Healthy Investment
Principles and Practices of Financial Management

Index

1. Introduction

This document outlines the principles and practices that Healthy Investment (the trading name of the Rechabite Friendly Society Limited, which is referred to in this document as "the Society") follow in the management of its With-profits policies. 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 be changed by Board resolution with all members affected by the change being notified as soon reasonably 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.

This document is available to all members. Copies can be obtained from the Society's office or from the website.

This is version 1.8 of the Principles and Practices of Financial Management which became effective from 16 December 2021.

Previous versions have been in force as follows:
version 1.1 was effective from 01/12/2006 until 28/02/2008,
version 1.2 was effective from 01/03/2008 until 19/06/2008,
version 1.3 was effective from 19/06/2008 until 16/09/2010,
version 1.4 was effective from 17/09/2010 until 20/12/2011,
version 1.5 was effective from 20/12/2011 until 22/06/2017,
version 1.6 was effective from 22/06/2017 until 16/03/2021,
version 1.7 was effective from 16/03/2021 until 16/12/2021,

On 28 October 2011 the Society took over the Coventry Assurance Society. The policies, assets and liabilities of the Coventry Assurance Society were transferred to a separate fund within Healthy Investment known as the "Coventry Fund". This is operated as a separate fund to ensure that the members within the Fund have their policy benefits set by the experience of the Coventry Fund. A separate Principles and Practices of Financial Management has been produced for this fund, and is available to all members on request, and has also been placed on our website.

2 Determining the amounts payable for With-profits policies

2.1 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. The Society does not have any shareholders and therefore all surplus belongs to the members of the Society. The surplus therefore includes surplus from non- profit policies and from the estate.

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.

Bonus is distributed by means of annual additions to the guaranteed benefits, a reversionary bonus and by a terminal bonus added to the guaranteed benefits when a claim arises or a withdrawal is made.

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 Society. The Society smooths terminal bonus rates to avoid large fluctuations in the payouts due to sudden changes in market or demographic experience.

The Society aims to ensure that the smoothing of payouts is neutral over the long term. This aim is measured by monitoring the estate (see section 8).

Any changes in bonus policy are implemented gradually unless this would conflict with the sound financial management of the Society.

Surrender values are set to ensure that exiting members do not disadvantage members who remain within the Society. 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. Any changes in the basis will relate to the interim reversionary bonus and the terminal bonus for conventional products. For the With-profits Bonds and ISAs the changes will relate to the interim reversionary bonus, the terminal bonus and possibly a Market Value Reduction.

2.2 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. Asset shares also include an allowance for profits and losses arising on business written by the Society that is not "With-profits" and for miscellaneous sources of surplus from With-profits business.

Management of the estate is covered in section 8. At present the estate does not contribute additional returns that can be added to asset shares.

The detailed methodology used to calculate asset shares is documented and is reviewed by the Board annually. The Board checks that the methodology is consistent with this PPFM.

The bonus reserve valuation method is the present value of all future benefits less future expenses 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. The disadvantages of the asset shares are the volume of historical data needed and the assumptions required in determining the allocation of past experience. For whole life regular premium assurances and policies with longer durations, an individual policy asset share is not appropriate, so the bonus reserve method is used instead. Policies where asset shares are not used comprise less than 1% of the in force With-profits business.

In determining the bonus rates the With-profits policies are split into two groups, conventional products and the accumulating With-profits products, which consist of the With-profits Bonds and ISAs. The bonus rates for each group apply universally to all policies within these groups that are deemed to have the same bonus earning potential.

For the With-profits Bonds and ISAs the asset shares are also examined by the year of entry. For conventional products, the asset shares are examined by duration of the policy in force and by full duration of the policy at maturity date.

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

3 Investment strategy of the Society

3.1 Principles

The investment strategy of the Society is to maximise the overall return on 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 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 investing directly in firms in arms, alcohol and tobacco industries.

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.

3.2 Practices

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

In addition to the fundamental principle of avoiding investing directly in alcohol, arms and tobacco industries the Society seeks to invest ethically, responsibly and sustainably.

The Board limits the proportion of total assets within each asset class based on optimising the return within the level of risk they are prepared to accept. The parameters also specify a modified duration and a range above or below the modified duration of the fund's liabilities within which the investment manager must manage the government and corporate bond holdings. Apart from direct holdings of UK government bonds, the Society's assets are held in collective investment funds. The Board relies on the providers counterparty limits within each fund.

The investment managers are tasked with maximising the performance of the fund of assets subject to the parameters laid down within the Society's agreement with them.

The investment managers consider the solvency position of the Society in determining the optimum mix of assets and duration of fixed interest investments which are approved by the Board.

The Chief Actuary reviews the proposed investment strategy, asset allocation and duration limits at least annually and advises the Board on the suitability for achieving its investment objectives and the compatibility with its appetite for risk.

The Board reviews the performance of the investment managers at least quarterly and a major review of the investment policy is carried out annually. The choice of Investment Manager and the basic strategy is reviewed by the Board triennially or sooner if thought necessary.

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

The investment managers may hold cash deposits as part of their investment strategy. Cash balances are also held by the Society for liquidity purposes and may when appropriate be invested in short term deposits.

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

4 Allocation of charges, expenses and investment return

4.1 Principles

Ultimately, all 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 the investment returns are owned by the members of the Society.

The Society will endeavour to measure payouts on maturity and surrender against expenses that reflect amounts incurred in the management of the policies.

Investment returns are shared amongst members allowing for the nature and duration of the underlying guarantees on their policies.

Risk benefits are met in accordance with the Board's best estimate of likely experience over the year. The additional risk costs (or surpluses) are charged (or credited) to the estate.

4.2 Practices

The Society calculates individual policy asset shares.

Since 2010, the Society has analysed its expenses annually between the major product types and between acquisition, maintenance, and investment costs. Appropriate expenses are charged directly to asset shares.

Prior to 2010, asset shares were charged with expense charges set out in the tables and policy documents. The remaining expenses (or any surplus) were charged (or credited) to the estate of the Society.

The risk charge reflects the Board's estimates of the likely risk costs based on advice from the With Profits Actuary. This advice is designed to arrive at a best estimate based on the Society's mortality and morbidity investigations.

Investment returns are split into two categories: (1) those arising from assets matching the guaranteed benefits, which are normally fixed interest investments of an appropriate duration with guaranteed returns; and (2) those on other assets chosen to maximise the return to members, which are normally property and equity assets.

No adjustments for taxation are made in calculating asset shares for ISAs and Tax-Exempt Savings Plans which are exempt from income and capital gains tax. For taxable policies the investment return credited is reduced by the rate of tax applicable each year, and expenses charged are relieved at the same rate. Should the Society move into a position where it is expected that expenses exceed investment income over the long term, this practice will be reviewed.

Bonus reserve valuation:
The assumptions for future investment returns, expenses and mortality, used in calculating the bonus reserve valuation are the Society's best estimate of future experience.

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

5 The use made of smoothing

With-profits policies are not designed to pay the exact amount accumulated within the funds of the Society allowing for the exact investment return on those assets, even if this could be calculated for an individual policy. 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 do not take account of the differences between these two elements other than in the calculation of the original sum assured.

2. Explicit smoothing. This is applied over different time periods, usually a year, the aim being to avoid payouts on similar policies moving by a large amount from time to time.

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.

5.1 Principles

Maturity and death payouts are smoothed from one period to the next by avoiding major changes in terminal or reversionary bonuses and uses 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 is also subject to the need to meet the level of solvency capital the Society is required to maintain.

Payouts on surrender on conventional With-profits policies are smoothed to a different extent from those on maturity or death.

On all With-profits policies the Society allows for the fact that maturity or death payouts are payments occurring to a member who has no choice in the timing of the payout. Surrender payouts are made at the request of the member who can choose to act against the interests of other members in the timing of the payout.

Surrender payouts are normally smoothed over the short term, but the Board maintains its discretion to change surrender payouts immediately on any change in the market.

5.2 Practices

Maturity and death benefits are determined by bonus declarations which are determined by the Board at least annually following the valuation of the Society's assets and liabilities. The methods employed are outlined in section 7 below.

The amount of smoothing in relation to the asset shares and the bonus reserve value of the liabilities is recorded at each valuation and is discussed by the With Profits Committee. The With Profits Committee reports on this in their report to members each year.

Surrender payouts are outlined in section 7 below and are set using asset share calculations allowing for 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.

6 Business risk and new business decisions

6.1 Principles

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

New policies tend to require extra capital to cover technical reserves and solvency margins required by insurance regulations. This capital is provided by existing members of the Society who require a return on their investment.

6.2 Practices

Initially, any costs or benefits from these two sources comes from or is added back to the estate of the Society. The amount of estate is targeted (as stated below) and so ultimately these costs are reflected in asset shares through adjustments to the investment returns allocated to policies.

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 being smoothed through the estate. Equally, a positive contribution of the same amount may be applied immediately to asset shares.

The Society has to make decisions on whether to remain open to new business and what types of insurance policies should be made available. The Board makes this decision each year from advice provided by the Chief Actuary 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.

7 Payouts, bonuses and surrender values

The payout on maturity or death of most of the With-profits policies 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 values will be calculated based on asset share.

7.1 Principles

Members are 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 are only paid if there are adequate free assets after payment, in the view of the Board, to afford the discretionary benefits.

Subject to the principle above, payouts on maturity and death also attempt to reflect fairly the contribution the member has made to the funds in existence. Surrender payouts are not penalised by the Society but reflect fully the expenses incurred and the incidence of those expenses.

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

7.2 Practices

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

The Board has set a target range for payouts to be within 70% to 130% of asset share for regular premium plans, and between 80% and 120% of asset share for single premium Bonds and the ISAs. 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 are be based on investment returns that are sustainable and some part of the additional investment return achieved in the period. Terminal bonus rates are set to bring the total payout into balance. The value of the estate is also considered (see below).

Surrender values are calculated on a target range based around the individual policy asset share. The asset share is 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. The Board has set the range to be within 60% to 130% of asset share for regular premium plans and between 70% and 120% for the Single Premium Bond and the ISAs.

A Market Value Reduction (MVR) may be applied to a withdrawal or surrender of a With-profits 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.

Some Investment Bonds, ISAs and Junior ISAs include MVR free guarantee dates, where the investment can be withdrawn without a MVR being applied, even if the Society is generally applying MVRs on withdrawals. MVR free guarantees are clearly detailed in the terms and conditions of the policy.

8 The estate of the Society

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 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 or the bonus reserve method liability for other types of policies,

- plus the adjusted asset shares for With-profits Bonds and ISAs,

- plus the realistic value of any other liabilities.

8.1 Principles

The estate is targeted at a range 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 is to allow for a reasonable level of capital to cope with smoothing the returns to members without unduly building up excess estate that is not needed.

8.2 Practices

The With Profits Actuary includes the two calculations for the estate outlined above as part of the valuation report to the Board. The Board considers:

- 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 believes 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 to10 year period and will be based on the business plans of the Society.

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