



**Healthy Investment – Principles and Practices of  
Financial Management**

## **1. Introduction.**

This document outlines the principles and practices that Healthy Investment follow in the management of its with profit insurances. 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 and this document will be updated. Principles can be changed by Board resolution but all members affected by the change will be sent written notification of the change.

This document will be available to all members who request it and will be placed on the web site 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 3.0 of the Principles and Practices of Financial Management  
which is effective 20/06/2008

There are two previous versions of the document. Version 1 which was effective 01/12/2006 until 28/02/2008 and Version 2 which was effective 01/03/2008 until 19/06/2008.

This document is divided into various sections:

- 1 This introduction;
- 2 Investment strategy of the Society;
- 3 Allocation of charges, expenses and investment returns;
- 4 The use of "smoothing";
- 5 Business risk and new business decisions;
- 6 Payouts, bonuses and surrender values;
- 7 The "estate" of the Society.

## **2. *Investment Strategy of the Society.***

### **2.1 Principles**

The investment strategy of the Society is to maximise the overall return of the investments of the Society subject to ensuring that the guaranteed benefits are met. These returns will be used for the benefit of the members of the Society. 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 Society may also invest in derivatives of these asset categories.

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

The Society may invest in the office space that it occupies as well as properties held as assets. This will only take place if the saving in rental income and the prospect of future capital growth make investment sense.

### **2.2 Practices**

The investment policy will be controlled by the Board of the Society. The Board will appoint an Investment Manager to make detailed decisions on purchases and sales.

The Board will lay down an investment matrix that outlines the proportion of total assets within each category on a neutral, maxima and minima position. The investment matrix will also give a term duration split for bond assets again with a neutral, minima and maxima holding in each duration. The Board will also lay down parameters for the maximum that can be held with Ony counter party both by investment asset class and by duration for bonds.

The Investment Manager will be tasked with maximising the performance of the fund of assets subject to the minima and maxima laid down. He 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 fund which equates 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 net 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.

Counter party risk levels will be set to avoid over concentration of assets by counter party and possible risks to solvency from a counter party defaulting on an obligation.

The Actuarial Function Holder will provide advice to the Board at least annually on the asset allocation matrix. The Board will seek input from the Investment Manager on the practicality of the matrix.

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

The Society will maintain two bankers for immediate liquidity to avoid any late payment problems caused by a banker becoming insolvent. 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.

The Society owns the office space that it currently occupies. The rental outgoing saved and the prospect of future capital growth is reviewed by the Board at least annually on the basis of valuations carried out by a qualified property surveyor at least triennially.

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

#### **3.1 Principles**

Ultimately, all of the expenses and risk charges suffered by the Society have to be paid for by the members of the Society as there are no shareholders. Equally, all of the investment returns are owned by the members of the Society.

However, if the Society has funds available, it will measure payouts on maturity and surrender against expenses that reflect the charges outlined in its tables and policy documents. The remaining expenses (or any surplus) will be charged (or credited) to the “estate” (see below for a definition of estate) of the Society.

Investment returns will be considered to be shared amongst members allowing for the nature of the underlying guarantees on their insurances and the duration of that guarantee.

Risk benefits will be met in accordance with the Board’s estimates of the likely cost suffered.

### **3.2 Practices**

The Society will calculate individual policy “asset shares”. Asset shares are calculated as an accumulation of the contributions paid less the expense deductions less the charges for risk benefits plus the investment returns credited to the insurance.

The asset share will be charged expenses in line with the published table expense deductions.

The risk charge 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.

Investment returns 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. The first group will be applied to the portion of the asset share representing the present discounted value of the guaranteed benefits less the present discounted value of future contributions subject to no more than the asset share. The second return will be applied to the excess assets in the asset share. This means that the investment return credited to an insurance with low guarantees will reflect the second group of assets more than the first whereas an insurance with high guaranteed benefits (and low remaining discretionary benefits) will have returns more in line with the matching assets. The matching assets will be bonds of the appropriate term.

### **4. *The use made of “smoothing”.***

With profits insurances are not designed to pay the exact amount accumulated within the funds of the Society 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.

Whilst smoothing helps to 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

## **4.1 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 payments or death payments are payments occurring to a member who has made payments for the full term of the insurance and that the member 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.

## **4.2 Practices**

Maturity and death benefits are fixed by bonus declarations and these will be decided by the Board annually following the valuation of the Society's assets and liabilities. The methods employed are outlined in section 6 below.

Surrender payouts are outlined in section 6 below and are fixed by asset share calculations allowing for table expenses and risk charges set by the Board and annual investment returns.

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

### **5.1 Principles**

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

New insurances tend to require extra capital to cover technical reserves and solvency margins required by the regulator (the Financial Services Authority or its successors). This capital is provided by existing members of the Society who require a return on their investment.

### **5.2 Practices**

Initially, any costs or benefits from these two sources will come from or be added back to the estate of the Society. 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 2.2 above.

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

The Society has to make decisions on whether to remain open to new business and what types of insurances the Society should make available. The Board will make this decision each year from advice provided by the Actuarial Function Holder and the With Profits Actuary. New business will only be accepted if it is deemed to give a positive contribution to the value of the existing members insurances over the term of the insurances written allowing for the business plan of the Society on growth in new business.

Any decision to close the Society to new business will require the formulation of a business plan allowing for no new business and showing the run off of the estate to the asset shares of the insurances in force. The Board will also consider winding up the Society and sharing the funds amongst the members. Any decision to wind up will need to allow for providing risk insurances for those members who still require the risk insurance from another provider.

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

The payout on maturity or death of most of the with profit insurances provided by the Society depends on the reversionary bonuses declared to date and the terminal bonus in force at the date of the claim. Surrender benefits depend on the method used to calculate surrender benefits.

### **6.1 Principles**

Members will be paid guaranteed benefits on maturity or death by the Society plus discretionary benefits set by the Board. The most important principle is that discretionary benefits will only be paid if there is adequate free assets after payment of expenses 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 funds in existence. 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.

## **6.2 Practices**

The Board will set a range around 100% for payouts on maturity as compared with the asset shares of the underlying insurances. This range will be reviewed annually after advice from the With Profits Actuary.

Bonuses will be set so that a discounted present value on best estimate assumptions of future experience of all benefits, including future bonuses, less premiums, plus expense allowances, provide 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).

The payout on maturity and death must be afforded out of the surplus emerging in the published returns to the regulator. Smoothing may be applied from year to year and this will be reflected in the position of the current payout compared with the target range.

Surrenders will be based on the individual policy asset share times a target range. 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 will be set by the Board subject to annual review and after advice from the With Profits Actuary.

A Market Value Reduction (MVR) may be applied to a withdrawal or surrender of a with profit bond or ISA. This is a reduction in the value of the investment to bring the overall payout closer to the 'asset share' when the underlying value of the assets in our fund is lower.

All our with profit bonds and ISA's have an MVR free period where you can withdraw your investment without an MVR being applied, even if the stock market has fallen in value and we are applying MVRs on withdrawals. This is on the 10<sup>th</sup> anniversary of the investment and every 5<sup>th</sup> anniversary thereafter.

## **7. *The estate of the Society.***

The Society needs an amount of working capital over and above the value of likely payouts to allow the Society to: meet any shocks that may occur; smooth experience into the asset shares and payouts; provide working capital to allow the writing of new business. This working capital is referred to as the estate and has two definitions of quantum:

1. the difference between total assets and the total of all of the individual asset shares;

2. the difference between the discounted present value of future payouts including expenses less contributions collected on a best estimate set of assumptions and the total assets of the Society.

## **7.1 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 Society.

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.

## **7.2 Practices**

The With Profits Actuary will give his advice as part of the valuation report to the Board. This advice will include the two calculations for the estate outlined above. 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 business plans of the Society;
- 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 10% to 20% of total assets of the Society excluding any assets for unit linked insurances.

Any movement to return the estate to the target level will be carried out over a 5 to 10 year period and will be based on the business plans of the Society.

### ***ETHICAL SAVINGS AND INVESTMENTS***

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