

SCOTTISH FRIENDLY ASSURANCE SOCIETY LTD

Scottish Friendly’s Annual Report to With-Profits Policyholders 2022

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# Summary

* 1. This report provides details of the review of the treatment of with-profits policyholders and, particularly, the consistency of the treatment with the published Principles and Practices of Financial Management (PPFM), which detail how we manage the with-profits sub-funds.
  2. There were not any changes applied to the PPFMs during 2022.
  3. In the opinion of Scottish Friendly, the management of the with-profits funds over 2022 has materially been in compliance with the obligations of the relevant PPFMs. The With-Profits Committee has considered this report and has decided that an additional report specifically from the With-Profits Committee is not required.

# Purpose

* 1. The purpose of this report is to explain how the Scottish Friendly with-profits fund and sub-funds have been managed during 2022 and to demonstrate that we have followed our published ‘Principles and Practices of Financial Management’ (PPFM) for each sub-fund.
  2. The Conduct of Business sourcebook of the Financial Conduct Authority (‘FCA’) requires firms to establish and maintain PPFM documents to govern their conduct of their with-profits business.
  3. The FCA also requires the firm to report to its with-profits policyholders stating whether, throughout the financial year to which the report relates, the firm believes it has complied with its obligations relating to each PPFM and setting out the firm's reasons for that belief.
  4. The PPFM documents are available electronically on the Scottish Friendly website: www.scottishfriendly.co.uk[[1]](#footnote-1).
  5. Throughout 2022 Scottish Friendly has published and maintained separate PPFM documents covering the management of the Unitised With-Profits (UWP) Policies and Conventional With-Profits (CWP) Policies written within the Scottish Friendly Main Fund. In addition, separate PPFM documents have been published and maintained throughout 2022 for the Rational Shelley, LANMAS, Scottish Legal, Marine & General and the Manulife sub-funds.
  6. The Principles are high-level statements that reflect the general approach adopted in managing the with-profits fund and are not expected to change often.
  7. The Practices are statements of specific practice employed in managing the with-profits fund. They reflect the current approaches given the particular circumstances of and established ways of managing each fund. Practices are likely to be revised in response to changes in the regulatory, business and economic environment and as new methods and techniques are developed in the life and pensions industry. However, the different Practices would still need to conform to the Principles.
  8. There were not any changes made to the PPFM documents during 2022.

# Governance

* 1. Scottish Friendly has a with-profits governance arrangement to ensure that its Board of Directors can satisfy itself at regular intervals that the with-profits business is being managed in accordance with the PPFM. This governance arrangement is the With-Profits Actuary and a With-Profits Committee.
  2. The With-Profits Actuary is Mr. Stephen Makin of Hymans Robertson LLP.
  3. Over 2022, the With-Profits Committee consisted of five members, who bring a wealth of diverse industry experience. It is chaired by a person who is entirely independent of Scottish Friendly and its Board, with one further independent member, as well as three further members who also sit on the Board of Scottish Friendly as Non-Executive Directors. It provides challenge of the With-Profit Actuary’s proposals and additional oversight of the fair treatment of with-profits policyholders. The terms of reference for this committee are available on the Scottish Friendly website[[2]](#footnote-2).
  4. The With-Profits Actuary gives advice and recommendations to the Board and With-Profits Committee on matters relating to with-profits business. This has included an assessment of compliance with the PPFMs and the oversight of communications provided to policyholders.
  5. A report from the With-Profits Actuary to with-profits policyholders is annexed to this report. The With-Profits Committee has considered this report and has decided that an additional report specifically from the With-Profits Committee is not required.

**Communication with policyholders**

* 1. Over 2022 a project was undertaken to review communications issued to with-profits policyholders at key points in the product life-cycle, and a number of enhancements are currently being made to these to enhance the information provided and improve clarity of key messages. The With-Profits Committee has oversight of this work. Furthermore, the content of bonus statements and any communications around changes to PPFMs is reviewed by the Actuarial Department and the With-Profits Actuary.

# How we have complied with our PPFM

* 1. In the opinion of Scottish Friendly, the management of the with-profits fund and each sub-fund during 2022 has materially complied with the obligations detailed in the relevant PPFMs. The reasons for reaching this opinion are detailed in this section.

**Bonus policy and payouts**

* 1. Details of the current bonus rates can be found on our website[[3]](#footnote-3).
  2. The assessment of bonus rates met the requirements of the PPFMs in terms of the bonus and smoothing policy detailed therein.
  3. For most classes of with-profits business, we endeavour to pay a value that reflects the asset share to ensure that fairness is maintained between different groups and generations of policies. As detailed below, the exception are Rational Shelley and Manulife policies. The PPFM contains target ranges for maturity and surrender payouts relative to their asset shares.
  4. The target ranges for each class of business are detailed below:

| **Policy Group** | **Target Range** |
| --- | --- |
| Scottish Friendly OB (Ordinary Branch) | 80% to 120% unsmoothed asset share |
| Scottish Friendly IB (Industrial Branch) | 75% to 200% unsmoothed asset share |
| Scottish legal Life | 70% to 130% unsmoothed asset share |
| LANMAS | 80% to 120% unsmoothed asset share |
| Marine & General Conventional Business | 80% to 120% unsmoothed asset share |
| Marine & General Unitised Business | 90% to 110% unsmoothed asset share |
| Rational Shelley | Not applicable as asset shares are calculated based on bonus rates |
| Manulife | Not applicable as asset shares are calculated based on bonus rates and surrender values are formulaic. |

* 1. The target ranges are set so that the business can be appropriately managed by allowing flexibility in the setting of bonus rates to smooth returns when markets are volatile, and to give confidence to policyholders that payouts will be fair. We set our bonuses with the aim of keeping the majority of our payouts within the applicable target range.
  2. Some target ranges, such as Scottish Legal Life and Scottish Friendly IB, are wider than for the other policy groups listed in the table in Section 4.5. For Scottish Friendly IB and Scottish Legal Life there is a greater number of whole of life policy claims within this sub-fund, which means that it is more difficult to achieve payouts within a small target range.
  3. During 2022 the payouts for maturities and surrenders for the majority of business blocks fell within the target ranges. For blocks where payouts fell outwith the target ranges the reasons for this are understood and there is no implication that these payouts, in aggregate, were unfair.

**Investment strategy**

* 1. Monitoring investment performance and investment strategy is the responsibility of the Board, and the Board delegates responsibility to the Investment Committee. The Investment Committee monitors the investment performance and strategy regularly. In addition, the With-Profits Committee is provided with updates on investment performance, as well as key decisions related to investment strategy, to consider whether these are consistent with expectations set by the PPFM.
  2. Over 2022 the investment strategy has been carried out in accordance with the PPFM.
  3. Details of the latest investment information relating to your policy can be found on our website[[4]](#footnote-4).
  4. The guidelines for the investment strategy can be found in the relevant PPFMs.

**Business risk**

* 1. Scottish Friendly’s with-profits policyholders in the Main Fund ultimately bear the risks and rewards of all business undertaken by Scottish Friendly. Any significant additional business risks to be undertaken by Scottish Friendly require the approval of the Board and Executive, acting on the advice of the With-Profits Actuary. The Board and Executive take into consideration the risks to which with-profits policyholders are and may become exposed, as well as the expectations of achieving appropriate returns for the with-profits policyholders commensurate to the risks borne.
  2. With-Profits policyholders in other sub-funds are also, although to a lesser extent, exposed to business risks as new business and acquisitions are not written into the sub-funds. The returns in each sub-fund are independent of one another and therefore reflect the risks taken in each sub-fund by the with-profits policyholders.
  3. Business risks are monitored regularly throughout the year and an annual review of business risks was carried out during 2022.

**Charges and expenses**

* 1. Scottish Friendly aims to allocate expenses to with-profits policies in a fair manner by giving consideration to the expenses incurred in administering the with-profits business, as well as an appropriate amount of overhead expenses. Consideration is also given to fairness between policies and classes of policies.
  2. The approach used to setting charges and expenses is regularly reviewed and remains in line with the PPFM.

**Management of the estate**

* 1. Where a sub-fund has an excess of assets over liabilities this is known as the estate. The management of the estate for each sub-fund is described within the PPFM. The management of the estate has been carried out in line with the PPFM during 2022.
  2. The use and possible distribution of the estate of each sub-fund has been reviewed over 2022 as part of the annual review. The level of the estate has been monitored regularly over the year to help ensure that the level of any distribution remains appropriate.

**Volume of new business**

* 1. New business is written in the Scottish Friendly Main Fund only. All sub-funds are closed to new business.
  2. The volume of new business written over 2022 was substantially in line with the new business plan and meets the requirements set out in the PPFM.
  3. Scottish Friendly undertakes an annual assessment to ensure that existing policyholders are not adversely impacted by the planned sales of new business over the coming year. If this assessment was to conclude that this was the case our planned new business sales would be changed accordingly.

# Changes to PPFM documents during 2022

* 1. No changes were made to the PPFM documents during 2022.

# With-Profit Actuary’s report to with-profit policyholders for 2022

***Report from the With-Profits Actuary to the with-profits policyholders of Scottish Friendly Assurance Society Limited***

*The management of with-profits business requires discretion to be exercised, for example by deciding on the bonus rates to apply in determining policy pay-outs.*

*As With-Profits Actuary to Scottish Friendly Assurance Society Limited (“Scottish Friendly”), I advise the firm on key aspects of how this discretion is exercised. I am also required to report to the with-profits policyholders every year on whether, in my opinion, Scottish Friendly’s annual report to the with-profits policyholders and the discretion exercised by it over the same period take into account in a reasonable and proportionate manner the interests of with-profits policyholders.*

*I have carried out a review for calendar year 2022 of Scottish Friendly’s exercise of discretion and its compliance with the requirements of its Principles and Practices of Financial Management (“PPFM”) for the SF Main Fund and for each of the notional sub-funds. The PPFMs are the key documents setting out how Scottish Friendly manages its with-profits business.*

*Based on my review, it is my opinion that:*

* *Scottish Friendly’s annual report to its with-profits policyholders for 2022, and its exercise of discretion during the year, take into account in a reasonable and proportionate manner the interests of the with-profits policyholders in the SF Main Fund and each of the notional sub-funds,*
* *Scottish Friendly has complied materially with the requirements of its PPFM for the SF Main Fund and each of the notional sub-funds, and*
* *Scottish Friendly has paid due regard to the information needs of its members.*

*My opinion is based on the information and explanations provided to me by Scottish Friendly, on which I have relied, and takes account of Scottish Friendly’s annual report to its with-profits policyholders for 2022 (to which this report will also be appended), Scottish Friendly’s PPFMs (which are available on the firm’s website), and the relevant rules and guidance issued by the Financial Conduct Authority, the Financial Reporting Council, and the Institute and Faculty of Actuaries.*

***Stephen Makin FFA CERA***

***With-Profits Actuary, Scottish Friendly***

***June 2023***

***For and on behalf of Hymans Robertson LLP***

1. https://www.scottishfriendly.co.uk/members-area/latest-investment-information/principles-and-practices-financial-management [↑](#footnote-ref-1)
2. https://www.scottishfriendly.co.uk/about-us/board-committee-terms-reference [↑](#footnote-ref-2)
3. <https://www.scottishfriendly.co.uk/members-area/latest-investment-information/bonus-rates> [↑](#footnote-ref-3)
4. <https://www.scottishfriendly.co.uk/members-area/latest-investment-information> [↑](#footnote-ref-4)