

Report for Policyholders
on compliance with the
Principles and Practices
of Financial Management (PPFM)
for the period
1 January – 31 December 2009



1. PURPOSE

- 1.1. All companies are required to report to their with-profits policyholders on their compliance with their PPFM and this report is in respect of this requirement. It covers compliance over the period from 1 January - 31 December 2009.

2. SUMMARY

- 2.1. In the opinion of the Managing Board, Police Mutual has complied with the obligations relating to the PPFM in all material respects during the period 1 January 2009 – 31 December 2009. The reasons for this opinion are outlined in this report.
- 2.2. Appended to this report is the opinion of the With-Profits Actuary (WPA) on the discretion exercised by Police Mutual during the period covered as required by the Financial Services Authority. The WPA concurs with the opinion above.
- 2.3. The Board for Actuarial Standards has introduced a new reporting standard, "TAS R". In the WPA's opinion, this report complies with TAS R. Whilst this report is not required to comply with TAS R, we have complied because it is good practice to do so.

3. BACKGROUND

- 3.1. Police Mutual first published its Principles and Practices of Financial Management (PPFM) on 30 April 2004. The latest version came into effect on 20 April 2010. The PPFM explains how the Managing Board manages the financial aspects of the Society's with-profits business.
- 3.2. The PPFM is available to policyholders on request and on the Society's website. The Society's contact details are shown at the end of this report.
- 3.3. The obligations a company is required to meet with reference to its PPFM are:
 - To maintain governance arrangements designed to ensure that in the conduct of with-profits business it complies with, maintains and records any applicable PPFM.
 - To make sure the governance arrangements involve independent judgement on compliance with PPFM.
 - To address the exercise of discretion in the conduct of its with-profits business and any competing interests between classes of policyholders in the report mentioned in 1.1.
 - To take the advice of an actuary in preparing the report to policyholders.This report covers these points.
- 3.4. The report also summarises the changes made to the PPFM in the period covered.

4. GOVERNANCE OF THE FUND IN ACCORDANCE WITH THE PPFM

- 4.1. Police Mutual has set up a With-Profits Committee (WPC). One of its functions is to enable independent judgement on compliance with the PPFM. For the period of this report the WPC consisted of three non-executive directors of the Society.
- 4.2. The WPC believe that this report from the Managing Board sufficiently covers its compliance with its PPFM and the way in which any conflicting rights and interests of policyholders have been addressed. Therefore, the WPC does not wish to make a separate report to the policyholders on Police Mutual's compliance with PPFM for this period but should they do so in future this will be facilitated.
- 4.3. Police Mutual also has an externally appointed With-Profits Actuary (WPA) who reports to the Managing Board and to the WPC regarding the PPFM. For the period of this report the WPA was David Murray, from the consultancy firm Deloitte. His report to the with-profits policyholders covers the whole period and is annexed below.

- 4.4. Reports made to the Managing Board during 2009 included comment on the appropriate PPFM issues involved, where relevant.
- 4.5. In the opinion of the Managing Board, Police Mutual has complied with the governance arrangements required for PPFM.
- 4.6. Throughout the period covered, the governance arrangements have ensured that in the conduct of with-profits business Police Mutual has materially complied with, maintained and recorded any PPFM.
- 4.7. During 2009 there was one breach of the PPFM. The proportion of fixed interest securities held in corporate bonds exceeded the stated limit of 50% of the sterling fixed interest portfolio. The WPA and the WPC are satisfied that the decision to breach this limit was taken after due consideration of policyholders' interests and was not unreasonable.

5. EXERCISE OF DISCRETION

- 5.1. The PPFM covers the use of discretion in the management of with-profits business where this is applicable.
- 5.2. There were a number of areas during 2009 where Police Mutual exercised discretion. The significant areas were regarding bonuses, surrender values, charges and expenses, investment strategy and management of the inherited estate.
- 5.3. Police Mutual made bonus declarations with effect from 1 January 2009, 1 May 2009 and 1 September 2009. Surrender values were changed on 20 April 2009 and 1 August 2009 to reflect losses (principally investment market losses) incurred. Charges and expenses charged to with-profits policies were also reviewed with effect from 1 May 2009. These issues involved the use of discretion with regard to smoothing and assumptions about future fund performance.
- 5.4. The management of the inherited estate was also reviewed. In 2007 it was decided to make a distribution of £54m from the estate as it exceeded the level deemed necessary in relation to the size and liabilities of the Society at that time. This distribution was intended to be made in tranches of £18m over a three year period and was to be used to increase the share of the Life Fund attributable to each policy. The first two tranches of this distribution were made in 2007 and 2008 but the Managing Board took the decision not to distribute the final tranche in 2009 due to investment market falls and continuing economic uncertainty.
- 5.5. Investment strategy was reviewed regularly in 2009 with changes made to reflect the economic climate at the time. This included reviewing and revising the triggers used for changing asset allocations based on the level of the FTSE 100 Index. During the year, the equity backing ratio (EBR) fell slightly outside the normal range stated in the PPFM as the Society acted on its agreed trigger points. This was not a breach of the PPFM, as the investment mix can move outside the normal range, especially in difficult conditions such as those in 2009. This was judged necessary by the Managing Board given the difficult prevailing investment markets. By the end of 2009 the EBR had been increased back towards the middle of the target range. Discretion was exercised with respect to the types of investment held and the proportions of the Society's assets held in each asset type.
- 5.6. A decision was made by the Board to increase the guarantee charge from 0.25% to 0.5% each year from 1 May 2009. This involved the use of discretion in response to worsening economic conditions that had changed the Society's position and increased the expected cost of guarantees.
- 5.7. Discretion was used in using the inherited estate to meet any excess of costs over charges for business other than the conventional with-profits business.
- 5.8. Advice was sought from the WPA on the above issues as they involve the use of discretion. The WPA was satisfied that the resulting decisions were in compliance with PPFM in all material respects.
- 5.9. The above decisions were reviewed fully by the WPA and the WPC. The Managing Board is satisfied that discretion was exercised in compliance with PPFM during 2009.

6. COMPETING OR CONFLICTING RIGHTS, INTERESTS AND EXPECTATIONS OF POLICYHOLDERS

- 6.1. Potentially competing or conflicting rights, interests and expectations of with-profits policyholders may come about, for example, between holders of:
- Different products
 - Policies with different terms or sizes
 - Policies with different entry dates or maturity dates
 - Policies undergoing different types of claim (for example maturity or surrender)
 - Or where the policyholders are in different demographic groups.
- 6.2. The main areas where judgement and discretion are exercised in respect of these differing policyholders are the smoothing of policy benefits and the grouping of policies when attributing such things as investment returns or policy expenses.
- Payouts to maturing policies in 2009 were considered carefully by the Board and were within the target payout parameters used to manage the fund and within the smoothing practices stated in the PPFM.
- 6.3. The advice of the WPA was sought with regard to these issues and they were reviewed by the WPC.
- 6.4. In the opinion of the Managing Board, Police Mutual managed these potential competing or conflicting rights, interests and expectations of policyholders in compliance with the PPFM.

7. ADVICE FROM THE WITH-PROFITS ACTUARY

- 7.1. This was sought and followed in the writing of this report.

8. CHANGES MADE TO THE PPFM DURING 2009

- 8.1. In November 2009 the Managing Board and With-Profits Actuary approved changes to the PPFM which were effective from 1 January 2010. These changes were to improve the clarity of the document. Full details of the changes can be obtained from Police Mutual if required.
- 8.2. All changes were made in line with regulations governing the PPFM.
- 8.3. Policyholders will be notified of these changes in their 2010 yearly statements.

9. CONTACT DETAILS

- 9.1. Call us on: 0845 88 22 999 (Monday – Friday, 8.30 am – 5.30 pm)*

Visit our website: www.pmas.co.uk

Write to us at:

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*Calls provided by BT will be charged at up to 4 pence per minute at all times. A call set-up fee of up to 8 pence per call applies to calls from residential lines. Mobile and other providers' charges may vary.

Scope of the With-Profits Actuary's Report

The Financial Services Authority (the "FSA") requires me, as the With-Profits Actuary, to confirm to the Police Mutual's with-profits policyholders whether, in my opinion Police Mutual's Annual Report to policyholders and the discretion exercised by Police Mutual in respect of the period covered by the report may be regarded as having taken their interests into account in a fair and reasonable manner.

This is my report and opinion in respect of the calendar year 2009. This opinion takes into account, where relevant, the rules and guidance in the FSA's New Conduct of Business rules ("COBS") 20.3, the Society's Annual Report and the discretion exercised by the Board in managing the fund.

This report is for information for policyholders only. Policyholders are not required to take any action. In my opinion, this report is compliant with TAS R (the required reporting standard governing reports produced by actuaries).

In giving my opinion I have relied on the completeness and accuracy of information and explanations supplied to me by the Society. Although I have considered this information for reasonableness, I have not audited, verified or otherwise substantiated it.

I was appointed to the role of With-Profits Actuary in April 2007.

Opinion

In my opinion, based on the information and explanations provided to me by the Society and taking into account where relevant the rules and guidance in COBS 20.3, I believe that discretion in managing the with-profits business during 2009 has been exercised in a fair and reasonable manner, with due regard to the Society's with-profits policyholders.

This opinion is formed taking into consideration the interests of the Society's with-profits policyholders as a body and not the interests of individual policyholders. Consequently this report does not constitute advice to any individual and no person should rely on it in making any decision with regard to an individual policy or a decision to effect a policy. To the fullest extent permissible by law I do not accept responsibility to anyone other than the with-profits policyholders of the Society as a body for my work in respect of this report and its conclusions.

David Murray FIA
With-Profits Actuary