With-profits Investments

A guide to unitised with-profits

NFU Mutual

How will this guide help?

This guide explains how our with-profits fund works for our unitised with-profits contracts and will help you to decide whether this type of investment is right for you. Please keep it in a safe place with your other documents, to refer to in the future. It is also available on our website www.nfumutual.co.uk.

If you'd like more information on how we manage our with-profits fund please read our principles and practices of financial management, available at www.nfumutual.co.uk, or from our customer services team on 0800 622 323.

Is this the right guide for you?

A with-profits investment can either be conventional or unitised. We call a with-profits policy unitised when your investment buys units in the with-profits fund.

NFU Mutual unitised with-profits polices include:

- Pension policies taken out after 30 June 1988
- Capital investment bonds (CIB)
- Flexibonds
- Shrewd savings plan ISAs.

If you need to check which type of policy you have, please call us on 0800 622 323.

This guide does not cover:

- Conventional with-profits contracts – when we guarantee to pay out an agreed amount when the policy matures. This could be a lump sum (the sum assured) or a series of payments (an annuity or pension)
- The capital access bond (CAB)
- With-profits annuities.

1. What is a unitised with-profits policy?

A with-profits policy shares in the profits and losses of our with-profits fund. We call a with-profits policy unitised when your investment buys units in the with-profits fund.

We share our profits and losses by adding bonuses to your policy. As bonuses are added to your policy, valuable guarantees build up. These are described in section six "What do we guarantee?" and are a feature of a with-profits investment.

The with-profits fund

When you invest in our with-profits policies, we pool the money with the money from other policyholders in the with-profits fund. The with-profits fund is invested in a wide range of assets including company shares, property and bonds. For more detail please read section two "What affects how much I get?"

Part of the with-profits fund covers the amount we owe to policyholders. The rest of the fund is called the estate and provides working capital for the fund. To find out more please see section nine "The estate and how we use it to manage your investment".

Smoothing

Smoothing is one of the unique features of a with-profits policy. Investment values can be volatile so the value of the with-profits fund can fluctuate considerably. Instead of simply sharing out what the fund makes or loses each year to policyholders, we even out some of the fluctuations. We describe this in section four "What is smoothing?"

Guarantees

Unitised with-profits contracts offer guarantees of the minimum amount of money you will receive on death and certain other dates. This is explained in section six "What do we guarantee?"

Payouts

The main factor that affects the amount your policy will pay out is what your share of the with-profits fund is worth. Your share depends on profits and losses earned by the fund over the period of your investment. We look at the share for groups of similar policies and use these results to help us decide the bonuses we will pay.

2. What affects how much I get?

How much you get back depends on:

- The investment return earned on the fund over the period you invest
- The effect of any guarantees
- The way we smooth payouts
- Policy charges
- The business risks the with-profits fund takes
- The tax we have to pay.

How your money is invested

Our with-profits fund pools your payments (less any deductions to cover charges), along with those of all our other with profits policyholders.

The with-profits fund invests in a wide mix of different types of assets, such as:

- UK and overseas company shares (equities)
- Commercial property
- Government and company bonds (loans to the government or companies)
- Deposits.

The investment strategy of the with-profits fund reflects what our Board of Directors believes is an appropriate balance between the risks of different investment and the potential reward they offer. Our investment managers aim to maximise the returns on our assets, whilst working within the overall investment strategy.

Higher risk assets, such as equities and property, offer the potential for higher returns over the long term than lower risk assets such as deposits and bonds. Currently we invest a significant proportion of the with-profits fund in equities and property in order to try and increase returns for our with-profits policyholders.

The actual mix of assets may change over time, depending on the risks our Board is willing to take and the investment managers' view on potential future returns from different types of asset. (Go to www.nfumutual.co.uk for information on the current mix).

The amount of risk our Board is willing to take will be influenced by the size of our estate (the excess of our assets over our liabilities) as this offers a cushion against volatility in asset values.

3. What are bonuses?

We aim to increase the value of your investment by adding bonuses to your policy. There are two types of bonus. These are regular bonus and terminal bonus.

Regular bonus

Regular bonus can be added in two ways. Depending on what type of policy you have, we may add bonuses by:

- Increasing the price of your with-profits units each day and/or
- Adding additional with-profits units to your policy monthly.

The level of regular bonus can go up and down and there is no guarantee that a regular bonus will be added each year.

We announce the level of bonus at least once a year.

Some capital investment bonds and personal pension plans have guaranteed minimum regular bonus rates. These guaranteed rates may be higher than the regular bonus rate paid on similar policies that do not have the guarantee.

Once regular bonuses have been added, they are guaranteed to be paid on death and on certain other guarantee dates. Please see section six “What do we guarantee?” for further information.

The level of regular bonus may be different for different products and for similar policies taken out at different times.

Terminal Bonus

A terminal bonus may be added to your policy when you leave the with-profits fund, for example when your policy matures, you retire or surrender your policy.

The level of terminal bonus can go up and down and there is no guarantee that any terminal bonus will be added. We can change terminal bonus levels at any time.

Currently we review terminal bonus levels twice a year or more often if investment conditions change significantly from what we were expecting.

Although we aim to smooth payouts, terminal bonus levels can be volatile and move up and down significantly. This is because we invest a significant proportion of the with-profits fund in higher risk assets (such as equities or property).

We set separate terminal bonus rates for different products. There are also different rates for:

- Investments that started in different years
- Regular and single investments that start in the same year
- Policies with different charging structures.

Where you have made additional investments to your policy, for example an additional single payment or an additional series of regular payments, different rates of terminal bonus may apply to each separate investment.

How do we set bonuses?

When you make an investment in the with-profits fund we create two types of units for you:

1. With-profits fund units – The value of your with-profits units may grow through the addition of bonuses.

2. Shadow fund units – The value of your shadow fund units represents your share of the with-profits fund (your asset share). The value of your shadow fund units will rise and fall reflecting the performance of our with-profits fund. The value of your shadow fund units depend on:

- How much you have invested
- When you made the investment
- The fund's performance over time, allowing for taxation
- Charges applied to your policy
- Various profits and losses (see section eight "Managing risks the with-profits fund is exposed to").

We use the shadow fund to decide what bonuses should be added to each policy and what level of market value reduction (if any) we will need to apply, if you surrender or transfer your policy (see the section "What is an MVR?").

Our aim when setting bonus levels is to pay out on average, the shadow fund value of your policy, when you leave the with-profits fund.

To work out the actual bonus level we group similar policies together, and determine a fair return for those policies. Different groups of policies may receive different levels of bonus.

Regular bonuses

We aim to set regular bonus rates so:

- They are sustainable over the long term considering current and future expected investment returns
- They will not vary too much from year to year
- Normally there will be scope to add a terminal bonus.

Terminal bonuses

Paying a terminal bonus enables us to pay out your share of profits that have not already been paid out as regular bonus. When your policy reaches maturity, or you want to retire, surrender or transfer your policy, we aim to pay out on average, the shadow fund value of your policy.

The things we consider when setting terminal bonus rates include:

- The shadow fund value compared to the with-profits fund value for groups of similar policies. This allows us to see how much of the value we haven't given to you already in regular bonuses
- What we expect investment returns to be for the period we intend the terminal bonus rates to apply
- The change in payouts for similar policies from one year to the next. We aim to restrict the change in the amount we pay out to policyholders in consecutive years to what we believe is a reasonable level.

4. What is smoothing?

Investment values can be volatile and consequently the value of the with-profits fund and your shadow fund value can fluctuate quite a lot. This is because we invest a significant proportion of the with-profits fund in higher risk assets (such as equities and property).

Instead of simply sharing out what the fund makes or loses each year, we even out some of the fluctuations. This is known as smoothing. In practice we may keep some of the growth back when investment conditions have been good, so that we can add it back when investment conditions are poor.

Although smoothing helps to even out some of the fluctuations in investment values, it can not fully protect the value of your policy from poor investment returns or long term market falls. When the value of your shadow fund falls, the value of your payout may also fall. On certain guarantee dates the amount we pay out can not fall below the minimum guaranteed amount, this is described more in section six "What do we guarantee?"

We aim to pay out on average, the shadow fund value of your policy. However, as described above, the actual amount we pay out will be subject to smoothing. Your payout will be between 80% and 120% of your shadow fund value.

5. Surrendering your policy

We work out the surrender value of your policy by multiplying the number of with-profits units allocated to your policy by the current unit price and then deducting any surrender penalties. In addition, we may add a terminal bonus to this value.

However if your shadow fund value is less than the value of your with-profits units when you choose to surrender, we may apply a reduction. This is known as a market value reduction (MVR).

If you switch your investments out of the with-profits fund into one of our investment linked funds then, whilst you will not be subject to a surrender penalty, you may be subject to an MVR.

What is a Market Value Reduction (MVR)?

When you make a switch out of the with-profits fund or withdraw money from your policy the value of your with-profits units can be reduced in certain circumstances by applying a MVR. This is most likely to happen following a large or prolonged fall in the stock market, or after a sustained period of low investment returns. The MVR ensures that investors who remain invested during poor market conditions are not disadvantaged by those who take money out of the fund.

When do we apply a Market Value Reduction (MVR) and how is it calculated?

An MVR is applied when the value of your shadow fund units falls below a certain percentage of the value of your with-profits units. The level is currently 90%. All of the individual payments (a single payment or group of regular payments) you make are treated separately for this calculation.

If you cash in or switch your investment from the with-profits fund when the MVR applies then:

- If the shadow fund unit value is less than 85% of your with-profits fund value then you will receive the value of your shadow fund units.
- If the shadow fund unit value is between 85% and 90% of your with-profits fund value then you will receive a value between the shadow fund value and with-profit fund value.

Please note:

- The 'trigger points' of 85% and 90% can be changed.
- An MVR is dependant on individual values for each policy. Whether an MVR applies and the size of the MVR therefore changes on a daily basis for any policy.
- When the MVR is applying in full, your surrender value will be the value of your shadow fund units, therefore there will be no smoothing on your value at that time and the value may be volatile.

If an MVR applies to your policy when you wish to surrender or switch it is worth considering what guarantees your policy has because they may be valuable. For example your policy may include dates where we guarantee not to apply an MVR. We strongly recommend you should take advice before acting.

6. What do we guarantee?

Our unitised with-profits policies contain guarantees. Any guarantees that your plan has are detailed in your policy documentation.

When do we guarantee not to apply a Market Value Reduction (MVR)?

If you have a guarantee that no MVR will apply on your policy on a certain date, the minimum amount you will receive is the value of your with-profits fund units including all regular bonuses that have been added to your policy, even if the underlying value of your shadow fund units is lower than this. You may not receive the full value of your with-profits fund units at other times.

We guarantee not to apply a market value reduction:

- If you die
- On your selected retirement date if you have a personal pension policy and certain later dates if you change your standard retirement date
- If you surrender (or switch funds on) your capital investment bond on its 10th anniversary
- On regular withdrawals taken from a capital investment bond or flexibond up to certain annual limits.

If you have a personal pension plan and you retire, switch or transfer out within three years of the selected retirement date, the amount of any MVR applied will be reduced so that the MVR is smoothed in over the 3 years prior to the selected retirement date. The proportion of the standard MVR that is applied reduces as you get nearer your selected retirement date.

For a capital investment bond we guarantee not to apply an MVR on the 10th anniversary of the date on which your bond started. This means that if you cash in your bond on the 10th anniversary date you will receive the full value of your with-profits fund units. After this date, the MVR may apply in certain circumstances. However, if you do not cash in your bond on the 10th anniversary and the shadow fund unit value is less than the with-profits fund value on that day, we will enhance the value of your shadow fund units so that they are equal to the value of your with-profits fund units on that day.

Guaranteed minimum regular bonus rates

Some capital investment bonds and personal pension plans have guaranteed minimum regular bonus rates. These guaranteed rates may be higher than the regular bonus rate paid on similar policies that do not have the guarantee.

7. Charges and expenses

The charges that apply to your policy are used to calculate the shadow fund unit prices and are considered when setting bonus rates. Therefore the charges impact on the amount we pay out.

More detail about the actual level of charge that applies to each type of policy is included in the PPFM Appendix, which is available on our website www.nfumutual.co.uk or on request.

8. Managing risks the with-profits fund is exposed to

The performance of the with-profits fund is affected by risks that may increase or reduce the value of the with-profits fund. These risks may change over time.

Currently the major risks facing the with-profits fund as a whole are:

- Potential losses on investments
- The cost of guarantees made on some with-profits policies being greater than expected
- Losses on our non-profit business (such as claims being more than expected)
- Expenses being higher than planned.

Our Board of Directors is responsible for actively managing any risks to the with-profits fund. They approve all significant risks after considering factors including:

- Whether the risk is worth taking
- The size of our estate (see the next section)
- The size of the potential impact on our assets and our ability to pay policyholders
- Our exposure to other risks.

The estate will normally absorb any profits or losses that arise from the risks the with-profits fund runs. However as a mutual organisation, with no shareholders, any losses (or profits) may ultimately be borne by (or credited to) the with-profits policyholders.

9. The estate and how we use it to manage your investment

The estate is the term we use to describe the excess of our assets over liabilities. Or in other words, what we own over what we owe. It provides us with the money (working capital) to operate our business. We carefully manage the estate so that it is big enough to:

- Provide enough money, so that we can continue to issue new business
- Cover the costs of smoothing
- Meet the costs of certain policy guarantees
- Meet any excess of expenses over charges to with-profits policies
- Provide investment freedom so we can invest in riskier assets which have potential for higher investment returns (for example equities and property)
- Cover one off exceptional expenses.

10. Volumes of new business

The financial soundness of the with-profits fund can be adversely affected if the company issues too many new policies. Our estate is large enough such that currently we do not set any limits on the amount of with-profits business that we sell in any year. We regularly monitor the levels of new business.

To find out more

If you'd like to know more about investing in the with-profits fund, you can:

- Contact your NFU Mutual financial consultant
- Call our customer service team on 0800 622 323
- Refer to the full principles and practices of financial management (PPFM) at www.nfumutual.co.uk. The PPFM overrides the contents of this guide if there are any differences between the two documents.

NFU Mutual financial consultants advise on NFU Mutual products and services, and in special circumstances those of other providers.

The value of investments may fall as well as rise. You may receive back less than your original investment.

NFU **Mutual**

www.nfumutual.co.uk

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CFP/GEN/UN/0110