

Report to With-Profits Policyholders
on the Society's Compliance with
its Principles and Practices of
Financial Management



NFU Mutual

Summary

The Board of the National Farmers Union Mutual Insurance Society Limited (the Society) has reviewed the management of the Society's with-profits business for the 2008 financial year (1 January 2008 – 31 December 2008) and is satisfied that it has met its obligations as set out in the Principles and Practices of Financial Management (PPFM).

In reaching this conclusion due regard has been paid to the advice received from the Society's With-Profits Actuary.

Introduction

It is a legal requirement for directors of insurance companies that write with-profits business to provide policyholders with an annual statement that explains how the business was managed during the year.

The overarching guidelines that describe how we manage the Society's long-term business fund are fully documented in the Principles and Practices of Financial Management (PPFM). This report (covering the period 1 January 2008 to 31 December 2008) sets out how we have complied with the PPFM and also provides a summary of the key decisions (e.g. bonus declarations) that have impacted with-profits policyholders during the year.

When reading this report you may find it helpful to refer to the Society's PPFM and, in particular, the section containing the glossary of terms.

Governance of With-Profits Business

In 2004 the Society established two key roles to provide reassurance that our with-profits business is being managed in accordance with the Society's PPFM – the With-Profits Committee and the With-Profits Actuary.

The With-Profits Committee is a sub group of the Society's Board that is responsible for monitoring ongoing compliance with our PPFM. It comprises three of the Board's non-executive directors and two executive directors and meets four times a year. The Committee chairman reports formally to the Board on its proceedings after each meeting.

In 2008 one of the executive director members of the With-Profits Committee, Ian Geden, was replaced by Lindsay Sinclair, who is the Group Chief Executive.

From 1st January 2009 Beverley Hodson has replaced Martin Ritchley as one of the non-executive directors of the With-Profits Committee.

The With-Profits Actuary is responsible for providing the Board with advice on all areas of discretion as they relate to the fair treatment of with-profits policyholders. This includes making recommendations regarding bonus rates, reviewing communications to policyholders and ensuring the interests of with-profits policyholders are taken into account in a fair and balanced way.

The With-Profits Actuary is also required to comment on the Board's actions with regard to with-profits business and his annual statement can be found in the Appendix to this report.

Compliance With the PPFM During 2008

Payouts and bonus rates

Asset share values, which payouts are based on, were calculated during 2008 using the methods described in the PPFM. During 2008 the With-Profits Committee approved a change to the level of renewal expense charge to the asset shares for with-profits annuities. The increase reflected an increase in expenses being incurred for with-profits annuities and was consistent with the PPFM.

Annual bonus rates were declared for 2007 in April 2008. All rates remained unchanged from the previous year, except those payable on with-profits annuities, which were increased. At the same time new interim bonus rates were set for 2008 at the same level as the declared rates for 2007.

Market interest rates have a direct impact on the returns we are able to achieve on the assets we hold to back our Capital Access Bond (CAB) policies. We therefore review CAB bonus rates each month and set CAB interim bonus rates accordingly. This practice is consistent with the PPFM.

In normal circumstances we set new terminal, or final, bonus rates twice a year in January and July. However, during 2008, investment markets were exceptionally volatile and as a result of this new terminal bonus rates were declared on 1 January 2008, 1 April 2008 and 10 November 2008. This is consistent with the PPFM, which states that we set terminal bonus rates twice a year or more often if necessary.

All bonus declarations were reviewed and approved by the With-Profits Committee, having taken advice from the With-Profits Actuary, and subsequently ratified by the Board.

In our opinion, the payouts made to with-profits policyholders during 2008 reflected fair value and we are satisfied that bonus rates were calculated using the methods described in the PPFM.

Surrender value terms

The surrender value bases for our traditional with-profits policies and all unitised with-profits policies were not changed during 2008. The bases used were consistent with the PPFM.

Target ranges

The PPFM includes target ranges for payouts for unitised and traditional with-profits business. The target ranges compare the payout to the underlying value of the policy and the aim is to make 90% of our payouts fall within these target ranges.

We can confirm that during 2008 we complied with the target ranges set out in the PPFM.

Investment policy during 2008

Assets backing the Capital Access Bond (CAB) were invested in cash and floating rate notes throughout the year. This is consistent with the PPFM.

In 2007 the investment strategy for backing asset shares was changed from fixed asset share allocation proportions to operating bands. The operating bands were:

- Equities 55-65% (Overseas equities within this 10-15%)
- Property 15-20%
- Fixed Interest 15-30% (including cash and index linked)

The operating bands remained unchanged until November 2008 when they were changed to:

- UK Equities 35-55%
- Overseas Equities 10-15%
- Property 15-20%
- Fixed Interest 15-35% (including cash and index linked)

The change in operating band levels was recommended by the With-Profits Actuary and approved by the With-Profits Committee.

The proportion of the asset shares invested in equities was 63% during the first eleven months of 2008. In December 2008 the proportion invested in equities was further reduced from 63% to 58%. On 1 January 2009 the proportion invested in equities was reduced to 55%. The proportion of the asset shares invested in bonds was increased during the year.

The proportion of the asset shares invested in each asset category remained within the operating bands throughout 2008.

The investment policy for asset shares is consistent with the PPFM, product documentation and marketing literature and therefore, in our opinion, satisfies Policyholder Reasonable Expectations (PRE)

Charges and expenses

Detailed expense investigations are periodically undertaken to ensure that the expenses incurred in the with-profits fund are fairly assigned to the relevant policies. The With-Profits Actuary and With-Profits Committee are satisfied that the current allocation of expenses is fair and equitable. In addition this process has been independently scrutinised by our external auditors.

Any large one-off project costs are borne by the Inherited Estate and therefore do not impact directly on the expenses attributed to policyholders.

In July 2008 the Society launched a summer campaign that included special offers on several products. This campaign included:

- A limited edition flexibond. This bond provided a choice of an enhanced unit allocation for all fund choices or a return of premium guarantee on the fifth anniversary of the commencement date for investments into the with-profits fund. (The enhancement was 1% for investments of less than £50,000 and 1.5% for investments of £50,000 or over.)
- A limited edition Shrewd Savings ISA with a reduced initial charge of 2% rather than 3%.
- A limited edition Shrewd Savings ISA that provided a return of premium guarantee on the fifth anniversary of the commencement date for transfers in of £15,000 or over.
- A limited edition Portfolio Investment Plan (OEIC) product and stocks and shares ISA that offered a reduction in initial charge of 1% for investments of less than £50,000 and 1.5% for investment of £50,000 or over.

The With-Profits Actuary and With-Profits Committee are satisfied that the charges remain sufficient to cover all expenses and the potential impact of the guarantee and hence the terms offered are not to the detriment of other with-profits policyholders.

In October 2008 the Society launched a second campaign that included special offers on several products. This campaign included:

- A limited edition flexibond with an enhanced unit allocation and a Portfolio Investment Plan (OEIC) with a reduction in the initial charge of:

Amount of investment	Increased allocation / reduction in the initial charge
Less than £50,000	1.0%
£50,000 to £99,999	1.5%
£100,000 - £249,999	2.0%
£250,000 and over	2.5%

- Waiver of the 1% initial charge for SIPP investments into the NFU Mutual Trustees Investment Plan.

The With-Profits Actuary and With-Profits Committee are satisfied that the charges remain sufficient to cover all expenses and the terms offered are not to the detriment of other with-profits policyholders.

In June 2008 the Society revised the premium rates for our term assurance products. The range of illnesses covered by our critical illness product was also extended. The With-Profits Actuary and With-Profits Committee are satisfied that the premiums remain sufficient to cover all benefits and expenses and the terms offered are not to the detriment of with-profits policyholders.

In June 2008 the Society changed its annuity pricing basis to reflect changes in mortality assumptions, investment returns and expenses. The With-Profits Actuary and With-Profits Committee are satisfied that the premiums are sufficient to cover all expenses and hence the terms offered are not to the detriment of other policyholders.

Management of the Inherited Estate

The Inherited Estate provides the working capital to support current and future business written within the long-term business fund.

The With-Profits Actuary and With-Profits Committee are satisfied that during 2008 the Inherited Estate was managed in accordance with the rules of the PPFM.

Volumes of new business and arrangements on stopping taking new business

During 2008 levels of new with-profits business were regularly monitored to ensure that the volume of new business was not so high that it threatened solvency nor too low so that any particular product was no longer viable.

The With-Profits Actuary and With-Profits Committee are satisfied that the volume of business written was within an acceptable range throughout 2008 and no restriction on new business or withdrawals of contracts was therefore necessary.

Sales of products during the campaign launched in July 2008 were restricted to £75m of single premium income, although actual sales did not reach this limit.

Changes to the PPFM

In February 2008 we introduced a new version of our PPFM. The new PPFM incorporated a number of improvements to the layout and appearance of the document and the wording of some practices was altered to make the text easier to understand. In addition, we published a PPFM appendix that provides a summary of information relating to current bonus rates, investment strategy and the charges and expenses that are applied to individual products. Customers were advised of the changes to the PPFM via their annual statements.

A new version of the PPFM (effective from 1 February 2008) was added to the NFU Mutual internet site (www.nfumutual.co.uk), giving policyholders access to the revised document.

No changes were made to the consumer friendly PPFMs during 2008, however new versions of these documents were introduced on 1 January 2009.

Communication with policyholders

The With-Profits Actuary has responsibility for controlling representations made to policyholders by reviewing and signing off documents for PRE and PPFM compliance. Documents that have been reviewed during 2008 include Key Features Documents, policy documents, marketing material, the Society's Consumer Friendly PPFM, annual statements and illustrations of possible future benefits from policies. During 2008 illustrations of possible future benefits were updated to comply with new rules issued by the Financial Services Authority.

The With-Profits Actuary and With-Profits Committee are satisfied that our illustrations and documentation comply with relevant regulations and guidance and do not have the effect of misleading with-profits policyholders as to their expectations.

Sir Don Curry
Chairman

L N Sinclair
Group Chief Executive

Appendix

Annual report from the With-Profits Actuary

In my opinion, and based on the information and explanations provided to me by the Society, discretion exercised by the Society over 2008 took the interests of the with-profits policyholders into account in a reasonable and proportionate manner.

I am also satisfied that the Society has complied with its PPFM during 2008 and that the annual Report to with-profits policyholders prepared by the Board provides an accurate summary of the key decisions that have impacted with-profits policyholders during the year.

In reaching these opinions I have taken into account the relevant rules and guidance issued by the Financial Services Authority and the Actuarial Profession.

Iain D Baker

Fellow of the Faculty of Actuaries

With-Profits Actuary

National Farmers Union Mutual Insurance Society Limited

www.nfumutual.co.uk

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