Transport Friendly Society Limited

Principles and Practices

of Financial Management

(PPFM)

Version 2.0 **6 November 2018**

Contents

1 Introduction

1.1 About this document

This document ("the **PPFM**") sets out the **Principles** and **Practices** by which Transport Friendly Society ("the **Society**", "our") manages its **with-profits** business. It has been authorised by the **Society**'s **Board of Management** ("**Board**", "we", "us") in accordance with the powers granted to it by the **Society**'s Memorandum and **Rules**, and has been adopted by the **Board**.

This document has two purposes:

- It meets the requirements of the **Financial Conduct Authority**, specifically section 20.3 of the Conduct of Business Sourcebook.

- It enables a better understanding of the way the **Society** conducts its **with-profits** business and, in particular, the principles and practices adopted by the **Board** in the application of its discretion in relation to such business. This improved understanding is intended to protect the interests of and promote confidence among **with-profits** policyholders.

The **PPFM** outlines two types of rules governing how the **Society** will manage its **with-profits** business: **Principles** of financial management and **Practices** of financial management, which are explained below.

This document does not override the **Society**'s **Rules** or the terms of its insurance products, but supplements them. The rules and product terms are contractual by nature, while this document outlines how the **Board** will exercise its discretion in managing **with-profits** business.

This document considers in turn each key area where discretion is applied.

This document is Version2.0 of the PPFM and was approved by the Board on 6 November 2018.

A history of changes is:

Version	Date
2.0	6 November 2018

1.2 Principles of Financial Management

Principles are intended to be enduring statements of the overarching standards adopted by the **Society** and are expected to change infrequently.

The **Principles** form a broad framework of rules underpinning the operation of the **Society**, 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. They also document how we intend to be compliant with relevant regulation and legislation and how we intend to interpret Principle 6 of the **Financial Conduct Authority**'s Handbook, which requires us to pay due regard to the interests of our customers and treat them fairly. They describe the business model used by the **Society** to enable it to meet its responsibilities to **policyholders** 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.

The **Principles** are not expected to change often. However, the **Society** is able to change them, where appropriate subject to regulatory requirements. This is further discussed in section 1.5.

1.3 Practices of Financial Management

Practices describe the **Society**'s current approach and may be subject to more frequent change whilst remaining within the **Principles** currently applying.

The **Practices** describe the way in which we manage the **Society** 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 **Principles**. From the information they contain, it should be possible for **policyholders** and potential **policyholders** to understand the prospective rewards and material risks of maintaining a **with-profits** policy with the **Society**.

1.4 Governance and Compliance

The **Society** is governed by its **Board**. It also maintains a **With-profits Advisory Arrangement ("WPAA")**, consisting of four non-executive members of the **Board**. This advises the **Board** on how it is managing its **with-profits** business and the exercise of discretion. The **Society** is advised by both a **Chief Actuary** ("**CA**") and a **With-profits Actuary** ("**WPA**"). The **CH**'s role is to advise the **Board** on the amount of **capital** the **Society** should hold to cover its statutory liabilities and on the demographic and financial assumptions used to value those liabilities. The **WPA**'s role is to advise the **Board** and the **WPAA** on the exercise of discretion in managing its **with-profits** business and on the level of distributions through **bonuses** and other **discretionary benefits**. Currently, the roles of **CA** and **WPA** are held by one person.

The **Society**'s governance arrangements aim to ensure that the conduct of its **with-profits** business complies with this **PPFM**. The **WPA** will report annually to the **Board** on its application of discretion including its application of the **PPFM**. The **Board** will produce an annual report, which will be placed on the Society's Website, within six months of the financial year-end to **with-profits policyholders** stating whether it believes it has complied with its obligations in relation to the **PPFM** and the reasons for that belief. Included with that report will be a report from the **WPA** stating whether, in his opinion, in writing its annual report and exercising its discretion over the previous year, the **Board** has taken reasonable and proportionate account of the interests of the **with-profits policyholders**.

In addition, the **WPAA** will advise the **Board** on whether the **PPFM** properly reflects the way the **Society** is managed and whether the firm is complying with the **Principles** and **Practices** set out in the **PPFM**.

1.5 Changes to the PPFM

The **PPFM** will be reviewed at least annually to ensure that it continues to correctly reflect the **Principles** and **Practices** that are applied to the **with-profits** fund.

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. As the **Practices** are concerned with the ongoing and shorter-term operation of the **Society**, it is to be expected that they will need to be changed more frequently than the **Principles**.

We will change our **PPFM** only if the change is justified by the need to respond to changes in the business, economic, or regulatory environment to protect the interest of **with-profits policyholder**s, or to change **Practices** better to achieve the **Society**'s **Principles**.

Where any changes are made to the **PPFM** that are immaterial, or necessary to correct an error or omission, or are made to improve clarity or presentation without materially affecting its substance, we will just change the **PPFM** on our website. Otherwise, we will give all **members** holding **with-profits** policies written notice of any proposed changes to the **Principles** at least three months before these become effective, and we will give all **members** holding **with-profits** policies written notice of any changes to the **Practices**, within a reasonable period after the changes have become effective. Where appropriate, we will notify the **regulators** in advance of any change to the **Principles** and within a reasonable period of any changes to the **Practices**.

At all times, the current version of this document will be placed on the **Society**'s website and will be available free of charge from the **Society**'s head office on request.

1.6 Consumer Friendly PPFM

A consumer friendly version of the **PPFM** (**"CFPPFM"**) is available on request. The **CFPPFM** is a shorter summarised version of the **PPFM** highlighting the key information and providing briefer explanations which are easier to understand. In the event of a conflict between the **PPFM** and the **CFPPFM**, the **PPFM** will take precedence.

1.7 Glossary

A glossary providing the definitions of key words and phrases used within this **PPFM** is attached to the end of the document.

2 Amount payable under a with-profits policy

2.1 Methods used to determine amount payable

This section describes the **Principles** and **Practices** to determine the amount payable before allowing for any distribution of the **estate**, as described in section 6.

2.1.1 Principles

The **Society** aims to provide **with-profits policyholder**s with a fair return that reflects the actual experience applicable to each generation and class of **with-profits** policy, subject to the **smoothing Principles** described in section 2.3.1 and having regard to statements made in marketing literature and communications to policyholders. The minimum the **Society** will pay upon an eligible maturity or death claim will be the guaranteed benefits under each contract.

When applying the methods that the **Society** uses to determine the amount payable to **with-profits policyholder**s, the **Society** may use approximations. Where appropriate experience data is not available, the **Society** uses assumptions and parameters which in the opinion of the **WPA** are broadly reflective of experience.

The **WPA** regularly reviews the methods and assumptions, including the parameters used. Any proposed material changes are referred to the **Board** for its approval.

The **Society** might change historical assumptions or parameters relevant to the methods if it can be shown that the changed assumptions or parameters are a more accurate reflection of the actual experience.

2.1.2 Practices

The guide to determining the amounts payable to **with-profits policyholder**s is currently a mixture of an **asset share** approach and a "**realistic valuation**" (or bonus reserve method valuation) of the **Society**'s liabilities. **Asset shares** are considered as a means to provide a guide for the realistic valuation, to investigate whether distributions payable are fair against the underlying assets of the **Society** and to test fairness between different generations of policyholders.

Asset shares can broadly be defined as an accumulation, at investment rates of return, of the contributions paid on the policy, less allowances for expense deductions, taxation (where appropriate) and any charges for cost of guarantees and use of capital. The cost of expected death claims and expected sickness benefits are also deducted in the **asset share** calculations.

A **realistic valuation** of the **Society**'s policy liabilities is the present value of all current guaranteed and expected future policy benefits less the present value of all expected future policy premiums to be received plus an allowance for future expenses. The main assumptions or parameters for the **realistic valuation** are based on the likely (or realistic) experience of the **Society** as at the valuation date.

For classes of business with a pre-defined maturity date, the aim in the long term, in determining **payout**s for maturing **with-profits** policies, is to return as a group, on average 100% of **asset shares**. The amounts payable on maturity in any year, or to any particular **with-profits policyholder**, may be more or less than 100%, due to the effects of **smoothing**, **guarantees**, size of premium, term and grouping of policies.

Where **asset shares** are not appropriate due to lack of historical data or unreliable **asset share** values, the **Board** may consider other methods to calculate a fair return for a policyholder's investment.

For determining **payout**s for surrendering **with-profits** policies, the **Society** currently returns a proportion of the accumulated benefits to date. The surrender value calculation methodologies for each class of business where a surrender value is paid are calculated as follows:

"Old Death" Section: The accumulated basic sum assured benefit is calculated by reference to a benefit table contained within the **Society**'s Policy Tables booklet. The total accrued bonuses to date are added to the accumulated basic sum assured benefit. A surrender value factor is then applied to the paid up benefit to calculate the surrender payout. A further factor may be used to reduce or increase the value arrived at to reflect the market value of assets on the date of calculation.

"**New Death**" Section: The method mirrors the asset shares for this class of benefits as closely as possible. The surrender payout for this class of business is calculated in a similar way to the Old Death section as described above except that a different surrender value factor is applied to the paid up benefit. The factors used reflect the normal asset share that would be payable if market conditions were normal. A further factor may be used to reduce or increase the value arrived at to reflect the market value of assets on the date of calculation.

"**Endowment**" Section: The method mirrors the asset shares for this class of benefits as closely as possible. The accumulated basic sum assured benefit is calculated based on completed years of contribution payment. The total accrued bonuses to date are added to the accumulated basic sum assured benefit. A surrender value factor is then applied to the paid up benefit to calculate the surrender payout. The factors used reflect the normal asset share that would be payable if market conditions were normal. A further factor may be used to reduce or increase the value arrived at to reflect the market value of assets on the date of calculation.

"**Provident**" Section: The surrender payout for this class of business is calculated in a similar way to the Endowment section as described above except that a different surrender value factor may be applied to the paid up benefit. A further factor may be used to reduce or increase the value arrived at to reflect the market value of assets on the date of calculation.

"Sickness" Section: The Society may pay a surrender value based on the value of the no claims bonuses accrued to date for a member if the policy has achieved 5 years membership. The method attempts to mirror the asset share of the policy for this class of benefit as closely as possible. A factor is applied to the bonus accrued to date which mirrors the asset share in normal market conditions. A further factor may be used to reduce or increase the value arrived at to reflect the market value of assets on the date of calculation.

The **Society** is allowed to use its own methodology to calculate surrender payments as long as it has good reason to believe that its methodology produces a result which, in aggregate across all similar policies, is not less than the result of an **unsmoothed asset share** calculation which may be reduced or increased by a factor to reflect the market value.

The aim is that at least 90% of maturity payments fall within the range of 65% to 135% of the average Asset Share for the group of policies to which they belong subject to any guaranteed benefits being met.

The main assumptions or parameters in the **asset share** calculations are determined by regular investigations into the experience of the **Society**. The approximations allowed when applying assumptions or parameters across generations and classes of policy are in line with the overall aim of sharing the experience of the **Society** between **with-profits policyholder**s. Where reliable data can be obtained that materially alters the results of the calculations, the degree of approximations used is low. Where historical data is unavailable, the degree of approximations used is high.

Currently **asset shares** are calculated using averaging across product class.

Where methods or parameters used in the calculations are considered to require changes, the **WPA** completes a comparison with current methods and parameters and if material reports on the reasons for changes and results to the **Board** for approval.

The mortality charges deducted in the **asset share** calculations are based on a best estimate assessment of the cost of deaths arising on the **asset shares** in question.

For sickness policies the sickness benefit charge deducted in the **asset share** calculations are based on a best estimate assessment of the expected cost of sickness benefit paid arising on **the asset shares** in question.

The **Society reserves the right to make a deduction** from **asset shares** for use of capital but currently does not do so.

When calculating **asset shares**, the **Society** may make deductions for the assessed cost (determined on assumptions the **Society** considers appropriate) of providing guarantees on the **with-profits** policies. These deductions may vary by product type. Currently no such deduction is made.

The **Board** periodically reviews the appropriateness of the level of the charges specified and may at its discretion make additional deductions to **asset shares** to ensure that the **Society** maintains adequate financial strength.

Policyholders of the **Society** are eligible to receive **discretionary benefits** to supplement payments towards dental, optical and osteopathic treatment costs. The **Society** manages the **with-profits** fund so that these **discretionary benefits** are paid to the extent necessary for all policyholders to be treated fairly.

The payments relating to these **discretionary benefits** are met by the **with-profits** fund. A charge for these **discretionary benefit** payments is deducted from the **asset shares**.

Miscellaneous profits or losses that are generated from the normal day to day activities of the **Society** are deemed to be allocated to the **inherited estate**. The principles and practices as to how the **estate** will be distributed are described in section 6. A subsidy from the estate to a limited amount may be made on payouts in the short term.

2.2 Approach to setting annual bonus rates

2.2.1 Principles

The **Society**'s general aims in setting **regular bonus** rates for all classes of **with-profits** policy are to:

- distribute a proportion of the underlying investment income earned / to be earned by the assets backing **the with-profits policyholders** statutory liabilities in a smoothed manner;
- reflect the surplus generated by policies.

Both of these general aims will need to take account of the current and projected financial position of the **Society**.

2.2.2 Practices

In the event of a significant difference in the **bonus** expectations between a range or generation of policies, and if the **Society** considers that a single **regular bonus** rate would violate the **Principles**, consideration would be given to setting up a new **bonus** series.

Regular bonus rates are currently set by reference to a sustainable level based on expected investment income according to the future investment strategy. This calculation takes into consideration the aims of achieving average maturity payouts equal to 100% of **asset shares** and ensuring that 90% of maturity payouts fall within the target range specified in section 2.1.2. This consideration is allowed for using **smoothing** described below in section 2.3 and the overall **solvency** of the **Society**.

Regular bonus rates are currently declared for Endowment, Provident, New Death and Old Death policy types as an amount per unit of sum assured.

Regular bonus rates for sickness policies are declared as an amount per unit if a policyholder does not make a claim during the valuation year (1st January to 31st December).

The **Society** declares regular bonuses each year in arrears following advice from the **WPA**. The regular bonuses are applied as at the year end. The regular bonus cannot be taken away once added to a policy.

If no significant change in **regular bonus** rates is anticipated at the next declaration, **interim bonus** rates are normally set equal to the previously declared **regular bonus** rates applicable to each particular policy group. If a significant change in **regular bonus** rates is anticipated at the next declaration, **interim bonus** rates may reflect partially or fully the anticipated change in **regular bonus** rates.

2.3 Approach to setting final bonus rates

2.3.1 Principles

The **Society**'s general aim in setting **final bonus** rates for all classes of **with-profits** policy is to:

- make maturity payouts of 100% of **asset shares** whenever appropriate and possible.

Again this aim will need to take account of the current and projected financial position of the **Society**.

2.3.2 Practices

As for annual **bonus** rates, the declaration of a **final bonus** takes into consideration the aims of achieving average maturity payouts equal to 100% of **asset shares** and ensuring that 90% of maturity payouts fall within the target range specified in section 2.1.2.

Final bonus rates are currently declared for Endowment, Provident, New Death and Old Death policy types as a percentage of sums assured.

The **Society** expects to review **final bonus** rates once a year, although the rates may be reset more frequently if there is a significant change in economic circumstances. There is no maximum amount by which **final bonus** rates may be changed.

2.4 Approach to smoothing

With-profits insurances are not designed to pay the exact amount accumulated within the **Society** allowing for the exact investment return on those assets, but to reduce volatility by **smoothing**. There are two levels of **smoothing** applied:

- Implicit smoothing occurs because the **Society** has uniform bonus rates between different contribution levels, durations and ages within the same product class.

- Explicit smoothing will apply over different time periods whereby the **Society** will try to avoid excessive movements in payouts.

Smoothing will involve the use of the "**estate**" (see section 6) to carry any deficits or **surplus**es compared with the unsmoothed **asset share**.

2.4.1 Principles

Different levels of **smoothing** will apply to **payouts** on surrender to those on maturity or death. Maturity payments or death payments are payments occurring to a **policyholder** who has made payments for the full term of the insurance and where the **policyholder** has no choice of the timing of the **payout**. Surrender **payout**s are made at the request of the **policyholder** and the **policyholder** can choose to act against the interests of other **policyholder**s in the timing of the **payout**.

Maturity and death **payout**s will be smoothed from one period to the next by avoiding major changes in **regular 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 **regulators**.

The **Board** will maintain its discretion to change the calculation of surrender **payout**s immediately on any change in the market.

There is no total scale or cost of **smoothing** that the **Society** believes should not be exceeded.

2.4.2 Practices

The **Society** aims for **smoothing** to be financially neutral over the course of an economic cycle. The **Society** aims to ensure an accumulated cost of **smoothing** that does not threaten its ability to demonstrate an adequate **solvency** position or its ability to meet its contractual obligations to **policyholder**s. The amount of **smoothing** in relation to the **asset share** and the **realistic valuation** will be recorded at each annual valuation and will be discussed by the **Board** and the **WPAA**. The **WPAA** will report on this in its report to **policyholder**s each year.

The **smoothing** strategy currently applied for new entrants is the same as that for existing policies.

For regular premium **conventional with-profits** policies, the **Society** aims to limit the differences between maturity **payout**s on similar policies. In the event of conflict arising between this aim and the aim for the target ranges described in section 2.1.2, the aim for the target ranges takes precedence.

Maturity and death benefits are determined 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 2.2.

3 Investment strategy

3.1 Principles

The investment policy of the **Society** is to maximise the overall return on the investments of the **Society** subject to ensuring that guarantees are met and that the **Society** is able to meet its regulatory **capital** and **risk appetite** requirements. These returns will be used for the benefit of the **Society**'s **policyholder**s. Returns include income and increases in **capital** value.

Investment may be in any of the following asset classes: property, bonds (government and corporate), equities, deposits, debentures, other loan stock, warrants, certificates representing securities, units in collective investment schemes, options, futures, contracts for differences, notes, spot and forward exchange contracts, bankers acceptances, precious metals, commercial paper, convertible instruments, rights to and interest in anything which is an investment falling within any paragraph of Part 1 of Schedule 1 to the Financial Services Act 1986 and any investment where such acquisition was made pursuant to obligations of the **Society** as an underwriter or sub-underwriter.

In determining the mix of assets between different asset classes, the investment strategy will take account of the current and projected financial position of the **Society**, its ability to meet its regulatory **capital** requirements and the long term expected returns for each class.

3.2 Practices

The investment strategy will be controlled by the **Board** of the **Society**. The **Board** will appoint one or more investment managers to aid investment strategy and make detailed decisions on purchases and sales.

The **Society**'s investment strategy aims to ensure a diversified portfolio of assets is held and that that performance for each asset class is measured against a specified set of benchmarks. There are documented aims, risk objectives and benchmarks for the equity, bond and property investment portfolios.

The investment strategy includes:

- target a central proportion of total assets for each category of assets, with maximum and minimum proportions giving ranges within which the assets can move
- duration range for all bond assets
- maximum holdings for credit quality levels for corporate bond assets
- limits on investment in non-sterling denominated assets and any collective investments with underlying holdings invested in non-sterling denominated assets.
- maximum holdings that can be with any counterparty for all assets
- whether derivatives may be used within the asset portfolios

The investment managers are tasked with maximising the performance of the assets subject to the target ranges, and bearing in mind the neutral asset allocations.

The neutral asset allocations are designed to:

- ensure that bond asset income matches the guarantees of the **Society** which equates to the value of guaranteed benefits 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 from mis-matching assets against liabilities without placing the **solvency** of the **Society** at risk. The minima for certain asset classes are also designed to ensure there is enough liquidity for the **Society** to meet its expected annual cash outflow.

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

The **CA** will provide advice to the **Board** at least annually on the investment policy. The **Board** will seek input from the investment managers on the practicality of the policy.

The **Board** will review investment performance of the investment manager at least quarterly.

Deposits will be placed by the **Society** to achieve the best rate of return whilst ensuring sufficient liquidity and security.

The **Society** does not own the office space that it currently occupies and is in leased premises. The **Society** may invest in an office space that it occupies. This will only take place if the saving in rental income and the prospect of future growth in market value make investment sense.

4 Business risk and new business

4.1 Principles

As the **Society** is owned by its **members**, all of the appropriate costs and benefits from business decisions, including whether to accept new business and on what terms will ultimately be shared amongst the with-profits **members**.

New insurances tend to require extra **capital** to cover **statutory liabilities** and the additional **capital** required by the **regulators**. This **capital** is provided by existing **members** of the **Society**, who require a return on their investment.

Compensation costs arising from a business risk will be borne by the with-profits fund and may affect with-profits payouts.

4.2 Practices

The Board determines the level of business risk it is prepared to take within its **risk appetite** statement. In assessing any potential business activity and the potential scale of the risk, the **Board** will consider the likely effects on the **solvency** of the **Society**, considering both the **realistic** and **statutory valuations**.

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 **payout**s. 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**.

The **Society** addresses risks through its risk management system, which identifies risks and puts controls in place to mitigate their likelihood and impact.

The **Society** has to make decisions on whether to remain open to new business, what types of business to make available and the terms and conditions of that business. The **Board** will make this decision each year taking advice provided by the **CA** (and the **WPAA** and **WPA** where appropriate). New business will only be accepted if, in the reasonable opinion of the **Board**, the terms upon which such plans are accepted are unlikely to have a materially adverse effect on the interests of existing **policyholder**s of the **Society** at that time.

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** and the business in force. The **Board** will also consider winding up the **Society** and sharing the assets amongst the **members**. Any decision to wind up will need to allow for providing risk insurances for those **members** who still require risk insurance from another provider.

5 Charges and expenses

5.1 Principles

All expenses are charged directly to the **Society**'s long-term business fund, other than those deemed to be incurred by the **non-profit** business. The **non-profit** charges are set at a level that is deemed appropriate relative to the expenses incurred by the **non-profit** business, subject to the maximum charges allowed by regulation. Any difference between the charges and expenses for **non-profit** business will flow to the **surplus** or deficit of the **Society**.

Where **asset shares** are used to set **payout**s, the expenses of the **Society** are apportioned across individual **asset shares** on a basis that aims to be proportionate to the level of cost and complexity involved. The allocation of expenses to policies necessarily involves a number of assumptions and allocations. The **Society** uses its best endeavours to ensure that the allocation is as accurate as possible and reflects the activities that give rise to such expenses. The basis of allocation may change to reflect changes in the activities (e.g. due to changes in regulations or outsourcing arrangements), changes in distribution methods or to improve the allocation in the light of new information.

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 or generations of **policyholder**s.

5.2 Practices

Expenses cover the acquisition of business, (including introduction fees) and the administration of existing business including claims and investment costs as well as other fixed costs.

Asset shares normally 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**. Where appropriate, these may be spread over subsequent years if it is fairer to **policyholder**s to do so.

The costs of **smoothing** are charged to the **asset shares**. These are expected to be broadly neutral over the medium to long 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 **Society**.

In the **asset share** calculations, for earlier years where information on expenses is not available, allowance is made for expenses chosen to be reasonably consistent with historic pricing assumptions. These charges are possibly lower or higher than historic expenses, so that an element of **miscellaneous profits or losses** is recognised in this component of the **asset share** calculation. Where fuller information on expenses is available, the expense charges are determined more accurately.

The **Society** currently outsources its actuarial, legal, internal audit, risk management and investment management resource requirements. These contracts are either on fixed terms and contain provisions enabling the **Society** to terminate the contract under certain breach conditions or have no fixed term and can be ceased with immediate effect.

6 Management of Inherited estate

The **inherited estate** ("**estate**") is the excess of assets within the **Society** 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. It provides working **capital** to allow the **Society** to meet any shocks that may occur, smooth **payout**s and provide **capital** to allow the writing of new business.

6.1 Principles

The **inherited estate** is defined by the **Society** as the **realistic valuation** of assets less the **realistic valuation** of liabilities. The **realistic valuation** of liabilities is the sum of:

- the **technical provisions** of the Society as required under the prudential requirements for the **"Solvency II Directive**"
- the value of other liabilities in the balance sheet at that time.

The **estate** will be targeted at levels that the Board (after advice from the **CA** and **WPA**) believes is reasonable given the nature of the liabilities and assets held by the **Society**.

The aims will be to hold a sufficient level:

- to cope with **smoothing** the returns to **policyholder**s without unduly building up excess that is not needed
- to provide statutory capital for regulatory reserving purposes
- to allow investment freedom
- to support new business and business risk
- to meet costs which in the opinion of the **Board** should not be charged to policyholders

6.2 Practices

The **WPA** will advise the **Board** at least annually on the size of the **estate** as part of the annual valuation of the **Society**. 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.

The **Board** will review whether the **surplus** assets within the **Society** are more than is needed to meet the prudent management of the **Society**. If it is determined that there is an excess **surplus**, then the **Board**, after receiving advice from the **WPA**, will decide at the time how it will be best utilised in the interests of the **Society**'s **policyholder**s.

The **Society** targets an **estate** of 150% to 250% of the required capital required under the prudential regime. This capital is referred to as the **Solvency Capital Requirement**. If the estate falls outside the range, the Board will consider the appropriate management action to take in order to return the estate to the target level as soon as reasonably possible whilst continuing to ensure policyholders are being treated fairly.

7 Glossary

asset share	a measure of the share of assets attributable to a **with-profits** policy, calculated by accumulating, at the rates of return earned on the assets assumed to be backing the policy, the premiums paid less expenses, tax and risk benefits, in accordance with the actual experience of the **Society**
Board	See Board of Management
Board of Management	the governing body of the **Society**, ultimately responsible in law for all actions taken by the **Society**
bonus	that part of any distributable **surplus** generated by the **Society**'s operation and management which is allocated to participating **with-profits** plans, either as **regular bonus** or **final bonus**
capital	assets that are available to the **Society** and not required to be used to cover existing liabilities
Chief Actuary	an actuary employed by the **Society** who has the responsibility under the **regulators**' rules for advising the **Board** on the amount of **capital** it should hold and on the assumptions used in valuing the **Society**'s liabilities, as well as carrying out that valuation otherwise referred to as the "Chief Actuary" within the **Prudential Regulatory Authority**'s rulebook.
Consumer Friendly Principles and Practices of Financial Management	a consumer friendly version of the **PPFM**
conventional with-profits	a **with-profits** policy that is not a **unitised with-profits** policy, and which generally has a specified **guaranteed** benefit payable, provided that all premiums due have been paid, on death or a fixed date, which can be increased by the addition of **bonuses**
counterparty	an individual or company in which the **Society** has made investments or against which the **Society** has rights under a contract.
CFPPFM	**Consumer Friendly Principles and Practices of Financial Management**
discretionary benefit	payments by the **Society** towards member dental, optical and osteopathic treatment costs.
estate	see **inherited estate**
final bonus	a method of distributing **surplus**, whereby the **bonus** is not **guaranteed** and is only declared when a policy becomes a claim
Financial Conduct Authority	one of the two **regulators** of financial services in the UK

guarantee or guaranteed	legally binding commitment by the **Society** to pay out specified monetary amount in certain specific circumstances, such as on death or on survival to the end of the term of the policy
inherited estate	the assets held in excess of those required to pay policy benefits and other liabilities, which include payments of guaranteed benefits and future **bonuses** in line with the **regulator**y duty to treat customers fairly in setting discretionary benefits
Interim bonus	the **bonus** granted in respect of the period since the last declaration of **regular bonus** to the date of claim
member	a holder of a policy that confers **members**hip rights on the holder
miscellaneous profits or losses	profits or losses other than arising from investment returns, mortality cost, tax and expenses
non-profit	a policy (or part of a policy) under which the value of the benefits is directly linked to the value of the assets backing the policy
payout	the amount paid in the event of a claim, whether due to death, **surrender** or maturity
policyholder	the holder of an in-force policy of the **Society**
PPFM	**Principles and Practices of Financial Management**
Practices	the practices of financial management as set out in this document
Principles	the principles of financial management as set out in this document
Principles and Practices of Financial Management	this document
Prudential Regulation Authority	one of the two **regulators** of financial services in the UK
realistic valuation	a valuation carried out using best estimate assumptions, which is less cautious than a **statutory valuation**
regular bonus	a method of distributing **surplus**, where the **bonus** is added on a regular basis throughout the life of a **with-profits** policy, providing an addition to the **guaranteed** benefits payable to the **policyholder**
regulators	**Prudential Regulation Authority** and/or the **Financial Conduct Authority**
Risk appetite	The degree of risk which the Society is prepared to take
Rules	the Rules of the **Society**, as registered from time to time under the Friendly Societies Act 1992

smoothing	the process whereby movements in **asset shares** are not fully reflected in **payouts** in order to reduce the volatility of **payouts**
Society	Transport Friendly Society
solvency	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**
Solvency II Directive	The Directive passed by the European Union reference Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) as being amended by subsequent directives and interpreted by Delegated Acts and Guidelines.
statutory liabilities	the liabilities determined from a **statutory valuation**
surplus	the excess of the value of the **Society**'s assets over the amount of its **statutory liabilities**
surrender	when the **policyholder** requests an insurance policy is cancelled
Technical provisions	The amounts defined under the rules of the **Prudential Regulatory Authority** (derived from the **Solvency II Directive**) as being the values of liabilities to policyholders on a best estimate basis allowing for the cost of capital risk margin
with-profits	a policy or group of policies which can share in the profits and losses of the **Society**, as they are eligible to participate in any established **surplus** through the addition of policy **bonuses**
With-profits Actuary	an actuary employed by the **Society** who has the responsibility under **Financial Conduct Authority** rules for advising the **Board** on its application of discretion in relation to **with-profits** policies
With-profits Advisory Arrangement	a body that advises the **Board of Management** on the fair treatment of **with-profits policyholders**, including compliance with the **Society**’s **Principles and Practices of Financial Management**
WPA	see **With-profits Actuary**
WPAA	see **With-profits Advisory Arrangement**