Report of the Board of the Transport Friendly Society Limited to its With-Profits policyholders for the calendar year 2021

1. Introduction

The Financial Conduct Authority (FCA) requires all firms with a With-Profits fund, with the exception of non-directive insurers to publish and maintain a Principles and Practices of Financial Management (PPFM) document. The PPFM is a fairly technical document that states the principles and practices that an insurer follows in managing its With-Profits fund.

The PPFM is available to all policyholders and you can obtain a copy from our website or by contacting this office.

Under the Solvency II regulatory regime, effective from 1 January 2016, the Society became a directive insurer. Whilst, as a mutual organisation, the Society has always worked only for the benefit of its members, the governance arrangements and reports for its With-Profits fund are now more formal and this is the sixth annual report the Board has made to its With-Profits policyholders.

2. Governance arrangements

It is the responsibility of the Society’s Board to provide an annual report to the With-Profits policyholders in respect of each financial year.

The purpose of this report is to confirm that the Board believes, it has complied with its obligations detailed in its PPFM for the management of its With-Profits fund and set out the reasons for that belief.

The report must also address all significant relevant issues, including the way in which the Society has:

- Exercised, or not exercised, any discretion in the way it has managed its With-Profits fund;
- Addressed any competing or conflicting rights, interests and expectations of its policyholders including those with different products and different lengths of membership.

All organisations who operate With-Profits funds must appoint a With-Profits Actuary, who is not a member of the Board, to advise on the use of discretion and the implications of the way in which the Board has used discretion in the fair treatment of the With-Profits policyholders.

The With-Profits Actuary makes a formal report at the end of every year to the Board on the implications of the Board’s discretionary decisions. He is also required to produce an annual report to the With-Profits policyholders stating whether, in his professional opinion, the Society has taken the interests of With-Profits policyholders into account in a reasonable and proportionate manner in all their decisions. This report is annexed to this document.

In order to ensure that even further independent judgement is applied as to whether the Board has complied with the PPFM and whether all With-Profits policyholders have been treated fairly, it is recognised good practice for all organisations operating a With-Profits fund to have a With-Profits Committee or other form of governance arrangement. The Society believes that as it is a mutual organisation and the Board only has the members' interests in mind, it would be more appropriate to have a With-Profits Advisory Arrangement. The Society's With-Profits Advisory Arrangement comprises of 4 non-executive directors who are deemed independent of the Society's management. This ensures that the With-Profits Advisory Arrangement has the proper degree of independence and knowledge of the Society.

The Society's With-Profits Advisory Arrangement met on 22 February 2022 and has reported to the Board that it believes the Board has acted in accordance with the PPFM and that the interests of With-Profits policyholders have been taken into account throughout the year.

3. Changes to the PPFM

The current version of the PPFM was issued on 6 November 2018.

4. Compliance with the PPFM during the year

This report comments on specific areas. In particular, where discretion was used and where the fair treatment of With-Profits policyholders was especially considered. This report follows the same sections as the PPFM.

4.1 The amounts payable on maturity

Asset share values, on which payouts are based, were calculated during 2021 using the methods described in the PPFM.

For Endowment and Sickness Policies, asset shares are calculated using historical overall With-Profits fund performance and actual experience for mortality, morbidity and expenses. The expense allowances within the asset shares for policies sold between 2004 and 2012 allow for a degree of expense subsidy from the Society's estate to cover expense overruns during this period, when total management expenses in a year exceeded total policy expense allowances. Between 2012 and 2019, the policy expense allowances charged to asset shares approximately covered the management expenses of the Society. For 2020 and 2021, the management expenses were materially greater than policy expense allowances due to the impact of the Covid-19 pandemic on the Society's ability to generate new business. It is anticipated that policy expense allowances will again cover management expenses from 2022 onwards. The final course of the pandemic is still unclear, but the success of vaccines and the development of other treatments, and the immunity built up by high levels of infection, may result in Covid-19 becoming endemic in the UK. The UK government has currently removed all self-isolation and social distancing measures resulting in the Society's development managers regaining access to bus garages.

Mortality and morbidity risk deductions are based on standard actuarial tables adjusted for actual experience. The asset shares allow for the increased sickness claims experienced by the Society during the Covid-19 pandemic.

Other sources of profits or strain within the calendar year are added to asset shares. The target range for payouts against asset shares stated in the PPFM is between 65% and 135% for regular premium policies. For 2021, 92% (86% in 2020) of the projected payouts for the premium paying maturing Endowment policies fell within the target range. The Provident policies had large reversionary bonuses declared in the past and the current payouts are expected to exceed their asset share. These reversionary bonuses are now guaranteed benefits and cannot be reduced.

The Board followed the advice of the With-Profits Actuary in declaring bonuses on policies.

4.2 The amounts payable on surrender

The target range for payouts on surrendered policies is close to the unsmoothed asset share for the policy. Our With-Profits Actuary has examined a range of between 65% and 135% of asset shares.

Endowment policies pay a surrender value that is determined from a formula adjusted by a potential Market Value Reduction (MVR) factor if required. This is in accordance with the PPFM. There were 373 (185 in 2020) surrenders for premium paying policies in 2021 of which 317 (155 in 2020) were within the range. Most of the surrenders outside the range are either for smaller policies where the per policy expense allowances had a disproportionate impact on asset shares for early surrenders where policies had negative asset shares and the surrender value was a positive amount. In year 1, the surrender value is nil even though the asset share may be negative. In year 2, there is a refund of one third of the contributions. The overall surrender values paid were some 89% of asset shares.

Between 24 June 2020 and 26 January 2021, the Society applied an MVR to surrender values. The MVRs applied were 7% for policies with commencement dates prior to 2016 and 5% for all other policies. The Board's decision to apply an MVR was based upon advice from the With-Profits Actuary, taking into account the impact of the Covid-19 pandemic on the Society's investments. The MVRs on surrender values was removed on 26 January 2021.

The Board is aware that the need to apply a MVR to reduce payouts needs to be reviewed on a regular basis.

4.3 Bonus rates

The annual bonus declaration for 2021 was agreed by the Board at their meeting on 1 March 2022.

The Board took advice from the With-Profits Actuary.

In determining the level of bonuses, the Board bore in mind: the asset share methodology used to determine maturity values; the fair treatment of all With-Profits policyholders with different types of policies and different lengths of investment; the smoothing of members’ returns; the solvency position of the Society; and the need for maturity payments to be calculated in line with the PPFM.

4.4 Smoothing

The Society aims to smooth the fluctuations of investment return and other sources of profits and losses over the period of the contract.

A formal smoothing account was established at the beginning of 2017.

The smoothing account forms part of the Estate of the Society.

The Board can confirm that the smoothing policy detailed within the PPFM is being followed.

4.5 Investment policy

The Board appoints discretionary fund managers to actively manage the equity, fixed interest and commercial property elements of the With-Profits Fund. During the year the appointed fund managers were Investec.

The mix of asset classes held has been within the investment limits laid down by the Board, which was agreed after advice from the With-Profits Actuary and the fund managers.

The mix of assets held is published by the Society on its website and has been in line with the fund managers’ view on the potential performance of each asset class.

The Board is satisfied that it and the fund managers have controlled investment policy in line with the PPFM.

4.6 Business risk

Risk management is the responsibility of the Board who use various tools including a Risk Management Team, a Risk Committee and a detailed risk register to manage potential risks.

Consideration of the various business risks is incorporated within the Society’s Own Risk and Solvency Assessment which was completed towards the end of the year.

The Society has three main outsourcers: RSM Risk Assurance Services LLP for internal audit, Milliman for actuarial functions (SDA llp up to 31 March 2022) and Investec for investment management.

Risk and outsourcing arrangements have been controlled in accordance with the PPFM.

4.7 Charges and expenses

The Society continues to control costs carefully.

The expenses incurred are close to the expenses used in the illustrations issued by the Society and to the expenses being charged through to the surrender value asset shares. The expenses for 2021 are broadly similar to the previous year and with a similar split between renewal and acquisition expenses. The new expense allowances were used for asset shares and the Solvency II valuation method. As part of the Solvency II governance process they will be reviewed before the next valuation.

The Board is content that the charges and expenses are in line with the PPFM, recognising that this position needs to be reviewed against the business plan on an annual basis.

4.8 Management of the Estate

The PPFM defines the Estate as the difference between the assets and the realistic prospective discounted value of policy cash flows on the regular premium policies.

The PPFM states the Society will target a realistic estate of between 150% and 250% of its solvency capital requirement ("SCR"). The SCR at 31 December 2021 was £14.2m and the Society's realistic estate was £32.9m. Therefore, the realistic estate was within the upper bound of the current estate target range of 250%. In accordance with the Practices described in the PPFM, the Board has considered how these surplus assets can best be utilised in the interest of With-Profits policyholders. In part, the surplus assets were a factor in the Board's decision to increase the terminal bonus rate for Endowment EB policies from 15% to 20%. The surplus assets were also a factor in the Board's decision to maintain the remaining reversionary and other terminal bonuses at current rates and increase the maximum annual claim levels for discretionary cash benefits. The impact of these decisions reduces the Society's realistic estate to £31.2m. Additionally, the Board after receiving advice from the With-Profits Actuary intends to continue to use some of the Society's estate to subsidise asset shares, support an increase in the proportion of assets invested in equities if investment conditions are conducive to do so.

4.9 New business

The Society provides a range of policies for their members through affinity marketing.

The Society is successful at selling With-Profits business. The Board is confident that sales were at a level which did not place an undue strain on solvency, were beneficial to the existing With-Profits policyholders and were in accordance with the PPFM.

4.10 Allocation of profits

The Society is a mutual friendly society which means that there are no shareholders. All profits are ultimately for the benefit of the members of the Society.

4.11 Customer communications

The With-Profits Actuary has responsibility for controlling representations made to the Society's With-Profits policyholders by reviewing and signing off documents. All new documents and amendments to existing documents (Terms and Conditions, Illustrations and Policy Documents) are reviewed and signed off prior to issue. The Society's PPFM and CFPPFM have been approved by the With-Profits Actuary, as have the bonus notices and any accompanying material.

4.12 Regulatory change

The Solvency II regulatory regime was introduced with effect from 1 January 2016.

The regulatory valuation as at the end of the previous financial year has been undertaken using the regulations and guidelines under this regime.

The Board believes that the Solvency II methodology allows the key issues of fairness and solvency to be closely related within the practices and principles detailed in the PPFM.

Since 1 January 2018, the Key Features Illustrations and Documents disclosure requirements for packaged retail and insurance-based investment products have been replaced by new Key Information Documents (KID) disclosure. The Society has adopted the KID standard and format required by the regulations. The KID presentation and methodology of calculating projections of expected future payouts is considerably different to the previous regime. Where appropriate, assumptions used to generate the KID projections are in line with the PPFM.

5. Conclusion

During the period covered by this report (2021) the Board is satisfied that the Society has complied with the PPFM. In accordance with the PPFM the Board is taking action to utilise this excess estate in the best interests of With-Profits policyholders.

Mr Peter Brown	Mr A Ramezankhani
Chairman	Chief Executive
April 2022	April 2022

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Registered and Incorporated under the Friendly Societies Act 1992
Register No. 434F

Authorised by the Prudential Regulation Authority and regulated by the
Financial Conduct Authority and the Prudential Regulation Authority
FRN 110020

Annex 1

Report from the With-Profits Actuary to With-Profits policyholders of Transport Friendly Society Limited

I have made a report to the Board in accordance with the requirements of the Supervision Manual of the FCA Handbook to inform them of my view of the way in which the Principles and Practices of Financial Management (PPFM) have been applied and how discretion has been exercised in respect of the With-Profits policyholders.

I am also required by the Supervision Manual to draft a report to With-Profits policyholders to accompany the firm's annual report required by COBS20.4.7R, stating whether, in my opinion, the discretion exercised by the firm in respect of the period covered by the report may be regarded as taking the interests of the firm's With-Profits policyholders into account in a reasonable and proportionate manner. In doing this, I must have regard to the rules and guidance laid down in COBS20.2 of the PRA Handbook.

I can confirm that, in my opinion, the Board has acted in a manner consistent with the PPFM in the year from 1st January 2021 to 31st December 2021.

I can confirm that, in my opinion, the Board has taken the interests of With-Profits policyholders into account in a reasonable and proportionate manner.

S. Dixon.

S W Dixon BA, FIFA
With-Profits Actuary for Transport Friendly Society Limited.

Dated: April 2022