

With-profits fund

Annual report to policyholders

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1. Introduction

The purpose of this report is to explain how we have managed our with-profits fund during 2017 and to demonstrate that we have followed our published Principles and Practices of Financial Management (PPFM). This includes the setting of bonuses and the investment decisions we have made.

You may find it helpful to refer to 'A guide to how we manage our with-profits fund', which provides a useful summary and is available on our website www.nationalfriendly.co.uk.

If you require more technical detail you can also view our current PPFM, which sets out the meaning of any terms used in this report and is also available on our website.

2. Summary

In the opinion of the Board, the with-profits fund has been managed in accordance with our PPFM over the period 1 January 2017 to 31 December 2017.

This opinion takes into account all areas where discretion has been exercised or where there have been any competing rights, or interest, between different groups of policyholders.

Appropriate governance arrangements have been maintained throughout this period to ensure we comply with the PPFM in the conduct of with-profits business.

3. Governance arrangement for with-profits business

We have two key roles to provide reassurance that our with-profits business is being managed in accordance with our PPFM. They are the With-Profits Advisory Arrangement (WPAA) and the With-Profits Actuary.

The WPAA was established to monitor, advise and report on matters relating to the management and governance of our with-profits business.

In particular the WPAA provides independent judgement in the assessment of compliance with the PPFM and how any conflicting rights of policyholders are addressed.

The With-Profits Actuary is responsible for providing the Board with advice on areas of discretion as they relate to the fair treatment of with-profits policyholders. This includes making recommendations regarding bonus rates, reviewing communication to with-profits policyholders and ensuring the interests of with-profits policyholders are taken into account in a fair and balanced way.

The With-Profits Actuary's report to policyholders in respect of 2017 can be found at the end of this document.

4. How we have complied with our PPFM

There are a number of important areas where the Board has exercised its discretion in managing the with-profits business during 2017.

Bonus rates

Bonus rates were reviewed by the With Profits Actuary and the WPAA and changes were approved by the Board and implemented with effect from 1 July 2017.

As part of the bonus recommendation, reversionary bonus rates were declared for the year 2016, replacing the interim bonus rates previously applicable (and those reversionary bonus rates are not subject to change whereas interim bonus rates may be changed). Revised interim bonus rates were also implemented for the year 2017 onwards. Both reversionary and interim bonus rates were lower than previously applicable reflecting lower interest rates. Terminal bonus rates were generally increased to reflect continuing satisfactory investment performance.

The Board was supplied with sufficient information for it to be content that bonus rates were consistent with the PPFM and reflected fair value to with-profits policyholders.

Surrender values

As part of the bonus declarations in 2017, surrender values for with-profits business were reviewed by the WPAA and the With-Profits Actuary.

Revised surrender values were approved by the Board and implemented with effect from 1 July 2017. No Market Value Reductions were applied to any with-profits policies during 2017.

Investment strategy

The investment strategy for the with-profits fund is monitored regularly, with any changes in strategy being approved by the Investment Committee, a sub-committee of the Board.

In the course of 2017, the Investment Committee has continued to review equity, fixed interest and property holdings where appropriate for potential disposal and to assess reinvestment opportunities in order to create value from this fund.

Charges and expenses

Charges to the with-profits fund and the way these are apportioned to products are reviewed on a regular basis. During 2017 charges made to the with-profits fund were in accordance with the PPFM and reflected the charges advised to policyholders in relevant disclosure material. Expenses in excess of these charges were borne by the inherited estate during 2017, with the exception of the cost of providing benefit guarantees. This cost was borne by the with-profits policyholders in accordance with the PPFM, as the inherited estate was less than the target minimum range of 10% of total liabilities although this was no longer the case by the end of 2017. The approach to treating the cost of guarantees will therefore be reviewed in the first half of 2018.

Inherited estate

The with-profits fund contains an amount of money over and above the amount expected to be paid to existing policyholders. This is known as the inherited estate.

The inherited estate provides working capital to cover statutory solvency requirements and to support current and future business. The target range for the inherited estate as specified in the PPFM is 10% to 40% of total liabilities (as determined under the solvency regime in force when the PPFM was drafted). As at 31 December 2016, the inherited estate was below the minimum of the target range due. However, the position has improved during the course of 2017 due mainly to lower expense assumptions and the inherited estate was no longer below the minimum target by the end of the year.

The PPFM provides that should the level of the inherited estate fall below the minimum target level then the Board may apply tighter restrictions on the use of the inherited estate. With effect from 1 January 2014, the Board has elected to charge the cost of guaranteed annuity contracts to with-profits policyholders while the level of the inherited estate remains below the minimum target level although this will be reviewed in the first half of 2018.

The Board continues to implement a plan to further improve the capital position.

Arrangements for new business

When setting the planned levels of new with-profits sales, there is a requirement to ensure there is sufficient capital available to the with-profits fund to support new sales, without adversely affecting the expectations of existing with-profits policyholders. In addition, new business should be transacted only if it is expected to be beneficial to the with-profits policyholders.

Equity between different groups of with-profits policyholders

Different groups of with-profits policyholders have potentially competing or conflicting interests, such as holders of:

- different products
- policies of different sizes or policy terms
- policies with different entry dates, maturity dates or dates of birth
- policies claiming for different reasons (e.g. maturity, death, surrender)
- policies exercising different policy options, who could receive different benefits relative to each other depending on how discretion is exercised.

The main area in which judgement is required in balancing the interests of different groups is with regard to the smoothing of policy benefits and the way in which policies are grouped when determining payouts. The approach taken to smoothing and grouping is described in the PPFM and was applied in determining payouts in 2017.

Changes to the PPFM and communications to policyholders

A formal review is in progress to confirm that the Society's PPFM remains up to date. The current version is dated May 2015. An updated version will be made available in 2018 that will take account of changes in the solvency regime that have occurred since the current PPFM was put in place.

The statements that were sent to with-profits policyholders in 2017 set out details of the declared bonuses that were implemented with effect from 1 July 2017.

Both the PPFM and 'A guide to how we manage our with-profits fund' are available on our website www.nationalfriendly.co.uk

5. Conclusion

During the period covered by this report (the calendar year 2017), the Board and the WPAA are satisfied that the Society has complied with its PPFM.

6. Report from the With-Profits Actuary

As With-Profits Actuary, I advise the Board of the National Deposit Friendly Society Limited (“the Society”) on key aspects of the discretion that it exercises in respect of with-profits business.

I have been involved in consideration of all the matters referred to in the report on the Society’s compliance with its Principles and Practices of Financial Management.

In my opinion, based on the information and explanations provided to me by the Society, the discretion exercised by the Society during 2017 took your interests into account in a reasonable and proportionate manner.

In arriving at my opinion, I have taken into account where relevant the rules and guidance contained in the Financial Conduct Authority’s Conduct of Business Sourcebook Section 20.2 (Treating with-profits policyholders fairly).

I Morris
Fellow of the Institute and Faculty of Actuaries
With Profits Actuary
National Deposit Friendly Society Limited

2 May 2018

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

Lines are open from 8am to 6pm Monday to Friday excluding bank holidays. Calls are recorded for training and quality purposes.

Alternatively, you can email us at info@nationalfriendly.co.uk



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