Our Principles & Practices of Financial Management (PPFM)

Introduction

The PPFM sets out how the Society conducts its with-profits business and, in particular, the principles and practices adopted by the Board in the application of its discretion in relation to such business.

A review was carried out of the PPFM by the Society's management, the With-Profits Actuary and its With-Profits Advisory Arrangement and this resulted in a new version which was approved by the Society's Board on 13 February 2020

The new version will come into effect on 1 November 2020, three months after the 2019 bonus statements communication, as required by the rules of the Society's regulator, the Financial Conduct Authority.

The FCA rules state that a firm must not change its PPFM unless the Board considers the change is justified for certain reasons. We set out these reasons and the changes made as follows:

1. Responding to changes in the business or economic environment

1.1 Updates to reflect current practices

There have been a number of significant changes to reflect changes to the Society's practices or terms for products, as follows:

1.1.1 Investment management

The section on investment strategy has been updated to reflect changes to the Society's investment strategy following the change in management of the Society's investments to AXA Investment Managers in 2019. The asset classes available for the Society to invest were expanded to include new classes – Commercial Real Estate Debt, Convertible Bonds, Infrastructure Debt and High Yield.

The PPFM now reflects this and also contains a statement that, before considering new types of investment, the Board will seek advice and guidance from the Investment Committee, the Chief Actuary, the With-Profits Advisory Arrangement and the With-profits Actuary.

The previous PPFM had target ranges for assets detailed in the principles. The new approach is for the asset classes to be listed under the practices without target ranges. The Society will publish information on the assets held within its fund on its website.

1.1.2 Investment Quality

The previous PPFM explicitly stated that the Society will not invest in assets rated lower than 'investment grade'. This is now changed to the following:

"The Society requires its appointed portfolio managers to invest in fixed income instruments where risks are appropriately rewarded. The Society maintains a preference for investing in securities rated investment-grade by an ESMA-approved rating service. However, the Society also recognises the importance of broadening its eligible asset universe by including sub-investment grade as well as non-rated assets when their risk profile is properly analysed and understood, and it offers attractive levels of expected return for unit of risk. In selecting its deposit-taking institutions, the Society applies maximum prudence. "

1.1.3 Market Value Reduction ("MVR")

There are amendments to clarify what happens in respect of MVRs for accumulating with-profits policies, reflecting changes in terms for more recent products. This is the practice whereby the amounts paid on death, surrender or maturity on certain with-profits policies are adjusted downwards to reflect falls in the value of underlying assets.

The change is that for policies in the Order Insurance Fund written from February 2018, MVRs may be applied both in the circumstances of death and surrender. MVRs applied to death benefits are limited by the guaranteed minimum death benefits specified in the Policy Conditions.

1.1.4 Other changes

There have also been a number of changes to amend the PPFM so it is consistent with what happens in practice, where what was previously described did not accurately reflect this or was incomplete.

- The explanation for not being able to pay 100% of asset share has been extended to include the fact that expenses are cross subsidised between small and larger policies, in addition to the reason of restricting movement in payouts.
- The PPFM previously stated that the neutrality of the cost of smoothing was applicable just to its Order Insurance Fund and Pure Endowment Fund, the wording has been revised so its applicability covers all funds, which is consistent with the approach taken.
- The different approach to charging expenses for conventional and accumulating with-profits policies is now described.
- The specific investment expectations for Pure Endowment Fund, Tunstall and Leek have been removed. The previous PPFM referred to historic expectations for certain groups of policyholders, particularly regarding property or equities. In view of the current investment position of the with-profits funds, these historical assumptions no longer apply.

1.2 Updates to comply with regulations or regulatory expectations

- The PPFM now includes a section on management actions, which is consistent with the Society's Management Action Plan. This addresses the FCA's expectations.
- The PPFM refers to the fact that expenses are charged to the Leek and Tunstall Funds in accordance with the expense agreements set out in the instruments of transfer.

- The wording in the existing PPFM on non-tradeable assets was removed as it is not relevant to the with-profits funds. A section has been added in its place to set out the approach in respect of asset classes that are not normally traded, as follows:

  > *The Board may decide to invest a level of the funds' assets into asset classes which are not normally traded, these asset classes will include commercial real estate debt, infrastructure debt and high-yield bonds. The allocation to these asset classes will be chosen, in a prudent manner within the overall investment strategy, to achieve a higher level of long-term return for the fund.*

2. Removing sections not relevant to with-profits funds

- Information not relating to the with-profits business has been removed and this has no material impact on the existing principles and practices.
- Elements relating to the non-profit fund that are relevant to the management of the with-profits business have been retained.

3. Revising wording and structure

A number of changes were made to the wording and structure of the PPFM to improve its clarity and to make the document easier to read for policyholders. These include removing information that was considered unnecessary detail, such as:

- Information included in appendices setting out business written by the Society and summaries of the Instruments of Transfer for the Leek and Tunstall Funds.
- Table of target investment percentages. The information on assets held by each fund are now shown on the Society's website https://www.forestersfriendlysociety.co.uk/
- Elements included in the section on business risks that covered generic background information about the Society's procedures for undertaking business risk, which are not specific to the with-profits business.

Should you have questions on any of the PPFM changes, please contact our Member Services department on memberservices@forestersfriendlysociety.co.uk.