Annual Report to With-Profits Policyholders for 2017

1 Summary

The Society has reviewed the management of its with-profits funds. The Society believes that it has complied with its obligations relating to its Principles and Practices of Financial Management.

The following sections provide the background and reasons for the Society having reached this opinion.

2 Introduction

The Principles and Practices of Financial Management (the PPFM) sets out the way that the Foresters Friendly Society (the Society) manages its with-profits business.

The Financial Conduct Authority rules require insurers to provide an annual report to with-profits policyholders on whether the Society believes it has complied with its obligations in relation to its Principles and Practices of Financial Management. In addition the report should describe how the Society has exercised discretion and the way that the Society has addressed matters such as the respective interests of its policyholders.

The Society maintains a number of with-profits funds (which may also include non-profit policies), namely "the Order Insurance Fund", "the Pure Endowment Fund", "the Tunstall Fund", the "Leek Fund" and the "POIS Fund". The Tunstall Fund, the Leek Fund and the POIS Fund were set up as a result of transfers of engagements to the Society on 31st December 2003, the 31st December 2005 and the 26th September 2014 of the Tunstall Assurance Friendly Society Limited, the Leek Assurance Collecting Society and the Post Office Insurance Society business from Family Assurance respectively. Each with-profits fund is ring-fenced with each fund having its own separate portfolio of assets.

3 Governance Arrangements

The Board has responsibility for compliance with the Society's PPFM. The Society has set up a With-Profits Advisory Arrangement for each fund, which is made up of non-executive directors. Details of the members are shown in the Society's Annual Report and Accounts. The role of the With-Profits Advisory Arrangements is to exercise independent judgement in assessing compliance with the Society's Principles and Practices of Financial Management and in addressing conflicting rights and interests of policyholders within the with-profits funds. The Board and the With-Profits Advisory Arrangements are advised by the With-Profits Actuary.

The With-Profits Actuary provides advice to the Board on the exercise of discretion with regard to with-profits contracts, including on key aspects of the application of the Society's PPFM. The With-Profits Actuary's report to policyholders in respect of 2017 is contained in the Appendix to this report.

4 Compliance with the obligations of the PPFM including the exercise of discretion

4.1 Investment Policy:

Investment performance is considered quarterly by the Board's Investment Committee. The Society monitors the actual assets held against the target ranges in the PPFM on a monthly basis. During 2017 asset classes were generally within the target ranges for the with-profits funds except for the Pure Endowment Fund where the maturities were paid out from the cash holdings without the need to disinvest any short dated fixed interest holdings in order to maximise the fund's investment return.

4.2 Bonus Rates:

This is the main area of discretion in managing the Society's with-profits business. Section 2 of the POIS PPFM and sections B4, B5, C5 and C6 of the PPFM for the remaining funds describe how the Society exercises its discretion in setting bonus rates.

In February 2017, annual bonus rates were reviewed and the rates declared were changed for ISAs, Bonds, 50+ and GSP products. All other products remained unchanged from the previous year.

Revised final bonus rates for the Order Insurance Fund were adopted with effect from 1 July 2017, whereas those for the Pure Endowment Fund, the POIS Fund and the Tunstall Fund were adopted with effect from 14 August 2017. In deciding on the revised bonus rates the Board considered the advice of both the With-Profits Advisory Arrangements and the With-Profits Actuary.

The Society believes that the bonus rates were consistent with the PPFM.

A review of the Leek Fund was carried out which concluded that the fund continues to be unable to afford to pay bonuses.

4.3 Payouts:

Maturity values are the amounts payable upon reaching the end of the term of the policy.

Surrender values, where applicable, are the amounts payable upon cancellation of a policy before it would otherwise be payable upon death or maturity. The calculation of surrender values was reviewed and updated as part of the review of final bonus rates.

For some products the Society has the right to apply a Market Value Reduction to reduce the amount paid on surrender to an amount that fairly reflects a policy's value. During 2017 there was no need for the Society to impose Market Value Reductions.

A review of the POIS fund payout ratios during 2017 indicated that less than 90% of the payouts were within the PPFM target range. The Society investigated the reasons for this outcome.

For maturities, 75% of payouts were within the target range of 85%-115% of asset share. The outliers are primarily paying greater than 115% rather than less than 85% and are in respect of small policies. This result arises from a historic approach to asset shares which was changed in 2016 to address this issue which will gradually improve over time.

For surrenders, 58% were within the target range of 75%-125% of asset share. The outliers with a lower than 75% payout were mainly whole of life policies. This result arises from the application of the smoothing rules where terminal bonuses are limited to an increase of 10% year on year. The outliers with a higher than 125% payout are mainly small policies. This result arises from differences in the asset shares used for terminal bonus and payout ratio purposes and so is regarded as an anomaly.

Despite not meeting all of the target range requirements, the Society is satisfied it has complied with the requirements of the PPFM due to the reasons given.

The Board have approved a change to the POIS target range for maturities and surrenders to 70%-130%. Payouts will not be affected and this is a more appropriate range for new payout methodology which was introduced post the transfer of the business to Foresters

4.4 Management of the Inherited Estate:

The Inherited Estate is defined in the Glossary of the POIS PPFM and Paragraph B10.1 of the PPFM for the remaining funds as:-

"The excess of assets maintained within a with-profits fund over and above the amount required to meet liabilities (including liabilities which arise from the regulatory duty to treat customers fairly in setting discretionary benefits)"

For the Pure Endowment Fund, special bonuses were declared at incorporation to reflect the differing financial positions and past practices of the Districts, so as to ensure equitable treatment for the former members of each district.

For the Pure Endowment, Tunstall, Leek and POIS Funds, the method of determining policy payouts aims to ensure that any surplus is extinguished as the portfolio of business declines. The inherited estate for these funds can therefore be considered to be negligible.

For the Order Insurance Fund, being the with-profits fund open to new business, the inherited estate continues to provide working capital to support new business risks within the fund. Miscellaneous profits and losses are absorbed by the inherited estate, to be allocated to with-profits policies in the future, depending on the size of the estate and risk profile of the fund.

4.5 Charges:

During 2017 the Board has continued to limit the effective charge to with-profits policies in the Order Insurance Fund and the Pure Endowment Fund to less than the actual expenses incurred, with the difference borne by the Group Capital Fund. For the Tunstall Fund, the Leek Fund and the POIS Fund the charges for expenses have been in accordance with the transfer agreements, updated in accordance with those agreements, and in addition, the Society has agreed a subsidy to further limit the expenses charged to the Leek Fund.

4.6 New Business:

The Pure Endowment Fund, the Tunstall Fund, the Leek Fund and the POIS Fund are all closed to new business. The Order Insurance Fund is the only with-profits fund that is open to new business. The profitability of the new business being written is considered on a regular basis. As part of the annual planning process, the Board remain satisfied that it is in the interests of the with-profits policyholders for the Society to remain open to new business.

The Board has recognised that in the post-Brexit investment conditions product profitability has reduced and has committed to:

- re-pricing the existing product range in 2018 with a view to improving product profitability;
- undertake a review of the profitability of new business was written from July 2016 to ensure compliance with the Financial Conduct Authority's Conduct of Business Sourcebook.

4.7 Managing competing or conflicting rights of policyholders:

The Society is a mutual organisation and therefore avoids any competing or conflicting rights between policyholders and shareholders. However, different groups of policyholders have potentially competing interests due to:

- Different types of products
- Policies of different sizes or policy terms
- Policies with different start and end dates
- Different with-profits funds

An important consideration in ensuring that the interests of different groups are balanced is the way that policies are grouped together. Policies are grouped together into distinct classes within each fund, taking the following criteria into account;

- Taxable or tax-exempt
- Endowment, whole life or pensions
- Regular or single premium
- Conventional or accumulating with-profits

Different bonus rates are declared for distinct classes of with-profits business.

When setting bonus rates the Society aims to limit the size of the change in payouts on policies of a similar type to no more than 10% from year to year.

The approach taken during 2017 was consistent with the PPFM.

4.8 Changes to the PPFM

The PPFMs were reviewed in 2017 and minor updates were made and publicised on the Society's website.

The Society's PPFMs provide definitions of the terms used within this paper. The PPFMs are available on our website. If you would like a copy of the PPFM, please contact our Member Services team on 0800 988 2418 during our normal office hours.

Appendix: Report of the With-Profits Actuary to With-Profits policyholders of The Ancient Order of Foresters Friendly Society Limited

1. I have been appointed by The Ancient Order of Foresters Friendly Society Limited ("the Society") to act as With-Profits Actuary. I am a Fellow of the Institute and Faculty of Actuaries and a Partner of Barnett Waddingham Limited. I am not a policyholder of the Society.

2. The Society must produce an annual report to its with-profits policyholders that states whether it believes it has complied with its obligations relating to Principles and Practices of Financial Management and setting out its reasons for that belief. As the Society's With-Profits Actuary I am required by Financial Conduct Authority ("FCA") rules to report to with-profits policyholders on whether the Society has exercised discretion in a reasonable and proportionate manner. The purpose of this report is to report to with-profits policyholders on the exercise of discretion in 2017.

3. I have been provided with a copy of the Society's report to with-profits policyholders for 2017. I have also requested from the Society such information and explanations as I consider reasonably necessary to enable me to perform my duties as the With-Profits Actuary. As is standard practice across the industry, new business written in the Order Insurance Fund needs to comply with the FCA's Conduct of Business Sourcebook 20. A review was undertaken in 2017 to ensure that the terms under which the new business was written in 2017 met this requirement. The terms for new business were revised following this review and the Society has committed to reviewing whether compensation is payable to the individual funds for the sale of any loss making products. An estimate of this compensation has been provided for within the financial statements.

4. In providing this report, I have based my opinion on this information and have relied on the accuracy and completeness of the Society's report and of the information and explanations provided to me by or on behalf of the Society. I have also taken into account, where relevant, the rules and guidance issued by the FCA and the Prudential Regulation Authority ("PRA").

5. I was appointed on 1 November 2017 and have therefore also relied upon the previous With-Profits Actuary work prior to my appointment.

6. There was a breach of the target investment ranges for the PEF which was due to a deliberate decision by the Society in order to maximise investment income. I am satisfied with the explanation provided to me and consider it fair to PEF with-profit policyholders.

7. There was a breach of the target payout ranges for the Post Office Insurance Society (POIS) Fund in respect of maturities and surrenders. Details are provided in the Society's report referred to in point 2 above.

8. In summary, based on the information that has been made available to me, I am overall satisfied that the discretion exercised by the Society in 2017 may be regarded as having taken the interests of the Society's with-profits policyholders into account in a reasonable and proportionate manner.

9. This report is provided for the purposes set out above, and should not be used as the basis to make any decisions regarding contracts with the Society, whether to enter into them, to continue them or terminate them, for which decisions fuller information and qualified financial advice should be sought.

Kim Durniat FIA
With-Profits Actuary

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