

2018 REPORT  
TO WITH-PROFITS  
POLICYHOLDERS



**NFU Mutual**  
INSURANCE | PENSIONS | INVESTMENTS

# 2018 REPORT TO WITH-PROFITS POLICYHOLDERS

Report to With-Profits Policyholders on The Society's  
compliance with its Principles And Practices Of Financial  
Management during 2018

## 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 2018 financial year (1 January 2018 – 31 December 2018) 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 2018 to 31 December 2018) 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 2018 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 May 2018 Chris Stooke (FCA) replaced Eileen McCusker as one of the non-executive members of the

Committee. Kim Arif (FIA), the Finance Director of NFU Mutual and one of the executives on the Committee, sadly passed away in 2018. As a result, Gary Stewart, Life Analysis Actuary (FIA) joined the Committee as one of the executive members.

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 2018

## 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. In 2018, the CAB interim rates in force throughout 2017 were confirmed as the declared rates.

In April 2018, annual bonus rates for our other with-profits products were declared for 2017. The 2017 declared annual bonus rate for with-profits annuities 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 (the underlying value of the policy) 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 2017.

At the same time, new interim bonus rates were set to take effect from 1 April 2018. The interim bonus rates were maintained or increased from their previous levels for the majority of products. This reflected a combination of our strong solvency position, the positive returns that had been achieved on asset shares over recent years and the returns we expect to generate on the underlying assets in future years.

The only exception was for our traditional with-profits deferred annuity pensions taken out before 1983. The interim bonus rate for this product was reduced from 0.2% to zero because the guaranteed benefits for many policies already exceed the underlying value of the policy and there is no scope to award a terminal bonus.

The approach followed to set annual bonus rates was 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).

Terminal bonus rates were declared on 1 January 2018 and 1 July 2018. This is consistent with the PPFM, which states that we set terminal bonus rates twice a year or more often if necessary. Throughout 2018 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.

# COMPLIANCE WITH THE PPFM DURING 2018

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 2018 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 2018 we removed the early withdrawal charge that applied to flexibond policies taken out before 2013. Previously this charge was applied when a withdrawal was made within three years of any single investment or any increase in regular payments.

The surrender value bases for our traditional with-profits policies and unitised with-profits policies were not changed during 2018. 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.

The target ranges published in the PPFM were unchanged in 2018 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 2018 we complied with the target ranges set out in the PPFM, with 95.1% of traditional and 100.0% of unitised payouts falling within range.

# COMPLIANCE WITH THE PPFM DURING 2018

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 2018**

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



## COMPLIANCE WITH THE PPFM DURING 2018

These operating bands remained unchanged throughout 2018 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 2018 is shown in the table below.

	01/10/17 - 31/12/17	01/01/18 - 31/03/18	01/04/18 - 30/06/18	01/07/18 - 30/09/18	01/10/18 - 31/12/18
UK equities	40.0%	40.0%	41.0%	41.0%	41.0%
Property	17.0%	17.0%	17.5%	17.5%	17.5%
Overseas equities	17.0%	17.0%	17.0%	16.5%	16.5%
UK corporate bonds	7.1%	7.2%	9.1%	9.6%	10.5%
Index-linked bonds	5.5%	5.5%	4.5%	4.5%	4.5%
Fixed interest gilts	6.0%	6.0%	5.0%	5.0%	5.0%
Overseas bonds	1.4%	1.3%	1.4%	1.4%	1.0%
Cash and other assets	6.0%	6.0%	4.5%	4.5%	4.0%

# COMPLIANCE WITH THE PPFM DURING 2018

The proportion of the asset shares invested in each asset category remained within the operating bands throughout 2018. Over this period the only significant movements were an increase in the proportion invested in UK corporate bonds and a reduction in the proportion held as cash and other bonds.

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 2018.

## **NEW BUSINESS TERMS AND VOLUMES**

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 2018 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.

In December 2018 the Society launched a new investment platform offering access to the Select ISA and Select Investment Plan products. The With-Profits Actuary and With-Profits Committee are satisfied that the charges for these products are expected to cover sufficient expenses and hence the terms offered are not to the detriment of with-profits policyholders.

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

In November 2018 the Capital Access Bond was closed to new business, meaning we no longer issue new policies or allow additional investments into existing policies.

During 2018 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 2018 and no restriction on new business was therefore necessary.

# COMPLIANCE WITH THE PPFM DURING 2018

## 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.

The With-Profits Actuary and With-Profits Committee are satisfied that the charges for existing business are expected to cover sufficient expenses and hence the terms continued to be offered are not to the detriment of with-profits policyholders.

Integrated life cover is an additional death benefit that policyholders could choose to add to their personal pension policies. The cover is no longer available but does still apply for some in force policies. The cover provides a payout of the higher of the policy value and sum assured in the event of death before retirement.

The charges we make for integrated life cover are reviewable and following a review were reduced in April 2018 to allow for improvements in mortality rates.

Regular premium personal pension policies the Society sold before 1998 did not have an initial charge. Instead, the premiums paid in the first two years bought capital units which had a higher annual management charge than the standard accumulation units that were purchased after the first two years had elapsed. The additional charge was designed to recoup initial expenses incurred in selling and setting up the policy. Therefore if a policyholder chose to surrender their policy before their selected retirement date the policy conditions allowed for an exit charge to cover the capital unit charges that would not be paid. In 2017 we removed this exit charge for policyholders who take benefits from age 55. In 2018 we reduced the charge on capital units from 3.125% to the 0.625% per annum charged on accumulation units and permanently removed the exit charge for all policyholders.

# COMPLIANCE WITH THE PPFM DURING 2018

In 2018 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 directly by policyholders, except for capital units in personal pensions whilst they had 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 program that aims to enhance our customer proposition. This strategic investment is being funded by the Inherited Estate.

Our with-profit 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. The With-Profits Committee previously agreed and implemented a long-term strategy for distributions from the Inherited Estate, the rate of distribution is subject to annual review. In 2018 the Committee agreed that the Long-Term Business Fund was able to support a long-term affordable rate of 1.25% per annum. The Board approved this level of distribution and the asset shares for all with-profits policies, except for CAB, were therefore enhanced by 1.25% in 2018. The long-term affordable rate of distribution will continue to be reviewed annually and may increase or decrease in future years.

# COMPLIANCE WITH THE PPFM DURING 2018

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 2018 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. We made no changes to the PPFM during 2018.

## **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 2018 include key features documents, policy documents, marketing material, our guides to with-profits, 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.

Most statements also include reference to the terminal bonus or current surrender value. In 2018 we introduced additional information to traditional with-profits pension statements including a transfer value. Similar information will be added to endowment and whole of life statements in 2019.

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 2018 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.

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 2018 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 2018 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  
June 2019

[nfumutual.co.uk](https://nfumutual.co.uk)



**NFU Mutual**

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Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority  
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