

**TUNBRIDGE WELLS EQUITABLE
LIFE AND ENDOWMENT FUND**

PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT

Version Dated 31 December 2005

1. INTRODUCTION

The Tunbridge Wells Equitable Life and Endowment Fund (the Fund) is the main business fund of Tunbridge Wells Equitable Friendly Society Limited (the Society). The Society was founded in 1881 and is now incorporated under the Friendly Societies Act 1992. It is authorised and regulated by the Financial Services Authority (FSA). Since January 2003 the Society has traded under the brand name “The Children’s Mutual”.

The Society is a fully mutual organisation, without shareholders. The business effectively belongs wholly to its members, being mainly those persons in whose name plans have been issued in the Fund. Certain other types of plan, issued in other funds of the Society, also give rise to membership of the Society. However, membership deriving from such plans does not carry any rights to or interest in the Fund.

The type of business transacted in the Fund is life insurance. Historically, plans have been offered as either whole of life insurances (under which the proceeds are paid out only on death) or as endowment assurances (under which the proceeds are paid out on survival to a specified date, or on earlier death). Currently, only endowment assurances (referred to hereafter as savings plans) are offered. Historically, both lump sum investment and regular payment plans were offered; currently only regular payment plans are offered. This document applies to both. Historically, plans were offered on either a with-profits or non-profits basis; currently only with-profits plans are offered.

Income protection plans are also written in the Fund although, for the purposes of managing the Fund, these are treated as a separate sub-fund. These plans are not considered further in this document other than to note that, ultimately, the Fund will benefit from profits and suffer from losses on both the non-profit and income protection business after holders of these plans have received their benefits.

The vast majority of plans issued in the Fund are *conventional with-profits* contracts. However, a small proportion of historic business was issued on a *unitised with-profits* basis.

Under current tax regulations (contained within the Income and Corporation Taxes Act 1988) the Society is able to claim exemption from income tax and capital gains tax on some of the plans issued in the Fund, subject to such plans satisfying certain criteria. Currently, such criteria include the limitation of eligibility in respect of each participating member to a maximum contribution into the Fund (and any other tax-exempt friendly society life funds) of £25 a month, or £270 a year. Those plans in respect of which the Society is able to claim exemption are referred to hereafter as tax-free plans; those in respect of which exemption cannot be claimed are referred to as taxable plans. Currently both tax-free and taxable plans are offered.

This document sets out the Principles and Practices of Financial Management (PPFM) by which the Society operates the Fund. The PPFM covers all those issues that have a significant impact on the way we operate and manage the Fund, and also any other issues which we can reasonably foresee may have such an impact.

Appendix 1 contains a glossary of terms used in this document, which may require further explanation. Such terms are shown throughout the document in italics.

2. PRINCIPLES OF FINANCIAL MANAGEMENT

The Principles form the broad framework of rules underpinning the operation of the Fund, in a way which is appropriate to its stated aims and objectives. They provide an enduring, long-term structure to ensure both continuity and consistency over time, and also document how we intend to interpret Principle 6 of the FSA's Handbook for participating plans. (This Principle requires us to pay due regard to the interests of our customers to treat them fairly). They describe the business model used by the Society to enable it to meet its responsibilities to members holding with-profits plans. They also set out the way in which we will respond to longer-term changes in the business and economic environments in which the Society operates.

Although the Principles are intended to be stable and permanent as far as is reasonably practicable, they can be changed from time to time if necessary. In accordance with FSA regulations, we will give all members holding with-profits plans in the Fund written notice of any proposed changes to the Principles at least three months before these become effective. Where appropriate we will notify the FSA in advance of any change to the Principles.

The with-profit plans written in the Fund are *conventional with-profits* with the exception of a small number (less than 1%) of *unitised with-profits* plans. The principles refer to all plans unless a specific difference is noted for the *unitised with-profits* plans.

2.1 Aims and Objectives of the Fund

- We will provide and manage a Fund suitable for both medium- and long-term investment by individual customers who are seeking a return that reflects some exposure to real assets while providing a degree of security of capital.
- We will manage the Fund in such a way as to enable each invested with-profits plan to benefit from investment returns achieved from a mix of asset classes held during its *participation period*, while at the same time limiting exposure to the risk of investment in volatile asset classes.
- Our objective is to achieve as good an investment return as is practicable for each invested with-profits plan. To do this, we take into account the expenses incurred by the Society in managing the Fund, the element of guarantee integral to that plan and our aim to smooth the impact of performance factors (such as market movements, *mortality experience*, *solvency* and other regulatory requirements) over the *participation period* of the plan, and the underlying investment principles of the Fund.
- We will use appropriate actuarial principles and models, based on tools that recognise what is a fair return to each individual with-profits plan while also aiming to limit large differences in payout between similar plans, to smooth the investment returns earned by the Fund. In this way we will seek to maintain consistency of payouts between all plans invested at any time, and between different cohorts of plans having entered into the Fund at different times.
- At all times we will strive to ensure the *solvency* of the Fund while, where achievable, managing the Fund in line with the objectives above. Where this is not achievable, the *solvency* of the Fund will take precedence, and members holding with-profits plans in the Fund will be advised accordingly.

2.2 Investment Policy

- We will invest in such mix of asset classes as is necessary to facilitate the aims and objectives of the Fund.

- Asset classes eligible for investment will include, but not be restricted to, UK and overseas equities, UK and overseas government bonds, UK and overseas corporate bonds, UK and overseas pooled investment vehicles (e.g. unit trusts, OEICS, etc.), money market instruments, derivative instruments, property (including property trusts) and cash.
- We will aim to ensure that the mix of asset classes matches the reasonable expectations of our customers (as gleaned from promotional and other material provided by us and/or information provided by financial advisers or salespeople) in terms of exposure to different market risks and the *guarantees* integral to each with-profits plan.
- We will vary the mix of asset classes from time to time in response to changes in the economic environment, to meet the aims and objectives of the Fund and, in particular, to ensure the *solvency* of the Fund.
- Where, in the judgement of the *Board of Management* (supported, as appropriate, by relevant professional opinion) and based on reasonable assumptions as to future experience there would be no adverse effect upon the interests of the members then currently holding with-profits plans to do so, we may use some of the assets of the Fund to invest in acquiring or developing, setting up and operating any other business that the Society transacts, or intends to transact. In doing so, any profits and losses from such business may be attributed to members holding with-profits plans by an adjustment to their plan's *asset share*.

2.3 Asset Share Methodology

- For each with-profits plan investing in the Fund, we will calculate, in accordance with rules laid down by the FSA, a value known as an *asset share*. This *asset share* represents an accumulation based on achieved investment returns, net of tax as appropriate, of all payments made to date less all charges incurred. Charges include an appropriate allowance for expenses, *mortality costs* and *guarantees*.
- The investment return used in the calculation of *asset shares* reflects the actual returns earned by the various classes of assets held within the fund, and may include an allowance in respect of income derived from other types of business transacted in the Fund, or from dividend or other income remitted to the Fund by any subsidiary undertaking owned wholly or jointly by the Society.
- Over the full *participation period* of a with-profits plan (other than *unitised with profits* plans) we will switch the assets notionally allocated to its *asset share* from higher- to lower-risk asset classes on an ongoing basis. For *unitised with profit plans* the assets notionally allocated to its *asset share* will be consistent with the assets allocated to this business as a whole.
- *Asset shares* are used as a core part of the process to determine plan payouts. As part of this process, *smoothed asset shares* are calculated by averaging *asset shares* from one time period to another. This averaging enables us to meet the objective of smoothing payouts from one time period to another.
- The value of each individual with-profits plan at any time will normally be expected not to vary by more than the greater of 10% or one third of the difference in the underlying plan *asset shares* from the value we had attributed to a directly similar plan in the previous *distribution period*.

2.4 Expenses and Charges

- All expenses incurred by the Society will be met in full by the Fund other than those in respect of the other funds of the Society and any subsidiary undertaking owned wholly or jointly by the Society.
- These expenses are met by the Fund through charges made to *asset shares* and contributions from the *Estate*.
- *Asset shares* only get charged for expenses that are incurred in connection with with-profits business. The *Board* may, however, elect to charge exceptional development costs to *asset shares* subject to any profits from the development being added to *asset shares*.
- Expenses charged to aggregate *asset shares* are spread across individual *asset shares* in line with *Board* decisions.
- The costs of smoothing are charged to the fund. These are expected to be broadly neutral over the medium to longer term. The Society has not set a maximum limit for these costs but should it do so in the future such limit would be determined by the need to maintain the *solvency* of the Fund.
- The *Board* may use its discretion to amend the basis on which charges are applied or expenses are apportioned if in its view the current basis leads to a material inequity between different types and generations of planholders.

2.5 Payout Policy

- We will endeavour to pay out for with-profits plans, on death or on reaching the end of the *participation period*, an amount that is as close to 100% of the notional *smoothed asset share* value of such sample plans as is reasonably practicable. If the guaranteed benefit under a plan is higher than this amount, then we will pay such guaranteed benefit.
- We will endeavour to pay out, in respect of with-profits plans being cancelled prior to the end of the *participation period* (on being cashed-in or surrendered) an amount as close to 100% of the notional *asset share* value of such sample at the time of cancellation as possible, after making full allowance for all of the expenses which the Society (1) has already incurred in respect of such sample plans and may reasonably have expected to recover from payments to be made for them over the remaining part of the intended *participation period* after the date of cancellation, (2) incurs directly as a result of realising assets in order to make the payouts, and (3) equate to the direct costs of administering the cancellations and payouts.
- The approach used in assessing payouts is to calculate payouts based on a representative sample of plans and to use the calculated bonus rates to derive our payout policy for all individual plans.

2.6 Bonus Distribution Policy

- In endeavouring to achieve our objectives for with-profits plan payouts and provision of *guarantees*, we will aim to distribute profits to plans throughout their *participation period* by allocating *bonuses* to them.
- We will allocate to each with-profits plan invested in the Fund a “fair and equitable” share of any surplus generated by the Fund, after meeting all expenses of operating

and managing the Fund, and after allowing for the retention of an amount to allow for future contingencies. Any such amount held in reserve shall not be excessive in relation to the ongoing liabilities of the Fund, to *guarantees* given to customers, and to the underlying *solvency* and capital requirements of the Fund. The amount of surplus allocated to a plan is referred to as *bonus*. In determining what is “fair and equitable” in this context we will use *asset shares* for sample plans to aim for consistency of approach between plans of different size, duration in force and original *participation period*.

- We will calculate the proportion of the available surplus of the Fund attributable to each with-profits plan for the relevant *distribution period* by reference to (1) its participating value brought forward from the preceding *distribution period* (being the aggregate of (a) the guaranteed sum payable on death and (b) the total of all *bonuses* previously allocated to the plan for *conventional with-profits* plans and the value of the units allocated to the plan for *unitised with-profits* plans), and (2) the payments made into the Fund in respect of it during the relevant *distribution period*. Each *distribution period* shall be one calendar year. *Bonuses* allocated at the end of each *distribution period* are referred to as “yearly *bonuses*”.
- The *Board of Management* sets an interim rate for allocation of a yearly *bonus* to any with-profits plan which pays out on either reaching the end of its *participation period*, or on the death of the person whose life is insured by the plan, during the succeeding *distribution period*. However, the interim *bonus* rate is subject to ongoing review, and may be changed at any time without prior notice.
- We may make a further allocation of surplus to each plan at the time it pays out, either on reaching the end of its *participation period* or on the death of the person whose life is insured by the plan. This is referred to as the “final *bonus*”. Calculation of the final *bonus* is based on the relationship between the *smoothed asset share* of the plan and the actual value of the plan as represented by the aggregate of its guaranteed sum payable on death and all yearly *bonuses* previously allocated to it. The aim is for the final *bonus* to be set at a level that achieves the payout objective of paying approximately 100% of the *smoothed asset share* at the time of exit from the Fund or the guaranteed benefit if higher.
- We will maintain a “fair and equitable” (as defined above) balance between yearly (guaranteed) *bonuses* and final (non-guaranteed) *bonuses*.

2.7 Discretion

- The operation of the *Bonus* Distribution and Payout Policies rests upon the exercise of the discretionary powers of the Society’s *Board of Management* in determining the proportion of the Fund available at any time for allocation to invested with-profits plans.
- In exercising their discretion, the *Board* will always take full account of the professional opinion of the With-Profits Actuary as to such matters as the overarching *solvency* of the Fund, the need for prudent reserving against future contingencies, the cost of benefits already guaranteed to customers, the level of investment return earned by the Fund and the potential for future returns in the light of current market conditions.
- The *Board* will always exercise its discretion in such a way as it believes, after having taken appropriate advice, to be fair to customers as a whole, and in a way that is consistent with the *governing rules* of the Society and this document (as established by monitoring at appropriate intervals).

2.8 Guarantees

- We will apply to each with-profits plan (other than *unitised with-profits* plans) investing in the Fund, from its inception, a monetary amount which the Society *guarantees* to pay out in full either (a) in respect of a whole of life insurance, on the death of the person whose life is insured, or (b) in respect of a savings plan, on either the death of the person whose life is insured or on their survival to the end of the *participation period* of the plan, whichever shall occur first. Payment of this sum in full is dependent upon all payments for the plan due to that time having been made to the Society. In the event that any payments are due and unpaid at the time the plan pays out, an appropriate deduction will be made from the value of the plan and the net balance paid out.
- We guarantee that all yearly *bonuses* allocated to the plan up to the time it pays out either on reaching the end of its *participation period*, or on the death of the person whose life it insures, will be paid out in full, subject to all due payments having been made.
- For our *unitised with-profit* plans, there are a limited number of *guarantees* that payouts will be at least equal to contributions.
- The costs of *guarantees* will be met by the Fund.

2.9 Past Considerations

- In managing the Fund, we will seek to take into account the approach to management that we have taken in the past.
- In managing the Fund, we will take reasonable steps to take into account the statements we have made in past marketing literature, plan conditions and disclosure documents.
- We will also take into account any special arrangements that were entered into in respect of any earlier funds which have been transferred to, or amalgamated with, the Fund.
- We will endeavour to be as consistent as is reasonably practicable with all past Principles, in so far as to do so does not compromise either the *solvency* or capital requirements of the Fund, or the interests of current and/or future members holding with-profits plans.
- We will always manage and operate the Fund in such a way as is compatible with the reasonable expectations of our customers, while also ensuring the continued financial *solvency* of the Fund.

2.10 Future Considerations

- No future new plans, or new types of plan (whether with-profits or non with-profits), will be accepted by the Society into the Fund unless, in the reasonable opinion of the *Board*, the terms upon which such plans, or types of plan, are accepted are unlikely to have a materially adverse effect on the interests of members already holding with-profits plans in the Fund at that time.
- The Society will not actively seek to acquire a substantially increased volume of new business into the Fund at any time unless, in the reasonable opinion of the *Board*, the financial resources needed to support the acquisition of such volume of new business

are available and will not materially disadvantage members already holding with-profits plans in the Fund by reducing the amount of any surplus available for distribution.

- The Society continues to write new business in the fund. In doing so, the *Board* takes advice from the With Profits Actuary on the levels of new business and the associated expenditure that can be supported by the fund, without adversely impacting existing with profit planholders.
- At any time, the Society may:
 - (1) close the Fund to all new business.
 - (2) close the Fund to certain types of new business.
- At any time, subject to ratification by a majority of then current members eligible to vote and voting in accordance with its *governing rules*, the Society may take such other action with regard to the Fund as is deemed by the *Board*, having regard to appropriate actuarial, legal and other relevant professional opinion, to be to the ultimate advantage of the majority of then current members holding with-profits plans.
- In taking any such action, we will endeavour to ensure that the outcome in terms of ongoing governance and the impact on with-profits planholders remains as close as is reasonably practicable to that set out in these Principles.

3. PRACTICES OF FINANCIAL MANAGEMENT

The Practices describe the way in which we manage the Fund on a day-to-day basis, and how we will respond to shorter-term changes in the business and economic environment. They represent the practical implementation of the business model described by the Principles of Financial Management. From the information they contain, it should be possible for members and potential members to understand both the prospective rewards of, and the material risks presented by, effecting or maintaining a with-profits plan investing in the Fund.

As the Practices are concerned essentially with the ongoing and shorter-term operation of the Fund, it is to be expected that they will need to be changed more frequently than the Principles. In accordance with FSA regulations, we will give all members holding with-profits plans in the Fund written notice of any changes to the Practices, within a reasonable period after the changes have become effective. Where appropriate, we will also notify the FSA of any change to the Practices.

The procedures underlying these practices are documented internally both in the form of procedure manuals and as part of our financial modelling systems. Historical assumptions and their derivation are included as part of such documentation. This documentation is part of our systems and controls and is regularly reviewed as part of our ongoing risk management process

Any changes to these procedures, in so far as they do not affect the Principles & Practices, are implemented as part of the ongoing management of the Society and will be authorised by the appropriate line manager. Where a change impacts on a Principle or a Practice, this will require agreement by the Society's *Board*.

Historical assumptions will only be amended where it is discovered that there was a material error leading to inequity between classes or generations of planholders.

The with-profit plans written in the Fund are *conventional with-profits* with the exception of a small number (less than 1%) of *unitised with-profits* plans. The practices refer to all plans unless a specific difference is noted for the *unitised with-profits* plans.

3.1 Asset Share Methodology

- For each with-profits plan investing in the Fund, we will calculate as required a value known as an *asset share*. This *asset share* represents an accumulation based on achieved investment returns of all payments made less all charges incurred. Charges include an appropriate allowance for expenses, *mortality costs* and *guarantees*. Details of the methodology for calculating *asset shares*, including current and historical assumptions and approximations used, are documented within the Society's internal systems and central procedural records.
- The expenses and mortality costs used in this calculation are based on yearly analyses of the Society's past experience for plans of the same or directly similar type.
- The rate of return is based on analyses of actual investment returns and, where appropriate, tax rates. In assessing the investment return achieved on a plan, we make an assumption about the assets underlying the *asset share*. In the earlier years of a *conventional with-profits* plan's *participation period* the nature of the assets notionally allocated to its *asset share* will be deemed to be weighted towards higher-risk assets (e.g. equities). In the later years of the plan's *participation period* the nature of the notional assets will be weighted towards lower-risk assets (e.g. bonds, gilts and cash). These respective weightings are set to provide the potential for as good an investment return as is realistically practicable, taking into account the nature of the *guarantees* integral to each plan. For a *unitised with profits* plan the assets notionally allocated to its *asset share* will be consistent with the assets allocated to this business as a whole.
- For *conventional with-profits* plans we currently assume that the actual assets underpinning each plan at its inception are fully (100%) invested in equities. We further assume that these assets are gradually switched from equities to fixed interest holdings over the full *participation period* of the plan, such that only 20% of the actual assets notionally allocated to that plan at the end of its *participation period* are invested in equities. However, the *Board* may use its discretion to amend this asset allocation to reflect significant changes in economic or market conditions if it deems this to be necessary to safeguard the interests of the Fund and the Society, including the overall solvency and capital requirements of the Fund and the Society
- By adding these individual plan *asset shares* together for all with-profits plans split into the equity and fixed interest elements, we obtain an overall split of those assets of the Fund representing planholder *asset shares*. An annual review is carried out to ensure the overall fund split reflects planholder *asset shares*. The remaining assets are then invested as appropriate given the overall *solvency* and capital requirements of the Fund and the Society. In any event, an amount equal to the *required minimum solvency margin* would be invested in relatively secure investments such as UK government bonds.
- Tax liability on the Fund is allowed for in *asset shares* by adjusting investment returns to reflect prevailing tax rates for income and capital gains and by adjusting expenses to reflect tax relief at the then prevailing rates. Any difference between tax charges levied on *asset shares* and tax paid by the Fund is met by/falls to the *Estate*.
- We smooth the value of the plan *asset shares* by (1) calculating, for each cohort of with-profits plans bearing the same *participation period* that entered the Fund within the same accounting period, the value of such *asset shares* for each of the three most recent consecutive years, and (2) calculating the average of the three values so calculated.

3.2 Investment Policy and Fund Management

- The *Board of Management* has overall responsibility for the investment policy of the Fund. This responsibility is delegated to a sub-committee of the *Board* (the Investment Committee).
- The Society employs professional asset managers to manage the investment of the Fund on its behalf. The Investment Committee monitors the asset managers' performance on a regular and continuous basis. The asset managers' fees for the services provided by them are a legitimate expense borne by the Fund.
- The asset managers are required to manage the Fund's investments in accordance with the principle aims and objectives set by the Society. Subject to such parameters, in particular the Society's desired asset allocation, and to the extent permitted by the Society, the asset managers have the power to exercise their discretion in buying, holding and selling specific equities, stocks, bonds, gilts or other tradeable financial instruments from time to time, in the light of the prevailing economic environment.
- The investment managers are given specific benchmarks against which asset classes are managed and set risks constraints to restrict movement from these benchmarks. These constraints are set with regard to the degree of risk the *Board* believe is desirable and in the light of performance objectives given to the fund managers.
- The actual investments held by the Fund will reflect, and be appropriate to, the underlying *asset shares* of invested with-profits plans. However, the *Board* may use its discretion to amend the asset allocation to reflect significant changes in economic or market conditions if it deems this to be necessary to safeguard the interests of the Fund and the Society, including the overall solvency and capital requirements of the Fund and the Society.
- Any assets in excess of the amount required to cover plan *asset shares* will be invested in such a way as to maximise the possible potential investment return from those funds while taking account of the anticipated costs of *guarantees* (and smoothing policy), the overall *solvency* of the Fund, and the investment principles.
- The Fund will not invest in corporate bonds that are rated less than Class BBB by a majority of the leading independent risk ratings agencies.
- The Society may allow the asset managers of the Fund to make use of derivatives as part of an investment strategy to aid efficient portfolio management and to reduce the risk exposure of the fund to significant movements in markets. The asset management agreement sets out controls on the use of derivatives and a range of appropriate counterparties is used to limit counterparty exposure.
- An annual formal review of investment strategy and asset allocation is carried out which reviews asset mix and duration in light of the Funds liabilities, taking account of policyholders reasonable expectations with regard to *asset shares* and also *guarantees* provided by plans written in the Fund.
- Any proposal for the fund to invest in a new or novel investment instrument would require to be approved by the *Board* following a written submission as to how such an investment would assist meeting the Fund's investment objectives.
- The Fund has a limited number of assets that would not normally be traded the most significant being an investment in the Society's Head Office and some subsidiary companies. Any investment in such assets requires to be authorised in consideration of the potential risk and return to the Fund. Such assets are included in the determination of the overall return on the fund and no constraints are placed on the Fund's or the Society's freedom as a result of the Fund's investment in them.

3.3 Expenses and Charges

- We will analyse the expenses incurred by the Society in operating and managing the Fund on an ongoing basis.
- This analysis will lead to a breakdown of the following expenses which are charged to the Fund in line with the Principles:
 - (1) acquisition costs – the costs to the Society of acquiring new plans to invest in the fund, including the costs of advertising and of producing and issuing product disclosure material and personalised projections; the costs of paying initial commission or similar procuration fees paid to distributors;
 - (2) plan set-up costs – the costs of inputting plan data to the Society's and/or its *appointed administrator's* computer system, of producing and issuing plan documents, of *underwriting* plans (where necessary) and of processing cancellations;
 - (3) maintenance costs – the costs of maintaining the plan data on the Society's and/or its *appointed administrator's* system and of keeping such data current; the costs of collecting regular payments due from customers including the pursuit of payments not made; the costs of producing and issuing regular statements showing the current value of plans; the costs of dealing with customers' enquiries and complaints; the costs of paying renewal commission to distributors (where appropriate);
 - (4) termination costs – the costs of paying out amounts due when plans reach the end of their *participation period*, or the life insured dies, or the plan is cancelled;
 - (5) investment management costs – the costs of acquiring, managing and disposing of the assets of the Fund;
 - (6) general overhead costs – such proportion of the general overhead costs of the Society (including any wholly or jointly owned subsidiary undertakings) as, in the reasonable opinion of the *Board*, is attributable specifically to the operation and management of the Fund.
- To the extent that any expense is common to all plans invested in the Fund, we will charge an equal proportion of such expense to each *asset share*.
- To the extent that any expense is common only to those plans forming part of a cohort which entered into the Fund during a specific period of time, we will charge an equal proportion of such expense to each *asset share* allocated to those plans.
- To the extent that any expense is peculiar to a particular plan, we will charge an equal proportion of such expense to each *asset share* allocated to that plan only.
- For items of exceptional expenditure, including payment of any fines and/or compensation directed by regulatory bodies, the *Board* may use its discretion to charge the costs to the *Estate*.
- Expenses, including charges paid to any provider of services, including an *appointed administrator* and fund managers will be charged to the Fund at cost.
- Outsourced services are reviewed on an on-going basis and formally at least once every three years. A key aspect of all arrangements entered into by the Society on behalf of the

Fund is the requirement to exit any arrangement due to non-performance on a satisfactory timescale and financial basis.

3.4 Bonus Distribution Policy

- We endeavour to operate and manage the Fund, and invest in asset classes, in a way designed to ensure that, over time, the total assets of the Fund are more than sufficient to meet the contractual obligations of the invested plans, including *guarantees*. In other words, surplus is generated.
- As the Society has no shareholders, and is not in business to make a profit for its own account, all profits earned by the Fund are used ultimately for the benefit of customers investing in the Fund.
- As the Fund relates to long-term business, it is not appropriate to allocate surplus arising in full at any given time to the invested with-profits plans in force at that time. Part of the surplus is retained in reserve for use by the Society in maintaining the existence and *solvency* of the Fund over the long term, and to facilitate smoothing of returns allocated to the *asset shares* underpinning and payouts made in respect of the invested with-profits plans.
- Each with-profits plan invested in the Fund participates in the distribution of surplus. For *conventional with-profits* plans, the extent of participation is determined initially by the amount of the minimum sum which we guarantee to pay out on the death of the person whose life is insured by the plan. For *unitised with-profits* plans, the extent of participation is determined by the contribution(s) made by the customer.
- The accounting period of the Fund is one calendar year. We value the liabilities and assets of the Fund at the end of each accounting period, and calculate the amount of any surplus at that time.

3.4.1 Policy in respect of *conventional with-profits* plans

- After taking into account the value of future liabilities (including under any non with-profits plans invested in the Fund), *guarantees* already attaching to invested with-profits plans, *solvency* requirements and prudent reserves against potential future contingencies, we calculate what proportion of the surplus can be reasonably distributed among invested plans of this type. We call this the distributable surplus.
- The distributable surplus is divided among invested with-profits plans in the form of *bonuses*. Because this is done on a yearly basis, these *bonuses* are referred to as “yearly *bonuses*”. *Bonuses* are allocated to each invested plan in direct proportion to (a) its minimum sum guaranteed payable on the death of the person whose life it insures, and (b) all yearly *bonuses* previously allocated to it. The rates at which we allocate *bonuses* depend upon the level of distributable surplus available, and may differ (a) from accounting period to accounting period, (b) between different cohorts of plans having entered the Fund in different years, and (c) between those allocated to minimum guaranteed sums payable on death and those allocated to previously allocated yearly *bonuses*.
- In considering the level of yearly *bonuses*, we give consideration to the consequent build up of *guarantees* and how this compares with projected *asset shares*. In line with our Principles, we aim to balance the distribution of surplus between yearly and final *bonuses*. As a result, we aim to ensure that, where possible, guaranteed benefits do not grow to an extent where members could receive an unfair or inequitable return when compared to their plan’s *asset share*.

- Once we have allocated a yearly *bonus* to an invested plan, we guarantee to pay out the full value of that *bonus* (1) on the death of the person whose life is insured by the plan, or (2) at the end of the plan's *participation period*, subject, in both cases, to all payments due to the Society in respect of the plan up to and including the date on which the event triggering the payout occurs having been made.
- When the accumulated value of an invested plan becomes payable on either (1) the death of the person whose life is insured by it, or (2) its having reached the end of its *participation period*, we may adjust the payout value by allocating to it a further *bonus*, referred to as the "final *bonus*". The final *bonus* represents the invested plan's share of such surplus as has been earned by the Fund during the plan's *participation period* but which has not been allocated to the plan as part of the yearly *bonuses* subject to the impact of any plan *guarantees*. We calculate such final *bonus* by reference to the *smoothed asset share* notionally underpinning the plan, and taking into account any difference between (1) the actual value of such *smoothed asset share* at the date the event triggering the payout occurs and (2) the aggregate value of the minimum guaranteed sum and all yearly *bonuses* previously allocated to the plan.
- Although we endeavour to allocate to the plan as much of that difference as is reasonably practicable, the actual proportion that we are able to allocate is not guaranteed, and may be more or less than 100%. The primary reason for this is that we aim to restrict the movement in maturity payouts from one year to the next for equivalent plans. The level of such restriction is determined by the *Board* on the advice of the Actuary but would normally be expected to be such that a payout level would not move by more than the greater of 10% and one third of the difference in the underlying plan *asset shares* for the representative sample of policies considered. These limits may be amended by the *Board* at any time but particularly in relation to significant shifts in economic conditions.
- If an invested with-profits plan is cashed-in before it has reached the end of its *participation period*, all *guarantees* which have previously been applied to it are no longer valid. We calculate the amount which we will pay out upon cancellation by reference to the value of the *asset share* notionally underpinning the plan at the cancellation date. We endeavour to perform this calculation so as to pay out as close to the actual value of the *asset share* as is reasonably practicable, after making a deduction to reflect, in the reasonable opinion of the *Board*, any costs incurred in (1) setting up and administering the plan prior to its cancellation, which we could have expected to recover if the plan had remained invested until the end of its *participation period*, (2) realising assets in order to make the payout, and (3) administering the cancellation and payout.

3.4.2 Policy in respect of *unitised with-profits* plans

- Before each accounting period starts, we calculate a rate of distributable surplus which we expect to apply to invested plans of this type for the ensuing accounting period. Our calculation will take into account all the same factors as are relevant to the calculation of distributable surplus for other types of with-profits plans invested in the Fund, but in addition we make reasonable assumptions as to the rate of investment return we expect the Fund to achieve during the ensuing account period, and as to the level of expenses to be borne by the Fund in respect of *unitised with-profits* plans during the same period. We refer to the result of these calculations as "yearly *bonus*".
- We declare this yearly *bonus* rate in advance, and then apply it to the invested unitised plans on a daily basis throughout the ensuing accounting period. We

allocate an equal proportion of the yearly rate on each day of the period. We apply the rate to each unit allocated to each plan.

- When the accumulated value of an invested unitised plan becomes payable we may adjust the payout value so as to ensure it reflects the actual value of the *smoothed asset share* underpinning the plan at that time. This adjustment is referred to as the “Market Value Adjustment” (MVA). We do not apply the MVA to any payout arising from (1) the death of the person whose life is insured by the plan, or (2) a regular income withdrawal facility for which the plan-holder opted at the time the plan was taken out.
- We may not apply the MVA in full to any plan which is cancelled on the tenth anniversary of the date on which it commenced and for which no part of the plan has previously been cancelled (other than in respect of any prior automatic transfers to a life insurance ISA plan arranged when the plan was set up). In these circumstances the amount paid out is subject to a minimum of the initial contribution (subject to adjustment in respect of any prior automatic transfers to a life insurance ISA plan arranged when the plan was set up).
- We will only apply an MVA to reflect changes in investment conditions or in response to an exceptional proportion of *unitised with-profits* plans exiting the Fund on cancellation.
- If the *smoothed asset share* of a plan significantly exceeded the value of units encashed, then if the whole plan is being encashed we may add a final *bonus* to a plan, but this is at the discretion of the *Board of Management* of the Society, and is not guaranteed.

3.5 Payout Policy

- Our policy is to pay out, either on the death of the person whose life is insured by a with-profits plan, or on its reaching the end of its *participation period*, an amount as close as is reasonably practicable to the actual value of the *smoothed asset share* underpinning that plan.
- Whilst we cannot guarantee to pay 100% of *smoothed asset share* for the primary reason that we aim to restrict the movement in payouts from one year to the next we would normally expect that for at least 90% of our policies the payout will fall within the range from 70% to 130% of *asset share*. In a number of circumstances, for example where the Society’s solvency position is at risk or would be at risk it may not be possible to make payouts which fall within this range.
- On early termination of a plan our policy is to pay an amount as close as is reasonably practicable to the actual value of the *asset share* underpinning that plan after making a deduction to reflect, in the reasonable opinion of the *Board*, any costs incurred in (1) setting up and administering the plan prior to its cancellation, which we could have expected to recover if the plan had remained invested until the end of its *participation period*, (2) realising assets in order to make the payout, and (3) administering the cancellation and payout.
- Whilst we cannot guarantee to pay 100% of *asset share* after making any relevant deduction we would normally expect that for at least 90% of our policies the payout will fall within the range from 65% to 135% of *asset share*. In a number of circumstances, for example where the Society’s solvency position is at risk or would be at risk it may not be possible to make payouts which fall within this range.

- The approach taken to meeting our payout policy is to calculate payout values for a representative sample of plans. From these payouts, bonus factors are derived and applied across plans of similar type and duration, ensuring that payouts on similar policies are consistent.
- When the aggregate value of the *smoothed asset share* underpinning a with-profits plan is greater than the value of the existing guaranteed benefits, we will endeavour to make good as much of the shortfall as we reasonably can. We will do this by allocating a final *bonus* to the plan, as described above under “*Bonus distribution policy*”.
- Where the payout diverges from the *smoothed asset share* the cost of any such adjustment is borne by (if positive) or credited to (if negative) the *Estate*.
- Where the *smoothed asset share* diverges from the *asset share* the cost of smoothing is borne by (if positive) or credited to (if negative) the *Estate*. These are expected to be broadly neutral over the medium to longer term. The Society has not set a maximum limit for these costs but should it do so in the future such limit would be determined by the need to maintain the *solvency* of the Fund.

3.6 Discretion

Under the *governing rules* of the Society, the *Board of Management* is required to exercise discretion in a number of areas governing the operation of the Fund. In particular it exercises discretion in relation to:

- the allocation of *bonuses* to plans, taking advice from the With-Profits Actuary with regard to the levels and split of *bonuses* and their impact on the Fund;
- the allocation of expenses to plan *asset shares* and to the *Estate*.
- the nature of the underlying investments of the Fund.

In all circumstances, the *Board* will exercise discretion in such a way as is fair to customers as a whole and is in accordance with both the *governing rules* of the Society and the Principles above.

3.7 Guarantees

- As part of our *asset share* methodology, at present we make no charge for the cost of guaranteed payouts when plans reach the end of their *participation period*. These costs are at present met by the *Estate*. However, the *Board* may decide to apply such a charge to existing and/or future with-profits plans at any time, subject to the principle of treating customers fairly and advising members affected.
- The *mortality costs* are charged to asset shares and are based on yearly analysis of the Society’s *mortality experience*.

3.8 Risks

- As a mutual organisation, ultimately with-profits planholders and the fund have exposure to key risks that could impact the Society.
- No specific limits have been set with regard to business risk. In assessing any potential business activity and the potential scale of the risk the benchmarks used are the statutory and realistic balance sheets.

- No minimum value has been set on the level of profit or losses from business risks that would be applied to *asset shares* and consequently impact payouts. Any such decision to include such profit or losses would be at the discretion of the *Board* and the impact would be smoothed in a manner consistent with the approach taken to smoothing *asset shares*.
- We address risks through our Risk Management system where risks are identified and controls put in place to mitigate their likelihood and impact. In practice, this means that we will consider each of the identified risk types as follows:
 - (1) Operational risk – by producing and maintaining written procedures for all operational processes undertaken routinely or irregularly by the Society, or by an *appointed administrator* on its behalf, and the ongoing review of both the procedures and the adherence to them, by a dedicated audit function and by the Society's senior management.
 - (2) Business risk – by undertaking a full risk assessment and cost benefit analysis of any proposed business activity prior to making a commercial decision whether or not to pursue such activity. Also by ongoing review of the internal and external risks associated with the Society's current business activities and the residual tail of any historic business activity no longer undertaken. Where appropriate, external third parties will be engaged to perform such assessments and/or analyses on the Society's behalf.
 - (3) Subsidiary risk – by maintaining close and continuous control of the activities of all subsidiary undertakings. In so far as is practicable, for the day-to-day management of any subsidiary to be carried out by the appropriate level of management within the Society itself. By ongoing review of the activities and supporting procedures of each subsidiary by the Society's dedicated audit function and senior management.
 - (4) Insolvency risk – by the provision of regular financial reporting to the *Board* including preparation of a Financial Condition Report and a detailed Annual Valuation Report. On-going *solvency* monitoring is the responsibility of the Appointed Actuary who reports to the *Board* as appropriate.
 - (5) Mortality risk – through comprehensive *underwriting* where appropriate and by effecting appropriate levels of reinsurance cover with specialist reinsurance carriers.
 - (6) Counterparty risk – the Society has a number of counterparty arrangements to which the Fund is exposed. The most significant of these are the reinsurance parties used to share mortality and morbidity risks. In ensuring the Fund is not unduly exposed to counterparty risk, reinsurance is only transacted with reinsurance carriers of appropriate financial strength.
 - (7) Legal risk – where the Society is proposing to enter into any contracts of material significance, external professional legal advice is sought on the contract and any resulting exposure.
 - (8) Litigation risk – by always maintaining awareness of the needs and requirements of customers and trading partners and acting entirely in accord with the terms and conditions of any agreement or contract between the Society (or a subsidiary) and the customer or other third party. By obtaining professional legal advice in connection with any matter pertaining to the law which falls outwith the knowledge or experience of the Society, its senior management, *appointed administrators* and employees.
 - (9) Regulatory compliance risk – by ensuring that the Society, its subsidiaries and *appointed administrators* operate entirely in accordance with all regulations applicable to the business transacted by the Society and its subsidiaries. By staffing and

maintaining a dedicated function to undertake compliance activities, monitoring and audits.

- (10) Mis-selling/mis-buying compensation risk – by always treating customers and potential future customers fairly and openly. By ensuring that all customer literature is written in a clear, fair and not misleading manner and is, so far as is practicable, expressed in plain language. By ensuring that employees are fully trained in the products and services offered by the Society and its subsidiaries, and the procedures it adopts in order to administer those products and services. By the Society not by itself, nor through any of its employees, giving advice to customers or potential customers as to the suitability for them of any product or service offered. To the extent that, historically, the Society has employed a sales team to give advice to customers, the risk that members of such team might have given misleading advice is monitored by the Society's dedicated compliance team. Whenever customers submit complaints of a mis-selling or other nature, these are fully investigated by the compliance team in accordance with procedures laid down by the FSA. If complaints cannot be resolved to customers' satisfaction, they are able to refer such complaints to the Financial Ombudsman Service, whose findings are binding upon the Society.
- (11) Money laundering risk – by adhering to established checking procedures as laid down by the relevant authorities and ensuring that *appointed administrators* and employees are suitably trained about money laundering issues.
- (12) Taxation risk – through the employment of specialist external tax advisers.

3.9 Future Considerations

- As part of the ongoing review of the financial condition of the Fund, the Society and any subsidiary undertakings, projections are prepared as to the impact on the Fund and the Society of different levels and/or types of new business. These projections are then used to input to and compare with the business plans of the Society and, where relevant, any subsidiary undertakings.
- From such comparisons, the *Board* gain assurance that both the Fund and the Society can support the planned mix and level of new business and/or types or, if this is not the case, information upon which to amend the business plans accordingly.
- No minimum or maximum limits have been set on new with-profits business. The key factors in setting any limits on new business will be the ability to write the business profitably and, based on reasonable assumptions as to the future, without adversely affecting the potential for achieving returns compatible with the reasonable expectations of holders of existing with-profits plans.
- If the decision were made to close the Fund to new business, then consideration would be given to the most effective way to administer and manage the closed Fund. Included within this consideration would be an assessment of future investment strategy to reflect the ultimately shrinking Fund, the associated distribution of surplus in *bonuses* and the general administration of the with-profits plans.

Glossary of Terms

<i>Appointed administrator</i>	A group, company or individual appointed under a contract to carry out some or all factors related to the operation of a plan or a group of plans.
<i>Asset share(s)</i>	The payments made by the planholder, less deductions for expenses, tax and other charges, plus allocations of business profits, accumulated at the rate of investment return achieved.
<i>Board/Board of Management</i>	The governing body of the Society, elected by members, subject to vetting as to their suitability to hold office by the FSA. Ultimately responsible in law for all actions taken by the Society.
<i>Bonus/bonuses</i>	That part of any distributable surplus generated by the Society's operation and management of the Fund which is allocated to participating with-profits plans. <i>Bonuses</i> are of two types: <ul style="list-style-type: none"> (1) <i>yearly bonuses</i> – allocated yearly, following the end of each <i>distribution period</i>. Once allocated, <i>yearly bonuses</i> are guaranteed. (2) <i>final bonus</i> – a one-off <i>bonus</i>, allocated to a plan upon its exit from the Fund upon the death of the person whose life is insured, or upon reaching the end of the plan's <i>participation period</i>. The allocation of a <i>final bonus</i> is not guaranteed.
<i>Conventional with-profits</i>	The form of with-profits plans where premium rate tables are used to determine the guaranteed sum payable on the death of the plan-holder, based on gender, payment amount and <i>participation period</i> .
<i>Distribution period</i>	One calendar year
<i>Estate</i>	Those assets representing the difference between the overall value of the Fund and the aggregate <i>asset shares</i> of the with-profits plans invested in the Fund.
<i>Governing rules</i>	The Rules of Tunbridge Wells Equitable Friendly Society Limited, as registered from time to time under the Friendly Societies Act, 1992.
<i>Guarantees</i>	Legally binding commitments by the Society to pay out specified monetary amounts in certain specific circumstances.
<i>Mortality costs</i>	The costs of the mortality guarantee provided by a plan.

<i>Mortality guarantee</i>	The guarantee that the life insurance cover (comprising both the minimum sum guaranteed by the plan and all yearly <i>bonuses</i> attaching to it at the date of death) will be paid in full on the death of the person whose life is insured, regardless of when this might occur within the <i>participation period</i> of the plan.
<i>Mortality experience</i>	Our actual experience of the proportion of insured lives of the same age at plan outset who die within a given period of time.
<i>Participation period</i>	The full period for which the customer contracts to save upon effecting a plan.
<i>Required minimum solvency margin</i>	The minimum margin laid down in the relevant regulations that the Society is required to demonstrate it has sufficient assets to meet.
<i>Smoothed asset share(s)</i>	The value of <i>asset shares</i> averaged over a period of time in such a way as to smooth the effect of those factors that are used to calculate the asset share, the most significant being the investment returns.
<i>Solvency</i>	The ability of the Society to demonstrate that it has sufficient assets to meet its liabilities and any other margins or capital required to be held by regulators.
<i>Underwriting</i>	The assessment of the extent to which the overall exposure to mortality risk presented by the person whose life is to be insured by a plan deviates from the underlying assumptions made when the cost of the <i>mortality guarantee</i> was calculated.
<i>Unitised with-profits</i>	The form of with-profits plans where the amount invested by the planholder secures a number of notional 'units' in the Fund, each unit representing a share of the overall value of the Fund. The value of each plan at any time is determined by multiplying the number of notional units allocated to it by the then prevailing price of one unit in the Fund. The unit price moves daily in relation to <i>bonuses</i> added to these plans.