

Committee of Management's Report to With-Profits Policyholders for the year 2019

1. Introduction

The Society's Principles and Practices of Financial Management ("PPFM") describes how the Society manages its with-profits business. This document is available free of charge from the Society's website www.sheffieldmutual.com or by contacting the Society's office.

The Society is required to produce a report for with-profits policyholders stating whether, throughout the financial year covered, it believes it has complied with its obligations relating to the PPFM and setting out the reasons for that belief. This report covers the financial year 01 January 2019 to 31 December 2019.

Version 6 of the PPFM applied from 15 December 2017 until 22 March 2019 when Version 7 was approved. Version 7 applied for the remainder of 2019.

2. Compliance with the PPFM

The Committee of Management (the "Committee") confirms that it has complied with its obligations relating to the PPFM throughout 2019. In particular, it confirms that:

- (a) the Committee has exercised any discretion in the conduct of the Society's with-profits business in accordance with the PPFM, and
- (b) any competing or conflicting rights, interests or expectations of the Society's policyholders have been addressed through the application of the PPFM.

In making this declaration of compliance the Committee has taken into account advice from the Society's With-Profits Actuary ("WPA") on compliance with the PPFM and discretion exercised throughout the year. A statement from her is annexed to this report. The Committee has also received advice and reports from the Society's With-Profits Advisory Arrangement ("WPAA") on compliance with the PPFM throughout the period. The WPAA has reviewed this report and has concluded that it is not necessary to provide a separate statement to policyholders.

3. Governance

The Committee is responsible for the effective governance of the Society's with-profits business and, in particular, compliance with the regulatory rules and guidance as set out in the Conduct of Business sourcebook of the Financial Conduct Authority ("FCA").

In managing the Society's with-profits business the Committee receives guidance from the Society's WPA and the WPAA. The Terms of Reference for the WPAA are available from the Society's website www.sheffieldmutual.com or by contacting the Society's office.

The WPA throughout 2019 was Cara Spinks of OAC plc and her statement is annexed to this report. Since 1 January 2012, when the Society became Directive, all key decisions are

reviewed by the WPAA who have provided comments on compliance with the PPFM and the fair treatment of with-profits policyholders throughout 2019.

4. Reasons for the Committee's Confirmation of Compliance with the PPFM

Having taken advice from the WPA and the WPAA the Committee has reviewed the key provisions and elements of the PPFM, and its conclusions on each area are as follows:

(a) Amounts Payable and Bonus Rates

The amount payable on a claim is normally determined by the sum assured and bonus added to the date of claim. Bonuses calculations are informed by specimen asset shares using standard policy sizes and allowing for the policy expenses assumed in the policy pricing basis. The Society uses a formulaic approach for the calculation of surrender values for both regular and single premium policies. ISA / Junior ISA policies receive their face value in the event of a claim. The application of an MVR reduces the face value by the percentage of the MVR applied. The methodologies used to calculate amounts payable and bonus rates have been consistent with the PPFM during 2019.

(b) Bonus Policy and Smoothing

The Society's normal practice is to review annual bonus rates on all business once a year and, at the same time, to consider whether a final bonus or MVR should be declared on any contracts. The normal full review took place in November 2018 and this set the provisional bonus rates for the year ended 31 December 2018 and interim rates for 2019. The Committee agreed to declare 2018 annual bonus rates in line with the 2018 interim rates. At the Committee meeting held in March 2019 to confirm the bonus rates, the Committee agreed to maintain the 2019 interim annual bonus rates at the same level as the rates declared for 2018. These decisions were made following the 2018 year end valuation and were based on an assessment of market interest rates, future investment returns and the high cost of policy guarantees within the Solvency II capital regime for insurance companies and friendly societies.

At the same time the Committee agreed to declare a 2.5% final bonus on maturing regular premium endowment contracts, a final bonus of 7.5% on Investment Bonds in force for five years or more and a 5% final bonus on Insurance ISAs taken out in 2003 and 2004, and on Investment (Stocks & Shares) ISAs where the money was invested in the tax years 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14. The Society also introduced a Terminal Bonus of 5% for Junior ISA subscriptions paid up to and including the 2013/14 tax year. The final bonuses largely ensured that these policies received a pay-out close to their asset share and compensated regular premium policyholders for the reduction in annual bonus rates.

There were no interim reviews during 2019. A full bonus report from the WPA was considered in November 2019, which recommended annual bonus rates for 2019 and interim rates for 2020. In March 2020, the Committee agreed to revise the declared 2019 rates downwards in response to the Covid-19 pandemic, which has

led to a slump in investment markets, the Bank of England base rate falling to a historic low of 0.1% and the increased possibility of a recession.

The Society has no formal smoothing policy but our aim is for payouts from year to year not to vary by more than 10% in normal circumstances. One exception to this is where a change of premium table leads to a change in payout. During 2013 the Society launched a new series of the Tax Exempt Savings and Regular Savings Plans, which have a lower guaranteed sum assured and higher management contributions. To maintain fairness the Committee has maintained slightly higher annual bonus rates for these plans, compared to the earlier series.

The bonus reports received from the WPA were consistent with the requirements of the PPFM for the fair treatment of policyholders.

(c) Investment Strategy

The investment strategy of the fund and asset mix according to class of business is reviewed each year and this is reflected in the Society's Investment Policy. The Finance and Investments Committee reviews detailed reports of the assets held by the fund each month and uses this information to monitor performance and compliance with the investment mandates of the fund. Investments have been managed according to the Society's Investment Policy throughout 2019 and further details on transactions and asset mix can be found in the 2019 Report & Accounts.

(d) Charges and Expenses

The Society allocates expenses to policy asset shares according to the amounts assumed in the premium tables, with the balance of expenses being met by emerging surplus or free reserves. From 2013 the Committee decided that a proportion of the surplus emerging from the expense charges arising from the Child Trust Fund ("CTF") would be used to cover the Society's renewal costs in excess of the allowance in the premium tables. This practice continued for 2019 and is expected to be maintained on an annual basis. The premium table expenses, which are also set out in the product key information documents, are incorporated in the specimen asset share calculations. Fund management charges are set against investment income. The Society's allocation of expenses in 2019 is consistent with the PPFM.

It has been the Society's practice to allocate roughly a third of the available expense loading on CTF funds to the calculation of asset share investment returns in order to support and enhance the bonus declaration. This has been the practice from 2013 to 2019. The additional return has increased the investment return credited to asset shares by 0.24% to 0.33% each year.

(e) Exposure to Business Risk

The Society's risk management process is set out in the 2019 Report and Accounts. As a Solvency II insurer the Society performed an Own Risk and Solvency Assessment ("ORSA") in 2019 in accordance with regulatory requirements. The purpose of the ORSA is to enable the Committee to assess, monitor and manage the Society's risks relative to the medium-term business plan and to understand how

much current and future capital is necessary to cover those risks having considered other mitigating factors. The Society has no exposure to business risk outside the normal risks associated with the ongoing transaction of insurance business.

(f) Management of Mutual Capital

The Society maintains a level of free assets which enables it to invest in a wide range of investments and to fund the writing of new business. A target range is set for the free asset and solvency ratios and if the free assets fall outside these ranges then remedial action would be taken. The Society can confirm that the management of the mutual capital has taken place in accordance with the requirements of the PPFM and that the free asset and solvency ratios were within the target ranges throughout 2019.

(g) Volume of New Business

The Society has reviewed its new business plans in conjunction with the WPA and considers the current plans to be acceptable in terms of the PPFM's requirements. Specifically, the plans can be supported by the existing margins of the with-profits fund or from the mutual capital without detriment to the interests of existing policyholders.

Work is being undertaken to assess the impact of recent events on the Society's business plan but it is still far too early to draw any conclusions as to what may need to change going forward.

(h) Communication with Policyholders

The Society aims to meet the information needs of policyholders by ensuring that communications are clear, fair and not misleading, and that they have been consistent with the PPFM. Bonus statements in relation to 2019 were sent to all with-profits policyholders in March/April 2020 and details of the Society's investment strategy and asset mix were outlined in the Summary Report & Accounts sent to members in May 2020. The Society is aiming to send a Member Newsletter later in 2020.

Jamie Bellamy
Chief Executive
for and on behalf of the Committee of Management

22 May 2020

With-Profits Actuary's report to with-profits policyholders for the year 2019

As With-Profits Actuary to Sheffield Mutual Friendly Society I am required to report to the with-profits policyholders on whether, in my opinion, the with-profits business of the Society has been managed over the year in a way that takes their interests into account in a reasonable and proportionate manner.

Policyholders should not rely solely on the information contained in this report when making financial decisions and this report does not represent financial advice.

I can confirm that, over 2019, I have had access to the Chief Executive and Committee of the Society to ensure that I have been informed and consulted on all important matters relating to the transaction of with-profits business. In addition, in preparing this report, I have taken account of the rules of the Financial Conduct Authority and the guidance requirements of the Actuarial Profession and the Financial Reporting Council.

In my opinion, the annual report by the Society to its with-profits policyholders, and the discretion exercised by the Society in respect of 2019, has taken the interests of its with-profits policyholders into account in a reasonable and proportionate manner.

I believe that the Society has complied appropriately with the requirements of its Principles and Practices of Financial Management. I also consider that the Society has paid due regard to the information needs of its members.



Cara Spinks FIA
With-Profits Actuary to Sheffield Mutual Friendly Society