National friendly

# Performance Summary

# 2016

This booklet provides a brief summary. For more detail please see our full Annual Report and Financial Statements for 2016 by visiting us at **nationalfriendly.co.uk** or call us on **0333 014 6244** for a copy.

*"To be a forward-thinking and trusted mutual that meets the health, welfare and protection needs of our customers."*

# CHAIRMAN'S REVIEW

2016 has been an eventful year for National Friendly with a combination of factors giving rise to some unique challenges. Nevertheless we have continued to pursue our overall strategic objective of being a forward thinking and trusted mutual that meets the health, welfare and protection needs of our customers.

We re-opened to new business in the spring with our new healthcare product, Your Health Fund, and followed this up with the launch of two savings products, a Tax-Exempt Savings Plan and a With-Profits Bond. The healthcare product is aimed at both existing members and new customers and, following market feedback, we have recently made some product refinements to better meet customers' needs. The two savings products are aimed primarily at our existing members that have maturing savings policies, allowing them to continue saving with us by re investing the proceeds or by taking out a new regular premium plan. These have been well received by our membership.

The new regulatory regime, Solvency II, came into force on 1st January 2016 and we are now reporting our quarterly results to our regulator under this basis. In respect of our Annual Report and Financial Statements for this year we have continued determining and reporting our reserves under the prior basis, Solvency I, as we are permitted to do so and this is more cost effective than reporting both this year and the comparative numbers for last year on a Solvency II basis. However, we intend to report Solvency II figures only from 2017 year end onwards.

Market conditions were difficult in 2016 with a severe fall in interest rates that had a positive impact on our fixed income assets due to an increase in valuation but also resulted in a lower discount rate increasing the present value of our long term liabilities. Furthermore, there was also an impact on the balance sheet value of our (now closed) staff defined benefit pension scheme which moved from an overall net surplus at the prior year to a deficit at the end of 2016.

Overall, our capital position has reduced over the course of 2016 primarily due to the fall in interest rates. In determining our reserves under Solvency I, and as reported in our Financial Statements, our Fund for Future Appropriation has fallen from £12.5m to £7.9m. Under Solvency II our net assets reduced from £21.6m to £17.4m and our free assets fell from £6.5m to £2.7m after taking account of our Solvency Capital Requirement.

The Solvency II regime is more sensitive to interest rate movements than Solvency I. However it recognises that there may be some anomalies such as this in moving over to the new requirements and so it has introduced a set of transitional measures to better manage this. We have therefore applied to use the Transitional Measure for Interest Rates which, if approved, will result in our free assets being similar to that at the start of the year. Our business planning and forecasting demonstrates that, by writing new business, our capital position will strengthen going forwards and so this is our focus for 2017 and future years.

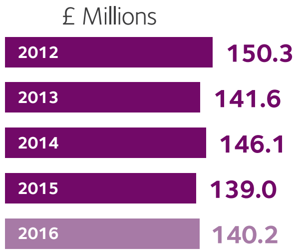
Finally I would like to take this opportunity to thank all of our staff for their continued hard work and commitment in 2016 and wish them every success in 2017 and beyond.

**Tracy Morshead**
Chairman
19 May 2017

# FINANCIAL HIGHLIGHTS

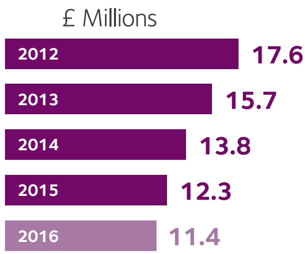
## Total Assets

Our asset base has increased during the year due to the increased return on the financial investments held by the Society.




## Annual Premiums Earned & Premium Income

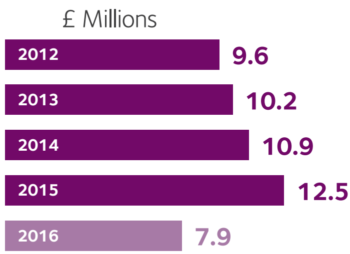
Premium income has reduced due to policy maturities and lapses.




Calculated using 10% of Single Premium Business.

## Fund for Future Appropriations

The Fund for Future Appropriations has decreased through a combination of the pension scheme deficit and increase in per policy expense reserves due to the declining book.



# CHIEF EXECUTIVE'S SUMMARY

The Society's vision is:

" To be a forward thinking and trusted mutual that meets the health, welfare and protection needs of our customers "

The Society's aim as an organisation is to provide for its policyholders products and services that look after their health and welfare to give certainty and control over their wellbeing both now and in the future. This service will be delivered in a timely, personal and friendly manner using technology as appropriate.

The Society re-opened to writing new business in early 2016 with 'Your Health Fund,' a deposit-based healthcare product, offering access to private diagnosis and out-patient treatments with the option of adding access to private hospital in-patient treatments. This was followed later in the year by the relaunch of the updated Tax-Exempt Savings Plan (TESP) providing an opportunity for maturing TESP policyholders to continue saving in a similar with-profits policy. Also, by the end of the year a single lump sum premium With-Profits Bond had been developed that was launched early in 2017 to allow policyholders with maturing policies a place to re-invest their funds.

The Society continued work on an innovative policy for later life care needs and we are currently working with a major reinsurer in designing, market testing and pricing a new product.

Our strategy has three key objectives all aimed to achieve net growth in our customer base, whilst continuing to strengthen our underlying capital position and act in the best interests of our policyholders:

- Expand our healthcare proposition with further new products and services.
- Establish a presence in the later life care market in accordance with our long term strategy.
- Promote customer retention, offering alternative choices when products mature or reach trigger points such as price and benefit review.

# BUSINESS PERFORMANCE

The solvency position of the Society is continually monitored and the level of liquid assets managed to make sure that sufficient liquid funds are held to cover liabilities and claims as they fall due.

As at 1 January 2016 the new Solvency II regulatory capital regime became effective. This is a risk-based approach to the assessment of capital requirements whereby Technical Provisions are calculated as the sum of the best estimate liabilities plus a risk margin. The Society is required to hold sufficient own funds (assets less technical provisions) to meet the Solvency Capital Requirement ("SCR"). The SCR represents the amount of risk capital required to withstand a set of events at the 1/200 confidence level which covers market, underwriting, counterparty and operational risks.

The Society assesses its capital position in accordance with the new Solvency II regulations and manages its business on this basis. However, the reserves within the Financial Statements are still reported on the old Solvency I reporting basis taking advantage of the allowed transition to the new regime with the intention to align the Financial Statement reserves to Solvency II for the 2017 year end reporting.

Under Solvency II, the excess capital after the SCR at 31 December 2016 was £2.7m, a reduction from £6.5m as at 31 December 2015. The reduction in capital position over 2016 was a result of number of factors including:

- A significant fall in the risk free rates used to set the discount rates to establish the current value of future liabilities had a significant adverse impact on the value of liabilities, solvency capital requirement and risk margin.
- The fall in interest rates also had an adverse impact on the staff pension scheme which was in surplus at the end of 2015 but was in deficit at the end of 2016.
- An increase in per policy expense reserves as broadly the same level of administration costs are spread over a smaller policy book as existing policies mature and lapse.

There were a number of positive factors that helped to offset some of the above downsides:

- The sale of the software asset that has been developed to its subsidiary ND Member Services Limited ("NDMS"), This will enable NDMS to licence back the use of the software to the Society as well as provide the opportunity to market it to similar insurers for policy administration.
- Based on experience to date, there was a reduction in provision for medical claim inflation.
- The fall in interest rates, referred to above, resulted in an increase in the value of our fixed income assets (being predominantly government and corporate bonds).

# BUSINESS OBJECTIVES

The Society's business plan for 2016 focussed on continuing to deliver our capital management plan, opening to new business and controlling costs.

The key objective remains for the Society to continue to write new contracts of insurance through products that meet the needs of existing and new policyholders. This will help reverse the increasing per policy cost of administration relative to the reducing number of policies and will help to achieve the target level of free assets set out in our risk appetite.

## Capital management

In 2016, interest rates fell sharply to unprecedented low levels, creating a harsh business environment. Although this fall in interest rates increased the market value of the Society's fixed income assets, it did result in a fall in the risk free rates used to discount our long term liabilities. Although the Society made changes in 2012 to largely match its assets and liabilities, the exceptional fall in interest rates identified that due to the nature and type of existing business and assets, these could not be fully matched, particularly against the prescribed methodology for assessing capital under Solvency II, the new regulatory regime which uses interest rates set by the European Insurance and Occupational Pension Authority ("EIOPA") that do not necessarily move in line with UK interest rates that determine the value of our fixed income assets.

The Board's view is that the previous Solvency I regime which was based on actual assets and yields obtainable continues to provide a credible basis of valuation and therefore, it has applied to the regulator, the Prudential Regulation Authority ("PRA"), for approval to smooth the transition from using the Solvency I discount rates to the Solvency II prescribed risk free rates for the existing policies over a 16 year period, as these policies mature. Transitional measures such as this are permitted as part of a smooth implementation of the new regulatory regime. If approved, this will provide enhanced capital headroom for the Society to pursue its strategy.

We have continued to monitor and manage morbidity carefully and continue to explore opportunities to mitigate further the exposure to morbidity risk on the existing healthcare book although this is much reduced from prior years due to policy lapses.

We have further strengthened our governance, capital and reporting requirements so that we are fully compliant with the requirements of Solvency II and the new Senior Insurance Managers Regime.

## Re-opening to new business

The Society continued to develop its overall health, welfare and protection proposition and launched Your Health Fund, being a deposit based healthcare product, as it returned to writing new business in early 2016. Our long term proposition remains in the long term care market providing both insurance and investment products to help members to insure and / or save towards meeting their long term care needs.

The launch of Your Health Fund, available at different levels of cover and providing insurance for a range of treatments, offers an alternative option to the Society's existing policyholders as well as providing affordable healthcare cover to new customers. Furthermore, in launching this product the Society is supported by a major reinsurer whereby we have an agreement in place on financial terms that will help to protect the Society from adverse claims experience thereby protecting the current surplus.

The Society also re-opened its with-profits investment business, firstly with the relaunch of the Tax-Exempt Savings Plan ("TESP") and, secondly with a With-Profits Bond early in 2017, both helping to mitigate the outflow of funds and reduction in policy count as the current investment policies mature. These products were developed in response to feedback from our members, through both the Focus Group and at the Annual General Meeting, indicating their desire to continue to save with the Society upon the maturity of their existing policies.

As well as developing the new TESP product, we have progressed in designing and developing a later life care product again in partnership with a major re-insurer. The objective of the product will be to provide the policyholder cover primarily to assist in continuing to live in their own homes for as long as possible as later life care needs emerge, funding a variety of needs such as the cost of external carers, mobility aids, minor home alternations (and the like). There will also be access to assisted living and care advice. The product will be an excellent fit and the first step in the Society progressing its later life and welfare strategy.

## Cost control

The Society is aware of the need to address future cost issues as the declining policy book provides progressively lower income to cover its cost base. Overall costs have been maintained within budgets that continue to be tightly controlled.

The development of our new policy administration system has continued to progress well with the first phase delivered in December 2016. This first phase provides a fully operational policy administration system and has enabled us to migrate a number of policy books onto the new system allowing us to decommission one of our legacy administration systems. The final completion is planned by end 2017 and after this the remainder of policies will be migrated over and administered on the new system.

The implementation of the new system and decommissioning of legacy systems will deliver medium to long term savings through improved efficiencies and the removal of manual processes as well as providing additional IT security and meeting enhanced data requirements. The new system should also provide the Society with a flexible platform to enable more effective development, launch, issue and subsequent administration of new products.

## 425 Financial Solutions

We continued to seek opportunities to deliver value through profitability of our intermediary subsidiary, 425 Direct Limited ("425"), to a level where it is able to cover its costs and contribute towards the Society's expense recharges.

At the start of the year, we restructured the business in order to capitalise on our strengths within 425 with a renewed focus on:

- Seeking and developing new opportunities by working in partnership with our main lead partner, Phoenix.
- Establishing a National Friendly new business stream, particularly in the distribution and conversion of the newly launched TESP and With-Profits Bond policies.
- Developing a later life care advice proposition to dove-tail into National Friendly's strategy.

Sales levels for 425 were disappointing for the year due to a combination of a fall in leads from Phoenix, primarily as the pension freedom changes introduced in 2015 have now become the established norm with no pent-up back demand, and a later than planned launch of the TESP and With-Profits Bond by the Society. That said, the cost base of 425 now reflects current and anticipated demand and provides a platform for sustainable profitable growth that continues to be our priority aim.

National friendly

**For further information or to request a copy in Braille, large print or audio please call us on:**

**0333 014 6244** Calls from UK landlines and mobiles cost no more than a call to an 01 or 02 number and will count towards any inclusive minutes.

8am–6pm Monday to Friday excluding bank holidays. Calls are recorded for training and quality purposes.
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National Friendly is the trading name of National Deposit Friendly Society Limited.
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