

# A guide to investing in the Police Mutual Life Fund

## This guide applies to the following plans, which invest in the fund:

- Regular Savings
- Moneyspinner
- Gold and Silver
- Full Endowment
- Children's Bond
- Low Cost Endowment
- Capital Growth Bond
- Minimum Low Cost Endowment

This guide explains what it means to invest in the Police Mutual Life Fund with a with-profits policy. It gives important information about how with-profits plans work and what you can expect back from them. Please read it and keep it in a safe place with your other plan documents.

There are separate guides for our other with-profits products which work differently but also invest in the Life Fund: one that covers our ISA product: the Guaranteed ISA; and another that covers our non-ISA products: the Guaranteed Investment Bond, Platinum Bond and Top-up Pension Plan.

We have tried to answer the questions you are likely to have. If, when you've read this guide, you still feel unclear about investing in our with-profits plans, please contact us directly. If you want more information than is contained in this guide, please ask for (or download) our Principles and Practices of Financial Management (also referred to as PPFM). This gives a fuller description of the way we manage the financial aspects of our with-profits business. Our full contact details are provided opposite.

## What is a with-profits plan?

Unlike some other stock market investments, our with-profits plans offer a guarantee when the plan matures<sup>3</sup> or if you die beforehand (see 'What are the guarantees?'). At these times you will get back at least the guaranteed minimum payout plus any bonuses that have been added. So if the stock market falls or our other investments don't perform well before your plan matures, the plan will still be worth at least the guaranteed amount, plus the bonuses added to date.

Your money is pooled with other investors' money to form a fund. This works in much the same way as any other pooled fund (such as a unit trust) although its value is calculated differently.

By combining your savings with those of other investors, you get a better spread of investments than by investing on your own. The Life Fund invests mainly in a mix of company shares, property, bonds (which are a type of loan to governments or to companies) and cash. Along with the smoothing (explained later), this means that the investment risk of a with-profits plan is lower than investing fully in shares.

<sup>3</sup>We use maturity in this guide to refer to the maturity date for all plans except the Children's Bond. This has no fixed maturity date, so 'maturity' refers instead to the end of the period you originally agreed to make regular payments for (10 years or until the plan anniversary after the Child's 16th birthday, whichever is greater).

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We assess what share of the Life Fund applies to your plan and use this to decide the level of bonuses. This share of the Life Fund reflects the premiums that you have paid accumulated with investment returns less allowances for expenses and the cost of life cover. It is also adjusted for tax and the management of the inherited estate (see '*What is the inherited estate used for?*').

Instead of simply sharing out what the fund makes or loses each year, a with-profits plan evens out some of the fluctuations in performance over the time you hold your plan. This is called 'smoothing'. We aim to pay out all of the profits and losses earned by the Life Fund over the long term. We smooth when we calculate any final bonus. This is described in the 'How do we decide the bonuses?' section.

## What affects how much I might get?

The biggest factor affecting how much you might get back is the performance of the investments in the Life Fund. This will depend on how the fund is invested. For example, the greater the proportion of the fund that is invested in shares, the better it is likely to perform over the long term, though this is not certain. However, while shares and property typically generate a higher return than bonds or cash over the medium to long term e.g. ten years, the return is also much more volatile. One year they may do very well-but the next could see a big slump in values.

Other important factors are:

- How we smooth investment returns
- The results from other business areas where the Life Fund shares the risks and rewards (see '*What are the business risks associated with investing in the fund?*' section)
- Our charges, which are described in your Key Features document
- The effect of the guarantees we offer to you and other plan holders
- How long you invest for

Other companies will have different proportions of their funds invested in different types of assets. The amount we have invested in company shares and property will vary according to market conditions, though we would normally expect between 30% and 60% of the Life Fund to be invested in these assets. Subject to the constraints described below, we would generally aim to be at the higher end of this range.

However, there are constraints on how much of the fund's assets we can put into higher risk assets. This is because we have to make sure our fund can cover all our liabilities to plan holders at any time. If the value of the assets fell below a certain level, we'd need to put more into lower risk assets such as cash or bonds. This means that in times of market uncertainty or in unfavourable market conditions we are likely to be at the lower end of the range and could reduce our holdings of higher risk assets further to make sure we can cover those liabilities.

The performance of different types of asset varies considerably over time. So we may change the balance of assets in the fund to improve long-term performance or maintain the financial security of the fund.

As the Society is a mutual, there are no shareholders to take a share of the profits. We cannot access additional capital as easily as companies which are quoted on the stock market. This will affect how the fund is invested and the level of risk that will be taken.

## **What are the guarantees?**

We guarantee to pay out at least a minimum amount if your plan continues to maturity, or on earlier death. This guaranteed minimum value increases the longer you hold the plan because of the addition of regular bonuses. We make a charge for providing this guarantee by reducing the investment return the fund produces. This charge is reviewed yearly.

## **What type of bonuses may be added to my plan?**

Each plan has a guaranteed minimum payout at maturity or on death. We may add bonuses to this amount throughout the duration of the plan as a way of sharing out the profits earned by the fund.

There are two types of bonus: regular bonuses and final bonus.

Regular bonuses: these may be added each year as a percentage of the guaranteed minimum payout and as a percentage of bonuses already added. Once added, they become guaranteed, provided you maintain payments to the end of the term of the plan.

Final bonus: we may pay this if you die or when your plan matures. We work it out as a percentage of the guaranteed minimum payout and the regular bonuses added over the term of the plan. It may make a significant difference to your payout.

We usually decide the bonus rates once a year. Regular bonus rates don't normally change each year; we aim to set them at a level that we do not have to change regularly. Any changes we do make are likely to be gradual.

Final bonuses do normally change each year. However, we may need to review and change them more than once a year, particularly in times of significant market movements.

There may be circumstances where we do not pay a bonus, such as if the Life Fund makes a loss or if the guarantees already built up on your plan are more than your share of the fund.

## **How do we decide the bonuses?**

The aim in setting regular bonuses is to distribute that part of the investment return and profit of the Life Fund which is reasonably certain, whilst maintaining a reasonable margin for final bonuses. We consider both past and potential future investment returns and the solvency of the Life Fund when setting regular bonus rates.

When your plan comes to an end we calculate the amount of your final bonus by assessing the share of the fund that applies to your plan. This will depend on how profits have built up over the years. When setting the final bonus we will allow for smoothing and consider factors such as payouts made in previous years. We aim to pay out between 80% and 120% of the share of the fund at maturity. However, on average plan holders can expect to receive the share of the fund attributable to their plan.

The smoothing process means that the payout at any one time can be more or less than your share of the fund at that time. However, on average we expect to pay the share of the fund attributable to a plan. The investment performance of the Life Fund will vary over time and, although we aim to smooth the effects of fluctuations, payouts will still vary over different periods.

In some conditions the total profits earned on your plan could be less than those we have already added as regular bonuses. If this happened then we might not add a final bonus. Only the guaranteed minimum payout and regular bonuses already added would apply on maturity or on earlier death. In the case of the Children's Bond this would apply at the end of the regular payment period.

## What are the business risks associated with investing in the fund?

Business risks arise from activities we have taken to move the business forward which we believe are in our members' interests. Major business risks currently include the cost of honouring guarantees on with-profits plans in adverse conditions (for which we make a charge) and the operation and costs of subsidiary companies. The risks identified above are not the only risks and they will change over time.

Before taking on any significant new business activity or risk this must be approved by the Society's Managing Board. They would consider the costs and benefits of entering into the venture and whether it would be in the members' interests. While we would expect to generate profits from these ventures there is always the chance that losses may occur and, as a mutual organisation, the Society's with-profits plan holders share in the results of all the Society's business activities. These results will affect the size of the Life Fund.

There are other risks associated with holding a with-profits plan. These are highlighted in the Key Features document which was issued when you took out your plan. For more information on these, or if you no longer have your Key Features document, please contact us.

## What is the inherited estate used for?

We hold some money known as the inherited estate. This money isn't needed to directly meet payments to current plan holders. It is primarily used to:

- Give investment freedom (with the aim of improving investment returns)
- Meet solvency and capital requirements

- Provide working capital and capital support for guarantees
- Finance other business ventures
- Enable smoothing of investment returns and payouts
- Meet any exceptional costs in managing the business
- Meet any excess of costs over charges for business other than conventional with-profits business

The size of the inherited estate is assessed regularly as part of the financial management of the fund. If the inherited estate is judged to be too high or too low then the Managing Board would seek to reduce (or increase) it over a specified period. We manage this by amending investment strategy or charges or by controlling the addition of regular and final bonuses.

## What if Police Mutual stopped accepting new business?

We will continue to allow people to invest in the Life Fund as long as we believe it is in the interests of both our existing and new members.

If Police Mutual stopped writing significant amounts of new with-profits policies then we would review our investment policy, the extent to which payments were being smoothed and the management of the inherited estate. The review would consider how the interests of both current and potential future members of the Society could best be met.

## What if I decide to move out of with-profits?

With-profits plans are medium to long-term contracts and are designed to provide better returns at maturity or at certain specified dates rather than if they are cashed in early. Cashing in before the end of their term may not be in your best interest.

If you decide not to keep your plan going, for example if you want your money back or you can't maintain the payments, you can either ask for a cash-in value or make it paid-up. The guarantees you have built up in the plan will not apply if you do this.

- We will calculate the cash-in value at the time. It will depend on the investment return, the amount you have paid in, our expenses, the cost of life cover and the outcome of the other business activities of the Society. We will apply a 5% reduction to the share of the fund that applies to your plan, which makes it more likely that you may get back less than you've paid in
- If you make the plan paid-up you stop paying premiums and it continues with a reduced guaranteed amount until the original maturity date. Any bonuses earned to the date the plan was made paid-up are payable in full at the end of the plan term or on earlier death. However, no further bonuses will be added (except for the Children's Bond where we will add bonuses for the rest of your original premium paying term)

We won't smooth your payout in the same way as if your plan had matured, as smoothing is designed for investors who pay premiums for the full term of their plan.

## How is the Life Fund managed fairly and effectively?

Police Mutual has a framework in place to ensure that we manage the Life Fund fairly and effectively, and in accordance with the regulations of the Financial Services Authority.

- We produce a document called the Principles and Practices of Financial Management (PPFM) which gives a fuller description of the way we manage the financial aspects of our with-profits business
- A sub-committee of the Managing Board meet on a regular basis to review whether the business has been managed in accordance with the PPFM. This sub-committee includes non executive representation and is attended by the With-Profits Actuary, who is specifically appointed under FSA regulations, to give advice to the Managing Board and ensure that policyholders are treated fairly
- On an annual basis, the Managing Board and the With-Profits Actuary make a report available to policyholders, confirming whether the Life Fund has been managed in accordance with the PPFM

## Will I be notified of any changes to my with-profits plans?

This guide summarises our current approach to managing the with-profits plans listed. We expect the way we manage the plans will change over time. We will tell you if we change the way we manage your with-profits plan when we send you your yearly statement. We will also send you an updated copy of this guide with your yearly statement if anything significant has changed in the previous year.

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