

Board's Report to With-Profits Policyholders for the year 2020

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 1 January 2020 to 31 December 2020.

Version 7 of the PPFM applied from 22 March 2019 until 20 March 2020 when Version 8 was approved. Version 8 applied for the remainder of 2020.

2. Compliance with the PPFM

The Board of Directors (the "Board") confirms that it has complied with its obligations relating to the PPFM throughout 2020. In particular, it confirms that:

- (a) the Board 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 Board 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 Board 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 Board 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 Board 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 2020 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 2020.

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

Having taken advice from the WPA and the WPAA the Board 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 Society aims to pay 100% of a policy's asset share on claim. However, asset shares can vary and the effect of smoothing from year to year means that, on maturity, the Society aims to pay an amount that is in the range 80% to 120% of asset share, and on surrender, an amount that is within the range 75% to 125% of asset share (based on specimen policy calculations).

The amount payable on a claim is broadly determined by the sum assured and bonus added to the date of claim. Bonus calculations are informed by the 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 and a final bonus or a Market Value Reduction ("MVR") may be applied. The application of a final bonus or an MVR respectively increases or reduces the face value by the percentage applied.

The methodologies used to calculate amounts payable and bonus rates have been consistent with the PPFM during 2020.

(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 2019 and this set the provisional bonus rates for the year ended 31 December 2019 and interim rates for 2020. At the Board meeting held in March 2020 to confirm the bonus rates, the Board agreed to revise the 2019 declared rates and the 2020 interim annual bonus rates as follows:

2019 Declared Rates:

- Regular endowment products - interim rates reduced by 0.25%
- Bonds and ISAs – interim rates reduced by 0.50%

2020 Interim Rates:

- Regular endowment products - reduce from 2019 declared rates by a further 0.25%
- Bonds and ISAs – reduce from 2019 declared rates by a further 0.50%

These decisions were made following the 2019 year end valuation and were based on an assessment of the pandemic's significant effect on investment markets, the reduction in prevailing bond yields to historically low levels, the outlook for 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, based on the above factors, the Board agreed to temporarily remove terminal bonuses and to apply the following MVRs:

- 5% on ISA surrenders
- 2.5% on bond surrenders and 'matured' bonds (held for five years)

The following interim reviews of the MVR were carried out during 2020:

<i>With effect from;</i>	<u>MVR applied</u>	
	ISA	Bonds
20/03/2020	10.0%	5.0%
04/05/2020	5.0%	2.5%
19/06/2020	2.5%	0.0%
24/07/2020	0.0%	0.0%

A terminal bonus of 1% was reinstated on 25th May 2020 for regular endowment maturities.

A full bonus report from the WPA was considered in November 2020, which recommended annual bonus rates for 2020 and interim rates for 2021. The Board agreed to declare 2020 annual bonus rates in line with the 2020 interim rates. At the Board meeting held in March 2021 to confirm the bonus rates, the Board agreed to maintain the 2021 interim annual bonus rates at the same level as the rates declared for 2020.

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 Board 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 2020 and further details on transactions and asset mix can be found in the 2020 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 Board 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 2020 and is expected to be maintained on an annual basis, taking into account the run-off of the now maturing CTF policies. 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 2020 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 2020. The additional return has increased the investment return credited to asset shares by 0.16% to 0.33% each year.

(e) Exposure to Business Risk

The Society's risk management process is set out in the 2020 Report and Accounts. As a Solvency II insurer the Society performed an Own Risk and Solvency Assessment ("ORSA") in 2020 in accordance with regulatory requirements. The purpose of the ORSA is to enable the Board 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 2020.

(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.

(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 2020 were sent to all with-profits policyholders in March/April 2021 and a Member Newsletter was sent along with the Notice of AGM in May 2021. The Society's SFCR and Report and Accounts are available on the Society's website.

Jamie Bellamy
Chief Executive
for and on behalf of the Board of Directors

14 May 2021

With-Profits Actuary's report to with-profits policyholders for the year 2020

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 2020, I have had access to the Chief Executive and Board 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 2020, 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