

# With-Profits Fund

Annual report to policyholders

| For 2009

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## **1. Introduction**

The purpose of this report is to explain how we have managed our With-Profits Fund during 2009 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 decision we have made.

You may find it helpful to refer to 'A guide to how we manage our With-Profits Fund', which summarises how we manage the With-Profits Fund and is available on our website [www.nationalfriendly.co.uk](http://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 2009 to 31 December 2009.

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 - The With-Profits Committee (WPC) and the With-Profits Actuary.

The WPC is a sub-committee of the Board and is responsible for monitoring on-going compliance with our PPFM. It comprises of at least three Non-Executive directors appointed by the Board and reports to the Board after each meeting.

The WPC provide 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 2009 can be found at the end of this report.

#### 4. How we have complied with our PPFM

There are a number of important areas where the Board has exercised their discretion in managing the With-Profits business during 2009.

##### **Bonus rates**

The main annual bonus declaration was made in respect of reversionary bonuses for 2008 effective 1 July 2009.

Two declarations were made in respect of terminal bonuses effective from:

- 1st January 2009
- 1st July 2009

The 1st January 2009 declaration was made in response to the adverse market conditions being experienced at the time and these declarations were reviewed by the WPC and With-Profits Actuary.

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

##### **Surrender values**

As part of the bonus declarations in 2009, revised surrender values for with-profits business were reviewed by the WPC and the With-Profits Actuary and approved by the Board.

The revised surrender values were implemented on 1 January 2009 and 1 July 2009.

In addition, revised Market Value Reductions were applied to with-profits bonds and revised Investment Performance Adjustments were applied to with-profits ISAs.

##### **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.

At the end of 2008 we appraised the asset class mix for with-profits contracts and increased our fixed interest holding to 40%, reducing both equity and property holdings to 30% each.

In March 2009 we further revised the asset class mix for with-profits pension contracts to 30% property and 70% fixed interest (and no equity exposure).

In the course of 2009 we:

- Realised £10 million from equity holdings and reinvested into Fixed Interest.
- Realised the small Overseas Equity Fund and reinvested into Long Dated Gilts.
- Continued to realise property holdings where appropriate and reinvest 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 2009 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.

### **Inherited estate**

The With-Profits Fund contains an amount of money over and above the amount expected to be paid to existing policyholders and risk capital needed to comply with FSA regulations. This is known as the inherited estate.

The inherited estate provides working capital to support current and future business and we are satisfied that during 2009 this was managed in compliance with our PPFM.

### **Arrangements for new business**

When setting the planned levels of new with-profits sales, there is a requirement to ensure there is enough 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 profitable to the With-Profits Fund.

With-profits sales remained within an acceptable range, throughout 2009 so as not to restrict new business.

The Board has no current intention to close the With-Profits Fund to new business and had no such intention during 2009. This is kept under regular review.

### **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 payout in 2009.

### **Changes to the PPFM and communications to policyholders**

A formal review carried out to confirm that the Society's PPFM remains up to date, resulted in no changes to underlying principles or practices although some minor wording changes were made to improve clarity. This became effective on 4 September 2009.

Statements sent to with-profits policyholders set out details of the bonuses added to their investments following the bonus declaration effective on 1 July 2009.

Both the PPFM and 'A guide to how we manage our With-Profits Fund' are available on our website [www.nationalfriendly.co.uk](http://www.nationalfriendly.co.uk).

## **5. Conclusion**

During the period covered by this report (2009), the Board and the WPC are satisfied that the Society has complied with its PPFM.

## **6. Report from the With-Profits Actuary**

As With-Profits Actuary, I advise the Managing Board of 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 2009 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 Services Authority’s Conduct of Business Sourcebook Section 20.2 (Treating with-profits policyholders fairly).

**S J Ainsworth**  
**With Profits Actuary**  
**National Friendly**

**5 May 2010**

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