsurance asset for non-profit contracts of £67,521k.

Adjustment Three: In the non-profit contract liabilities, a regular review of actuarial models calculating the technical provisions identified an error relating to the use of data and assumptions which did not accurately reflect a range of product features. This adjustment has amounted to a decrease to non-profit contract liabilities of £23,728k and a decrease to the reinsurance asset for non-profit contracts of £24,275k.

Adjustment Four: In the non-profit contract liabilities, a regular review of actuarial models calculating the technical provisions identified an error relating to an incorrect modelling approach being applied to a portfolio of whole of life contracts. This adjustment has amounted to an increase to non-profit contract liabilities of £3,739k.

Adjustment Five: In the unit-linked contract liabilities, a review of the accounting treatment of a portfolio of onshore bonds identified an error relating to taxation on investment gains on assets within the funds. This correction has amounted to a reduction to unit-linked contract liabilities of £10,213k.

Adjustment Six: Amounts recognised as annual management charges on investment contracts was overstated in the 2020 Accounts following a review of the model identifying an error relating to the fee rate applied to the invested assets. The correction amounts to a reduction of £10,625k from Other Technical Income with corresponding reduction to Change in other Technical Provisions. There is no impact to the balance sheet.

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Scottish Friendly Assurance Society Limited
Head Office: Galbraith House,
16 Blythswood Square, Glasgow G2 4HJ.
Telephone: 0333 323 5433
Email: enquiries@scottishfriendly.co.uk
Web: www.scottishfriendly.co.uk

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