

2019 REPORT  
TO WITH-PROFITS  
POLICYHOLDERS



**NFU Mutual**  
INSURANCE | PENSIONS | INVESTMENTS

# 2019 REPORT TO WITH-PROFITS POLICYHOLDERS

Report to With-Profits Policyholders on The Society's  
compliance with its Principles And Practices Of Financial  
Management during 2019

## 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 2019 financial year (1 January 2019 – 31 December 2019) 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.

Jim McLaren MBE

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 2019 to 31 December 2019) 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 2019 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 September 2019 Ali Capper joined the Committee to replace Jim McLaren (MBE) as one of the non-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 considered 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 2019

## PAYMENTS AND BONUS RATES

In April 2019, annual bonus rates for our with-profits products were declared for 2018.

Market interest rates have a direct impact on the returns we can 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 2019, the CAB interim rates in force throughout 2018 were confirmed as the declared rates.

The 2018 declared annual bonus rate for with-profits annuities was set at the level of annual inflation, based on the retail price index (RPI) in the year to November 2018. This was in line with the PPFM target to set bonus rates to match annual inflation increases 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 set equal to the interim rates in force during 2018.

In 2018 the interim bonus rate for traditional with-profits deferred annuity pension policies taken out before 1983 was reduced to zero. The rate for 2018 was then declared as zero on 1 April 2019. The rate had to be set to zero because the benefits already guaranteed to customers exceed the underlying value of assets for the majority of policies. This has

happened because the level of pension guaranteed for these policies was set before 1983, when interest rates were much higher and people were not expected to live as long as they do today. Therefore the benefits guaranteed when the policies were set up are valuable. If we paid an annual bonus for this product we would be increasing the guaranteed benefits further above the underlying value of the assets, so we set the annual bonus rate to zero to be fair to all customers.

The zero declared bonus rate was included on policyholders' annual statements for the first time in 2019. Additional information was included to explain why the rate had been reduced to zero and to help policyholders understand the valuable benefits these policies continue to offer to them.

New interim bonus rates were set to take effect from 1 April 2019. The interim bonus rates were maintained at their previous levels for all products apart from with-profits whole of life policies. 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 interim bonus rate for the traditional with-profits deferred annuity pensions was maintained at zero because the guaranteed benefits for the majority of policies still exceeded the underlying value of the policy.

# COMPLIANCE WITH THE PPFM DURING 2019

Previously with-profits whole of life policies received the same annual bonus rate as with-profits endowment policies. From 1 April 2019 separate annual bonus rates have been set for whole of life and endowment policies. The interim bonus rate for whole of life policies issued after 1982 was reduced from 2.25% to 1.75% and the rate of 2.25% was maintained for all other whole of life and endowment policies. The change is in line with the PPFM and the need to treat different generations of policyholders fairly.

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 2019 and 1 July 2019. This is consistent with the PPFM, which states that we set terminal bonus rates twice a year or more often if necessary. Throughout 2019 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.

Previously we have set payouts on death for with-profits whole of life policies using the same terminal bonus rates as for with-profits endowment policies. However, unlike whole of life policies, many of our endowment policies are now reaching maturity and the total number in force is reducing significantly. Therefore since 1 May 2019 we have set whole of life death payouts using a separate set of whole of life terminal bonus rates that vary by age at entry, entry year and premium paying term. The aim is to target payouts close to the underlying value of the policy, subject to the normal smoothing rules we apply when setting payouts for other products. The methods of setting terminal bonus rates for both products continue to comply with the PPFM and target fair payouts for customers.

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 2019 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.

# COMPLIANCE WITH THE PPFM DURING 2019

## SURRENDER VALUE TERMS

Previously we have set surrender values for with-profits whole of life policies using the same projected terminal bonus rates as for with-profits endowment policies. To be in line with the change made for whole of life payouts on death, from 1 May 2019 we updated the whole of life surrender value basis to set values using rates specific to whole of life rates that vary by entry age at entry, entry term and premium paying term. The methods of setting surrender values for both products continue to comply with the PPFM and target fair payouts for customers.

On 1 May 2019 we altered the basis used to calculate payout values on death for with-profits endowments. The basis aims to set the death benefit close to the surrender value unless the guaranteed value is higher. The method continues to comply with the PPFM and target fair payouts for customers.

Our retirement annuity pensions (deferred annuities and pure endowments) had a premium loading charge applied when customers chose to pay monthly rather than annually. In 2019 we removed the premium loading for all retirement annuity pensions. The change was made to ensure consistency between product groups and to ensure the fair treatment of long-standing customers.

The surrender value bases for our other traditional with-profits policies and unitised with-profits policies were not changed during 2019. 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 2019 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.



# COMPLIANCE WITH THE PPFM DURING 2019

We can confirm that during 2019 we complied with the target ranges set out in the PPFM, with 92.3% 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 or whole of life policies where the change to the basis to calculate surrender and death values is being applied gradually in accordance with the smoothing rules in our PPFM. 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 2019

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. The appropriateness of these ranges is reviewed regularly.

## COMPLIANCE WITH THE PPFM DURING 2019

The operating bands were changed on 1 July and 1 November 2019 and with-profits policyholders were notified of the changes via letter. The changes were made to allow our investment management team flexibility to invest a higher proportion of assets in international equities to improve the potential for future returns, without changing the risk level of the investment. The operating bands throughout 2019 were as follows:

	01/01/19 - 30/06/19	01/07/19 - 31/10/19	01/11/19 - 31/12/19
UK Equities	35-55%	15-45%	15-35%
International Equities	10-20%	15-45%	15-45%
Property	15-20%	15-20%	15-20%
Fixed Interest (including cash, gilts, bonds and index-linked)	15-35%	20-35%	20-35%

The proportion invested in each asset class during 2019 is shown in the following table.

	01/01/19	01/04/19	01/08/19	01/09/19	01/11/19
UK Equities	42.0%	42.0%	38.2%	38.2%	32.5%
International Equities	16.5%	16.5%	19.3%	19.3%	25.0%
Property	17.5%	17.5%	17.5%	17.5%	17.5%
UK Corporate Bonds	11.5%	10.8%	12.2%	15.4%	15.4%
Index-Linked Bonds	4.5%	2.8%	3.0%	2.5%	1.0%
Fixed Interest Gilts	4.5%	5.0%	6.0%	3.5%	2.0%
International Bonds	0.5%	0.7%	0.3%	0.1%	3.1%
Cash and Other Assets	3.0%	4.7%	3.5%	3.5%	3.5%

# COMPLIANCE WITH THE PPFM DURING 2019

The proportion of asset shares invested in each asset category remained within the operating bands throughout 2019. Over this period there was an increase to international equities and reduction in UK equities reflecting the investment management team's views on expected returns. They believe this will diversify our funds by reducing exposure to UK specific risks while giving us greater access to economic growth in other parts of the global economy. Smaller changes in allocation between the different bond and cash assets were also implemented.

During 2019 we made changes to the way we manage international assets within the Long-Term Business Fund to ensure we continue to be best placed to take advantage of international investment opportunities. Previously all investment management of our funds was carried out by our investment management team, including the international elements of our funds. Over the past few years we have strengthened our in-house investment management team and are now also utilising external investment management expertise for some of our international investments. As the breadth of

investment opportunities across the globe continues to grow and the pace of change generally increases, we believe that it was appropriate to complement our in-house team. We adopted this revised approach across all of the international investments managed by the NFU Mutual Group.

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 2019.

## **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 2019 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.

# COMPLIANCE WITH THE PPFM DURING 2019

In December 2019 the Society extended the investment platform to offer access to the select pension product and select junior ISA, in addition to the select ISA and select investment plan products launched in 2018. 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.

During 2019 levels of new 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 2019 and no restriction on new business was therefore necessary.

## 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 fund charge for the Gilt and Corporate Bond Fund for the Select ISA, Select Investment Plan and Select Pension Plan products was reduced from 0.75% per annum to 0.5% per annum in 2019.

The charges policyholders investing in funds with exposure to international equities pay for the ongoing management of their funds increased marginally as a result of our decision to use specialist external investment managers to manage a proportion of the international assets with our funds. The increased charge applies to those invested in with-profits because the asset shares are partially invested in international equities.

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.

# COMPLIANCE WITH THE PPFM DURING 2019

In 2019 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. The cost to the Estate was not material 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. This is a temporary measure and we will continue to review this practice on an annual basis or earlier if the cost increases.

## **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 2019 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 2019. The long-term affordable rate of distribution will continue to 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 2019 the Inherited Estate was managed in accordance with the rules of the PPFM.

# COMPLIANCE WITH THE PPFM DURING 2019

## CHANGES TO THE PPFM

The PPFM describes how we manage the Society's Long-Term Business Fund. The PPFM was updated on 1 May 2019 to reflect the changes in calculating payouts for with-profits whole of life business payouts on death for with-profits endowment policies.

A summary of changes document was produced for policyholders that explained the changes to the PPFM. 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.

## 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 2019 include key features documents, policy documents, marketing material, our guides to with-profits, annual statements and illustrations of possible future benefits from policies.

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 2019 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.

Customers were informed by letter of changes we made to the way we manage assets within our funds during 2019. The letter included notification of the appointment of external investment managers for a proportion of our international assets and the resultant small increase to the ongoing management charge policyholders pay. This also included a notification to our with-profits policyholders of the increase to the maximum proportion of asset shares that can be invested in international equities and the reasons for this change.

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 2019 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 2019 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 2020

[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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