Shepherds Friendly

Your modern mutual

A guide to our With-Profits business

Aim of this guide.

This guide is the consumer friendly version of our Principles and Practices of Financial Management (PPFM).

How will this guide help?

This guide explains how we manage our With-Profits business for our traditional With-Profits contracts and will help you to decide whether this type of investment is right for you. Please keep it in a safe place with your other documents for future reference. It is also available in the 'How we manage your money' section on our website: **www.shepherdsfriendly.co.uk**

If you would like more information on how we manage our With-Profits Fund please read our Principles and Practices of Financial Management, also available at **www.shepherdsfriendly.co.uk**, or by phoning our customer services team on **0800 526 249**.

This guide sets out only the key points from the PPFM which remains the definitive document describing how we manage our With-Profits business.

What is a With-Profits Investment?

The fund

When you invest in our policies, we pool the money with the money from other plan holders in a single fund. The fund is invested in a wide range of assets including company shares, property and bonds and often in a range of countries.

This fund includes money received for a variety of insurance contracts including traditional regular and single premium With-Profits, Holloway income protection, pure income protection, unit-linked Child Trust Funds ("CTF") and non-profit whole of life contracts. The assets within the fund are sub-divided into smaller parts (sub-funds) in line with these broad groups of contract types.

Most of the fund covers the amount we owe to plan holders. The rest of the fund is called the surplus and provides working capital for the fund. To find out more please see the section on "The surplus and how we use it to manage your investment".

Smoothing

Smoothing is one of the unique features of a With-Profits investment. Investment values can be volatile so the value of both the total fund and sub-fund can fluctuate considerably. Instead of simply sharing out what the sub-fund makes or loses each year to plan holders, we even out some of the fluctuations over the lifetime of the plan. We explain this in more detail in the "What is smoothing?" section.

Guarantees

Our traditional With-Profits contracts offer guarantees of the minimum amount of money you will receive when the policy matures or for certain contracts on death. This is explained in the section "What do we guarantee?"

Over the life of your plan we aim to increase the value of the guaranteed amount by adding bonuses.

Payouts

The main factor that affects the amount your plan will pay out is what your share of the sub-fund is worth. This will depend on profits and losses earned by the sub-fund where your plan was allocated over the period of your investment. We look at the share for groups of similar plans and use these results to help us decide the bonuses we will pay.

What affects how much I get?

How much you get back depends on:

- The investment return earned on the sub-fund your policy is allocated to, and the amount of time you have chosen to invest for
- The effect of any guarantees
- The way we smooth payouts
- Plan charges and expenses
- The business risks the With-Profits Fund takes
- The tax we have to pay

The value of investments may fall as well as rise, you may receive back less than your original investment.

How your money is invested?

The payments received are pooled with those of other plan holders in one fund. This fund includes money received for a variety of insurance contracts including traditional regular and single premium With-Profits, Holloway income protection, pure income protection, unit-linked Child Trust Funds ("CTF") and non-profit whole of life contracts. The assets within the fund are sub-divided into smaller parts (sub-funds) in line with the broad groups of contracts given above.

The sub-fund that contains the traditional regular and single With-Profits contracts invests in a mix of different types of assets, such as:

- UK and overseas company shares (equities)
- Property
- Government and company bonds (loans to the government or companies)
- Deposits

The investment strategy of the sub-fund for traditional regular and single With-Profits contracts reflects what our Board of Directors believes is an appropriate balance between the risks of different investments and the potential reward they offer. Our investment managers aim to maximise the returns on our assets, whilst working within the overall investment strategy. The investment strategy looks to maintain the solvency and financial strength of the Society, to the assets being able to meet any payments on contracts as they fall due and to the plan holders being treated fairly.

Higher risk assets, such as equities and property, offer the potential for higher returns over the long-term than lower risk assets such as deposits and bonds. Currently we invest a significant proportion of the sub-fund in equities and property in order to try and increase returns for the plan holders with traditional With-Profits contracts.

The actual mix of assets may change over time, depending on the risks our Board are willing to take and the investment managers' view on potential future returns from different types of asset. (Information on the current mix is available upon request).

Assets of good quality are chosen and limits are set for the amounts of each asset type, sector and any single asset to further help with risk exposure.

The amount of risk our Board is willing to take will be influenced by the size of the surplus (the excess of our assets over our liabilities) as this offers a cushion against volatility in asset values.

What are bonuses?

We aim to increase the amount we guarantee to pay out by adding bonuses to your plan. There are two types of bonus. These are annual bonus and final bonus.

Annual bonus

Annual bonus is normally added to your policy each year. The level of annual bonus can go up and down and there is no guarantee that a bonus will be added each year.

We announce the level of bonus at least once a year. Once we have added an annual bonus it is guaranteed to be paid at the maturity or on death along with the original amount we guaranteed to pay you, unless you alter the terms of the policy. It cannot be taken away.

The level of annual bonus may be different for different products and for similar policies taken out at different times.

An interim bonus may be added if you claim during a period for which an annual bonus has not been declared.

Final Bonus

A final bonus may be added to your policy when you leave the fund because, for example, your policy matures or you surrender your policy. The level of final bonus can go up and down and there is no guarantee that a final bonus will be added. We can change final bonus levels at any time.

Currently we review final bonus levels at least once a year and this will be more often if investment conditions change significantly from what we were expecting.

Although we aim to smooth payouts, final bonus levels can be volatile and change significantly. This is because we invest a significant proportion of the sub-fund in higher risk assets (such as equities or property).

We set separate final bonus rates for different products. There are also different rates for:

- Similar policies that have been invested for different lengths of time
- Regular and single investments that start in the same year
- Policies with different charging structures

How do we set bonuses?

A share of the sub-fund is notionally allocated to your policy, based on:

- How much you have invested
- When you made the investment
- The sub-fund's performance over time, allowing for taxation, if any is payable
- The costs related to running our business
- Various profits and losses (see section "Managing risks the sub-fund is exposed to")

This is known as the asset share and is used to decide what bonuses to add to each plan.

To work out the actual bonus level we group similar policies together, and determine a fair return for those policies. Different groups of policies may receive different levels of bonus.

Whole of life policies are generally awarded the same bonus rates as endowment policies of a similar term. However, where no endowment policy of a similar term exists or where the rate payable to an endowment policy of a similar term is not deemed appropriate then the whole of life policy will get a different bonus rate.

Annual Bonuses

We aim to set annual bonus rates so:

- They are believed to be sustainable over the long-term, considering current and future expected investment returns
- They should not vary too much from year to year
- There may be scope to add a final bonus

Final Bonus

Paying a final bonus enables us to pay out your share of profits that may not have already been paid out as annual bonus. When your policy reaches maturity, or you want to surrender or transfer your policy, we aim to pay out, on average, the asset share of your plan.

What is smoothing?

Investments values can be volatile so the value of the sub-fund and your asset share can fluctuate quite a lot. This is because we invest a significant proportion of the sub-fund in higher risk assets (such as equities and property).

Instead of simply sharing out what the sub-fund makes or loses each year, we even out some of the fluctuations. This is known as smoothing. In practice we may keep some of the growth back when investment conditions have been good, so that we can add it back when investment conditions are poor.

Although the actual amount of smoothing will vary between different types of With-Profits policy, the principle remains the same. We also adjust the level of smoothing to maintain fairness between plan holders who voluntarily leave the fund, for example, by surrendering or transferring, and those who remain in it. This is to ensure that remaining plan holders are not disadvantaged.

Although smoothing helps to even out some of the fluctuations in investment values, it can not fully protect you from poor investment conditions or long-term market falls. When the value of the asset shares fall the value of pay outs may also fall. On your maturity date or for certain contracts on death, we guarantee to pay out a minimum amount, this is explained in more detail in the "What do we guarantee?" section.

On death the payout is based on the initial guaranteed basic benefits plus the annual bonuses awarded to the date of claim, plus a final bonus amount as if the contract had matured at the date of claim.

Surrendering your plan

If you decide to leave the sub-fund early by surrendering or transferring your policy, we aim to pay out, on average, the asset share of your plan.

What do we guarantee?

Our traditional With-Profits plan contain guarantees. Any guarantees that your plan has are detailed in your plan documentation.

For a traditional With-Profits on maturity and death, the Society guarantees that the payout will be no less than the initial guaranteed basic benefit plus the annual bonuses awarded to the date of the claim. No guarantees apply on surrender.

Charges and expenses

We aim to share the costs of providing advice to customers, selling and administering policies fairly among plan holders. These expenses are used to calculate the asset shares and therefore impact on the amount we pay out.

Managing risks the sub-fund is exposed to

The performance of the sub-fund is affected by risks that may increase or reduce its value. The Society has established robust procedures, systems and controls for the management of risk. These risks may change over time.

Currently the major risks facing the sub-fund are:

- Potential losses on investments
- The cost of guarantees made on some With-Profits plans being greater than expected
- Losses on our non-profit business (such as claims being more than expected)
- Expenses being higher than planned

Our Board of Directors is responsible for actively managing any risks to the With-Profits Fund. They consider factors including:

- Whether the risk is worth taking
- The size of the surplus (see the next section)
- The size of the potential impact on our assets and our ability to pay plan holders
- Our exposure to other risks

The surplus will normally absorb any profits or losses that arise from the risks the sub-fund runs. However as a mutual organisation, with no shareholders, any losses (or profits) may ultimately be borne by (or credited to) the With-Profits plan holders.

The surplus and how we use it to manage your investment

The surplus is the term we use to describe the excess of our assets over liabilities. Or in other words, it is the amount over and above what is needed to cover all the Society's policies. It provides us with the money (working capital) to operate our business.

We carefully manage the surplus so that it is big enough to:

- Provide enough money, so that we can continue to issue new business and develop new business activities
- Cover the costs of smoothing
- Meet the costs of certain policy guarantees
- Meet any excess of expenses over charges to With-Profits plans
- Provide investment freedom so we can invest in riskier assets which have potential for higher investment returns (for example equities and property)
- Cover one-off exceptional expenses

Volumes of new business

Regular consideration is given to whether it is in the interests of the plan holders for the fund to remain open to new business against the alternative of closure and the options available for managing a closed book of business.

The financial soundness of the sub-fund can be adversely affected if the company issues too many new policies. The surplus is large enough such that currently we do not set any limits on the amount of With-Profits business that we sell in any year. We regularly monitor the levels of new business. There is no upper limit in place. New business will not be written if the Society believes there is a risk that it may disadvantage existing plan holders.

The Society also considers the types of products being sold, their suitability for customers, the associated risks and the terms on which they are available.

To find out more

If you would like to know more about investing in traditional With-Profits sub-fund, you can:

- Contact Shepherds Mutual Solutions on **0800 092 1245**
- Call our Customer Service team on **0800 526 249**
- Read the principles and practices of financial management (PPFM) at **www.shepherdsfriendly.co.uk**

The PPFM overrides the contents of this guide if there are any differences between the two documents.

The PPFM is a long and detailed document describing how we manage our With-Profits business. If it is necessary to change the Principles we will write to you giving three months advance notice of such a change. Changes to Practices will be published on our website.

All references to taxation are to UK taxation and are based on Shepherds Friendly Society's understanding of current legislation and H M Revenue and Customs practice which may change in the future. Please ensure that you read the full Terms and Conditions of your plan which are available from your financial adviser or by contacting us directly.

Shepherds Friendly

Your modern mutual

to make members feel valued

to remain mutual when in our members interests

to provide simple, value for money financial solutions

to be a place where people want to work

We believe that mutuality is the best way of providing maximum benefit to our members and at the heart of the Society we have the mutual core values of trust, mutual benefit and ownership. We ensure that the money you invest with us is treated in a responsible and sensible manner to give as good a return on your investment as possible.

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