Forester Life Limited

Communication Workers Fund

Principles and Practices of Financial Management

Version 2.0
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Introduction

These Principles and Practices of Financial Management ("PPFM") set out how Forester Life controls and manages its *with-profits business* in the Communication Workers Fund ("CWF"). This fund relates to business transferred from the Communication Workers Friendly Society on 1 August 2011.

The Principles are the standards Forester Life adopts in managing its *with-profits business* in the CWF. They describe the business model used by Forester Life in meeting its duties to *with-profits policyholders* in the CWF and in responding to longer-term changes in the business and economic environment. The Principles are not expected to change often.

The Practices describe the current approach used by Forester Life to manage its *with-profits business* in the CWF and to responding to changes in the business and economic environment in the shorter term. Subject to the Principles, the Practices may change from time to time as circumstances and the general business environment changes.

The PPFM is the responsibility of the Board of Directors. Compliance with the PPFM is reviewed by the Board of Directors and the Forester Life Advisory Panel, with the assistance of the *With-Profits Actuary*. Changes to the PPFM will only be made by the Board of Directors and will be communicated to *with-profits policyholders* as specified by the *Regulator* from time to time.

Background information

The Communication Workers Friendly Society was a mutual friendly society owned by its members and run by a Board of Directors. Its entire business was transferred to Forester Life on 1 August 2011. There are five main classes of business:

- life and savings policies sold before 2009 that are conventional with-profits endowment contracts;
- life and savings policies sold from August 2009 onwards that are conventional with-profits endowment contracts and are referred to within this PPFM as *post-2009 policies*;
- children's policies (old design) that are with-profits endowment contracts operated on a unitised basis;
- children's policies (new design) that are conventional with-profits endowment assurances operated on similar lines to the life and savings policies; and
- sickness benefit policies that are non-profit policies.

This PPFM applies to the four with-profits classes of business. Approaches described apply to all types of *with-profits business* other than in a small number of areas (separately identified) where alternative treatment applies to either the *post-2009 policies* or the children's policies (old design).

All ex-Communication Workers Friendly Society business is managed together and is supported by a single investment fund – referred to in this PPFM as the CWF (Communication Workers Fund).

Because of the closure to new business, the number of policies remaining in the fund is gradually decreasing. The *Transfer Agreement* states that when the number of policies in force falls below 1,000 Forester Life shall be released from its obligation to maintain the fund as a separate account. In these circumstances, the *surplus* would be used to determine a scale of guaranteed bonuses that would apply to all remaining policies in each subsequent year. It is expected that the number of policies in force will fall below 1,000 during 2033.

1. Overarching Principles

1.1. Forester Life applies a number of overarching principles to the management of the *with-profits business* of the CWF. These are set out below in the order in which they would normally apply:

- meet all contractual obligations, in particular the timely payment of *guaranteed benefits*;
- meet appropriate tests of *solvency* and capital adequacy; and
- treat all policyholders fairly, taking into account the conflicting interests between them.

1.2. In the event of a conflict arising as a result of the application of any one or more of the Principles set out below, these Overarching Principles will take precedence.

2. Amount payable under a *with-profits policy*

Principles

2.1 Forester Life aims to provide *with-profits policyholder*s with a fair return on their investment.

2.2 For amounts on maturity, death, redundancy and ill-health, the return will primarily reflect the amounts earned by the CWF in respect of the *with-profits policy*.

2.3 In addition, the *inherited estate* will also be distributed among the *with-profits policyholder*s over the lifetime of the CWF.

2.4 The methods, assumptions and parameters used will be sufficient for Forester Life to make reasonable decisions on the amount payable to *with-profits policyholder*s.

2.5 Significant levels of smoothing (see also section 5 below) may result in cross-subsidies between with-profits policies of different terms and sizes within a generation of with-profits policies and between different generations of with-profits policies.

2.6 Estimates of experience are used where actual results are not readily available.

2.7 Changes in methods and to historical assumptions and parameters may be made, where these improve the accuracy or appropriateness of the assessment. Material changes will be considered by, and are subject to approval by, the Board of Directors, following consideration of the opinions of the Forester Life Advisory Panel and the *With-Profits Actuary*.

Practices

2.8 The current approach to determining a fair return on maturity, death, redundancy and ill-health for a *with-profits policy* is to use an *asset share* for that *with-profits policy* as a guide to the amount payable. For surrenders, where the amounts payable are not otherwise specified in the policy conditions, *asset shares* are used as a guide to the amount that is paid.

2.9 *Asset shares* are calculated for maturing with-profits policies and these are used to set the bonus scales that determine pay-outs for all death and maturity claims.

2.10 The main assumptions or parameters in the *asset share* calculations are determined by regular investigations into the experience of the fund (mostly annual investigations but may be less frequent for minor assumptions). Investment returns are based on the assets backing the with-profits policies. In particular, children's policies (old design) have a minimum guaranteed rate of 4% a year.

2.11 Tax rates reflect the proportion of taxable and tax-exempt business from time to time, with no tax being charged to *asset shares* for *post-2009 policies*. The basis for taxation is set out in the *Transfer Agreement*. However, the fund is taxed as if it were the sole long-term business of Forester Life.

2.12 The expense charges set out in the *Transfer Agreement* are fully allocated and are expressed as a proportion of premiums and a separate proportion of the *asset share*. Prior to the transfer of the business to Forester Life, expenses were not always fully allocated to *asset shares*.

2.13 The approximations allowed when applying other assumptions or parameters across generations and classes of *with-profits policy* are in line with the overall aim of sharing the experience of the CWF between *with-profits policyholder*s.

2.14 Currently no charges are made to *asset shares* for the use of capital or for the cost of meeting guarantees.

2.15 Additionally, the *inherited estate* will be distributed over the lifetime of the CWF by one or more of the following methods:

- An increase in the *asset shares* of all policies.
- An increase in the proportion of *asset share* targeted on claim.
- Increases in the *annual bonus* rates.
- Using the *inherited estate* to pay for the *guaranteed benefits* in excess of the *asset share*.

2.16 Extraordinary *miscellaneous profits or losses* are allocated to *asset shares* immediately subject to the agreement of the Board of Directors and may be added or subtracted by means of a percentage adjustment to *asset shares* of groups of with-profits policies. Any profits allocated to *asset shares* in this way may subsequently be removed in the event of adverse financial conditions or if the *solvency* of the fund is threatened.

2.17 All other *miscellaneous profits or losses* (including costs of guarantees) generated from the normal day to day activities of the CWF are not allocated to *asset shares* directly. When setting *final bonus* rates, account is taken of the accumulated *miscellaneous profits or losses* over the lifetime of the relevant with-profits policies and a decision is taken whether to add or subtract part or all of such *miscellaneous profits or losses* from the *asset shares*, taking account of the financial position of the CWF at that time. Any profits taken into account in setting *final bonus* rates in this way may subsequently be removed in the event of adverse financial conditions or if the *solvency* of the fund is threatened.

2.18 The aim in determining pay-outs on maturity for with-profits policies is to return, on average, 100% of *asset shares* (after including adjustments as described in 2.16). The target of 100% of *asset shares* may be increased in accordance with paragraph 2.15 above. The amounts payable in any year or to any particular *with-profits policyholder* may be more or less than 100%, due to the effects of smoothing and guarantees.

2.19 The aim in determining pay-outs on surrender prior to maturity for with-profits policies is to return, on average, 95% of *asset shares*. This amount includes an allowance for the cost of processing surrender claims. It is intended that pay-outs for at least 90% of with-profits policies will fall in a range of 80% to 120% of *asset shares*. The target of 95% and the range of 80% to 120% of *asset shares* may be increased in accordance with paragraph 2.14 above.

2.20 Paragraphs 2.18 and 2.19 above apply to with-profits policies where guarantees do not exceed *asset shares* – where payments are affected by guarantees then the guaranteed amount is paid and this *asset share* test is not applied.

3. Approach to setting *regular bonus* rates

Principles

3.1. The general aim in setting *regular bonus* rates for all classes of *with-profits policy* is to distribute a prudent proportion of the expected investment return on the assets backing the *with-profits business* whilst leaving a margin to provide for a *final bonus* in maturity payments. Account will also be taken of the current and projected financial strength of the CWF.

3.2. In the event of a significant difference in the bonus expectations of different groups of with-profits policies, consideration would be given to setting up a new *bonus series*.

Practices

3.3. *Regular bonus* rates are set by reference to a maximum supportable level based on a prudent estimate of current and future expected investment returns from *gilts*. This calculation is subject to the overall *solvency* of the fund and the level of guarantees in in-force contracts and this position is reviewed annually (although *regular bonus*es are not expected to be changed each year).

3.4. For all with-profits policies except children's policies (old design), a bonus rate is declared to apply to the *sum assured* and a separate *regular bonus* rate is declared to apply to the attaching *regular bonus*es. For the children's policies (old design) a single rate of *regular bonus* is declared to apply to the units allocated to the policies including previously declared bonus units.

3.5. For children's policies (old design), units receive a guaranteed 4% a year interest allocation and *regular bonus*es are added on top if accumulated and expected future returns exceed this rate with a margin of at least 1% a year.

3.6. A separate *bonus series* applies to *post-2009 policies* in order to reflect their fully tax-exempt nature.

3.7. Forester Life will review *regular bonus* rates at least once a year but would often expect to leave rates unaltered.

3.8. There is no maximum amount by which *regular bonus* rates may be changed and, if *solvency* is threatened, the overriding principles will be applied and no *regular bonus* will be declared.

3.9. If no significant change in *regular bonus* rates is anticipated at the next declaration, *interim bonus* rates are normally set equal to the previously declared *regular bonus* rates applicable to with-profits policies in the same *bonus series*. If a significant change in *regular bonus* rates is anticipated at the next declaration, *interim bonus* rates may reflect partially or fully the anticipated change in *regular bonus* rates.

3.10. The Board of Directors reserves the right to declare bonuses in excess of the rates justified by the considerations above if the financial position of the CWF is strong enough to allow such extra bonuses to be declared.

4. Approach to setting *final bonus* rates

Principles

4.1. *Final bonus* rates are set so that the amounts paid on with-profits policies reflect the principles in section 2 above, subject to the smoothing Principles and Practices set out in section 5 below. In addition, the following Principles are followed in setting *final bonus* rates:

- separate scales of *final bonus* rates are declared for different classes of *with-profits policies* where this is necessary to provide *with-profits policyholders* with a fair return;
- within a particular class, *final bonus* rates may vary by duration since commencement of the *with-profits policy*, and any other factor considered necessary to maintain fairness between different groups of *with-profits policyholders*;
- there is no restriction on the company paying *final bonus* on some categories of *with-profits policies* whilst at the same time not on others; and
- account will be taken of the current and projected financial strength of the CWF.

Practices

4.2. *Final bonus* rates are set by reference to *asset share* calculations, the level of accumulated *miscellaneous profits or losses* (see paragraph 2.17 above) and expected future *final bonus* rates for maturing with-profits policies subject to the smoothing Principles and Practices set out in section 5 below. There might also be an adjustment for the *inherited estate* in the CWF, as described in section 2.15 above.

4.3. Where *final bonus* scales are currently shared between classes of *with-profits policy* this does not preclude a change at any time to separate scales. This would also apply to taxable and tax-exempt business where, currently, the same scales of *final bonus* are applied. A separate bonus scale applies to *post-2009 policies*.

4.4. The same *final bonus* scale is used for maturity and death claims.

4.5. The *final bonus* is declared as a percentage of the attaching *regular bonus*, except for children's policies (old design), where the *final bonus* is expressed as a percentage of the units.

4.6. *Final bonus* will be reflected in surrender values as required to meet the aims set out in section 2 above.

4.7. *Final bonus* rates are reviewed annually but may be changed more frequently if there are significant changes in the value of the relevant assets held in the CWF in respect of the relevant class of with-profits policies.

4.8. The overriding principles mean that all *final bonus*es could be reduced to zero in adverse circumstances.

5. Approach to smoothing

Principles

5.1. Forester Life smooths *final bonus* rates so that the differences between pay-outs on with-profits policies before and after the change in *final bonus* rates, ignoring the impact of any *guaranteed benefits*, are within the Board of Director's current interpretation of fairness between *with-profits policyholder*s.

5.2. Forester Life aims for the *cost of smoothing* to be neutral over time.

Practices

5.3. Forester Life aims to ensure an accumulated *cost of smoothing* that does not threaten its ability to demonstrate an adequate *solvency* position for the CWF or its ability to meet its contractual obligations to *with-profits policyholder*s.

5.4. Forester Life aims for smoothing to be neutral over a period of time which would normally be between 3 and 5 years.

5.5. For regular premium with-profits policies, Forester Life aims to limit the differences between pay-outs on maturity on with-profits policies before and after the change in *final bonus* rates to a maximum of 10%, although this is subject to the application of the overriding principles. In adverse financial circumstances all *final bonus*es could be removed and smoothing would not apply.

6. Investment strategy

Principles

6.1. The investment objectives of the CWF are to maximise the investment return on *with-profits policyholder* assets by taking an acceptable level of risk, subject to being able to meet *with-profits policy* benefits with an appropriate level of certainty and taking into account the amount of *surplus*, expected strains and past communications made to *with-profits policyholder*s.

6.2. *Derivative instruments* or other asset-liability instruments may be used either for the purpose of reduction of investment risk and/or efficient portfolio management. The use of *derivative instruments* would require the approval of the Board of Directors.

6.3. There are no constraints on Forester Life's investment strategy with respect to parts of the fund or between different generations of *with-profits policyholder*s, subject to the other investment strategy Principles.

6.4. Forester Life's exposure to individual counterparties is monitored periodically. Limits on exposure to individual counterparties are set from time to time, taking into account the fund's overall risk appetite.

6.5. Explicit Board of Directors' approval is required to trade assets that would not normally be traded because of their importance to Forester Life.

Practices

6.6. The CWF's investment strategy is reviewed at least once a year.

6.7. The target asset allocation for the CWF is that 50% should be in equities and similar investments.

6.8. The Board of Directors maintains a written statement of the approach taken in relation to risk in the investments made in the fund, taking into account the overall financial position of the CWF. This statement is reviewed periodically.

6.9. The fund invests in assets appropriate to the nature of the *with-profits business*.

6.10. All investments, except direct holdings of property, are outsourced to Schroders, a global investment manager.

6.11. The fund will mainly invest in, but is not limited to, a range of UK and global equities, government bonds, corporate bonds and index-linked securities. This includes indirect investments through collective investment funds.

6.12. Limits are imposed on the credit ratings of the corporate bond portfolio. The CWF normally invests in corporate bonds that have investment grade ratings, but may retain investments that lose this rating. Any changes to limits would need to be approved by the Board of Directors, following consideration of the opinions of the Forester Life Advisory Panel and the *With-Profits Actuary*.

6.13. *Derivative instruments* are only used for efficient portfolio management within guidelines provided to the investment manager.

6.14. There are no material non-tradable assets.

7. Business risk

Principles

7.1. Business risk relates to the risks inherent in undertaking other business activities or ventures.

7.2. The CWF will not undertake any material business risks other than in relation to with-profits and non-profits business described in the background information.

Practices

7.3. Currently the CWF does not undertake any material business risks other than in relation to with-profits and non-profit business described in the background information. This position is not expected to change.

7.4. Compensation and redress costs arising from the CWF would be borne by Forester Life. These amounts exclude any payment or transfer of liabilities made to correct an error and which has the effect of restoring a policyholder, or former policyholder, and the fund to the position they would have been in if the error had not occurred.

7.5. There is a residual risk to the with-profits policyholders as they bear the profits and losses arising from the non-profits business.

8. Charges and expenses

Principles

8.1. Forester Life's approach to applying charges and apportioning expenses is to reasonably reflect the underlying experience and to allocate the costs incurred in respect of the *with-profits business* fully across that business. However, where the Board of Directors considers it appropriate, alternative approaches to allocating costs may be followed, taking into account the need to treat all customers fairly.

8.2. The normal approach allocates expenses in proportion to the size of contract by relating those expenses to a proportion of premiums and to an adjustment to investment return.

8.3. Other charges that could be made include charges for capital and charges for guarantees.

Practices

8.4. The charges incurred by the *with-profits business* that are charged through to the *asset shares* of that business are set out in the *Transfer Agreement*, as follows:

- a charge of 8.3% of each premium received in 2011 and 2012. This charge will increase on each 1 January, commencing 2013, in line with the increase in the Retail Price Index over the twelve months ending on the preceding 31 October; and

- an annual charge of 0.2% of the asset value of the CWF.

8.5. In normal circumstances, all expenses incurred in respect of the *with-profits business* will be allocated to that business. Any expenses incurred in relation to other business risks undertaken would be excluded from this main apportionment and would be reflected in the investment returns earned on those business risks.

8.6. Currently no charges are made for cost of capital or for guarantees. These would be reviewed if the approach to assessing *asset shares* were to be reconsidered.

9. Management of the *inherited estate*

Principles

9.1. The *inherited estate* is being distributed to policyholders, as described in section 2.15 above. It will reduce to zero as the number of policies and the CWF reduces to zero, subject to the termination of the fund as outlined at the end of the Background Information above.

Practices

9.2. The whole of the *inherited estate* is being distributed to policyholders in increased claim values, apart from the annual 0.2% charge. However, should the cost of the *guaranteed benefits* or the *cost of smoothing* exceed their expected value then the excess will be deducted from the *inherited estate*.

9.3. The same investment strategy is used for the *inherited estate* and the remainder of the fund.

9.4. There are no guidelines in place regarding the maximum or minimum size of the *inherited estate*. In the long-term, the *inherited estate* is expected to decrease slightly faster than the fund, but this position can be different in the short-term.

10. Volumes of new business and arrangements on stopping taking new business within the with-profits fund

Principles

10.1. The Fund has been closed to new business since 1 August 2011. Therefore, the arrangements for reviewing the limits on the quantity and type of new *with-profits business* and the anticipated actions to be taken on ceasing to write new business do not apply to the CWF.

11. Equity between the with-profits fund and any shareholders

Principles

11.1. All *surplus* arising in the CWF is ultimately available for members.

11.2. No change to this profit sharing arrangement is envisaged.

Glossary

Asset share	In relation to a *with-profits policy*, the accumulated value of premiums paid plus exceptional miscellaneous profits with deductions for expenses, mortality charges, exceptional miscellaneous losses and tax, where the accumulation rate is the rate of return achieved by that part of the assets that is assumed to back the *with-profits policy* of the CWF.
Bonus series	A group of *with-profits policies* considered separately in the bonus recommendation.
Cost of smoothing	The extent to which the pay-out under a *with-profits policy* diverges from its *asset share* except where due to applicable *guaranteed benefits*.
Derivative instruments	Includes options, futures contracts and contracts for difference as well as contracts under which the amount payable by either counterparty is calculated by reference to the value of any other asset.
Final bonus	A method of distributing *surplus*, whereby the bonus is only declared when a *with-profits policy* becomes a claim.
Gilts	Fixed interest securities issued by, and guaranteed by, the UK Government.
Guaranteed benefits	The amount specified under the *with-profits policy* as being payable on death or on survival to the end of the term of the *with-profits policy*. At any point in time the *guaranteed benefits* of a policy will not be lower than the *sum assured* plus any *regular bonus* added to the *with-profits policy*.
Inherited estate	The excess of assets maintained within the with-profits fund over and above the total of all *asset shares* and a realistic value of those *guaranteed benefits* in excess of the *asset shares*.
Interim bonus	The bonus paid in respect of the period since the last declaration of *regular bonus* to the date of claim.
Miscellaneous profits or losses	Profits or losses other than arising from investment returns, mortality, tax and expenses, including profits and losses on other business risks.
Post-2009 policies	Life and savings policies sold from August 2009 onwards.
Regular bonus	A method of distributing *surplus*. The bonus is declared each year but is not paid until a *with-profits policy* becomes a claim.

Regulator	The Financial Conduct Authority (FCA) or such other body as shall from time to time carry out such functions in relation to insurance business carried on in the United Kingdom as are allocated to the FCA under the Financial Services Act 2012.
Solvency	The extent to which the *surplus* within the CWF meets the relevant minimum requirements in the fund, assuming that the CWF was the only fund of Forester Life and ignoring any minimum requirement based solely on a fixed monetary amount.
Sum assured	The amount specified under a *with-profits policy* as being payable on survival to the end of the term of the *with-profits policy* or earlier death if applicable.
Surplus	The excess of the value of the assets of the CWF over its liabilities.
Transfer Agreement	The document that sets out the basis, including charges, on which Forester Life will manage the Communication Workers Fund.
With-Profits Actuary	The *With-Profits Actuary* is a defined role specified by the *Regulator* to be filled by a qualified actuary.
With-profits business	The *with-profits policies* in the CWF.
With-profits policy	Any policy that at the relevant time confers on the holder a right to share in the profits of the CWF.
With-profits policyholder	A person who holds a *with-profits policy*.