

TEACHERS PROVIDENT SOCIETY LIMITED

**PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT
(PPFM)**

REPORT TO WITH-PROFITS POLICYHOLDERS ON COMPLIANCE FOR 2011

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Summary

It is the opinion of the Committee of Management of Teachers Provident Society Limited (the Society) that the Society's with-profits business has been managed throughout the period 1 January 2011 to 31 December 2011 in compliance with the obligations contained in the Society's Principles and Practices of Financial Management.

The following sections of this report provide the background and reasons for the Committee of Management having this opinion.



REPORT TO WITH-PROFITS POLICYHOLDERS ON COMPLIANCE FOR 2011

1. Introduction

The Society's Principles and Practices of Financial Management (PPFM) is a document that describes how its with-profits business will be managed. The first PPFM was published on 30th April 2004. Since then there have been 10 updates, in August 2005, December 2005, February 2007, April 2007, December 2008, June 2009, November 2009, August 2010, April 2011 and November 2011. Updates are made to reflect changes in regulations by the Financial Services Authority or in the way the Society operates, and for corrections and modifications to improve clarity.

This report to with-profits policyholders is with regard to the PPFM that applied during 2011, being the August 2010, April 2011 and November 2011 versions.

The role of the Society's Committee of Management ("the Committee" or "COM") is to ensure that the management of the with-profits business is carried out in line with PPFM.

In discharging its responsibilities for the management of the with-profits business, the Committee necessarily makes numerous assumptions with respect to economic and operating conditions, taxes and other matters, many of which are outside the Society's control. Although the assumptions used represent estimates which the Committee believes are together reasonable, actual experience in future may vary from that assumed in the calculations used to inform the exercise of discretion in managing the with-profits business, and such variation may be material. Deviations from assumed experience are normal and are to be expected. In particular, the resulting bonus declarations and policy benefits are based on these assumptions, and could be different if alternative assumptions had been used.

Each year, the Society's Committee of Management must report to with-profit policyholders on whether the with-profits business has been managed in compliance with the PPFM over the past financial year.

The report must cover:

- 1.1. The governance arrangements for with-profits business
- 1.2. How compliance with PPFM has been fulfilled in exercising discretion in managing the with-profits business
- 1.3. How competing or conflicting rights, interests or expectations of policyholders have been addressed

This report covers the period 1 January 2011 to 31 December 2011.

All the Society's with-profits business is managed in one with-profits fund, including those policies that transferred from Teachers Assurance Company Limited to the Society on 30 June 1999, although separate investments are held for the unitised with-profits business sold since January 2005.

2. Governance Arrangements for With-Profits business

As part of the Society's systems and controls, the following governance roles are maintained to oversee that the with-profits business is managed in compliance with the PPFM:

- An Independent Reviewing Director
- A With-Profits Actuary

2.1 Role of the Independent Reviewing Director

The Committee of Management appoints one of its non-executive directors to assess the way in which the Society manages its with-profits business in relation to the PPFM and to provide a confidential report after the end of each financial year.

During the period under review the Independent Reviewing Director (IRD) was Mr Patrick O'Keeffe. Mr O'Keeffe was appointed to the position of IRD with effect from 11 July 2008. Mr O'Keeffe had previously been a Partner of the consulting firm Deloitte where he had held a number of Appointed Actuary roles; he had also been a Member of the Council of the Institute of Actuaries.

Mr O'Keeffe has formally assessed compliance with the PPFM during 2011 and presented his confidential Independent Reviewing Director's Report to the Committee of Management on 20 March 2012. His report did not highlight any significant issues in respect of the Society's compliance with PPFM, the exercising of discretion in setting bonus rates or in managing fairly the competing or conflicting rights, interests or expectations of policyholders. The IRD has provided a summary of his report in respect of 2011 and this is contained in Annex1 to this report.

Role of the With-Profits Actuary

Throughout 2011 the Society had appointed an actuary, David Murray – a Partner of the consulting firm Deloitte LLP – as the With-Profits Actuary (WPA).

The WPA regularly advises the Committee of Management on the management of the with-profits business, including compliance with the PPFM, the interests of with-profits policyholders, and areas of discretion such as setting bonus rates and surrender values.

The WPA's report to with-profit policyholders in respect of 2011 is contained in the Annex to this report.

3. Compliance with PPFM in exercising discretion in managing with-profits business

The main areas of discretion in managing with-profits business are provided below.

3.1 Amounts payable under a with-profits policy

Policy claim payouts continued to be based on the results of bonus reviews that used policy asset shares as a means of assessing a policy's fair share of the assets of the with-profits fund, subject to a minimum payout of any guaranteed policy benefits.

Maturity and surrender claim payouts during the year were within the target payout ranges stated in the PPFM. The target ranges for maturities was changed from a range of 80% to 120% to one of 85% to 115% and the target ranges for surrenders was changed from a range of 70% to 130% to one of 80% to 120%

Surrender values were updated in line with changes to final bonus declarations as necessary.

3.2 Bonus Rates

A number of bonus reviews took place in 2011:

Conventional with-profits

- In March 2011 for the main annual and interim bonus declarations.
- In March, June, September and December 2011 for final bonus declarations

Unitised with-profits

- In December 2011 for the annual bonus declaration for the Teachers Anniversary Bond for claims during 2012
- Quarterly annual bonus declarations for Series 1 unitised with-profits products

3.3 Smoothing Payouts

The PPFM Practice states a limit of 10% in normal circumstances, with the Board reserving the right to exceed these limits, when the financial effect is small, in order to treat members equitably. The 10% limit was exceeded during 2011 for a very small number of policies by a small percentage.

3.4 Investment Strategy

There were no changes to the target, to be aimed for over the long-term, asset mix of the with-profits fund during 2011. The target percentage of the with-profits fund invested in equities and property was maintained at 60% and the actual percentage was maintained at around this level.

The Capital Management Group met three times during 2011 its purpose being to provide advice to the Executive Committee and the Board on capital matters including investment strategy. The Investment Committee met quarterly to review investment matters. The Investment Performance Monitoring Group monitored investment performance each month during 2011.

Throughout the year, Legal & General Investment Management Limited (LGIM) has carried out the investment management of the equity and bond assets in the with-profits fund. Information is provided by LGIM to demonstrate that holdings are within limits prescribed by the Committee of Management.

Advice on property investments was received during the year from an independent property adviser, Andrew Clark.

The Society continued to manage its own cash and deposit balances including through the use of fixed term deposits and Money Market Funds.

3.5 Business Risk

Similar to the discretion exercised last year, with-profits policies' asset shares were not debited with any overall losses arising from those business risks specified in the PPFM as being attributable to with-profits business. Instead any such losses were met by the inherited estate. The Society's ability to apply this approach in the future will depend on the level of free assets within the fund.

3.6 Charges and Expenses

There were no significant changes to the method of apportioning expenses of the Society to with-profits policies.

3.7 Management of the Inherited Estate

The inherited estate represents the amount of assets in the with-profits fund in excess of that needed to cover the liabilities owed to with-profits policyholders. These, so called, free assets form the working capital that supports and finances the day-to-day running of the Society and sales of new policies. The inherited estate provides the solvency of the Society.

The size of the inherited estate decreased by £13.9m in 2011 to £96.3m, this was mainly as a result of investment and economic factors and the £3.3m distribution referred to below. The Society has cover of over 1.7 times its statutory Capital Resources Requirement, thereby maintaining a high level of security of with-profits policyholders' benefits.

The Committee of Management determined that the Society had sufficient excess capital within its inherited estate at its meeting on 20 March 2012 to approve a £3.3m distribution to existing with-profits policyholders.

3.8 New Business

The Society continued to manage the volumes of new policies during 2011 in line with its annual Operating Plan.

The Society was open to new business throughout 2011. The Committee of Management has no plans to close the with-profits fund to new business.

4. Competing or conflicting rights, interests or expectations of policyholders

The Society is a mutual organisation and therefore avoids having any competing or conflicts of interests with shareholders.

Potential competing or conflicts of interests between groups of with-profit policyholders can arise due to:

- Different types of with-profits products
- Policies with varying benefits and policy conditions
- Policies starting and ending at different dates
- Policies with different sizes of premium or varying policy terms
- Policies ending for different reasons eg maturity, or earlier death or surrender

To ensure that with-profits policyholders are treated fairly in balancing their respective interests, throughout 2011 the Society has:

- Maintained different bonus series for conventional and unitised with-profits policies
- Set bonus rates based on the results from grouping similar policies together
- Applied smoothing to the policy benefits paid out
- Shared the experience of the with-profits fund, such as investment returns, in accordance with PPFM, subject to applicable policy conditions
- Exercised discretion so that payouts on maturing policies in 2011 were not less than premiums paid into a policy
- Exercised discretion to allocate any losses arising from non-profits business to the estate

**The Committee of Management
Teachers Provident Society
20 March 2012**

ANNEX 1

TEACHERS ASSURANCE

Summary of the Report by the Independent Reviewing Director to the Committee of Management

1 This report is prepared in accordance with sections 20.3 and 20.4 of the Conduct of Business Sourcebook (“COBS”) issued by the Financial Services Authority (“FSA”). It summarises my independent judgement on compliance with the Society’s Principles and Practices of Financial Management (“PPFM”) during the calendar year 2011 and on how any conflicts between different classes of policyholder or between management decisions and the PPFM were addressed.

2 The PPFM document was updated twice during the year. There were no changes made to Principles and any changes made to Practices were to clarify existing wording. These were all minor in nature and no policyholder interests were affected.

3 There were no changes made to the methods used to calculate policy asset shares.

4 No significant proportion of participating policies surrendered during the year had surrender values, expressed as a proportion of asset shares, outside the target ranges set out in Section 2 of the PPFM. I am satisfied that there was no differentiation between groups of policies of different type and bonus series.

5 I am satisfied that the principles underlying the valuation and the declaration of annual bonus rates were in accordance with those set out in Section 3 of the PPFM and in particular no individual policy or class of policies received favourable treatment compared with any other class.

6 I am satisfied that the principles underlying the allocation of final bonuses were in accordance with those set out in Section 4 of the PPFM and in particular no individual policy or class of policies received favourable treatment compared with any other class.

7 No significant proportion of participating policies maturing or vesting during the year had maturity values or vesting values, expressed as a proportion of asset shares, outside the target ranges set out in Section 4 of the PPFM.

8 I am satisfied the approach to smoothing payouts as described in Section 5 of the PPFM was applied equitably to policies becoming claims in the course of the year.

9 One uniform investment strategy continued to be used for assets backing with-profits policies and the free assets in the inherited estate. The Committee of Management had no reason to regard investment conditions in the year as “exceptional”. The target Equity Backing Ratio remained at 60% throughout the year.

10 Regular risk assessment reviews as described in Section 7 of the PPFM were carried out throughout the year and were reported to the Committee of Management. There was a small net profit arising from miscellaneous sources which the Committee of Management determined should be credited to the inherited estate. I am satisfied that this exercise of their discretion was appropriate in the circumstances.

11 I am satisfied that the principles underlying the allocation of charges and expenses as described in Section 8 of the PPFM continued to be applied throughout the year and in particular no individual policy or class of policies received favourable treatment compared with any other class.

12 The Committee of Management received regular reports on the free assets of the Society throughout the year. Following the valuation of the Society's assets and liabilities as at 31 December 2011, the Committee of Management determined that it was appropriate to distribute a Special Mutuality Bonus to with-profits policyholders. I am satisfied that the method of distribution of this bonus was equitable to all parties.

13 Section 10 of the PPFM explains the constraints on the volume of new business that may be written and requires that the financial effect of any new business should not impact unfavourably on the interest of existing policyholders. I am satisfied that the costs of writing new business at the current level do not adversely affect the interests of the currently existing with-profits policyholders.

14 In summary, I am satisfied that, for the calendar year 2011, the financial affairs of the Society were managed in compliance with the provisions set out in the PPFM and that when they were required to exercise discretion, the Committee of Management did so in a manner which paid proper regard to the interests of the with-profits policyholders.

P J L O'Keeffe
Independent Reviewing Director
20 March 2012

ANNEX 2

Report from the With-Profits Actuary to the With-Profits Policyholders

Teachers Provident Society Limited (“the Society”) has prepared a report (“the Annual Report”, which is set out above) to the with-profits policyholders of the Society, stating whether the Society believes it has complied with the obligations relating to the Principles and Practices of Financial Management (“PPFM”) during 2011. The Annual Report, the PPFM and the management of the with-profits business so as to comply with the PPFM are each the sole responsibility of the Society. This report from the With-Profits Actuary should be considered in conjunction with the Annual Report.

The Financial Services Authority (the “FSA”) requires the With-Profits Actuary to confirm to the Society’s with-profits policyholders whether, in his opinion and based on the information and explanations provided to him by the Society, and taking into account where relevant the rules and guidance in the FSA’s Conduct of Business Sourcebook 20.2, the Society’s Annual Report and the discretion exercised by the Society may be regarded as having taken their interests into account in a reasonable and proportionate manner.

I have considered the Annual Report prepared by the Society, together with those acts of discretion in respect of the year 2011 of which the Society has made me aware. As With-Profits Actuary I advise the Board on the key aspects of discretion that they exercise in managing the with-profits business. I have relied on the completeness and accuracy of information supplied to me by the Society. Although I have considered this information for reasonableness, I have not audited, verified or otherwise substantiated that information.

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 Conduct of Business Sourcebook 20.2, the Annual Report and the discretion exercised by the Society in 2011 may be regarded as having taken the interests of the Society’s with-profits policyholders into account in a manner which is reasonable and proportionate.

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. My report is made solely to with-profits policyholders as a body. 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
With-Profits Actuary
20 March 2012