



Report for With-Profits Policyholders

Purpose	The PPFM explains how we manage your policy. This report is to tell you whether we have followed the PPFM.
Period covered	1 January 2019 to 31 December 2019

Summary

- We have a framework, our *Principles and Practices of Financial Management (PPFM)*, which makes sure we manage our Fund fairly and effectively for with-profits policyholders and in accordance with the regulations of the Financial Conduct Authority (FCA).
- Every year the Managing Board, With-Profits Committee and the With-Profits Actuary assess how we've managed the Fund and if we've followed the PPFM.
- This report details the findings and includes a separate view from the With-Profits Actuary (Appendix 1).
- It also summarises any changes we've made to the PPFM in the period.

Key findings

- The Managing Board's opinion is that there has been one instance where we have not done what we said we would do. However, other than that one exception, we have complied in all material respects with our PPFM in the treatment of our with-profits policyholders.

Exception

During 2019 three Practices in the PPFM were not followed for the same reason. This related to the fact that not all expenses incurred on the Conventional With-Profits products have been charged to those products. Instead, a different Principle has been followed which means that the estate has been used to make up the shortfall. The Managing Board allowed these breaches to occur because they were believed to be in your interests. Full details are provided below.

- The With-Profits Actuary believes that we have exercised discretion in managing the with-profits business during 2019 in a reasonable and proportionate manner, with due regard to the interests of the Society's with-profits policyholders as a whole.

Definitions

Conventional With-Profits business – Regular Savings Plan, Regular Savings Plan (without guarantee), Moneyspinner, Children’s Bond, Full Endowment, Low Cost and Minimum Low Cost Endowments.

Discretion - The PPFM covers the use of discretion, which is particularly relevant to the management of with-profits business.

Discretion is how we make judgements and how we apply our judgement in managing your money.

Estate - That part of the Life Fund not directly required to meet the obligations of the Society for current policyholders, including any part already set aside or identified for the benefit of current policyholders.

Governance - We have arrangements which make sure that we manage our Life Fund fairly and effectively for members and we call this governance.

Smoothing - One of the ways in which we aim to reduce the risk to you is by evening out short-term highs and lows in how the Life Fund performs. This is called smoothing.

Unitised With-Profits business – Options ISA: Protected growth, Options ISA: Non guaranteed, Guaranteed ISA, Guaranteed Investment Bond, Platinum Bond, Top-up Pension Plan, Group Personal Pension.

PPFM background

We first published our PPFM on 30 April 2004.

Changes are made as our business and the wider economic environment alters and to make the document clearer. The latest changes were made from 1 July 2019.

It’s available on request or online at policemutual.co.uk.

The PPFM focuses mainly on with-profits policies invested in the Life Fund, but other product types that invest in our other funds are also included so that all of our policyholders can see how their policies are managed.

PPFM obligations

There are a number of regulatory requirements that a PPFM must meet. The following list briefly describes some of those obligations that we believe to be most important:

1. Governance

To ensure that when we manage with-profits business we do so in line with the applicable PPFM. We also keep the PPFM up to date and keep records of it.

2. Obtain independent views

To make sure the governance arrangements involve independent judgement, separate from the management of the business, on whether we have followed the PPFM.

3. Monitor the exercise of discretion

To review any exercise of discretion in the conduct of our with-profits business and how we manage any competing interests between different groups of policyholders.

4. Obtain actuarial advice

To take the advice of an actuary in preparing annual reports for policyholders.

How Police Mutual met its PPFM obligations in 2019

1. Governance

In the opinion of the Managing Board, throughout the period covered and with one exception, we've followed the PPFM in all material respects. We have kept it up to date and documented any changes to it.

During 2019 three Practices in the PPFM have not been followed for the same reason.

- The PPFM says that all expenses incurred on Conventional With-Profits (CWP) products will be charged to those products.
- However, in order to ensure that those taking CWP policies out in 2019 get a fair return after expenses, the Managing Board felt it appropriate to charge some of the expenses to the estate in 2019 and therefore lower expenses were charged to those policyholders.
- The PPFM allows exceptional costs to be charged to the estate if the Managing Board believes they should not be directly charged to policyholders.

2. Obtain independent views

Police Mutual's With-Profits Committee provides independent judgement on whether we have followed our PPFM. The With-Profits Committee is responsible for safeguarding policyholders' interests.

During the period January-June 2019, the With-Profits Committee consisted of three Non-Executive Directors and an independent Chair. In June, one Non-Executive Director stood down and was not replaced. Therefore for the period June-December 2019, the With-Profits Committee consisted of two Non-Executive Directors and an independent Chair.

The Committee believes that this report from the Managing Board sufficiently covers the way in which we have followed the PPFM and the way in which any conflicting rights and interests of policyholders have been addressed. Therefore, the Committee has not made a separate report of their own for this period.

3. Monitor the exercise of discretion

During 2019 there were a number of areas where we exercised discretion:

- a) The payments that we made to those whose policies matured and those who surrendered their policies;
- b) The charges and expenses applied to policies;
- c) The management of the estate;
- d) The way in which your money was invested; and
- e) The strategic review of Police Mutual's future.

a) Maturity and surrender values

The PPFM contains target ranges (as percentages of a policy's share of the Life Fund) for how much we'll pay out when our Conventional With-Profits policies reach the end of their term or are surrendered before the end of the term. Where policyholders' payouts are below the range, they may not be receiving their fair share of the Life Fund's returns. Where payouts are above the range, the fund may be paying out more than it can afford, potentially affecting the remaining policyholders. When setting these target ranges we consider:

- How much smoothing might be applied to payouts to even out short-term highs and lows in how the Life Fund performs – for example, a narrow range would mean that smaller changes in performance would cause payouts to fall outside of the range;

- Our approach to setting payouts across tax-exempt and taxable contracts. Regular Savings Plans pay the same benefits whether the amount you save is classed as tax-exempt or not;
- Our approach to setting payouts across policies of different sizes as benefits are calculated based on the guaranteed value set at the start of the policy; and
- How often it might be appropriate to change our payouts - for example, a narrow range would mean that we would need to change payouts more often to reflect changes in performance.

We believe that we have set the ranges to strike a balance between these considerations.

On maturity the target range is 80% to 120% of a policy's share of the Life Fund. This range reduces to 75% to 115% for policies that are surrendered before the end of the term.

We made bonus declarations for our Conventional With-Profits policies to apply from 1 January 2019 and 18 March 2019. Surrender values were also changed on the same dates. The declaration decisions involved the use of discretion with regard to smoothing and were taken by the Managing Board, with advice from the With-Profits Actuary and after considering the views of the With-Profits Committee.

Annual bonus rates were not changed.

Final bonus rates were set to target an average maturity payout of 100% of a policyholder's share of the Life Fund.

Surrender values were set to target an average surrender payout of 95% of a policyholder's share of the Life Fund.

In setting payouts, Conventional With-Profits policies taken out in the same year and for the same term are grouped together as these are the most significant factors which may affect the underlying value of these plans. However, within these groups there will be different levels of premium payments. Smaller savings may not be able to fully bear the costs of setting up and running a policy and so these policies are more likely to fall outside of the target range and be paid more than if all the costs were met. On the other hand, larger policies may bear more costs and this may cause them to fall outside of the lower end of the range particularly in the first few years of a policy.

There is far less discretion applicable to Unitised With-Profits business as how the amounts payable are calculated is described in detail in the PPFM.

b) Charges and expenses

A yearly charge is taken from each policy's share of the Life Fund to ensure guaranteed payouts can be offered. This charge was reviewed at the November 2019 Managing Board meeting. We regularly monitor a number of triggers (which would indicate if a change was needed). The 2019 review concluded that no changes to the charge were required. The guarantee charge remained at 0.25% a year for Children's Bond, 0.50% for the other Conventional With-Profits products and 0.75% a year for Unitised With-Profits products.

c) Management of the estate

Police Mutual's Life Fund has been operating for many years and contains an amount of money in excess of the amount we expect to pay out to existing policyholders. This excess is what we call the estate. It's the working capital of the business.

We applied discretion in charging some costs to the estate. For example, the estate was used to finance the cost of providing Financial Education and to make contributions to the Police Mutual Foundation. The Foundation was established with the aim of supporting benevolent

causes and activities for the benefit of members and the wider Police community. The Foundation supports our purpose of improving the lives of the Police family. The estate was also used to support other business activities such as the operation of the subsidiary companies. As already noted above, the estate was also used in 2019 to meet some of the 2019 expenses incurred on Conventional With-Profits products.

The Managing Board sought advice from the With-Profits Actuary on the use of the estate and also considered the views of the With-Profits Committee before making its decisions.

d) Investment strategy

In 2019 we regularly monitored and reviewed our investment strategy to reflect the economic climate. We exercised discretion with respect to the types of investments held and the proportions of the Life Fund's assets held in each asset type.

The PPFM says that we would normally expect between 50% and 60% of assets in total to be invested in combinations of equities, property and commodities. During the first quarter of 2019, we made the decision to move to the lower end of this range in order to improve the Society's financial position. Later in the year, the amount of assets held in equities, property and commodities was reduced further in order to protect the positive investment return earned to that point in time. This was a reflection of the uncertainty around the investment return that could be earned in the remaining part of the year primarily due to the uncertainty surrounding Brexit. The investment return earned to that point in time was also above the higher estimate we make for the investment return we expect to earn in any one year.

A quarterly update on investment strategy and fund performance is posted on our website - policemutual.co.uk/news.

e) Police Mutual's future

During 2019 we reviewed Police Mutual's future as an independent financial institution. We have proposed, and our Force Authorised Officers have voted in favour of, a move to become part of the Royal London Mutual Insurance Society Limited (Royal London).

Now that the Force Authorised Officers have voted for this transfer, we will be issuing information to all of our policyholders and members so that they can understand what this is and what it means for Police Mutual's future. The transfer will also need approval from the Prudential Regulatory Authority, who regulate us and Royal London. If this is received, Police Mutual will become part of the Royal London Group on 1st October 2020.

Royal London's PPFM will then provide the detail of how the PMAS with-profits policies will be managed and Royal London's Managing Board will be responsible for providing future reports to policyholders on whether their policies have been managed in accordance with that PPFM annually. There are some changes to how the policies will be managed by Royal London and these have been highlighted in the information policyholders will receive. The biggest changes relate to the way surrender values are calculated and the way the estate is managed. The other changes are not expected to have large impacts on the way policies are managed as Royal London have similar intentions in their approach to us.

Competing or conflicting rights, interests and expectations of policyholders

Potentially competing or conflicting rights, interests and expectations of with-profits policyholders may come about, for example, between holders of:

- Different products
- Policies with different terms or sizes
- Policies with different entry dates or maturity dates
- Policies undergoing different types of claim (for example maturity or surrender)

- Where policyholders are in different demographic groups

The main areas where judgement and discretion are exercised in respect of these differing policyholders are the smoothing of policy benefits, the level of guarantee charge, the grouping of policies when attributing such things as investment returns or policy expenses and the proposed transfer to Royal London.

In 2019 maturity payouts were considered carefully by the Managing Board taking account of these factors and were in line with the smoothing practices stated in the PPFM. Analysis of 2019 maturity and surrender claims shows that the vast majority of payouts were within the PPFM target ranges. For maturity claims this was 95% by number of claims and 98% when measured by claim value and for surrender claims it was 84% by number and 96% by value. Our analysis shows that most of the claims paid outside the range were paid more than if we had remained within the range.

The advice of the With-Profits Actuary was sought and the proposed payouts were reviewed by the With-Profits Committee.

The Managing Board has also considered these different factors when assessing the proposed transfer to Royal London.

The Managing Board followed the PPFM when managing these potential competing or conflicting rights, interests and expectations of policyholders.

4. Obtain actuarial advice

Police Mutual has a With-Profits Actuary who is specifically appointed to advise the Managing Board on the fair treatment of different groups of with-profits policyholders and its use of discretion.

For the period of this report the With-Profits Actuary was Julia Beresford. Her report to you is attached to this report.

Changes made to the PPFM during 2019

During 2019 no changes were made to the Principles included in the PPFM, but a number of changes were made to the Practices. These largely fall into three areas:

- Changes to the investment strategy.
- Changes to our Investment Management process.
- Minor updates to improve clarity which did not change the substance.

Both the With-Profits Actuary and the With-Profits Committee were consulted about these changes and were supportive of them.

Contact details

If you have any questions about this report, or would like a copy of the PPFM, you can contact us in any of these ways:

Call us on: 01543 441630 (Monday – Friday, 8.30am – 5.30pm)

Visit our website: policemutual.co.uk

Write to us at: Police Mutual
Alexandra House
Queen Street
Lichfield
Staffordshire
WS13 6QS

For your security, all telephone calls are recorded and may be monitored.

Appendix 1

Report from the With-Profits Actuary to the With-Profits Policyholders

Scope of the With-Profits Actuary's Report

I am required, as the With-Profits Actuary, to report each year to the with-profits policyholders of Police Mutual on whether, in my opinion, the discretion exercised by the firm in the period may be regarded as having taken the interests of the relevant classes of the firm's with-profits policyholders into account in a reasonable and proportionate manner.

This is my report and opinion in respect of the calendar year 2019. I have been the With-Profits Actuary throughout the year.

This report is for information only. You are not required to take any action.

Opinion

In my opinion, I believe that discretion in managing the with-profits business during 2019 has been exercised in a reasonable and proportionate manner, with due regard to the interests of the Society's with-profits policyholders as a whole. Nevertheless, there have been factors which have adversely or might adversely affect with-profits policyholders such as the reduction in the amount invested in equities, property and commodities which if maintained would be expected to decrease potential future payouts.

My opinion is based on the information and explanations provided to me by Police Mutual and my interactions with them over 2019.

There were no new or substantially changed principles during 2019. There were a number of changes to practices which I was consulted on and I am satisfied that the changes went through an appropriate process of review, including full consideration by the With-Profits Committee and the Managing Board.

As the Managing Board have explained above, they have proposed that Police Mutual becomes part of Royal London during 2020. As part of this proposal, I have been consulted and I have concluded that this is in the interests of with-profits policyholders. My report on the proposal will be made available to policyholders and other interested parties as part of the communications of the proposals.

In my opinion, this report, and the work underlying it, is compliant with the required standards governing reports produced by actuaries in all material respects (TAS 100 and TAS 200).

In giving my opinion I have relied on the completeness and accuracy of information and explanations supplied to me by the Society. Although I have considered this information for reasonableness, I have not audited, verified or otherwise substantiated it.

Limitations

My opinion is formed taking into consideration the interests of the Society's with-profits policyholders as a body and not the interests of individual policyholders. Consequently, this report does not constitute advice to any individual and no person should rely on it in making any decision with regard to an individual policy or a decision to effect a policy.

To the fullest extent permissible by law, I do not accept responsibility to anyone other than the with-profits policyholders of the Society as a body for my work in respect of this report and its conclusions.

Julia Beresford FIA
With-Profits Actuary
June 2020