Customer Friendly Principles and Practices of Financial Management

Pure Endowment, Tunstall & Leek Funds

Straightforward financial solutions with a human touch

Foresters Friendly Society

What are the Principles and Practices of Financial Management (PPFM)

The Society manages a number of funds for its members and these funds have different uses such as managing our insurance business and running the Society's branches. Four of the Society's funds are with-profits funds; this means that the with-profits policyholders of each particular fund participate in any profits or losses that are generated within the fund. This guide is an outline of how we manage the three with-profits funds that we are no longer writing new business in: the Pure Endowment Fund (PEF), Tunstall Fund (TF) and Leek Fund (LF).

Principles and Practices of Financial Management (PPFM)

The PPFM is a document describing, in detail, how we manage our with profits funds. Because the PPFM is a long and very detailed document, this guide only highlights its key points.
The PPFM covers:

- Principles: High-level statements that describe our long-term approach to managing the funds.
- Practices: Specific statements on how we intend to put the Principles in place.

We do not expect to change the Principles often, but will do so if we think they could lead to members being treated unfairly, or if they could stop us managing the funds properly. If we do intend to materially change any of our Principles, we must inform you at least three months in advance. This ensures that you will know if our long-term approach is changing.

Practices change more regularly, as we need to be able to respond to how the economy is performing and new rules and regulations. We will publish any changes to Practices on our website and tell you about them in our next letter to you. In this way, you will be kept informed of how our approach has changed.

A copy of the PPFM can be found on our website at: www.forestersfriendlysociety.co.uk

What is a With-Profits Fund?

A With-Profits Fund is a fund where your money is combined with that of other policyholders and then invested on your behalf in a range of different assets. The three With-Profits Funds covered by this document are:

- Pure Endowment Fund which holds all of the pure endowments and with-profit whole of life policies sold through the Society's branches and districts prior to the Society incorporating in 2003.
- Tunstall Fund is a fund set up to manage the policies sold and previously administered by Tunstall Assurance.
- Leek Fund is a fund set up to manage the policies sold and previously administered by Leek Collecting Society.

Our main objective is to ensure that we are able to pay all the guaranteed benefits, including any annual bonuses added to the policies within each fund at all times. At the same time we want to maximise the financial returns to policyholders without taking undue levels of risk. Profits are distributed to with-profits policyholders by way of annual and final bonuses, although neither is guaranteed in advance.

Annual bonus – This is set by taking into account what the fund can afford to pay both now and what we can expect it to be able to afford in the future. Annual bonus rates are then set to make sure that we can meet all the guaranteed amounts when they need to be paid and to build a cushion for any final bonus. For the Tunstall Fund, annual bonuses are generally lower than this method implies in order to allow the fund greater investment freedom.

Once an annual bonus has been added it increases the guaranteed benefit and so cannot be taken away. However it is only guaranteed as described in the policy conditions, and is not guaranteed at other times, such as on surrender. An interim bonus may be added if you claim during a period for which an annual bonus has not yet been declared.

Final bonus – When you claim on your policy, if what we calculate as a fair payout on your policy exceeds your total guaranteed benefits then we may add a final bonus to make up the difference.

How do we determine payouts?

In determining what we consider to be a fair payout, the first stage is determining the policy's asset share.

Asset shares are calculated for groups of similar policies by taking into account: the premiums paid; the investment returns earned; deductions made for the charges that we make to cover expenses and guarantees; and adjustments made for tax if appropriate.

Any profit or loss generated within the fund will be passed on to policyholders by increasing or decreasing the investment return. Asset shares are adjusted to spread the total fund across all policies so that the assets are fairly shared as the number of policies within the fund depletes.

On most claims we set final bonuses so that on average we pay out the full asset share to policyholders on maturity or surrender. We also use smoothing to make sure that payouts, wherever possible, do not alter significantly from year to year or between similar policies. This may mean the actual payout is higher or lower than the asset share.

The position is slightly different for regular premium whole life policies with guaranteed death benefits but no maturity date. As these policies' asset shares will build up over time as premiums are paid in we would naturally expect some members to die while their asset share is lower than their guaranteed benefit. Final bonus rates are therefore set so that the estimated future cost of providing the benefits payable on death is equal to the asset share for this group of plans.

What is smoothing?

The Society smoothes the returns paid to with profits policyholders with the main aim of protecting policyholders from short term fluctuations in the value of assets within each fund.

However, this approach does not protect policyholders from long term and sustained falls in asset values.

The two main ways that the Society smoothes returns are: setting annual bonus rates that are fairly constant year on year, and aiming to limit the change in payouts on similar policies to a maximum of 10 % year on year (subject to meeting the guaranteed benefits of the policies). The Society may make more rapid changes than these in times of significant market or regulatory change.

How is investment return determined?

The investment return is determined for the different types of assets held within each fund. The investment return credited to a type of policy reflects the investment return of the assets backing that specific policy type.

Also the level of guarantees on an individual policy type may affect which assets we use to back that policy type. If the guaranteed benefits on a policy are high we may have to adopt a safer investment approach in order to ensure that we can meet the guarantee in adverse investment conditions (for example by investing in deposits or fixed interest assets). However where guarantees are relatively low we may invest in assets that have a higher level of risk attached but over time could be expected to outperform the safer assets and thus to provide a better return to policyholders.

How do we determine charges?

In determining asset shares we make deductions for charges for two main reasons: to cover expenses and to pay for guarantees. The level of charges to cover expenses is based on what we consider to be each funds fair share of Foresters Friendly Society's total costs. For the Tunstall Fund and Leek Fund the allowable level of charges is defined by their respective transfer agreements. This cost is then split between policies with different policies having different shares based on the size and type of policy.

The main guarantees that we charge for are life insurance cover for products which have a significant level of life insurance cover and maturity guarantees for pure endowment products in the Pure Endowment Fund. The assumed cost of life cover is based on recent mortality experience, with allowance for mortality improvements. Currently the charge for maturity guarantees in the Pure Endowment Fund is set at 2 % of asset share. The level of these charges may vary from time to time depending upon the actual cost of guarantees.

What happens if you surrender your policy early?

If you surrender your policy, we work out how much to pay you with the aim of being fair to you and to those staying in the fund. We do this by setting surrender payouts that are broadly consistent with asset share.

What is a Market Value Reduction (MVR)?

If an ISA or Bond policy written in the Tunstall Fund is surrendered or transferred out and what we consider a fair payout on that policy, when considering its asset share, is less than the contributions paid plus the annual bonuses, then we may apply a market value reduction (MVR). An MVR reduces the face value of the policy to its fair value to ensure that a fair share of the Tunstall Fund is left to those remaining in the fund.

MVRs are not applied to payouts when an ISA or Bond policyholder dies; additionally for a Bond no MVR will be applied if the policy is surrendered on the 10th anniversary or on any 5th anniversary thereafter.

How do we invest your money?

We invest in a range of different assets including:

- equities (shares)
- property
- fixed-interest type assets (such as government Bonds and corporate Bonds)
- cash

We control the risks that come with investing by choosing assets of good quality and by setting limits on the amounts we invest in any one asset or our exposure to any third party. If we think it is right to do so, we may allocate certain assets to specific policies in the fund.
For example, we may do this to reflect the type, the amount and the timing of guarantees.

When deciding exactly what to invest in and how much, we do so by looking at:

- The fund's current and future financial position and the need to make sure there is enough money in the fund
- The level of guarantees within the fund
- The expected timing of future expenses
- Members' reasonable expectations, in relation to how your money is invested.

This may lead to the different funds having significantly different backing assets, and significant change to backing assets over time.

How we manage potential risks?

The funds are exposed to a number of risks. Our biggest risk comes from the need to pay all guarantees when they are due given the possibility of falls in asset values. The funds are also exposed to the risk of more policyholders dying than expected – which increases the claims cost, or the risk that our expenses are higher than expected - increasing our charges.

We aim to reduce our exposure to investment risk by changing our investment strategy as market conditions dictate. Currently, we aim to spread risk over each separate fund as a whole. However, if a risk arises which is related closely to a particular policy type, we may apply some or all of the cost of this risk to the policies in question as long as this is consistent with the plan conditions and the law.

The other funds of the Society may be used to reduce some of the risks faced by the Pure Endowment, Tunstall Fund or Leek Fund; however the other funds are not normally available to otherwise benefit the policyholders within these funds. Similarly the assets of the Pure Endowment, Tunstall Fund or Leek Fund will be maintained for the policyholders of the respective fund and not normally called upon to support other areas of the Society.

How to get in touch

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Information, including a copy of this document, is available in large print, audio and Braille upon request.

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