WITH-PROFITS GUIDE

Your Future is
Our Business

Sheffield
Mutual

A guide to how we manage our With-Profits business

The premiums you pay in to your Sheffield Mutual with-profits policy are invested in the Society's long-term business fund. This guide explains how we manage the fund and what you might expect to get back from your policy. It is the customer friendly version of our Principles and Practices of Financial Management (PPFM).

Contents

Please read this guide -

it gives you important information about how with-profits policies work.

1. Glossary

Actuary
The actuary or with-profits actuary is the appropriately qualified and FSA approved person the Society employs to undertake its investment, solvency and asset share calculations, and to advise the Committee on its compliance with the PPFM.

Annual Bonus
This is the bonus we may add to your policy each year. It is sometimes called a reversionary or regular bonus.

Assets
These are the investments held within the Society's long-term business fund.

Asset Share
The term used to describe your fair share of the underlying assets in the fund.

Committee of Management (the 'Committee')
This is the governing body of the Society, elected by our voting members.

Estate
This term describes the value of the assets in the fund, which have been built up over time and are not part of an individual's asset share.

Final Bonus
This is the bonus that we may add at the end of the investment. It is sometimes called a terminal bonus.

Fund
This is all the money that has been contributed to our long-term business fund, which is held in a variety of assets.

Interim Bonus
This is the bonus we will add when your policy matures or is surrendered part way through a bonus year.

Market Value Reduction
This describes an adjustment to the value of your policy in adverse investment conditions.

Maturity
The term used when the policy has run its full term and the investment is paid out.

Smoothing
This is the term used to describe the practice employed to make your return more even.

Sum Assured
This is the amount shown on your illustration and is the guaranteed minimum you will receive on maturity and death (depending on the type of policy), providing you continue to pay all the premiums due.

Surrender
To cash in your policy before the end of its term.

With-profits
The name of the type of policy that this guide describes.

2. Why should I read this?

This document gives information about the with-profits policies issued by Sheffield Mutual Friendly Society (the 'Society'). It is intended to help you understand how the Society will manage its long-term business fund (the 'fund') in which your policy is invested and how bonuses are calculated. It also describes various matters which affect the fund and lets you know how the Society deals with them.

This document is known as the 'Consumer Friendly Principles and Practices of Financial Management' (CFPPFM for short). It is an extract of the most important information from the Society's full Principles and Practices of Financial Management (PPFM for short) in a form which we hope you will find easier to understand. If there are any differences between this document and the full PPFM, then it is the version in the full PPFM which will apply.

This document uses a number of special terms. These are defined within the Glossary. To help you know which these are, they are shown in bold italics (for example ***asset share***).

3. Introduction

We manage our long-term business ***fund*** by following a set of Principles and Practices, which are explained in the full PPFM. If changes are required to any of the Principles, you will be given at least three month's prior written notice of such changes. Changes to Practices will be communicated within a reasonable time period.

4. What is a with-profits policy?

A ***with-profits*** policy shares in the profits of the Society through the addition of bonuses. The amount of bonus will depend on how the investments in the ***fund*** have performed while you have been paying premiums into it. The amount of bonus will also depend on the allowance we make for the expenses of setting up and running the policy. The Society is a mutual organisation, which means that there are no shareholders. The Society is, therefore owned by its members, which includes ***with-profits*** policyholders.

The following policy types are classed as ***with-profits:-***

- **Tax Exempt Savings Plan (TESP) – with or without life cover**
- **Regular Savings Plan**
- **Investment Bond**
- **Income Bond**
- **Pension Bond**
- **Individual Savings Account (ISA)**
- **Junior Individual Savings Account (JISA)**

5. What are the main principles we follow?

- We aim to meet the contractual obligations to all policyholders
- We aim to meet the tests of solvency and capital adequacy as required by regulatory bodies
- We aim to treat policyholders fairly and meet policyholders' reasonable expectations

6. How do we decide annual bonuses?

- ***Annual bonuses*** are set by taking account of what the ***fund*** can afford now and in the future
- The amount of bonus is based on the investment return achieved within the ***fund*** after allowing for any guaranteed basic benefit
- We normally set ***annual bonus*** rates each year in March

The bonus rate is decided by the ***Committee of Management,*** after taking advice from the Society's ***with-profits actuary.***

Annual bonuses are normally declared on the policy's ***sum assured,*** with two exceptions. Bonuses on the Society's Income Bond and Stocks & Shares ISA/JISA are applied to the accumulated ***fund*** (capital balance plus previous bonus), allowing for any income payments or withdrawals that have been made. ***Annual bonuses*** are expressed as a percentage of the policy's ***sum assured*** or, in the case of the Income Bond and ISA/JISA, the accumulated fund.

When ***annual bonuses*** are added to the guaranteed ***sum assured*** of a regular premium ***with-profits*** policy, they cannot be taken away, providing the policy is held until ***maturity.***

With-profits policies which become claims by death or ***maturity,*** or which are ***surrendered*** prior to the bonus declaration for the year, are entitled to an ***interim bonus*** at the relevant interim bonus rate as set by the ***Committee***.

7. How do we decide final bonuses?

- ***Final bonuses*** are from time to time declared to ensure the amount you get back fairly reflects your share of the performance of the ***fund.*** We call this amount your ***asset share***
- Any ***final bonus*** is generally conditional upon your policy being in force for a minimum number of years

Final bonus rates are declared at the discretion of the ***Committee*** on the advice of the with-profits ***actuary.***

With-profits policies which become claims by death or ***maturity,*** or which are ***surrendered*** prior to the bonus declaration for the year, may be entitled to an interim ***final bonus*** at the relevant final bonus rate as set by the ***Committee*** at the previous or any subsequent declaration. A lower final bonus may be paid if the policy is ***surrendered*** before its scheduled ***maturity*** date.

8. What is an asset share?

The ***asset share*** for a policy is calculated by taking the premiums paid, deducting the expenses of setting up and administering the policy, and increasing the value by the interest earned on the ***fund*** from year to year, less tax where appropriate.

The ***asset share*** of a policy does not dictate the amount of money a policy will receive when it becomes a claim, but our ultimate target is to pay an amount which is 100% of the ***asset share.*** However, it does inform the decisions that are made with regard to the right amount of bonus to declare each year and we do aim, with the effect of ***smoothing,*** to pay out an amount on ***maturity*** which is between 80% and 120% of the ***asset share*** based on the relevant specimen policy calculations.

9. What is smoothing?

Smoothing is a process which applies to ***with-profits*** policies to ensure that the amounts paid out do not vary excessively from year to year. The Society's current approach to ***smoothing*** is to ensure that the amount paid out on a claim on a particular policy within the same premium table will not vary by more than 10% from year to year. The ***Committee*** can, on the advice of the ***Actuary,*** depart from this 10% limit should the financial condition of the ***fund*** so dictate.

The process of ***smoothing*** also means that if a Bond or an ISA policy is surrendered or encashed at the time of a severe fall in the value of the ***assets*** within the fund, a ***market value reduction*** may be applied to the ***surrender*** value to ensure that only a fair share of the ***fund*** is paid out.

10. What happens if you leave (surrender) early?

We use a formula to calculate the ***surrender*** value, but our ultimate target is to pay an amount which is 100% of the ***asset share.*** However, with the effect of ***smoothing,*** asset shares may fluctuate from year to year and, therefore, we will aim to pay an amount which is between 75% and 125% of ***asset share*** based on the relevant specimen policy calculations.

11. What does the fund invest in?

The money you pay in premiums is invested by the Society in a range of different ***assets.*** These include fixed interest investments including Government securities, equities (shares), commercial property and commercial mortgages. Your policy's bonus performance will depend on the investment return generated by these ***assets,*** based on your policy's ***asset share.***

The Society aims to maintain a balanced investment portfolio, including equities (shares), fixed interest (including UK Government Gilts), tenanted commercial property, commercial mortgages and cash. Our investment strategy has regard to the Society's long term business liabilities, the extent of any guarantees applying to policies and the need to demonstrate financial strength. We formally review the percentage of each ***asset*** in the ***fund*** every year, or more frequently when investment markets are volatile.

Guidelines for the proportion of ***assets*** to be invested in each class of ***asset*** are agreed by the Society's ***Committee*** at least annually. The current allocations can be obtained on request from the Society.

The Society follows an ethical investment policy and aims to invest in companies that are not involved in the production of armaments, tobacco or pornography.

12. What are the charges?

The premiums you pay for your ***with-profits*** policy include an allowance for the expenses of selling and administering that policy. The only exception to this is the ***with-profits*** ISA/JISA contracts, which are described separately later in this section. The charges are set out in the relevant product Key Features document and brochure.

All Sheffield Mutual's policies, both ***with-profits*** and without-profits are administered in a single ***fund,*** and all the expenses are charged to that ***fund.*** These expenses include all the expenses of acquiring new business and the expenses of keeping that business in force, including, for example, costs of administration, investment management and regulatory fees. The Society splits the costs between acquisition and maintenance in different ways according to the particular costs. The split may be based on an allocation of time, on the number of policies, the size of the premium or some other appropriate measure.

Certain exceptional expenses (for example setting up a new computer system) may be treated separately from "normal" expenses and will not be charged directly to ***asset shares*** but will be charged to the free assets or ***estate*** (see below).

For the ***with-profits*** ISA/JISA contracts the charges for expenses are deducted from the build up of the fund by reducing the bonus rate allocated to the contract. So for example if it was decided that the policies had earned a bonus of 3.5% and the expenses were 1.5% of the fund the bonus allocated would be reduced from 3.5% to 2.0%.

13. What risks is the fund exposed to?

The Society does not have any shareholders, so the long-term business ***fund*** bears the costs of the risks of all business activity. However, in general, the Society is unlikely to accept any business risks outside the routine risks of effecting and carrying out long-term insurance contracts.

The Society does not operate formal limits on the taking on of business risk, but the Society has established and robust procedures, systems and controls covering the management and mitigation of risk. For example, we review our business plans each year to ensure that the costs of selling and maintaining the policies can be supported by the ***fund*** without adversely affecting the interests of existing policyholders.

There is currently no risk from other investments in subsidiary or associated operations, and the Society's Child Trust Fund business, which is held in a segregated sub-fund, is not considered to be a significant source of risk.

14. Why does the fund have a surplus of assets?

The ***free assets*** are the amount of ***assets*** in the ***fund*** over and above the amount needed to secure all policyholders' guaranteed benefits with some allowance for future bonuses. This has been built up over the history of the Society and is the result of a number of detailed calculations. The ***free assets*** are sometimes also referred to as the inherited estate or ***'estate'.***

The ***free assets*** provide the capital necessary to fund the writing of new business and also to fund exceptional expenditure and other items which cannot rightfully be charged to policyholders. They provide a buffer to allow the ***fund*** to smooth policy payouts and absorb losses and profits. They also enable the Society to invest in a wider range of ***assets*** than would otherwise be the case.

The Society targets the amount of ***free assets*** it feels appropriate to hold for the size of the ***fund*** and its policies in force. The ***free assets*** are built up by the interest earned on them and by profits arising from miscellaneous sources including non profit business and the Child Trust Fund.

15. How do we manage new business?

The Society sets a target for new business each year in consultation with the ***actuary*** and taking account of the financial and processing resources required. Consideration is also given to the types of policies sold and our aim is to ensure that policies are financially self-supporting over their duration. New business will not be written if the Society believes there is a risk that it may disadvantage existing policyholders.

16. Where can I find out more?

The PPFM is available on our website **www.sheffieldmutual.com**, or you can request a copy by calling 01226 741000.

You can also write to the Society at 3 Maple Park, Maple Court, Wentworth Business Park, Tankersley, Barnsley S75 3DP.

The Government's website **www.moneyadviceservice.org.uk** also has further information on ***with-profits.***

You may also find it helpful to speak to a professional adviser.

Sheffield Mutual

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