

2017 REPORT  
TO WITH-PROFITS  
POLICYHOLDERS



**NFU Mutual**  
INSURANCE | PENSIONS | INVESTMENTS

# 2017 REPORT TO WITH-PROFITS POLICYHOLDERS

Report To With-Profits Policyholders On The Society's  
Compliance With Its Principles And Practices Of Financial  
Management During 2017

# 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 2017 financial year (1 January 2017 – 31 December 2017) 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.

Richard Percy

Chairman

Lindsay Sinclair

Group Chief Executive

# INTRODUCTION

**It is a requirement for directors of insurance companies that write with-profits business to provide with-profits 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 2017 to 31 December 2017) 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. For more information about the company you may also like to read the latest Report and Accounts. The PPFM and Report and Accounts are both available on our website [www.nfumutual.co.uk](http://www.nfumutual.co.uk).

# GOVERNANCE OF WITH-PROFITS BUSINESS

**The Society has two key roles within its governance structure that 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 subordinate Committee of the Society's Board that is responsible for monitoring on-going compliance with our PPFM. During 2017 it comprised three of the Board's non-executive directors and two executives from the company. The Committee met four times during the year and the Committee chairman reported formally to the Board on its proceedings after each meeting. From 1 January 2017 Jim McLaren (MBE) replaced John Elliot (FCA) as one of the non-executive members of the 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 2017

## PAYOUTS AND BONUS RATES

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 regularly review CAB bonus rates and set CAB interim bonus rates accordingly. This practice is consistent with the PPFM. The interim rates in force throughout 2016 for CAB were confirmed as the declared rates.

Annual bonus rates for our other with-profits products were declared for 2016 in April 2017.

The declared annual bonus rate for with-profits annuities for 2016 was set slightly below the level of annual inflation increase. This was in line with the PPFM target to set bonus rates to match annual inflation increases only if the accumulated asset shares support such a declaration.

For the rest of our traditional and unitised with-profits contracts, the declared rates were equal to the interim rates in force during 2016.

At the same time, new interim bonus rates were set to take effect from 1 April 2017. The interim bonus rates were maintained at their previous levels for the majority of products, with a smaller number of products having small reductions applied to their rates. This reflected a combination of our strong solvency

position, the positive returns that had been achieved on asset shares over recent years and the expectation that asset returns are likely to be lower over the next few years.

The only exception was traditional life policies where the interim bonus rate was increased in order to maintain the balance between annual and terminal (final) bonuses.

This is consistent with our PPFM which states that we set annual bonus rates once a year or more often if necessary for unitised with-profits products.

The annual bonus rates are included in our PPFM appendix which is available on our website [www.nfumutual.co.uk](http://www.nfumutual.co.uk).

During 2017 several new with-profits bonus series, paying lower annual bonus rates than the existing series, were launched for our Flexibond and Shrewd Savings ISA business. Any new with-profits business and increases to existing policies are now invested into the new bonus series. This helps to maintain fairness between different generations of policyholders. This is consistent with our PPFM which states a new bonus series may be introduced into an existing product if the annual bonus rate falls materially above or below the level that is deemed appropriate for new business.

# COMPLIANCE WITH THE PPFM DURING 2017

Terminal bonuses were declared on 1 January 2017 and 1 July 2017. This is consistent with the PPFM, which states that we set terminal bonus rates twice a year or more often if necessary. Throughout 2017 asset share values, on which terminal bonus rates and therefore payouts are based, were calculated using the methods described in the PPFM. There remains an emphasis on using terminal bonuses to ensure that policyholders receive payouts close to 100% of the underlying asset share where possible whilst following the smoothing rules defined in the PPFM.

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 2017 reflected fair value. We are satisfied that bonus rates were calculated using the methods described in the PPFM and where discretion was applied it was appropriate.

## **SURRENDER VALUE TERMS**

In 2017 we removed any exit fees that apply for personal pension policyholders who take benefits after age 55.

For our traditional with-profits pensions, falling interest rates in recent years had reduced the maximum proportion of the fund that could be taken as tax-free cash due to the product terms. This was because the amount of tax-free cash was effectively based on an annuity rate rather than a percentage of the fund. In October 2017 we introduced the option for our customers with traditional with-profits pensions to access 25% of their fund as tax free cash (in line with the current maximum regulatory limit) without transferring their policy to an alternative pension plan. This means that customers with pure endowment policies can now take the maximum tax free cash without transferring and hence avoid losing the valuable benefit of guaranteed annuity rates.

The surrender value bases for our traditional with-profits policies and unitised with-profits policies were not changed during 2017. The bases used continue to be 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 our aim is to have at least 90% of the payouts falling within these target ranges.

# COMPLIANCE WITH THE PPFM DURING 2017

The target ranges published in the PPFM were unchanged in 2017 and were:

- 75% - 125% for traditional with-profits business
- 80% - 120% for unitised with-profits business

The With-Profits Actuary and With-Profits Committee are satisfied that the published target ranges continue to remain appropriate for our with-profits business. The ranges are set to be wide enough to allow us the continued investment freedom to choose the mix of assets that we believe will maximise returns for policyholders, whilst continuing to apply smoothing in line with the PPFM and customer expectations. For example we currently invest a significant proportion of assets in equities.

We can confirm that during 2017 we complied with the target ranges set out in the PPFM, with 96.3% of traditional and 100.0% of unitised payouts falling within range.

The vast majority of the small number of payouts that fell outside of the target ranges were traditional with-profits policies that had stopped paying regular premiums. Each policy was investigated and the yields underlying the payments were

considered to be fair by the With-Profits Committee.

Payouts are regularly monitored against the target ranges during the year in order to provide early warning of any potential divergence from our target ranges.

## INVESTMENT POLICY DURING 2017

The mix of assets was the same for all types of with-profits policies, except for the CAB.

Assets backing the CAB were invested in cash and floating rate notes (FRNs) throughout the year. This is consistent with the PPFM. FRNs are bonds which pay a variable rate of interest. They are mostly issued by financial institutions and governments and the interest they pay is usually called a coupon. The coupon is linked to a specified market rate and is re-calculated at regular intervals.

The With-Profits Committee, after considering advice from the With-Profits Actuary, is responsible for setting asset allocation limits for the part of the Long-Term Business Fund that backs asset shares of all other with-profits policies. Specifically, it sets a maximum and minimum

## COMPLIANCE WITH THE PPFM DURING 2017

percentage of the asset shares that can be invested in each category of asset.

These operating bands remained unchanged throughout 2017 and were:

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

The proportion invested in each asset class over 2017 is shown in the table

below. There were no significant changes over the period.

	01/01/17 - 31/03/17	01/04/17 - 31/05/17	01/06/17 - 30/06/17	01/07/17 - 30/09/17	01/10/17 - 31/12/17
UK equities	41.0%	41.0%	40.0%	40.0%	40.0%
Property	18.0%	18.0%	18.0%	18.0%	17.0%
Overseas equities	17.0%	17.0%	17.0%	17.0%	17.0%
UK corporate bonds	6.1%	6.2%	6.2%	6.3%	7.1%
Index-linked bonds	5.5%	5.5%	5.5%	5.5%	5.5%
Fixed interest gilts	6.0%	6.0%	6.0%	6.0%	6.0%
Overseas bonds	1.4%	1.3%	1.3%	1.2%	1.4%
Cash and other assets	5.0%	5.0%	6.0%	6.0%	6.0%

The proportion of the asset shares invested in each asset category

remained within the operating bands throughout 2017.

# COMPLIANCE WITH THE PPFM DURING 2017

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

## **BUSINESS RISK**

The Board Risk Committee has acted in the capacity set out in the PPFM and no concerns over risk management were raised in 2017.

## **NEW BUSINESS TERMS AND VOLUME**

The level and mix of new business written into the Long-Term Business Fund is regularly monitored. The With-Profits Actuary and With-Profits Committee are satisfied that during 2017 all new business was written on terms that we expect to have no adverse effect on the interests of the existing with-profits policyholders in the Fund.

Over the last few years interest rates have fallen significantly and this resulted in guarantee costs for with-profit investments increasing for all new business products. In response the With-Profits Committee approved the following actions:

- The Capital Investment Bond was closed to premium increases from 1 May 2017.

- The existing with-profits series of units for Flexibond and Shrewd Savings Plan ISA were closed to premium increases.
- Several new with-profits series were launched for new policies and premium increases to existing policies for both Flexibond and Shrewd Savings Plan ISA. These series had lower annual bonus rates than the existing series, which helps to reduce the guarantee costs.
- The new Flexibond with-profits series have an annual management charge that is 0.1% per annum higher than the existing series, with the additional charge contributing towards the cost of guarantees.

NFU Mutual's annuity pricing basis was regularly updated throughout the year to reflect underlying changes in mortality assumptions, investment returns and expenses.

During 2017 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 were satisfied that the volume of business written was within an acceptable range throughout 2017 and no restriction on new business was therefore necessary.

# COMPLIANCE WITH THE PPFM DURING 2017

## CHARGES AND EXPENSES

Detailed expense investigations are periodically undertaken to ensure that the expenses incurred in the Long-Term Business 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.

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 2017 we continued to restrict the annual management charge taken from the life and pension deposit funds to prevent the unit prices falling when fund returns are less than the annual management charge. We applied this restriction to all deposit funds held by policyholders, except for capital units in Personal Pensions, which have a higher annual management charge. The cost to the Estate was not material in relation to the overall assets held by the Long-Term Business Fund and therefore the With-Profits Committee and With-Profits Actuary are satisfied that the restriction did not act to the detriment of with-profits policyholders. We will continue to review this practice on an annual basis.

## MANAGEMENT OF THE INHERITED ESTATE

The Inherited Estate is the excess of the total assets of the Long-Term Business Fund over the amount required to meet future liabilities to non-profit and with-profits policyholders and other obligations of the Long-Term Business Fund. The Inherited Estate provides the working capital to support current and future business written within the Long-Term Business Fund.

The company is currently running a strategic programme that aims to enhance our customer proposition. This strategic investment is being funded by the Inherited Estate.

Our with-profits policyholders share in the profits and losses of the Long-Term Business Fund. Therefore the With-Profits Committee regularly reviews whether it is appropriate to make an additional distribution to existing policyholders from the Inherited Estate, considering fairness between different groups and generations of policyholders.

In 2017 the With-Profits Committee agreed and implemented a long term strategy for distributions from the Inherited Estate and agreed that the Long-Term Business Fund was able to support a long-term affordable rate of distribution of 0.75% per annum. The Board approved this strategy and the asset shares for all

# COMPLIANCE WITH THE PPFM DURING 2017

with-profits policies, except for CAB, were enhanced by 0.75% in 2017. The long-term affordable rate of distribution will be reviewed annually and may increase or decrease in future years.

The investment strategy for the Inherited Estate differs from the strategy for the asset shares and for the rest of the Long-Term Business Fund. The investment strategy aims to maximise investment returns subject to policyholder reasonable expectations and managing levels of risk.

The With-Profits Actuary and With-Profits Committee are satisfied that during 2017 the Inherited Estate was managed in accordance with the rules of the PPFM.

## **CHANGES TO THE PPFM**

The PPFM describes how we manage the Society's Long-Term Business Fund. The PPFM was updated in May 2017 to reflect the introduction of the new series of Flexibond with-profits units. A summary of changes document was produced for policyholders that explained the changes to the PPFM and a copy is sent to with-profits policyholders with their annual statement in the year following any change. The new version of the PPFM and summary of changes document were added to the NFU Mutual internet site ([www.nfumutual.co.uk](http://www.nfumutual.co.uk))

at the appropriate time, giving policyholders access to the revised documents.

Prior to November 2016 the FCA also required insurance companies that write with-profits business to produce a Consumer Friendly version of the PPFM (CFPPFM). We therefore produced four shorter, simpler versions of our PPFM to cover different types of products. One described our unitised with-profits products, one covered our conventional products, one was for our CAB and the final one described how our with-profits annuities work. The unitised version was updated in May 2017 in line with the PPFM and added to the website.

In August 2017, following the FCA removing the requirement to produce CFPPFMs, we removed our CFPPFMs from publication. The relevant information from the unitised with-profits and CAB versions was moved to other existing documents, including the Fund Guide which is available on our website. We decided to keep the content of the conventional with-profits business and with-profits annuity CFPPFMs on the website in the form of two guides to with-profits because they contain information that is still an important reference point for our policyholders.

# COMPLIANCE WITH THE PPFM DURING 2017

## 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 2017 include Key Features Documents, policy documents, marketing material, the Society's Consumer Friendly PPFM, annual statements and illustrations of possible future benefits from policies. The annual statements that customers receive include details of the annual bonuses added to their policies or the annual bonus rates. Some statements also include reference to the terminal bonus.

When illustrating potential policy payouts all companies use standard growth rates provided by the Financial Conduct Authority (FCA), unless they believe that using lower rates would be more appropriate for their products. During 2017 we used projection rates that were lower than these FCA maximums for all funds, including with-profits, apart from those that were invested solely in

equities. We believe the projection rates used for our different funds are appropriate and reflect the mix of assets within the funds and our view of future investment returns. The appropriateness of the rates used for all illustrations is reviewed regularly.

Our traditional with-profits pensions sold between 1 January 1983 and 30 June 1988 benefit from guaranteed annuity rates. This means that for each £1 of accumulated fund we provide a guaranteed minimum income when at retirement. We include the impact of this benefit when we provide projections of possible future pension levels to our policyholders. In 2017 we altered the projections to also illustrate the possible future pension level without the benefit of the guaranteed annuity rates. This helps to highlight the value of this benefit.

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

# APPENDIX

## **ANNUAL REPORT FROM THE WITH-PROFITS ACTUARY**

As With-Profits Actuary for NFU Mutual, I advise the With-Profits Committee and the Board on the management of the with-profits business and the key aspects of discretion that are applied. I am required by the Financial Conduct Authority's rules to report to with-profits policyholders as to whether NFU Mutual's annual report to with-profits policyholders and the discretion exercised by NFU Mutual in respect of the period covered by the report have taken the interests of the with-profits policyholders into account in a reasonable and proportionate manner.

In my opinion, and based on the information and explanations provided to me by the Society, discretion exercised by the Society during 2017 did take 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 2017 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 Conduct Authority, the Actuarial Profession and the Board for Actuarial Standards.

### **Iain Baker**

Fellow of the Institute and Faculty of Actuaries

With-Profits Actuary

National Farmers Union Mutual Insurance Society Limited  
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**NFU Mutual**

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