Management of our With-Profits Funds in 2009

The Children's Mutual™

Introduction

Each company managing a fund in which With-Profits business is written is required by law to produce a PPFM (Principles and Practices of Financial Management) that sets out how the company will manage the fund. Amongst other things this document explains how the company works out payout values for With-Profits plans written in the fund, and the extent to which it is able to use discretion in determining these values.

As the Society has two funds in which it operates With-Profits plans we have two PPFM documents. Each PPFM is available on our website – thechildrensmutual.co.uk/wp – where there is also a simplified version, or you can call us on 0845 609 0085 to ask for a paper copy.

The purpose of this leaflet is to tell you how the specific fund in which your With-Profits plan is invested was managed during 2009, and in particular what discretion was exercised when managing the fund. The two funds in which the Society operates With-Profits plans are the Tunbridge Wells Equitable Life and Endowment Fund and the Boots Life Fund. Your plan documents will show which fund is applicable to your With-Profits plan.

Throughout this leaflet we use some technical words and phrases, which are shown in **bold** and have the following meanings:

Asset share(s)	The value of all the payments made by or on behalf of the plan holder, less deductions for management expenses, tax and other charges, plus allocations of business profits. These are then all built up at the rate of investment return achieved on the assets (investments) allocated to the plan.
Smoothed Asset share(s)	The value of **asset shares** averaged over a period of time in a way that smoothes the effects of the factors we use to calculate those **asset shares**. The PPFMs explain our approach to smoothing which also includes managing payouts within a target range around the **asset shares**.
Bonus/bonuses	The part of the operating profit (the surplus of income over expenditure) generated by the operation and management of the fund that the Committee of Management decides is available to allocate to With-Profits plans written in the fund.
Conventional With-Profits	Type of plan for which benefits are expressed as the total of the sum assured, yearly **bonuses** and final **bonus**.
Guarantees	Legally binding commitments on the Society to pay out specific amounts of money in particular circumstances – for example, when a plan reaches the end of its term or on the earlier death of the person whose life is insured by it.
Unitised With-Profits	A type of plan for which benefits are expressed as the value of a number of ‘units’ in the fund.

How we have managed the funds in 2009

In determining the policyholder benefits for With-Profits plans the Committee of Management exercises its discretion in a number of ways. The key areas of this discretion, all of which are detailed in the relevant PPFM, are:

– determining yearly and final **bonuses**;

– managing the funds' assets;

– determining the proportion of the Society's operating expenses that should be charged to the funds.

Determining Bonuses

To decide how much we can add to plans as **bonuses** we use a method based on what we call **asset shares**. We follow this method as it provides a fair return given the actual investment returns earned and expenses incurred during the lifetime of each individual plan.

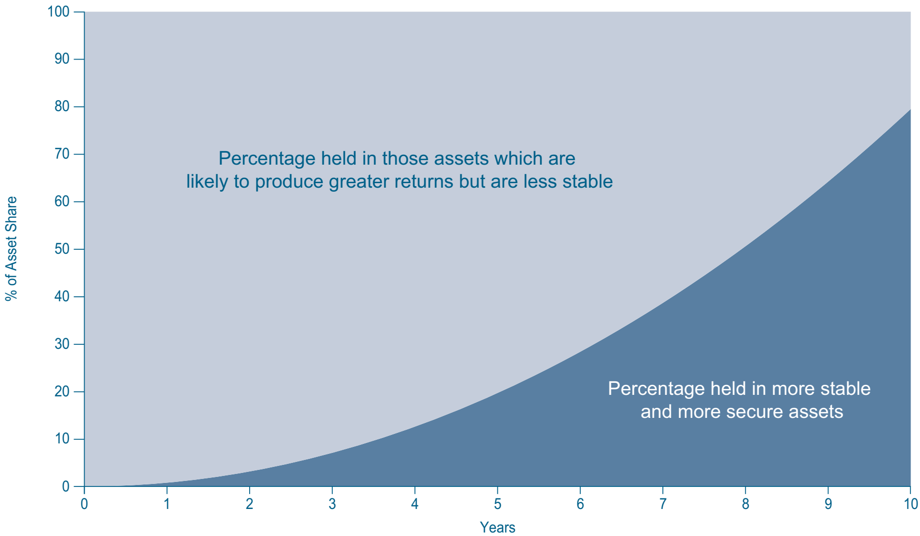
An individual plan's **asset share** consists of the payments made into it, less management expenses, tax and other charges, but with a share of any business profits added. These amounts are then built up at the rate of investment return allocated to the plan.

The rate of investment return allocated depends upon the type of investments held, which include shares in stock market listed companies, government and corporate bonds, units in property funds, collective investment schemes and cash deposits. However, the proportion of each investment type held for an individual plan depends on when it started, how long before it is due to end, and which fund it invests in.

All Tunbridge Wells Equitable Friendly Society Limited Conventional With-Profits plans, and Boots Conventional With-Profits plans that started on or after 1 November 1990

For these plans we switch the types of investment allocated to its **asset share** to reflect its value to date, and the **guarantees** that have built up for it. This means that in the early years, most of a plan's **asset share** will be represented by investments that are more likely to produce greater returns over the longer term, such as shares. However, the values of these types of investment tend to go up and down in the short term, sometimes very significantly. So in the plan's later years we will gradually switch the investments representing the **asset share** to those where the value is more stable. Generally, the greater the **guarantees** already built up by a plan, the greater the proportion will be of more stable investments we hold for it. This process takes place within the fund and does not mean we have to buy and sell the actual assets themselves, which would increase our expenses and so lead to lower overall returns.

The graph below shows how the split of assets allocated to a typical **asset share** might change over time. This is just an example – the actual split for individual plans may be different:



All Unitised With-Profits plans and Boots Conventional With-Profits plans that started before 1 November 1990

For these plans the mix of assets remains constant throughout the life of the plan.

To help determine the yearly **bonus** rates on **Conventional With-Profits** plans, we follow three steps:

1) We take a number of sample plans that are representative of all **Conventional With-Profits** plans investing in the fund. We work out what the value of the **smoothed asset shares** of each of these sample plans could be when it reaches the end of its term. Our figures are based on the value of current **asset shares** and our view of future investment returns and future expenses.
2) We then look at the gap between the value of the projected **smoothed asset share** and the value of the **guarantees** attached to each sample plan which could be paid out at the end of the term. This gap should be positive, to ensure that when a plan is due to mature its **smoothed asset share** covers the **guarantees**.
3) If the value of these **guarantees** is lower than the projected **smoothed asset share** value, we add part of the difference to the plan as a yearly **bonus**. As all assets (except cash) can go up or down in value over time, then the value of an individual plan's **asset share** will also move up or down. Therefore to ensure that in future the value of the **guarantees** does not become greater than the value of the **smoothed asset shares**, only a part of the difference is used for a yearly **bonus**.

We also aim to add a further **bonus** to your plan when it pays out at the end of its term or through death. This is called a 'final **bonus**'. The final **bonus** is intended to make up any remaining difference between the value of the **smoothed asset shares** and the **guarantees** that have built up for the plan. If the value of the **guarantees** at this time is greater than the value of the **smoothed asset shares**, we pay out the **guarantees** in full.

For **Unitised With-Profits** plans we announce a yearly **bonus** rate at the beginning of each calendar year. This is based on the level of investment return and expenses we expect to experience over that year. We apply this **bonus** on a daily basis to the number of units already held by a plan.

We also aim to add a final **bonus** to **Unitised With-Profits** plans when they are paid out to make up any remaining difference between the value of the **smoothed asset shares** and the **guarantees** that have built up for the plan. However for **Unitised With-Profits** if the current value of units is greater than the **smoothed asset share** then we may apply a market value reduction (MVR) – which will reduce the amount we pay out.

We may not apply an MVR if the plan is cashed in on the 10th anniversary of its start date and no part of the plan has been previously cashed in. In these circumstances the amount paid out is subject to a minimum of the initial single premium. Additionally, we do not apply an MVR if we pay out because the planholder has died, or on regular withdrawals that were set up when the plan started.

During 2009 there were no changes to the approach of using **asset shares** and **smoothed asset shares** to help determine payouts and the aim of managing payouts within the target ranges as prescribed in the PPFM was met.

Yearly Bonuses for 2009

As you will be aware the much publicised 'credit crunch' has had a major impact on the world's economy. In 2008 and the early part of 2009 this led to significant downward movements in most major investment markets.

For both **Conventional** and **Unitised With-Profits** these investment returns resulted in **asset shares** falling significantly across all terms. Thus for **Conventional With-Profits** the gap between the **smoothed asset shares** and the existing **guarantees** was severely reduced, and for **Unitised With-Profits** the gap between the **smoothed asset shares** and the current value of units was severely reduced.

In light of these falls the Society's Committee of Management decided that the yearly **bonus** rate for 2008 would be zero because adding to either the level of **guarantees** for **Conventional With-Profits** or the value of units for **Unitised With-Profits** would increase the risk that the **smoothed asset shares** would fall below the **guarantees** to an unacceptable level.

Despite falls in the first few months of 2009 the major investment markets have produced positive returns over the whole of 2009. As a result there has been an increase, across all terms, in the **asset shares** of With-Profits plans and therefore an overall reduction in the risk that the **smoothed asset shares** would fall below the **guarantees**. Despite these increases **asset shares** remain below the levels that they were prior to the onset of the 'credit crunch'.

The risk that the **smoothed asset shares** would fall below the **guarantees** varies quite significantly between different groups of With-Profits plans, particularly as it depends upon the type of investments allocated to the **asset shares**.

For all Tunbridge Wells Equitable Friendly Society Limited **Conventional With-Profits** plans, and Boots **Conventional With-Profits** plans that started on or after 1 November 1990, the risk that the **smoothed asset shares** would fall below the **guarantees** has reduced significantly and is now at a more acceptable level. Given this the Society's Committee of Management has decided to declare a small yearly **bonus** rate for these plans.

However for all **Unitised With-Profits** plans and Boots **Conventional With-Profits** plans that started before 1 November 1990 this risk, despite the positive investment returns in 2009, is still at an unacceptable level. The Society's Committee of Management has therefore decided that the 2009 yearly **bonus** rates for these plans should remain at zero.

Final Bonuses and MVRs in 2009

Final **bonuses** and MVRs ensure that the value of a plan's payout represent a fair value overall, reflecting investment performance during the whole policy term and after making allowance for costs incurred.

During 2009 final **bonus** rates and MVRs were regularly reviewed to ensure that the payouts for those plans maturing in 2009 continued to represent a fair value. These reviews led to the rates being revised in both January and July.

Final **bonus** rates and MVRs have also been revised in January 2010. These will continue to be kept under review and could be reduced or increased as appropriate in light of market movements.

Managing the Funds' assets

Both of the funds in which the Society writes With-Profits business invest in a range of assets, including company shares, government and corporate bonds, units in property funds, collective investment schemes and cash deposits.

For each fund the asset mix depends largely on the types of plans investing in it, for how long these plans have been running, and how long remains before they mature, which determines the nature of their **asset shares**, as explained in the previous section. It is also influenced by assets the fund holds over and above the total of all individual plans' **asset shares**.

As a general rule we review the investment strategy of each fund once a year, although we may do so more frequently if investment conditions are particularly volatile. In 2009, although the investment strategy was reviewed on a number of occasions, no changes were made.

At the end of 2009 the asset mix of each fund was as follows:

Asset Type	TWEFS Fund % holding	Boots Fund % holding
Shares	30.0	27.4
Property	5.4	4.7
Fixed Interest*	42.8	54.1
Targeted Return Funds	21.8	13.8
Total	100.0	100.0

* includes bonds, cash and money market instruments

As already noted the major investment markets produced positive returns in 2009, as highlighted in the following table:

Type of Investment	2009 Return
UK Equities	30.1
Emerging Markets	58.9
Property	2.2
UK Fixed Interest Gilts	-1.2
UK Index Linked Gilts	6.5

The Society was exposed to all of these movements and given the actual mix of assets held the investments underlying the Society's funds have increased significantly in value.

The actual returns earned on each asset type during 2009 for each fund, are set out below:

Asset Type	**TWEFS Fund** % yearly return	**Boots Fund** % yearly return
Shares	15.8	9.9
Property	-2.4	-5.6
Fixed Interest*	3.9	4.0
Targeted Return Funds	14.3	15.0
Total Fund Return	9.0	7.0

* includes bonds, cash and money market instruments

Two of the above tables include Targeted Return Funds as an asset type. These funds are collective investment schemes that seek to provide steady and positive returns in any 12 month period.

An important part of our approach to risk management is to put in place protection against severe market falls. This stood us in good stead in 2008 when the financial options we had in place limited the impact the Society experienced as a result of the falls that were experienced by the UK equity market. Conversely when markets are rising, as happened in 2009, these options lead to reduced performance.

Throughout 2009 the type of assets that each fund held, and the way the fund was managed (including the use of financial options to protect the funds), achieved a balance between the potential risks and rewards that the investments present. This is in line with the PPFMs.

The Child Trust Fund and other products launched by The Children's Mutual in 2005 are provided by a subsidiary company. However, the costs of developing and promoting these products have been met from the assets held over and above the total of all individual plans' **asset shares** and not from the assets underlying the **asset shares** of individual plans. The principles and practices followed in making such an investment are set out in the PPFMs and this particular investment fully conforms to both.

Charges for Operating Expenses

In 2009 the **asset shares** of individual plans in each fund were charged with a fair proportion of the operating expenses incurred both by that fund and by The Children's Mutual overall in managing its With-Profits business. This is in line with the PPFMs.

Each With-Profits plan provides certain **guarantees** which, except for **Unitised With-Profits** plans, increase as **bonuses** are added. In 2009 the costs of providing **guarantees** were met by the relevant funds and not charged to the **asset shares** of individual plans. This is in line with the PPFMs.

Report from the Committee of Management of Tunbridge Wells Equitable Friendly Society Limited

It is the opinion of the Committee of Management of Tunbridge Wells Equitable Friendly Society Limited that the Society has, throughout 2009, complied with its Principles and Practices of Financial Management in all material aspects, for the two funds in which With-Profits plans are written.

S. J. Allford

Simon Allford, Society Secretary — January 2010

Report from an Independent Non-Executive Director

Acting in my capacity as an Independent Non-Executive Director of Tunbridge Wells Equitable Friendly Society Limited, I have throughout 2009 reviewed the actions that the Society has taken in respect of the two funds in which it writes With-Profits business and I am satisfied that throughout 2009 the Society has complied with the Principles and Practices of Financial Management of both funds in all material aspects.

Cath Keers, Non-Executive Director — January 2010

Report from the With-Profits Actuary

As With-Profits Actuary for the two funds in which the Society writes With-Profits business my role is essentially to advise the Committee of Management as to how to use its discretion in managing these funds. On each occasion during 2009 that the Committee has used this discretion it has sought my advice before deciding how to act.

It is my opinion that the Society has, throughout 2009:

- Fully complied with the Principles and Practices of Financial Management of both funds.
- Taken the interests of each class of its With-Profits plan holders into account in a reasonable and proportionate manner in both the discretion it has exercised during the year and its annual report on compliance with the PPFMs.

I have based this opinion on the information and explanations I have obtained from The Children's Mutual and taking into account where relevant the rules and guidance set by the Society's regulator (The Financial Services Authority) on treating With-Profits policyholders fairly.

Alan Buckland, FIA, With-Profits Actuary — January 2010

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