

**Healthy Investment  
Principles and Practices of Financial Management of the  
Coventry Assurance Ring Fenced Fund**

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## 1. Background

Healthy Investment is the trading name of The Rechabite Friendly Society Limited which is an incorporated friendly society.

Coventry Assurance Society was an unincorporated friendly society. In October 2011, all of the policies, assets and liabilities of the Coventry Assurance Society were transferred to a special fund within Healthy Investment known as the “Coventry Fund”.

The members in the Coventry Fund were previously members of Coventry Assurance Society. They now are full members of Healthy Investment (the Society) and will benefit fully from membership of the Society. The Coventry Fund is designed to ensure that the members within the Fund have their policy benefits set by the experience of the Fund. This will be referred to as a “ring fenced fund”.

The Coventry Fund will operate as follows:

- All premiums for the transferred business will be credited to the Fund;
- All claims payable on the transferred business (including contingent claims for, say, compliance failures) will be debited from the Fund;
- An expense charge will be levied against the Fund by the remainder of Healthy Investment;
- The Fund will have its own investments separate from the investments in the main Healthy Investment funds;
- Investment return will be credited to the Fund according to the performance of this separate pool of assets;
- The liabilities of the policies within the Fund will be assessed separately from the remainder of Healthy Investment’s policies and bonuses will be declared depending upon the financial strength shown by the assets and liabilities of the ring fenced fund. This will be determined by the Board of Healthy Investment but subject to challenge by the With Profits Committee with both being advised by the With Profits Actuary.

The Fund will cease to be operated as a separate fund (collapse) on the later of:

- Less than £1.5 million of policy liabilities as determined for reporting to the regulator within the Fund;
- 5 years after the date of transfer.

On the collapse of the Fund, the policies and assets will be transferred into the main Healthy Investment fund and will be subject to the main Principles and Practices of Financial Management for Healthy Investment. They may continue to receive differing bonuses to those of other Healthy Investment policies due to their differing ability to generate future bonuses as advised to the Board by the With Profit Actuary at the time of the collapse.

## **2. Introduction**

This document outlines the principles and practices that Healthy Investment follow in the management of the With profit policies in the Coventry Assurance Fund (the Coventry Fund). The items under each heading are divided into two groups:

1. Principles. These are overarching statements of what the Society would like to achieve over the long term. They are not likely to change in the short term.
2. Practices. These are the current techniques and methods used by the Society to achieve the principles. They will change over time as new techniques replace older ones and the financial background to the Society changes.

The Principles and Practices are controlled by the Board of the Society after taking advice from the With Profits Actuary. Practices can and will be changed by Board resolution with all members affected by the change being notified as soon reasonable possible. Principles can be changed by Board resolution but all members affected by the change will be given 3 months notice of the proposed changes.

The first section (headed 1. Background) does not form part of the Principles and Practices of Financial Management but outlines some of the background to the need for a document for this Fund.

This document will be available to all members who request it and will be placed on the website of the Society. There may be different versions of this document and it will be clearly stated when the new document is in force. This is:

Version 1.1 of the Principles and Practices of Financial Management  
effective from 28 October 2011

### **3. Determining the amounts payable for With profits policies**

#### **3.1 Principles**

The Society aims to treat its customers fairly, having regard to statements made in marketing literature and communications to policyholders.

The aim of the bonus policy is to provide members with a fair return for their contributions to the Society and previous contributions to Coventry Assurance Society. The Society does not have any shareholders and therefore all surplus within the Coventry Fund belong to the members within the Coventry Fund. The surplus therefore includes surplus from non profit policies within the Coventry Fund.

The amount of surplus arising that is distributed each year will be constrained by the need to ensure the sound financial management of the Society and the Coventry Fund.

Bonus is distributed by means of annual additions to the guaranteed benefits (a reversionary bonus) and by an additional sum added to the guaranteed benefits when a claim arises (a terminal bonus).

Terminal bonuses are determined so that the total payout on a policy becoming a claim represents a fair reflection of the return on the premiums invested with the Coventry Fund. The Society will smooth changes in the terminal rates to avoid large fluctuations in the payouts due to sudden changes in market or demographic experience, this is known as smoothing.

The Society aims to ensure that the smoothing is neutral over the long term. This aim is measured by monitoring the estate (see section 6).

Any changes in bonus policy will be implemented gradually unless this would conflict with the sound financial management of the Coventry Fund.

Surrender values are set to ensure that exiting members do not disadvantage members who remain within the Coventry Fund. The Society will aim to smooth the payouts on surrender but may change the basis to reflect the changes in the market values of the assets within the Fund.

#### **3.2 Practices**

The Society uses an asset share approach that involves a mixture of asset shares and the bonus reserve method to determine the reversionary and terminal bonuses payable to the With profits policyholders.

Asset shares are calculated as an accumulation of the contributions paid less the expense deductions less the charges for risk benefits, and where appropriate tax, plus the investment returns credited to the insurance.

The bonus reserve valuation method calculates the present value of all future benefits plus future expenses less future premiums, based on the assumptions of the likely experience. The assumptions include future investment returns, expenses and mortality rates.

Asset shares provide a good basis for achieving a fair distribution of surplus between the varied types of policies. Asset shares, calculated for each policy, are best suited to policies with a pre-determined maturity date. For whole life assurances and policies with longer durations, an individual policy asset share is not appropriate.

The asset share approach therefore combines the results for the asset shares and the bonus reserve method to determine the appropriate amounts payable.

The assumptions and methods used for determining the bonuses are reviewed annually by the Board and the With Profits Actuary. Any changes will be investigated by the With Profits Actuary who will report on the implications of the proposed changes. The Board will then decide on whether it should make the proposed changes.

## **4. Investment Strategy of the Coventry Fund**

### **4.1 Principles**

The investment strategy of the Society is to maximise the overall return on the investments of the Coventry Fund subject to ensuring that the guaranteed benefits are met. These returns will be used for the benefit of the members in the Coventry Fund. Returns include both increases in capital value as well as income.

Investment may be in any category of asset class including bonds, equities, properties and deposits. The Fund may also invest in derivatives of these asset categories.

The Society has an ethical investment strategy which precludes knowingly investing directly in firms that are involved in the following trades: alcoholic beverages, arms and tobacco.

### **4.2 Practices**

The Coventry Fund will be invested separately from the other assets of the Society. Returns will reflect the actual investment returns achieved in the period.

The investment policy for the Society is controlled by the Board of the Society. The Board will appoint investment managers to make detailed decisions on purchases and sales.

The Board will lay down parameters that specify the proportion of total assets within each category on a neutral, maxima and minima position. The parameters will also specify a duration split for bond assets, again with a neutral, minimum and maximum holding in each duration. The Board will also lay down parameters for the maximum that can be with any counterparty both by investment asset class and by duration for bonds.

The investment managers will be tasked with maximising the performance of the fund of assets subject to the parameters laid down. They will bear in mind the neutral asset allocations.

The neutral asset allocations are designed to:

- Ensure that bond assets match the guaranteed liabilities of the Society. These guaranteed liabilities equate to the value of guaranteed sums assured and bonuses to date less the value of future contributions;
- Match the bond assets to the duration of these guaranteed liabilities.

The minima and maxima are set at the level of risk that the Society can afford to run of mismatch against liabilities without placing the solvency of the Society at risk.

Counterparty risk levels are set to avoid over concentration of assets by counterparty and possible risks to solvency from a counterparty defaulting on an obligation.

The Actuarial Function Holder will provide advice to the Board at least annually on the parameters. The Board will seek input from the investment managers on the practicality of the parameters.

The Board will review the performance of the investment managers at least quarterly and a major review of the investment policy will be carried out annually. The choice of investment managers and the basic strategy will be reviewed by the Board at least triennially.

Deposits will be placed by the treasury function of the Society to achieve the best rate of return whilst ensuring liquidity is present when required.

## **5. Allocation of charges, expenses and investment return**

### **5.1 Principles**

The Coventry Fund will be charged an expense charge by the rest of the Society.

The Coventry Fund will bear its own costs for risk benefits provided to members and any profit or loss made on these risk benefits will accrue to the members in the Coventry Fund.

Investment returns will be credited to the Coventry Fund based on the actual return achieved by the assets within the Fund. These investment returns will be shared amongst members allowing for the nature of the underlying guarantees on their insurances and the duration of that guarantee.

### **5.2 Practices**

Expenses will be charged to the Coventry Fund from the rest of the Society in line with the following amounts:

- 0.7% of the value of assets within the Coventry Fund;
- 7.5% of the premiums received for Unibond policies;
- 12.5% of the premiums received for all other policies;
- £25 per policy claiming death benefits under Table A insurances.

The Society calculates individual policy asset shares which will be charged expenses in line with these amounts from the date of the creation of the Coventry Fund.

The risk charge in the individual asset shares will reflect the Board's estimates of the likely risk costs based on advice from the With Profits Actuary. This advice will attempt to arrive at a best estimate and will be based on the mortality and morbidity investigation. Profits and losses made against these estimates of risk costs will be shared amongst asset shares on this basis.

Investment returns of the Coventry Fund will be split into two categories: (1) those on assets matching the guaranteed benefits; and (2) those on other assets chosen to maximise the return to members.

An assessment of the level of matching of all of the guaranteed liabilities in the Coventry Fund by assets designed to meet the guaranteed liabilities will be undertaken as part of the process. Thus, whatever percentage of the guaranteed liabilities are covered by assets designed to match the guaranteed liabilities, that same percentage of the guaranteed liabilities in the individual policy asset share will attract the return from the guaranteed benefit assets, and the remainder of the individual policy asset share will attract the returns on the assets chosen to maximise the returns for members.

For the bonus reserve valuation, the assumptions for future investment returns, expenses and mortality, used in calculating the valuation will be the Society's best estimate of future experience.

These assumptions are reviewed annually by the Board and the With Profits Actuary. Any changes will be investigated by the With Profits Actuary who will report on the implications of the proposed changes. The Board will then decide on whether it should make the proposed changes.

## **6. The use made of “smoothing”**

With profits insurances are not designed to pay the exact amount accumulated within the Coventry Fund allowing for the exact investment return on those assets. There are two levels of smoothing applied:

1. Implicit smoothing. The Society has uniform bonus rates between different contribution levels and between different plan types within the same bonus series. Maturity and death benefits will, therefore, not take account of the differences between these two elements other than in the calculation of the original sum assured.
2. Explicit smoothing. This will apply over different time periods whereby the Society will try to avoid payouts moving by a large amount from time to time.

Explicit smoothing is achieved by managing the estate of the Coventry Fund

Whilst smoothing helps protect members from short term fluctuations in the stock market, it will not protect against long term and sustained falls in the value of stocks and shares.

### **6.1 Principles**

Payouts on surrender will be smoothed to a differing extent from those on maturity or death. The Society allows for the fact that maturity or death payouts are payments occurring to a member who has no choice of the timing of the payout. Surrender payouts are made at the direct control of the member and the member can choose to act against the interests of other members in the timing of the payout.

Maturity and death payouts will be smoothed from one period to the next by avoiding major changes in terminal or reversionary bonuses and using the estate to finance this element of smoothing. The Society intends this smoothing to be neutral in cost to the estate in the long term. Any smoothing will also be subject to the need to meet the solvency requirements of the regulator (the Financial Services Authority or its successors).

Surrender payouts will normally be smoothed in the short term but the Board will maintain its discretion to change surrender payouts immediately on any change in the market.

### **6.2 Practices**

Maturity and death benefits are fixed by bonus declarations and these will be decided by the Board at least annually following the valuation of the Coventry Fund’s assets and liabilities. The methods employed are outlined in section 8 below.

The amount of smoothing in relation to the asset shares and the bonus reserve value of the liabilities will be recorded at each valuation and will be discussed by the Board. The Board will report on this in their report to members each year.

Surrender payouts are outlined in section 8 below and are set using asset share calculations allowing for table expenses and risk charges agreed by the Board and annual investment returns. The asset shares may be adjusted to reflect the incidence of expenses and risk costs.

## **7. Business Risk and New Business Decisions**

### **7.1 Principles**

As the Society is owned by its members, all of the costs and benefits from management taking business decisions will ultimately be shared amongst the members.

The Coventry Fund will not sell any new policies. The policies within the Coventry Fund will, therefore, not share in any profits made by new policies nor in the capital requirements of new policies.

### **7.2 Practices**

Initially, any costs or benefits from the business risks will come from or be added back to the estate of the Coventry Fund. The amount of estate is targeted (as stated below) and so ultimately these costs or benefits are smoothed into the asset shares above. These adjustments will be adjustments to the investment returns mentioned in 4.2 above.

If a business risk causes a major cost to the Coventry Fund (over 5% of total assets), the impact of this loss may be applied immediately to asset shares rather than being smoothed through the estate. Equally, a positive contribution of the same amount may be applied immediately to asset shares.

## **8. Payouts, bonuses and surrender values**

The payout on maturity or death of most of the With profit policies provided by the Coventry Fund depends on the reversionary bonuses declared to date and the terminal bonus in force at the date of the claim. Surrender values will be calculated based on asset share.

### **8.1 Principles**

Members will be paid guaranteed benefits on maturity or death by the Coventry Fund plus discretionary benefits set by the Board. The most important principle is that discretionary benefits will only be paid if there are adequate free assets in the Coventry Fund after payment, in the view of the Board, to afford the discretionary benefits.

Subject to the principle above, payouts on maturity and death will also attempt to reflect fairly the contribution the member has made to the Coventry Fund. Surrender payouts will not be penalised by the Society but will reflect fully the charges within the tables plus any other expenses deemed necessary and adjusted to reflect the incidence of expenses.

Bonus declarations will be uniform for each bonus series except for terminal bonuses which will vary by duration.

### **8.2 Practices**

The Board will set payouts on maturity in relation to the asset shares and the bonus reserve value of the liabilities.

The Board has set the range for the payouts to be within 70% to 130% of asset share. The range is reviewed annually after advice from the With Profits Actuary.

The method used to smooth the payouts is to set the bonuses such that the discounted present value on best estimate assumptions of future experience of all benefits including future bonuses less premiums plus expense allowances provides a reasonable match against the historic asset shares. Reversionary bonuses will be based on investment returns that are sustainable and some part of the additional investment return achieved in the period. Terminal bonus rates will be set to bring the total payout into balance. The value of the estate will also be considered (see below).

Surrender values will be calculated on a target range based around the individual policy asset share. The asset share will be adjusted to allow more closely for the incidence of initial sales costs and for the costs of carrying out the surrender. The target range is set by the Board and is reviewed at least annually, after advice from the With Profits Actuary.

## **9. The estate of the Coventry Fund**

The estate of the Society provides working capital to allow the Society to (amongst other things) meet any shocks that may occur, smooth experience into the asset shares and payouts and provide capital to allow the writing of new business.

The Coventry Fund will maintain its own estate to (amongst other things) meet any shocks that may occur and smooth experience into the asset shares and payouts.

The estate is the realistic value of assets less the realistic value of liabilities.

The realistic value of liabilities is set as the prospective values of future benefits (including future reversionary and terminal bonuses) for conventional assurances plus any realistic value of any other liabilities.

### **9.1 Principles**

The estate will be targeted at levels that the Board (after advice from the With Profits Actuary) believe is reasonable given the nature of the liabilities and assets held by the Coventry Fund.

The aim will be to allow for a reasonable level to cope with smoothing the returns to members without unduly building up excess levels of estate that is not needed. The estate will be run off during the duration of the insurances within the Coventry Fund.

### **9.2 Practices**

The With Profits Actuary will give their advice as part of the valuation report to the Board. The Board will consider:

- the likely financial impact of known events in the future;
- the likely financial impact of volatility of experience in the future;
- the level of capital required by regulators;
- the level of smoothing of bonus rates that the Board wishes to achieve.

Currently, the Board believe that the estate should be in the range of between nil and 20% of the total assets of the Coventry Fund.

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