

## **Scottish Friendly's report to with-profits policyholders for the year 2007**

### **Introduction**

The Conduct of Business sourcebook of the Financial Services Authority ('FSA') requires firms to establish and maintain 'Principles and Practices of Financial Management' ('PPFM') to govern their conduct of their with profits business.

The FSA also requires the firm to report to its with-profits policyholders stating whether, throughout the financial year to which the report relates, the firm believes it has complied with its obligations relating to PPFM and setting out the firm's reasons for that belief.

Throughout 2007 Scottish Friendly have published and maintained separate PPFM documents covering the operation of the Ordinary Branch Conventional With-Profits Fund, the Ordinary Branch Unitised With-Profits Fund, the Industrial Branch Conventional With-Profits Fund and Rational Shelley business.

The long term business of Scottish Legal Life was transferred to Scottish Friendly on 30 September 2007 and, since that time, Scottish Friendly have maintained a separate PPFM in respect of the with-profits business included within this transfer.

'Consumer-friendly' versions of each of these documents have also been published.

Both the PPFM documents and the consumer-friendly versions are available electronically on the internet at [www.scottishfriendly.co.uk](http://www.scottishfriendly.co.uk).

The Principles are high-level statements that reflect the general approach adopted in managing the with-profits fund and are not expected to change often.

The Practices are statements of specific practice employed in managing the with-profits fund. They reflect the current approaches given the particular circumstances and economic conditions. Practices are likely to be revised in response to changes in the regulatory, business and economic environment and as new methods and techniques are developed in the life and pensions industry. However, the different Practices would still need to conform to the Principles.

These documents have been reviewed during the year. A number of minor amendments and clarifications have been made. No changes have been made to the underlying Principles.

### **Compliance with PPFM**

Scottish Friendly has established procedures to ensure that its Board of Directors can satisfy itself at regular intervals that the with-profits business is being managed in accordance with the PPFM; these procedures include formal reports to the Board from the With-Profits Actuary, Gary Beamer of OAC Actuaries and Consultants, and Independent Persons Nick Morrell of OAC Actuaries and Consultants, appointed to review PPFM compliance for Scottish Legal and David Lechmere of OAC Actuaries and Consultants to review PPFM compliance for Scottish Friendly and Rational Shelley sub funds.

A report from the With-Profits Actuary to with-profits policyholders is annexed to this report.

Scottish Friendly believes that it has complied with its obligations relating to PPFM for the reasons described in the following sections.

### **Payouts**

The Bonus Declaration agreed by the Board, based on the recommendations made by the With-Profits Actuary in his Bonus Recommendation Report as at 31 December 2007, met the requirements of the PPFMs in terms of the bonus and smoothing policy detailed therein.

For most classes of with-profits business, payouts were determined having regard to asset shares to endeavour that fairness is maintained between different groups and generations of policies. Where appropriate these asset shares have been enhanced to distribute excess surplus. During 2007 the payouts for maturities and surrenders met the requirements of the target ranges set out in the PPFM.

### **Investment Strategy**

Responsibility for monitoring investment performance and strategy is carried out by the Board. This has been carried out in accordance with the PPFM.

Asset allocation was carried out in accordance with the parameters set out in the PPFM.

### **Expenses**

Scottish Legal and Rational Shelley expenses have been charged in accordance with their expense agreements. No one-off expenses were charged to Scottish Legal as part of the transfer. Scottish Friendly policyholders bear the total costs of the Society, offset by the charges from the subfunds.

### **Business risk**

As members of a mutual society, with-profits policyholders ultimately bear the risks and rewards of all business undertaken by Scottish Friendly. Any significant additional business risks to be undertaken by the Society require the approval of the Board and Executive, acting on the advice of the With-Profits Actuary, and are based on expectations of achieving appropriate returns for the with-profits policyholders commensurate to the risks borne.

Two examples in 2007 were the transfers of business from Scottish Legal (30<sup>th</sup> September 2007) and later LANMAS (31<sup>st</sup> December 2007), which both underwent the due approval process in line with the PPFM to ensure that it was in the interests of Scottish Friendly policyholders.