

# With-Profits Fund

Annual report to policyholders

For 2010

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## 1. Introduction

The purpose of this report is to explain how we have managed our With-Profits Fund during 2010 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 2010 to 31 December 2010.

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 2010 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 2010.

##### **Bonus rates**

The main annual bonus declaration was made in respect of reversionary bonuses for 2009 effective 1 July 2010.

One declaration was made in respect of terminal bonuses effective from 1st July 2010.

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

##### **Surrender values**

As part of the bonus declarations in 2010, 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 and 1 July 2010.

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.

In the course of 2010 we:

- Realised £7.5 million from equity holdings and reinvested into Fixed Interest, Property and Cash.
- Continued to review property holdings where appropriate for potential disposal and 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 2010 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. The target range for the inherited estate as specified in the PPFM is 10% to 40% of total liabilities. As at 31 December 2010, the inherited estate had fallen below the minimum of the target range due to the performance of the healthcare policy book. The Board is implementing a recovery plan to 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 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.

As a result of the reduction in the level of the inherited estate and to protect the best interests of our policyholders, the Board has temporarily ceased to write new business with effect from 1 June 2011 until further notice.

### **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 2010.

### **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 although some minor wording changes were made to improve clarity. This became effective on 5th May 2010.

Statements sent to with-profits policyholders set out details of the bonuses added to their investments following the bonus declaration effective on 1 July 2010.

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 (2010), 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 2010 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

13 June 2011