

# The Shepherds Friendly Society Limited

## A guide to how we manage your with-profits business

### **Aim of this guide.**

This guide explains how we manage your with-profits business.

### **Why it is important to read this guide.**

It gives important information about how policies invested in our with-profits fund work and what plan-holders can expect back from them.

If you are considering investing in with-profits, it is advisable to read this guide after you have read:

- Your key features document, which gives essential information on the plan's aims, its risks, and charges;
- Your illustration, which shows what you might get back in the future.

If you decide not to read this guide now, please keep it in a safe place with your other plan documents for future reference.

*This guide is the consumer friendly version of our Principles and Practices of Financial Management (PPFM).*

# Contents.

1. Introduction.
2. How is the amount you get back from your plan worked out?
3. What are bonuses and how are they set?
4. What happens if you stop your plan early?
5. What is smoothing?
6. How do we invest the with-profits fund?
7. How do we manage the exposure to risk?
8. How do we manage the exposure to new business?
9. How do we work out the charges and expenses?
10. What is the inherited estate and how do we manage it?
11. How can I find out more?

## **1. Introduction**

The purpose of this guide is to explain in easy to understand plain English, how we manage our with-profits business for the benefit of all our with-profits plan-holders. Our aim is to protect your money and to promote confidence in the way we manage your business.

The with-profits fund is managed in accordance with a set of Principles and Practices of Financial Management (PPFM). The PPFM and this document helps you and your advisers understand how we run your with-profits business. This is important because the amount of money you receive from your plan can be heavily influenced by how we manage the with-profits business.

### **What is the PPFM?**

The PPFM is a long and detailed document describing how we manage your with-profits business. It is divided into Principles and associated Practices:

- Principles are high-level statements that describe the long-term approach to managing the business and should not change very often.
- The associated Practices are more defined statements, which flow from the Principles, detailing our current approach. They are likely to change more often.

Our approach may change from time to time. If it is necessary to change the Principles (for example, to maintain fair treatment or to manage the business differently) we will write to you giving three months advance notice of a change. Changes to Practices will be published on our website, our magazine and noted on your next bonus statement.

This guide sets out only the key points. If there is any conflict in interpretation between this document and the PPFM then the PPFM takes precedence. Details on how you can obtain the PPFM are provided in Section 11 “How can I find out more?”

## **2. How is the amount you get back from your plan worked out?**

Our overall aim is to provide you with a fair return on your fund within your plan which reflects the performance of the fund during the length of time you have been invested and subject to any smoothing (see Section 5).

In return for your premium(s), we agree to pay a guaranteed amount on a preset date or event, for example: - on death, or the date stated in your plan, the end or maturity date. We aim to increase the guaranteed amount by adding annual and final bonuses as described in the following Sections.

Different amounts may be paid out on other events, such as surrendering your plan early and your plan and Key Feature Documents will tell you what these amounts are. If you stop your plan early, we may reduce the amount we pay out.

Asset share (a share in the growth of the asset) is the main method used to determine a fair payout to with-profits plan-holders (except where it is considered inappropriate or impractical). The asset share is:

- Premiums that you have paid.
- Less a deduction for expenses, tax and the cost of providing life cover.
- Plus additions or less deductions for miscellaneous profits or losses.
- Plus the growth of the investment during the term of the plan.

The aim in the long-term is to pay out 100% share of the growth through a combination of annual (including interim) and final bonus additions. However the value of the fund goes up and down on a daily basis. This may result in any one plan getting more or less than the asset share.

### **3. What are bonuses and how are they set?**

There are two main types of bonus that may be added to your with-profits plan:

- Annual bonus, sometimes called a reversionary bonus
- Final bonus, sometimes called a terminal bonus

Bonuses help determine the amount you get back from your with-profits plan and will vary according to different types of plan. In setting bonuses we will be careful, prudent and use our good judgment, it is not guaranteed that bonuses will always be added. We review bonuses at least once a year. Interim bonus is similar to annual bonus and is paid where a claim is made between annual bonus declarations.

#### **Annual bonus**

When setting annual bonuses we take into account both the current financial position of the fund and how this might be expected to change in the future. This approach enables us to establish the level of annual bonus that can be afforded now and how it may continue in the future. This is important because the aim is not to vary too much the amount of annual bonus from year to year.

Once an annual bonus has been added, it increases the guaranteed amount payable under a plan so that, once added, it can't be removed.

## Final bonus

Final bonuses may be paid when your plan ends. We pay a final bonus where appropriate to ensure plan-holders receive a fair payout in line with the aim stated in Section 2. A final bonus is calculated by looking at: -

- The policy's asset share (please see section 2)
- Deducting the guaranteed sum assured
- Plus any bonuses that have already been added
- Minus other reduction, perhaps because you have stopped paying your premiums or you are taking your plan earlier than you originally stated.

Example of a typical recent 10 year Bonus Plan maturing 5<sup>th</sup> October 2007

<b>Premium</b>	<b>£25/month</b>
<b>Sum Assured</b>	<b>£2,595.00</b>
<b>Bonuses</b>	<b>£635.78</b>
<b>Final Bonus Rate</b>	<b>110.00% of existing bonuses</b>
<b>Final Bonus</b>	<b>£699.36</b>
<b>Maturity Value</b>	<b>£3,930.14</b>

Please note that past performance is not necessarily a guide to future performance.

## Investment freedom

Investment freedom allows a higher proportion of the with-profits fund to be invested in equities (stocks and shares) and property and can offer the prospect of better growth in the longer term.

The level of guaranteed benefits has an effect on the level of investment freedom (see Section 6). It is for this reason that we aim to pay a significant proportion of profits at the end of the contract as a final bonus.

## 4. What happens if you stop your plan early?

If you stop your plan early (known as a surrender), we work out how much to pay you with the aim of being fair to all plan-holders i.e. between those leaving the fund and those staying. There is generally no guarantee that you will be paid a certain minimum amount: if you surrender a regular savings plan within the first two years you are unlikely to receive any payment at all. If the

value of the assets in the with-profits fund is low, you may get back less than you invested.

A market value reduction (MVR) may apply to certain claims, subject to contractual MVR free events. A MVR is a downward adjustment to bring the overall payout closer to the fair payout figure where the fair value of your plan has decreased.

## **5. What is smoothing?**

The with-profits fund is invested in a mix of asset types as described in Section 6. The returns from some of these asset types (particularly equity and property) are volatile. One year an investment may grow, the next it could fall in value.

Smoothing is a process designed to reduce the effect of the ups and downs in the performance of the assets of the with-profits fund through the bonuses we declare. We hold back some of the profit earned during good years and then release it as bonuses when returns have been poorer.

In normal circumstances, the amount paid will not vary by more than 10% compared with the amount paid under the previous bonus declaration.

We aim to apply smoothing in a way that ensures all with-profits plan-holders are treated fairly.

## **6. How do we invest the with-profits fund?**

The aim of the investments of the with-profits fund is to achieve a reasonable rate of growth whilst:

- Maintaining the solvency and financial strength of the fund.
- Ensuring the fund is able to meet all payments to members when due.
- Meeting the reasonable expectations of members and ensuring fair treatment.

The fund invests in a mix of equities (shares), property, fixed-interest type assets (such as government bonds and corporate bonds), and cash.

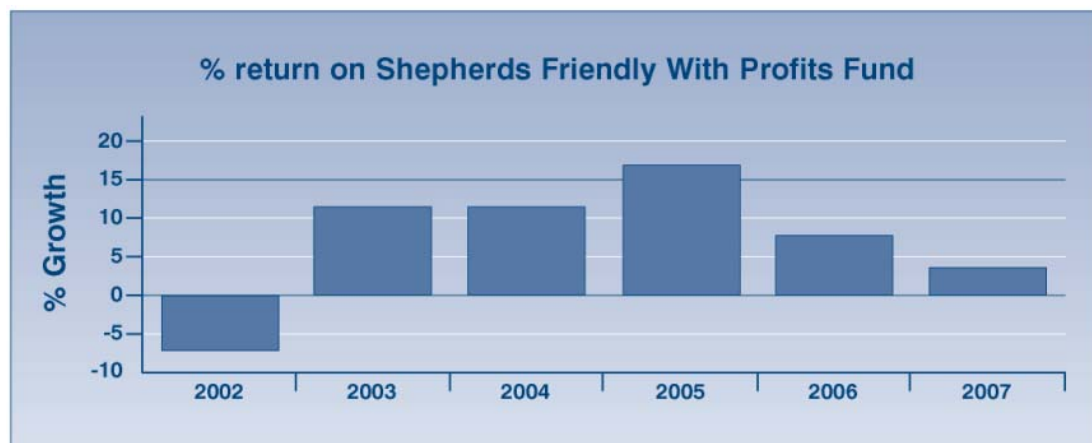
We aim to invest a significant proportion (50%-75%) of the assets of the with-profits fund in equities and property. Over time, declaring small annual bonuses will allow us to invest a higher percentage of the fund in this type of asset.

We control the risks that come with investing by choosing assets of good quality and by setting limits on the amounts we invest in each type of asset, in

each sector and in any single asset. We also limit our exposure to any single third party.

We review our investment strategy at least annually and more often if market conditions change quickly.

**The Shepherds Friendly with-profits fund has achieved the following growth rates over the past 6 years**



Please note that past performance is not necessarily a guide to future performance.

**What are Equities “Stocks & Shares”?**

Stocks and shares are forms of finance used by Public Limited Companies (PLC's). They are released for sale on the stock exchange. The main buyers of stocks and shares are financial institutions such as insurance companies, but private investors may also buy stocks and shares. If you own shares you own a part of a company, and you will receive dividends if that company chooses to pay them. There are various forms of shares, some more risky than others. Generally the more risky, the more money you can potentially earn from shares.

**What are fixed-interest type assets?**

Fixed-interest or bonds are loans to a government or a company for a set period of time. They offer a pre-determined rate of return and the repayment of your original investment on a set date, known as a redemption date. UK Government bonds are also known as 'gilts'. Bonds from companies are known as corporate bonds.

**7. How do we manage exposure to risk?**

The with-profits fund is exposed to a number of risks. The biggest is the need to meet all payments to plan-holders these are due in the face of possible sharp falls in the investment values. This risk is managed by monitoring the performance and moving investments when it's an appropriate time to do so.

As suggested in Sections 3 and 6, it is important that the costs of the guaranteed benefit are maintained by using suitable investments (typically a lower risk type of asset such as fixed interest). As a consequence, the higher the levels of annual bonuses (and hence guarantees), the lower the investment freedom to invest in equities and property and the lower the prospective returns in the longer term.

More generally, as a mutual insurer, all activities of the Society can affect the amounts payable to with-profits plan-holders. We have established procedures, systems and controls to reduce the business risk. Along with other insurers, the society needs to ensure it has money available to meet all the business risks in all but the most extreme circumstances.

## **8. How do we manage the exposure to new business?**

It is our aim to continue to offer competitive products and we will manage any risk this may cause.

We consider whether or not it is in the interests of with-profits plan-holders for the with-profits fund to remain open to new business against the alternative of closure and the options available for managing the closed book of business.

Then we consider whether any limits are required as to the amounts and mix of new business written. We would take into account the resource required, both in terms of capital and processing capability. Currently no limits are required.

A further consideration concerns the nature of the products sold, their potential suitability for customers, the associated financial and business risks and the terms upon which they are sold. The current products and terms meet these criteria.

## **9. How do we work out charges and expenses?**

The expenses incurred in the running of the with-profits fund, such as the cost of administration, investment management, the costs for obtaining new business and taxation are deducted from the fund. The actual expenses charged may be different than the actual expenses incurred.

We aim to share out the expenses to with-profits policies in a way that is fair and appropriate. These expenses, together with the cost of providing insurance cover, are allowed for within the asset share calculation as described in Section 2.

## **10. What is the inherited estate and how do we manage it?**

The inherited estate, also known as the estate or free assets, is the amount over and above what is needed to cover all the society's policies. It is usually used to support the operation of the company. It can be used from time to time (for example) to smooth payouts, meet the costs of guarantees, enable greater investment freedom and meet other strains on the fund.

The amount in the fund is not set or fixed and its value does go up and down but the aim is to manage it so it allows us to meet the costs, guarantees etc as above, now and over time.

If the inherited estate exceeds the amount needed to meet the above requirements we will distribute any excess, over time, as an enhancement to with profit payouts. These are known as "Special Bonuses"

## **11. How can I find out more?**

If you want a more detailed technical description of how we manage our with-profits business you can get a copy of the full PPFM from our website ([www.shepherdsfriendly.co.uk](http://www.shepherdsfriendly.co.uk)) or by writing to us at the address below.

The Shepherds Friendly Society Limited  
Shepherds House  
Stockport Road  
Cheadle  
Cheshire  
SK8 2AA

O800 526249 (freephone)

**For specific details regarding your with-profits plan you should refer to your plan documentation.**

The Shepherds Friendly Society

Registered office: The Shepherds Friendly Society Limited, Shepherds House, Stockport Road, Cheadle, Cheshire, SK8 2AA

Incorporated under the Friendly Societies Act 1992

Registration No: 240F

Authorised and regulated by the Financial Services Authority

FSA Register No: 109997

CFPPFM 0708