PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT (PPFM)

NFU Mutual

INSURANCE | PENSIONS | INVESTMENTS

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1. INTRODUCTION

1.1 Background

We are required by the **regulator** to make available a document containing our Principles and Practices of Financial Management (PPFM). The PPFM aims to explain how a company manages its **with-profits business**.

This document contains the Principles and Practices of Financial Management as at 1 January 2024 for all of the **with-profits business** written by The National Farmers Union Mutual Insurance Society Limited (the Society).

All of this business, together with the Society's **non-profit business**, forms part of the Society's **long-term business fund**. We have issued both **traditional with-profits business** and **unitised with-profits business** in the fund. References to "We" within the document refer to The National Farmers Union Mutual Insurance Society Limited, a company limited by guarantee and owned by its members ("the Society"). Membership of the Society is conferred by the issue of a policy (including with-profits, non-profit and general insurance). All but an immaterial part of its long-term business relates to business transacted within the United-Kingdom.

There has been one transfer of business into the **long-term business fund**, of the subsidiary company Avon Insurance Plc's **long-term business fund**.

A glossary of certain terms used in the PPFM is provided in section 10. The terms included in the glossary are highlighted in bold throughout this document.

1.2 Principles

The With-Profits Principles are high level statements describing how we manage our **with-profits business**.

They are enduring statements of the overarching standards which we adopt in managing the **long-term business fund**. They describe the business model used by the Society in meeting its duties to with-profits policyholders and in responding to longer-term changes in the business and economic environment.

The Principles are highlighted by yellow shading throughout this document.

1.3 Practices

The With-Profit Practices give more detail about the specific practices we follow when managing our **with-profits business.** They describe our approach to managing the long-term **business fund** and to responding to changes in the business and economic environment in the shorter term. They may change more frequently than the Principles. The Practices contain sufficient detail to enable a knowledgeable observer to understand the material risks and rewards from effecting or maintaining a with-profits policy with the Society.

1.4 Governance

The **Board** is responsible for the management of our **with-profits business** and ensuring we comply with our Principles and Practices.

The **With-Profits Actuary** gives advice to the **Board** on managing the **with-profits business**. Any changes to the PPFM are approved by the **Board**.

The **Board** has a subordinate committee called the **With-Profits Committee**, which monitors the ongoing compliance with the PPFM.

The **Board** will produce a report each year for our with-profits customers stating how we have complied with our PPFM. This includes a report to confirm whether the **With-Profits Actuary** believes we have complied with the PPFM.

The PPFM contains a number of references to the **Board**. Whilst the **Board** bears the overall responsibility for managing the **with-profits business**, certain aspects of managing the **with-profits business** covered by this PPFM are reviewed by various other committees in the first instance as appropriate.

1.5 Changes to the PPFM

We may change the contents of the PPFM in the future for a variety of reasons including in response to new product launches, changes in the economic or business environment, regulatory changes or changes to the way we manage our **with-profits business**.

If we change any of the Principles or Practices we will ensure we comply with the rules in place at that time.

Currently we must provide our with-profits policyholders who are affected by the change with information on any changes to the Principles at least three months before the change is introduced.

We must also provide our with-profits policyholders who are affected by any change to the PPFM with information on any changes to the Practices within a reasonable time of the change being introduced.

1.6 Product range

The **long-term business fund** has two blocks of **with-profits business** that are covered by this PPFM:

- **Traditional with-profits business** including life insurance policies (including pure endowment, endowment assurance, whole of life), individual pension policies, with-profits annuities (immediate and deferred) and the **Capital Access Bond** (CAB).
- **Unitised with-profits business** including the Flexibond, Personal Pensions, SSP ISA, Capital Investment Bond, Vintage Bond and Trustee Investment Plans.

1.7 Further information

Our website **nfumutual.co.uk** contains information on the **long-term business fund** including current **annual bonus** rates, the asset mix backing **with-profits business** and the charges applicable to the different with-profits products within the **long-term business fund**. This information is updated at least annually as this information changes.

2. OVERRIDING PRINCIPLES

2.1 Principles

The Society's assets are divided between a **long-term business fund** and other assets whose primary function is to support the Society's general insurance business.

The **long-term business fund** is managed in a sound and prudent manner with due regard to the interest of its policyholders and with the aim of meeting its liabilities as they fall due, treating customers fairly, and covering its own **regulatory capital requirements** in normal circumstances.

In adverse circumstances, certain management actions may be necessary in order to achieve this aim. In addition, during adverse circumstances, should the assets within the **long-term business fund** be insufficient to meet its **regulatory capital requirements**, allowance may be made for the availability of additional assets (up to certain monetary limits as determined from time to time by the **Board**) outside of the **long-term business fund** in order to meet its **regulatory capital requirements**.

Should the assets within the **long-term business fund** be insufficient to meet its **minimum regulatory capital requirements**, assets may be transferred into the **long-term business fund** under a **contingent loan** arrangement, such assets being repaid (with reasonable interest) should circumstances improve. The Society will structure the **contingent loan** arrangement in a way that provides adequate legal certainty for the **long-term business fund** and the remainder of the Society.

3. THE AMOUNT PAYABLE UNDER A WITH-PROFITS POLICY

3.1 The amounts payable to our with-profits policyholders

3.1.1 Principles

The aim of the Society is to ensure that policyholders are paid a fair return. That is, a return which reflects the smoothed experience of the assets backing their policy as well as the profits (and losses) which have been generated within the **long-term business fund** whilst a policy has been in force, including the expense, demographic and taxation experience of the fund and allowing for any deductions in respect of charges. Amounts payable may also be subject to certain contractual guaranteed amounts.

Certain approximations are accepted by the Society in the application of the methods used to meet the aim to ensure a fair return is paid. These approximations relate to the pooling of experience between policies and practical constraints, including:

- The adoption of a common **bonus series** for some groups of policies.
- Approximations in allowing for investment returns and other experience when determining a fair return.
- Timing delays in implementing changes to bonus rates and surrender bases, and the need to avoid incurring undue administration costs by making frequent changes to these.

Changes to the methods used to meet the aim to pay policyholders a fair return are subject to **Board** approval, after requesting and considering the advice of the **With-Profits Actuary** and the **With-Profits Committee** and, where necessary, obtaining independent expert input. This includes changes to historical parameters underlying these methods when a material need is identified and considered appropriate.

3.1.2 Practices

Policy benefits

All policy types other than CAB

For **traditional with-profits business**, policy benefits will be determined with regard to **asset shares**, with the aim of ensuring fairness between different classes and generations of policyholders. The **asset share** for a policy is the theoretical amount which represents the sum which is built up by accumulating premiums in the fund at the achieved rate of investment return, after allowing for the effects of mortality, charges and expenses, taxation and any charges for guarantees.

We maintain equity in maturity payments between different classes and generations of with-profits policies by calculating separate **asset shares** for each class and generation as appropriate. We aim to ensure that, on average and over the longer term, the amount paid out on maturity, surrender and retirement claims is 100% of the **asset share**, subject to a minimum of the guaranteed benefits. This average is taken over all policies becoming claims over a number of years, so that in any one year the amounts paid out on claims may be more or less than 100% of **asset shares**. As described below (in section 3.4.2) we would expect this to be broadly in balance over the longer term (ten years or more). For miscellaneous classes of business approximations may be used when determining the amounts payable.

For **unitised with-profits business**, policy benefits will be determined with regard to the value of the **shadow fund**. The **shadow fund** contains the notional units that represent each policy's share of the with-profits fund, and which grow in line with the return on the underlying assets, subject to an annual management charge. We sometimes use the term **asset share** to refer to the **shadow fund** of a unitised with-profits policy.

For both **traditional with-profits business** and **unitised with-profits business**, the total **asset share** across a suitable group of policies is compared to the total guaranteed benefits across that group of policies, which includes

accumulated **annual bonuses** plus other guarantees which vary by product type and the date a policy was issued. In order to ensure that policyholders are paid a fair return on their policy, for certain product types **terminal bonuses** (or, where applicable, **market value reductions**) may also be applied so that the amount payable under the policy reflects the underlying performance of the **asset share** of the policy over its term.

The types of guarantee that may apply to a particular policy include:

- For certain traditional with-profits pensions policies, guaranteed rates at which accumulated funds can be converted into an annuity, as specified in the policy document or other policy literature.
- For certain minimum cost endowment policies, a guaranteed minimum death benefit.

CAB

The benefit payable under a **CAB** is increased by a daily addition of contingent or notional amounts described as interim bonuses. Each year the **Board** reviews these interim bonuses and a final bonus is added to the bond to replace them. In normal circumstances the final bonus will be of the same amount as the total of the interim bonuses. Once a final bonus has been added, it cannot subsequently be taken away. No **terminal bonuses** are added to a **CAB**.

Methods and assumptions used to calculate policy benefits

We document the methods, assumptions and parameters used in determining the amount payable to with-profits policyholders.

Changes to the experience assumptions influencing **asset shares** will be made over time as a matter of course, as the experience of the **long-term business fund** and the Society changes.

The **Board** must approve any change to the current methods. If a change is made to the way we calculate assumptions or parameters used to determine the amount payable to with-profits policyholders, the change is approved by the **With-Profits Committee** and the **Board**, after considering advice from the **With-Profits Actuary**. Our internal documentation will also be amended to reflect the change. In order to treat customers fairly, the Society will not change historical parameters underlying the calculations relevant to the methods used to meet the aim to pay policyholders a fair return unless, in the opinion of the **Board**:

- An error has been found which should be corrected, or
- A different approach is deemed to be more equitable, or
- Previous approximations can be replaced by more accurate information, or
- There has been a change in legislation (including tax legislation) which makes a retrospective adjustment appropriate.

Procedures and governance are in place to ensure that the correct experience assumptions are used, with information being received from all relevant departments and available to the **With-Profits Committee.**

Key factors influencing the amount payable to with-profits policyholders:

Investment return

One of the main factors influencing the amount payable to with-profits policyholders is the size of investment returns. The rate of investment return credited to a with-profits policy will be net of any applicable tax on investment return on the **long-term business fund** assets backing that **bonus series**. The investment strategy in relation to **asset shares** may vary by **bonus series** and by product type and is described in section 4.

Expenses

The **long-term business fund** incurs operating expenses in providing advice to customers, selling, setting up new policies and in servicing existing policies. The approach to allocating these expenses when determining the amount payable to with-profits policyholders varies by product type and is described in section 6.

Tax

The part of the **long-term business fund** that is attributable to life assurance business (excluding new **life assurance protection business** from 2013) is subject to tax on its investment income (excluding dividends on equity shares), including market value movements on bonds and realised capital gains less relevant expenses. Withholding tax is suffered on foreign dividend income. The investment return attributable to with-profits life assurance business policies is therefore reduced by the effect of this taxation. To preserve equity amongst policyholders, an allowance for deferred tax on unrealised capital gains on equity shares and property is also provided in the **asset share** calculation.

However, we can offset the expenses attributable to life assurance business (excluding new **life assurance protection business** from 2013) against taxable income. This reduces the tax bill significantly and effectively reduces the expenses that are:

- Charged directly to **asset share**, or
- Used when setting the explicit or implicit charges for business where **asset shares** are charged in this way.

Some approximation of the actual tax payable is necessary to determine **asset shares** and we use a best estimate of the tax for that purpose. For example, approximations apply to the allowance for unrealised capital gains (in particular the allowance made for indexation relief) and translating company level taxation to a product level. Any difference between the aggregate allowance for tax in the **asset share** calculations and the actual tax payable by the **long-term business fund** accrues to or is charged to the **inherited estate**.

Allocation of profits and losses

As a mutual company we have no shareholders. As a result, any profits made can be paid out to with-profits policyholders, subject to sufficient assets being maintained to ensure that the **long-term business fund** remains financially strong. However, if the **long-term business fund** were to make any significant losses, we may have to reduce the return to with-profits policyholders.

The basic allocation of profits and losses to **with-profits** business is as set out in this PPFM. In addition, there may be further sources of profits or losses on **non-profit business** and CAB business, and investment profits or losses on assets attributable to the **inherited estate.**

The annual return credited to **asset shares** may be enhanced or reduced to reflect the above.

Other items

Certain product types benefit from guarantees. We may apply an additional charge to these products in order to make a contribution to the expected cost of the guarantees. The form of the charge is either an overall reduction from the annual returns credited in the calculation of the **asset share** or a higher annual management charge.

Where a benefit is payable on death during the term of a traditional with-profits policy, in the early years of the policy this will normally be significantly more than the policy's **asset share**. A charge is made to the **asset share** of all policies with this benefit feature to cover the cost of providing this benefit.

We currently apply no charge to **asset shares** for the use of capital, but may do so prospectively for both in force and new business, if the **Board** decides, with the advice of the **With-Profits Committee** and the **With-Profits Actuary**, that the growth in new business and the financial position of the **long-term business fund** requires this. The form of any charge would be an overall reduction from the annual investment returns credited in the calculation of the **asset share**.

3.2 Setting annual bonus rates

3.2.1 Principles

For products that are eligible for a **terminal bonus**, the aim in setting **annual bonus** rates is to establish an underpin to the policy's value on a claim arising which, in normal circumstances, will leave scope for the addition of a **terminal bonus**.

For products that are not eligible for a **terminal bonus**, the aim in setting **annual bonus** rates is to increase policy values in line with the investment return earned on the assets deemed to be backing these policies, with certain deductions which vary by product type, for example to allow for tax and a margin for expenses.

The **Board** may allocate to policy classes a different bonus rate to reflect differences in the tax treatment, the expenses, the explicit charges, the investment return on the assets backing the relevant policies and the nature and cost of guarantees. When assessing the nature and cost of guarantees, regard will be had to any historical bonus rates added and the implication this has for projected future **terminal bonus** levels.

A new **bonus series** may be introduced into an existing product if the contract charges or contract design is amended in any way, or if, for any other reason, the **annual bonus** rate falls materially above or below the level which is deemed appropriate for new business.

3.2.2 Practices

Annual bonus rates are recommended by the **With-Profits Actuary** and require formal approval by the **Board**. Our current **annual bonus** rates can be found on our website at **nfumutual.co.uk**.

Annual bonuses are payable only with the basic benefit, at the same time as the basic benefit and in the same form as the basic benefit. Once **an annual bonus** has been added to a policy, it is guaranteed in the same way as the basic benefit under the policy is guaranteed and it cannot subsequently be taken away provided that the policy continues in full force (other than when a **market value reduction** applies).

All contract types other than with-profits annuities and CAB

Our approach for **traditional with-profits business** is to set **annual bonus** rates once a year. **Unitised with-profits annual bonus** may be set more frequently.

For both **traditional with-profits business** and **unitised with-profits business**, we aim to target **annual bonus** rates before smoothing (smoothing is described in section 3.4) such that when the declaration is considered across all of the portfolio of policies receiving the same annual bonus rate, the annual bonus rate is declared at a level which takes account of previous annual bonus declarations whilst ensuring there is no undue accumulation of guarantees within the **long-term business fund**, and to leave scope for the addition of a **terminal bonus**.

For both **traditional with-profits business** and **unitised with-profits business**, an allowance is made for Capital Gains Tax when setting annual bonus rates. This allowance will reflect the likelihood and amount of future capital gains. In addition, consideration is given to the scope left for adding **terminal bonus** on policies becoming claims in the future by declaring this rate. If, by declaring this annual bonus rate the scope left for **terminal bonus** is deemed insufficient or excessive (having regard to foreseeable adverse investment scenarios) then the above annual bonus rate may be changed.

For the majority of products, there is no guarantee on the level of **annual bonus**, except that the **annual bonus** before the deduction of any charges cannot be less than zero. For a small number of product types, certain rules apply to the **annual bonus** rate, such as guaranteed minimum accumulation rates and deductions to the effective rate of **annual bonus** to allow for certain charges.

When a claim is made, an interim bonus may be payable. The interim bonus is the allowance for **annual bonus** from the time the last bonus was allocated to the time of claim. Interim bonus rates are set as a best estimate of the **annual bonus** rate that will subsequently be set at the next declaration. Interim bonuses are set once a year, but may be reviewed more frequently.

In normal circumstances, for **traditional with-profits business** we will not change **annual bonus** rates by more than 1% compound from the previous year's value. For **unitised with-profits business** these limits are either 1.25% or 1.5% depending on the product type, as specified in the policy document or other policy literature.

With-profits annuities

For with-profits annuities we set **annual bonus** rates once a year.

For **with-profits annuities** no **terminal bonus** is payable, and therefore investment returns are realised solely through the addition of **annual bonuses.** The aim in setting annual bonus rates is to target increases in the annuity payments in line with changes in price inflation. Annuity payments will not decrease, even if the change in the price inflation index is negative. However, the total accumulated **asset shares** for this class of contract is compared with the present value of expected future annuity payments. After considering the difference between these two values we may set an **annual bonus** rate that is higher or lower than this target.

A different **annual bonus** rate may be declared for different years of policy commencement, with a year running for each 12 months following 1st April. The structure of these products is such that no interim bonus rate is declared.

CAB

For CAB policies no **terminal bonus** is payable, and therefore investment returns are realised solely through the addition of **annual bonuses.**

Policyholders benefit from a daily addition of interim bonus to their bond. We review interim bonus rates every month, although actual changes are generally made less frequently. Rates are set to reflect the actual investment returns on the assets backing the contract, after allowing for tax and expenses. The adjustment for expenses varies with the size of policy.

Rates can change sharply if the net yield on the underlying assets changes sharply. There is no upper ceiling on the change that can be implemented.

In normal circumstances the declared **annual bonus** will usually be of the same amount as the total of the interim bonuses over the previous year.

3.3 Setting terminal bonus rates

3.3.1 Principles

For certain products, no terminal bonus is payable. The products for which no terminal bonus is payable are detailed in section 3.3.2 below.

For products that are eligible for a **terminal bonus**, the scales of **terminal bonus** will be set to increase the policy benefits up to the amount payable under the policy, as set out in section 3.1, but not reflecting day-to-day fluctuations in the market value of the assets within the **long-term business fund**.

Separate **terminal bonus** scales may be applied to different **bonus series** to reflect the different aspects of the products in each **bonus series**, including their tax treatment, forms of benefits, guarantees and history of the addition of **annual bonus** rates, and the investments deemed to be backing each **bonus series**. For most **bonus series, terminal bonus** scales also differentiate between different dates of issue and different periods in force.

For **unitised with-profits business**, **market value reductions** may be applied to certain claims to maintain fairness between policyholders exiting the fund and those remaining in it. **Market value reductions** will only reflect the effects of movements in the value of assets backing the relevant contracts.

3.3.2 Practices

All contract types other than with-profits annuities and CAB

Approach to setting rates

Our current approach is to set **terminal bonuses** twice a year, aside from **terminal bonuses** for With-Profits Trustee Investment Plans, which are set monthly. We will review **terminal bonuses** more regularly if the difference between payouts and **asset shares** becomes excessive due to market movements. **Terminal bonus** rates are recommended by the **With-Profits Actuary** and are approved by the **With-Profits Committee** and the **Board**. The **Board** delegate authority to set **terminal bonus** rates for the With-Profits Trustee Investment Plans to the **With-Profits Actuary**.

It is current practice to declare separate **terminal bonus** scales for major classes of business and for each **bonus series**. Within those categories, we set different rates for each entry year and entry age for whole of life policies, for each term for other **traditional with-profits business**, for each entry month for the With-Profits Trustee Investment Plan and for each entry year for all other **unitised with-profits business**. When determining **terminal bonus** scales, no allowance is made for the presence or absence of guaranteed annuity options.

We also set different **terminal bonus** rates for each premium frequency, premium term for whole of life policies and for policies with different escalation rates applying to regular premiums. For With-Profits Trustee Investment Plans, the same **terminal bonus** rates apply to all premiums invested in any given month. Other types of policies will receive the most appropriate **terminal bonus** for their policy class.

Terminal bonus scales are set to target payouts, in aggregate and over the longer term, of 100% of **asset shares** on maturity, subject to the limits on maximum changes in payouts under our smoothing approach, as set out in 3.4.2.

Our aim when setting **terminal bonuses** in normal market conditions is to ensure that the overwhelming majority of payments (excluding those where the guaranteed benefits already exceed **asset share**) would fall within the following ranges, expressed as a percentage of the underlying **asset share**:

- **Traditional with-profits business**: 75% to 125%.
- **Unitised with-profits business other than With-Profits Trustee Investment Plans:** 85% to 111%.
- **With-Profits Trustee Investment Plans:** 80% to 120%.

The ranges are set to be wide enough to allow the Society the investment freedom to choose the mix of assets that we believe will optimise returns for policyholders, whilst continuing to apply smoothing in line with the PPFM rules and customer expectations in periods of market volatility.

However, payments may fall outside of the above ranges during times of extreme investment market conditions.

For With-Profits Trustee Investment Plans our practice is to ensure that the **terminal bonus** does not result in a payout above 120% of the underlying asset share calculated for each contribution received. For all other **unitised with-profits business** our practice is to ensure that the **terminal bonus** does not result in a payout above 111% of the underlying asset share calculated for each single contribution, or series of regular contributions. If this were to occur, terminal bonus would be reduced to a level such that the payout equals the relevant percentage (120% or 111%) of the asset share, subject to the terminal bonus being a minimum rate of nil. We call this **terminal bonus** capping. Conversely, we ensure that payouts are not below 80% of the asset share for each contribution received for With-Profits Trustee Investment Plans, or 85% of the asset share, for each single contribution, or series of regular contributions for other **unitised with-profits business**. The **terminal bonus** would be increased if such a situation were to arise. We call this a **terminal bonus** rate floor. These adjustments can happen at any claim event.

Surrender values and policy alterations

On surrender, it is our aim to ensure that payouts are consistent with maturity values where relevant. To achieve this aim we target surrender payouts close to 100% of **asset shares**, subject to a smooth blend of surrender values into guaranteed maturity values for **traditional with-profits business**. We review our methods for determining surrender payouts regularly to ensure the methods are consistent with this aim, and it is possible that surrender values may be reduced at short notice in the event of adverse investment market conditions.

It is current practice that policies that have been made paid up or altered in some way are awarded the same **terminal bonus** rates as those that continue in full force. For these policies, payouts may diverge from the target **asset share** ranges outlined above. For traditional with-profits whole of life policies that have been made paid up, we determine a separate set of **terminal bonus** rates in order to ensure fairness.

Market value reductions

For **unitised with-profits business** a **market value reduction** may be applied if the economic circumstances justify this, which would reduce the amount paid out on a claim event. **Market value reductions** may be applied on any type of claim except for the following:

- On death for all products.
- On retirement on the **selected retirement date** for some specified products, as set out in the policy document or other policy literature.
- On certain switches out of the with-profits fund or certain withdrawals (subject to various restrictions) for some specified products, as set out in the policy document or other policy literature.
- On any cancellation of units to pay for ongoing product charges.

For **unitised with-profits business** aside from With-Profits Trustee Investment Plans, **market value reductions** are calculated for each single contribution, or series of regular contributions, separately. Therefore it is possible that, for example, a **market value reduction** will be applied to one contribution whilst a **terminal bonus** is applied to another contribution. However, a **terminal bonus** and a **market value reduction** cannot apply at the same time on the same single contribution or series of regular contributions.

For the With-Profits Trustee Investment Plan, **market value reductions** are calculated in a similar way to **terminal bonuses**, with market conditions giving negative outcomes rather than positive ones. However, a **market value reduction** will not reduce the amount payable below the **asset share**.

In normal circumstances for **unitised with-profits policies** other than the With-Profits Trustee Investment Plan, the application of a **market value reduction** is triggered when the **asset share** is below 90% of the value of the with-profits units (including declared and interim **annual bonuses**). For **asset shares** between 85% and 90% of the value of the with-profits units, the amount of the **market value reduction** applied is smoothed in linearly. If the **asset share** is below 85% of the value of the with-profits units, the **market value reduction** will be applied in full, reducing the amount payable to the **asset share.**

The approach to smoothing **market value reduction** rates is set out in section 3.4.2.

With-profits annuities and CAB

No **terminal bonus** is payable and no **market value reduction** can be applied.

3.4 Smoothing the value of policies

3.4.1 Principles

We will smooth policy benefits to limit the impact of market movements on the amounts payable under with-profits policies, having regard to the historic balance over time of under and overpayments relative to asset shares.

The extent of smoothing will vary by product and claim type, and the extent of smoothing applied on claim values other than on death or maturity may be less than that applied on death or maturity. This is to maintain fairness between policyholders voluntarily exiting the fund, and those remaining in it. In addition, **annual bonuses** are also subject to smoothing, the extent of which varies by product type.

3.4.2 Practices

All contract types other than CAB

Overall aim of smoothing

Smoothing is applied to policy payouts through the application of **terminal bonuses**. **Terminal bonus** rates (and **market value reduction** rates for **unitised with-profits business**) are intentionally set to target payouts greater or less than 100% of **asset share**, in order to reduce the volatility of payouts. Our aim when setting **terminal bonuses** is to ensure that the overwhelming majority of maturity payments fall within the ranges set out in section 3.3.2.

Smoothing approach

The smoothing practice differs by product type and also for claims that occur due to maturity or death versus surrenders and transfers.

Our practice for smoothing **traditional with-profits business** aside from with-profits annuities is:

- To smooth the payouts for policies with the same original term maturing in successive years. In normal circumstances, payouts should not differ by more than 15% compared to the previous year's payout. However it is possible that for some contract types this limit could be exceeded for some original terms due to circumstances specific to that contract type and original term.
- To smooth payouts between policies of different terms. This is achieved by ensuring that the yields to the policyholder on policies of similar terms are not too divergent.

For with-profits annuities, there is no smoothing of payouts between different policies.

The surrender and transfer bases for **traditional with-profits business** are smoothed. Surrender and transfer value bases are reviewed at the same time as **terminal bonus** rate changes on maturity values to ensure consistency between maturity and surrender payments. However, the degree of smoothing applied may be less than on claims that occur due to death or maturity. We aim to smooth surrender and transfer values into maturity values so that policies with a short remaining term to maturity will have surrender or transfer values that reflect, to some degree, the smoothing currently being operated on maturity values.

Our practice for smoothing **unitised with-profits policies** (other than the With-Profits Trustee Investment Plan) of the same term maturing or being surrendered in successive years is similar to our practice for **traditional with-profits business**. The key difference is that whilst smoothing rules are applied when assessing bonus rates, the interaction of **terminal bonus** caps and floors or **market value reductions** can lead to changes outside of these parameters for individual **unitised with-profits** policies. In general, when **market value reductions** are being applied no smoothing is applied to the payouts for these policies, and the policy receives its **asset share**. The exceptions to this are:

1. As set out in section 3.3.2, in normal circumstances and where the **asset share** is between 85% and 90% of the value of the with-profits units (including declared and interim **annual bonuses**), the **market value reduction** is phased in linearly.

2. For some specified products (as set out either in policy literature or on our website **nfumutual.co.uk**), in normal circumstances and upon retirement, switch or transfer out within three years of the **selected retirement date**, the amount of any **market value reduction** applied will be reduced so that the **market value reduction** is reduced over the 3 years prior to the **selected retirement date**. The proportion of the standard **market value reduction** which is applied reduces linearly from 100% 3 years before **selected retirement date** to 0% on the **selected retirement date**.

The rules covering the smoothing of **market value reductions** described in the two paragraphs above would not apply if, in the opinion of the **Board** acting with the advice of the **With-Profits Committee** and the **With-Profits Actuary**, there was an exceptional increase in discontinuance rates. In this scenario, a **market value reduction** would apply more generally than as described above, but not to reduce payouts below **asset share**.

Our practice for smoothing With-Profits Trustee Investment Plans **terminal bonus** and **market value reduction** rates is to set rates with reference to projected **asset shares** for specimen policies based on best estimate future investment returns over the short term. Under this approach, if the **asset share** has moved significantly since the time the rates were last set, the payout will not be moved straight to the revised **asset share**. In addition, payouts are smoothed so that the payout for a specimen policy would not differ excessively compared to a payout made for the same policy 3 months earlier, and for resulting **market value reductions** of less than 3%, the rate is altered to 0%.

The limits and time periods used in the smoothing methods set out in this section can be changed over time to target payouts in aggregate, over the longer term, of 100% of **asset shares.**

Smoothing constraints

The extent of smoothing may be constrained:

- In certain adverse circumstances, as set out in section 7.2, or
- If the **Board** is not satisfied that the overwhelming majority of maturity and surrender payments would fall within the target ranges set out in section 3.3.2.

Additional implicit smoothing

In addition to the explicit application of smoothing set out in the section, smoothing applies implicitly as follows:

- Policies are grouped by entry month, year or term in force, and by age at entry for whole of life policies, for the purposes of setting **terminal bonus** rates (and **market value reduction** rates for With-Profits Trustee Investment Plans).
- Appropriate specimen policies are used to represent each group of actual policies when **terminal bonus** rates are calculated.
- **Terminal bonus** rates for **traditional with-profits business** remain unchanged between declaration dates.
- Minor classes of business are allocated the same bonus rates as for a similar major class.

CAB

No significant smoothing of bonuses takes place.

4. INVESTMENT STRATEGY

4.1 Principles

The investment strategy of the **long-term business fund** is to seek to optimise the total investment returns through a combination of income and capital gains from a wide and diversified spread of investments, including derivatives. This, however, is subject to any constraints reflecting the level of guarantees granted and the aim of the **long-term business fund** to meet its **regulatory capital requirements** under normal circumstances, together with any other capital requirements of the **regulator** above those which the **Board** has agreed can be met by the Society's "other than long-term assets". The Society also incorporates environmental, social and governance considerations into its investment strategy, with the aim of balancing good long-term investment growth and sustainable investing.

The **Board** sets limits on certain asset classes to ensure the investment portfolio is appropriately diversified.

4.2 Practices

Overall investment approach

For all business other than **CAB business**, the investment strategy in relation to **asset shares** for each **bonus series** is set by the **Investment Function**, taking advice where appropriate from the **With-Profits Committee** and the **With-Profits Actuary**. The investment strategy is to seek to optimise the total investment returns through a combination of income and capital gains from a wide spread of investments including equity shares, gilts and other fixed interest stocks and property, both within the UK and internationally, subject to being able to meet our **regulatory capital requirements** and making due allowance for policyholders' reasonable expectations. It is the investment return on the **asset shares** of the **long-term business** fund that is credited directly to **asset shares**.

We may also invest some of the assets of the **long-term business fund** in non-traditional assets such as **infrastructure** and **commodities**, to optimise the investment returns whilst managing risk by investing across a diversified range of investments. These assets are also known as **alternative assets**. We will only invest in **alternative assets** if the overall expected return or the reduction in overall risk (due to their low correlation with other assets) is better than expected on an investment in similar traditional assets such as equity shares and bonds. Any such investment will be subject to being able to meet our regulatory capital requirements and liquidity requirements of the fund.

We may also need to distinguish amongst different **bonus series** when selecting the appropriate assets to back **asset shares** having regard to the levels of guarantees provided.

Due to the investment nature and the discretionary aspects of **with-profits business**, it is not always necessary to precisely match assets and liabilities. The extent to which liabilities are precisely matched will reflect the investment risk that the **Board** concludes the **long-term business fund** can run in the interests of the policyholders whilst still meeting policyholders' reasonable expectations and its own **regulatory capital requirements**.

The investment strategy in relation to the part of the **long-term business fund** attributable to **CAB** policyholders is to invest the assets mainly in floating rate notes, certificates of deposit and cash. Bonuses allocated to **CAB** policies will then follow the investment performance of this mix of assets.

We back our non-linked **non-profit business**, including our non-profit annuity business, with appropriate fixed interest and index-linked assets and cash to broadly match the liabilities. Other assets, for example **derivatives**, may also be used to match these liabilities where deemed appropriate.

Investment in derivatives

Derivatives and other instruments may be used, within limits set by the **Board**, for efficient portfolio management, to match particular liabilities, to manage investment

risk or to improve tax or cost efficiency. Stock lending within limits set by the **Board** may take place with the **long-term business fund** benefiting from any fees earned.

Investment in non-quoted assets

We invest some of the assets of the **long-term business fund** in non-quoted assets. These assets may include physical assets such as our head office buildings, fixed assets, non-quoted equity investments selected purely for their investment potential and certain subsidiary companies of the group.

The **long-term business fund** will only invest in non-quoted group companies providing that the overall expected return on those investments is better than that expected on an investment in similar quoted companies or where the group company provides benefits to the Society's customers.

The most significant of these are a 100% holding in NFU Mutual Unit Managers Limited and a 100% holding in NFU Mutual Select Investments Limited. These investments are made in order that those companies can provide appropriate benefits to the Society's customers, i.e. to enable the Society to offer investments into collective investment vehicles. These investments are held within the **long-term business fund** because these companies provide services which benefit the **policyholders** within the **long-term business fund** and support the Society's long-term savings offerings.

The investment return earned on non-quoted assets is included in the **asset share** return or is allocated to the **inherited estate** and therefore contributes to the payouts as described in section 3 of the PPFM. The size of the **long-term business fund's** investment in these assets is monitored to ensure that the fund maintains sufficient levels of liquid assets.

Investment strategy governance

The **Board** sets the overall investment risk appetite for the **long-term business fund**. Investment objectives and constraints are recommended by the **With-Profits Committee** and approved by the **Board** after considering the overall position of all of the Society's funds under investment and the financial strength of those funds, both individually and in aggregate. The Investment Mandate sets limits for the level of investment in different asset classes, concentration limits of investment in any one company, guidelines for bond purchases, **stock lending** limits and any other limits deemed appropriate by the **With-Profits Committee** and the **Board**.

The **Board** delegates responsibility for executing the investment strategy of the **long-term business fund** within the agreed risk appetite to the **Investment Function**. At least quarterly, the **Board** will review key aspects of the investment performance and financial position of the **long-term business fund** including movements in the relevant securities markets, the liquidity position of the fund and performance of the fund against suitable benchmarks and portfolio risk profiles.

In carrying out these duties, the **Investment Function** will take advice, where appropriate, from the **With-Profits Committee** and the **With-Profits Actuary** with regard to:

- Appropriate asset allocation limits for **asset shares** for different classes and generations of policyholders.
- Policyholder reasonable expectations and compliance with both the PPFM and the regulatory regime for with-profits policyholders.

The **Investment Function** has discretion to select individual assets with the aim of optimising investment return within the overall investment strategy as reviewed by the **Board**, and subject to the Investment Mandate approved by the **Board**. Investing outside the Investment Mandate, including investment in new instruments, would require initial sanction of the **Board**.

Information regarding the investment strategy being followed for our **with-profits business**, in particular the asset allocation of **asset shares**, can be found on our website (**nfumutual.co.uk**).

5. BUSINESS RISK

5.1 Principles

As members of a mutual society, the with-profits policyholders (with the exception of certain product types as detailed in section 5.2 below) are entitled to the profits and must meet the losses arising from the business activities of the **long-term business fund**. These arise mainly from the profits or losses emerging from the writing of non-profit policies, from any under-or over-payment of benefits on with profits contracts, and from any other business activities of the **long-term business fund**.

When entering into any activity with an associated business risk, the Society seeks to provide long-term value to with-profits policyholders, while managing the concentration of risks within the **long-term business fund** in a prudent manner.

The inherited estate will, in normal circumstances, meet certain costs arising from the risks of the **long-term business fund**, including:

- Any cost of guarantees provided on with-profits policies exceeding any explicit charges made in the calculation of policy values.
- Any costs incurred by the **long-term business fund** in fines, redress or compensation awards.
- Any costs arising from residual risks which are not borne by with-profits policyholders.

5.2 Practices

All contract types other than CAB

The **Board Risk Committee** recommends to the **Board** the Group's strategy and policy/philosophy for risk management, and monitors its adoption throughout the Group. The **Board Risk Committee** reviews the processes and procedures for ensuring all business risks are properly identified and appropriate systems of monitoring and control are in place under the categories Market, Insurance, Credit, Liquidity and Operational. This includes reviewing the procedures for identifying business risk and controlling their financial impact.

When considering whether to undertake a business risk we will consider factors including:

- Whether the business risk will provide a suitable return above the risk free rate to our policyholders.
- Our current financial strength.
- Size of potential impact on the **inherited estate** and our ability to meet our **regulatory capital requirements.**
- Our exposure to existing business risks.

We will only undertake a significant business risk after approval by the **Board**.

The Society may seek to limit mortality and morbidity risk arising on term assurance, critical illness and impaired life annuity business by means of reinsurance arrangements.

The circumstances in which we will limit the acceptance of new business are detailed in section 8.1.

We regularly review the profitability of the existing **non-profit business** in the **long-term business fund**. This includes assessing the adequacy of charges for these contracts and considering whether the charges need to be adjusted. Current practice is to broadly match non-linked **non-profit business** with bonds (nominal or index linked as appropriate) and cash, where there is certainty over the expected liability cashflows, to minimise market risk.

Other than in relation to CAB policies, the profits and losses arising from business risks in the **long-term business fund** are either included in the **asset share** return calculation or are allocated to the **inherited estate**. Where the profits and losses are included in the **asset share** return calculation, they impact directly on the payouts to with-profits customers. Where the profits and losses are allocated to the **inherited estate,** they may affect the amount payable to with-profits policies via an increase or decrease to **asset share** returns in some years. This is described in section 3.1.2.

CAB

Whilst CAB policyholders are members of the Society, they do not benefit from profits arising from miscellaneous sources, nor are they liable to losses occurring.

6. CHARGES AND EXPENSES

6.1 Principles

The Society apportions expenses to its **with-profits business** and amongst different classes of **with-profits business**, in a way that is fair and reflects the actual expenses incurred in selling and administering each class of business and managing its investment portfolio.

For **traditional with-profits business**, expenses apportioned to the relevant classes of business are then allocated to individual policies as an annual deduction to the **asset share**. The allocation to individual policies has regard to any policy fee payable; the policy fee is deemed to cover those expenses unrelated to the size of the policy. If the **Board** judged that the basis on which expenses are apportioned to classes of business had become inequitable, it may exercise discretion to revise the apportionment.

For **unitised with-profits business** and certain other product types, the Society will apply any explicit charges specified in the policy documentation. On contracts where explicit charges are not specified expenses are allowed for when we set the level of bonus rates. To the extent that charges and expenses differ, then the difference will, in normal circumstances, be charged to/credited to the **inherited estate**. With some exceptions, the **Board** may increase these charges if the expenses of administering the relevant business are not met by the allowance for administration expenses within the charges.

For both **traditional with-profits business** and **unitised with-profits business**, certain expenses relating to managing the investments may be deducted when determining the investment returns which are applied to the **asset share** or **shadow fund.**

6.2 Practices

Charges

The charges that we apply to **unitised with-profit policies** and **CAB** are those described in the relevant policy documentation (with implicit charges being applied if explicit charges are not specified in the policy documentation). These charges may include:

- A deduction from premiums invested for the initial advice charge or for other product charges.
- An annual management charge.
- An annual per policy charge.
- A monthly charge to cover the cost of life cover and waiver of premium benefits.
- Surrender charges when withdrawals are taken in the early years of a policy.
- A charge for guarantees.

For policies where no guarantee charges are currently applied, we may introduce a charge for the cost of these guarantees, provided this is approved by the **With-Profits Committee**, after considering advice from the **With-Profits Actuary**. The form of any charge would either be an overall reduction from the annual returns credited in the calculation of the **asset share** or an increase in the annual management charge.

More details about the charges that apply to different products are included on our website (**nfumutual.co.uk**).

The charges for **unitised with-profits** policies are reviewed regularly by the **With-Profits Actuary** to ensure that they are appropriate to cover the expenses allocated to the relevant class of business. If the **With-Profits Actuary** believes that the charges are no longer appropriate for the expenses of any class

of business, the **With-Profits Actuary** will submit a recommendation to the **With-Profits Committee** and the **Board** that the charges are altered. However, increases to charges will not be made in order to recoup excess acquisition expenses which the **Board** has agreed should be written off when calculating **own charge illustrations**.

In normal circumstances any difference between the charges applied to **unitised with-profits business** and the expenses incurred for those policies is charged or credited to the **inherited estate**.

Expenses

The following description excludes the **non-recurrent expenses** (e.g. large systems development projects), which are either charged to the **inherited estate** or amortised into expenses over a period determined by the **Board**, having received advice from the **With-Profits Committee** and the **With-Profits Actuary**.

The **long-term business fund** incurs operating expenses in setting up new policies and in servicing existing policies. We split these expenses amongst all policies that form part of the **long-term business fund,** having regard to the relative time taken to process transactions. The expenses are split into acquisition and maintenance expenses.

Where expenses cannot be directly allocated to a type of product, the expenses are allocated by the most appropriate method for the specific type of expense being considered. Examples of the methods used include splitting expenses in proportion:

- to funds under management
- to number of new policies sold
- to number of policies in force
- to time taken to process business
- to the number of employees in various areas of the business

The expense assumptions or parameters in the **asset share** calculations for **unitised with-profit policies** are the explicit charges set out in the policy conditions.

For **traditional with-profits business**, expenses apportioned to the relevant classes of business described above are then allocated to individual policies by deducting the expenses from the **asset share** of the policy.

For both **traditional with-profits business** and **unitised with-profits business**, certain expenses relating to managing the investments may be deducted when determining the investment returns which are applied to the **asset share** or **shadow fund**.

The expenses are reviewed by the **With-Profits Actuary** and our external auditors, and the basis on which expenses are apportioned may be revised subject to judgement by the **Board**. For example, the basis could require amendment if there was a change in the way the Society sells or administers its business, such as a new distribution channel, or use of out-sourced services.

We currently cap the annual increase to the expenses apportioned to **traditional with-profits business** so they move broadly in line with an inflation index adjusted to allow for salary inflation. This approach may be changed in the future.

Costs derive from internal and external services, including those provided by other companies in the NFU Mutual Group. We may outsource services if there is a potential cost or customer service benefit to our policyholders. The outsourced service providers are subject to ongoing performance management and commercial review.

The Society's overheads are allocated between the Life and General Insurance business and a number of subsidiary operations. The allocation will reflect the nature of the overhead – for example the Society's human resource costs may be apportioned in proportion to the number of employees in each area of the business.

7. MANAGEMENT OF THE INHERITED ESTATE

7.1 Principles

The **inherited estate** provides the working capital of the **long-term business fund**. It is managed in such a way that there will be a sufficiency of working capital in the future in foreseeable circumstances. The primary uses of the **inherited estate** include:

- Supporting the smoothing of benefits paid to with-profits policyholders
- Providing capital to meet **regulatory capital requirements** and any additional capital requirements deemed necessary, in addition to the statutory minimum, to reflect risks run by the Society and new business plans.
- To meet certain costs which, in the opinion of the **Board**, should not be charged directly to policyholders.
- To meet the expenses of policies which exceed the charges made to those policies and which, in the opinion of the **Board**, are more appropriately met from the **inherited estate**.
- To provide capital to support writing **non-profit business**.

The Society aims to manage the **inherited estate** to an appropriate size over time, having regard to the interests of policyholders, the uses to which the **inherited estate** is put and the business plans of the Society.

In adverse circumstances, it may be necessary for the Society to take certain actions that it would not take under normal circumstances, in order to maintain the strength of the **inherited estate**.

The Society has only one **long-term business fund** and hence the **inherited estate** is attributable to that fund.

Other than the above requirements, there are no constraints on the Society's freedom to manage the **inherited estate**.

7.2 Practices

Management of the inherited estate

The **inherited estate** is used to:

- Smooth benefits being paid to with-profits policyholders.
- Provide regulatory and working capital, including to cover any mismatch in timing between the receipt of charges applied to the policies in the **long-term business fund** and the actual expenses incurred in the acquisition and maintenance of those policies, and to provide capital support to write **non-profit business**.
- Provide investment freedom. A strong **inherited estate** enables us to invest a higher proportion of the **long-term business fund** in more risky assets, such as equities and property, which have the potential for higher investment returns.
- Meet the costs of guarantees (including any implied guarantees or promises) that are unable to be funded from the accumulation of deductions made from policies for that purpose.
- Meet the excess of expenses over charges to with-profits policies.
- Meet any compensation payments.
- Meet any 'one-off' or exceptional expenses, such as expenses arising as a result of legislation, taxation or other circumstances which, in the opinion of the **Board**, should not be charged directly to policyholders.
- Provide working capital for operational projects and business risks.

The investment strategy for the **inherited estate** is regularly reviewed with the aim of optimising investment return subject to policyholder reasonable expectations and the overriding principle of managing the **long-term business fund** to cover its own **regulatory capital requirements** in normal circumstances. As such, the investment

strategy for the **inherited estate** (including any use of derivatives) may differ from the strategy for the **asset shares** and for the rest of the **long-term business fund**.

Distribution of the inherited estate

The **Board** aims to manage the **inherited estate** to an appropriate size over time. In the event of the **inherited estate** becoming too large, the **Board**, after advice from the **With-Profits Committee** and the **With-Profits Actuary**, may choose to distribute part of the **inherited estate** to with-profits policyholders or a sub-group of with-profits policyholders over an appropriate time period by making enhancements to **asset shares**. The **Board** would have regard to policyholders' reasonable expectations and the nature of the different classes of with-profits policies, including consideration of the level of guarantees already attaching. The Board may apply different enhancements to different classes and types of with-profits policy if it judges that that is the most appropriate way of being fair to policyholders generally and meeting their reasonable expectations.

Actions to manage the inherited estate

In adverse circumstances, consistent with the Overriding Principles, the **Board** may need to take management actions to ensure the **long-term business fund** can meet its liabilities as they fall due and to meet its own **regulatory capital requirements**. Some or all of the following actions may be taken by the **Board** in such circumstances. These actions are non-exhaustive and the order in which they are listed does not imply the order in which these actions would be taken:

- Reducing past or suspending ongoing enhancements to **asset shares**
- Reducing **annual bonus** rates, including reducing **annual bonus** rates to zero if necessary
- Reducing the level of investment risk in the **long-term business fund**, for example by reducing investment in higher risk assets backing **asset shares** such as equities and property
- Constraining the extent of smoothing applied to payout amounts, including any smoothing applied to **market value reductions**
- Introducing or increasing charges, such as introducing certain charges for guarantees or increasing initial or annual charges for **unitised with-profits business**
- Reallocating costs previously borne by the **inherited estate** to all with-profits policyholders, including any excess of actual expenses over charges applied, any excess costs of guarantees over explicit charges made, and any costs incurred in fines, redress or compensation awards
- Reducing payouts to below 100% of **asset shares** and **shadow funds** or applying a charge to **asset shares** and **shadow funds**

The application in adverse circumstances of some or all of the above management actions may override the normal practices described elsewhere within this PPFM.

In addition to the above, where the **Board** has agreed, the Society may rely on the appropriation of assets from outside of the **long-term business fund** to meet the **regulatory capital requirements** of the **long-term business fund** above the **minimum regulatory capital requirements**.

Furthermore, should the assets within the **long-term business fund** be insufficient to meet the **minimum regulatory capital requirements** and where the **Board** has agreed, assets may be transferred into the **long-term business fund** from outside the **long-term business fund** by means of a **contingent loan**, subject to compliance with applicable regulation.

The **contingent loan**, with interest, would be repaid if the **long-term business fund's** solvency had recovered to the extent that there was no reasonable likelihood of being unable to meet the **minimum regulatory capital requirements** in the following twelve months. The **long-term business fund** would be managed with the aim of securing, with a high probability, repayment of the loan, and hence more of the above management actions may need to be applied, or applied with greater severity, in order to achieve this result.

8. VOLUMES OF NEW BUSINESS AND ARRANGEMENTS ON STOPPING TAKING NEW BUSINESS

8.1 Principles

If the volume of new **with-profits business** is sufficiently high that the capital strain being placed on the **long-term business fund** threatens either its solvency or the benefit expectations of with-profits policyholders, then the **Board** may choose to limit the volumes of one or more categories of new contracts being written. If, on the other hand, the volumes of new business are sufficiently low that the burden of expense makes a contract non profitable or non-viable, then the **Board** may choose to withdraw the contract from sale.

Other changes may occur in, for example, the regulatory environment or in taxation which would make a contract non-viable in which case the **Board** may choose to withdraw the contract from sale.

If the **Board** choose to withdraw all contracts from sale, the **inherited estate** will be managed for the continuing benefit of the remaining with-profits policyholders, subject to retaining sufficient capital within the **long-term business fund** to meet **regulatory capital requirements**.

8.2 Practices

There are currently no constraints on the volume of new business that may be accepted into the **long-term business fund**. Projections of solvency are carried out at least annually, using various modelling techniques, to ensure volumes of new business do not threaten the financial soundness of the **long-term business fund**.

We may set a maximum volume for sales of a specific product or campaign if the product offers significant guarantees or involves other risks. The **Board** would set maximum limits around sales volumes after considering the risk to the solvency of the **long-term business fund** from selling the product.

There are a number of reasons other than solvency constraints why we may choose to permanently stop selling a particular product. These reasons include:

- Changes in regulation, legislation or taxation rules
- Low volumes of sales
- Product strategy changes

In addition, there are reasons why we may choose to temporarily stop or start selling particular products. For example, the appropriate charge for guarantees for certain products is sensitive to market conditions. The required level of charge may make the product commercially unviable and as a result we may choose to temporarily stop or start selling this product.

Should the **Board** decide that it would be appropriate to withdraw completely from the sale of new **with-profits business**, the management of the **inherited estate** would be reviewed, in particular:

- The investment policy in respect of the **inherited estate** will be reviewed to ensure it remains appropriate.
- The investment policy in respect of **asset shares** may need to be reviewed and it might be considered appropriate to realign investments by, for example, selling equity shares and buying fixed interest investments and **derivatives** to match closely any guarantees.
- The extent that payments were being smoothed would be reviewed.
- The Society would need to ensure that it complies with the applicable regulatory requirements on closing funds to new with-profits business and on the ongoing management of with-profits funds closed to new with-profits business.

The Society is a company limited by guarantee and is owned by its members. Membership of the Society is conferred by the issue of a policy (including with-profits, non-profit and general insurance). The long-term fund's **inherited estate** is available to support the writing of **non-profit business** and therefore there is no minimum scale of new business of a with-profits type required to justify the long-term fund remaining open to new business.

9. SHAREHOLDERS

9.1 Principles

The fund is a mutual fund with no shareholders. All profits or losses arising within the **long-term business fund** are attributable to with-profits policyholders.

10. GLOSSARY

ALTERNATIVE ASSETS

Alternative assets are generally considered to be investments that fall outside of the traditional asset classes commonly accessed by most investors, such as equity shares, gilts, and cash. These investments typically provide better diversification with other asset classes, may be less liquid than their traditional counterparts, and may require a longer investment period before any material enhancement to returns is realised. Examples of alternative assets include infrastructure and commodities.

ANNUAL BONUS (ALSO KNOWN AS REGULAR OR REVERSIONARY BONUS)

A bonus which is added on a regular basis throughout the life of a with-profits policy, providing an addition to the guaranteed benefits payable to the policyholder.

ASSETS BACKING/UNDERLYING ASSET SHARES

The assets backing (or underlying) asset shares are the theoretical assets in which asset shares are invested. This is set by the investment managers to fall within the asset share bands set by the With-Profits Committee and the split of assets between different asset categories is detailed on our website (nfumutual.co.uk). The asset split of asset shares and resulting investment return credited to asset shares is unaffected by any internal share shorting arrangement. Shorting involves holding fewer risky assets in the long-term business fund than required to cover the asset share liabilities, with the balance of assets being held in lower risk assets.

ASSETS OUTSIDE THE LONG-TERM BUSINESS FUND

The Society's assets are divided between a long-term business fund and other assets outside the long-term business fund whose primary function is to support the Society's general insurance business.

ASSET SHARE

The theoretical amount which represents the sum which is built up by accumulating premiums in the fund at the achieved rate of investment return, after allowing for the effects of mortality, expenses, taxation and any charges for guarantees. The achieved rate of investment return may have been enhanced/ debited with the profits/losses on non-profit business for years prior to 2004 and may, from 2004, be enhanced/debited with items related to credits from the estate/debits for the cost of business risks as explained in the PPFM. The enhancements/debits represent the miscellaneous items of surplus.

BOARD

The ultimate governing body of the Society which bears the overall responsibility for managing its business, including the with-profits business. The Board may delegate certain aspects of managing the with-profits business to various committees in the first instance as appropriate, subject always to review and oversight by the Board.

BOARD RISK COMMITTEE

The Committee of the Board that recommends to the Board the Society's strategy and policy/ philosophy for risk management and monitors its adoption throughout the Society.

BONUS SERIES

A group of policies for which the same set of bonus rates is declared.

CAPITAL ACCESS BOND (CAB)

An investment bond designed to mimic the performance of a deposit account.

CHIEF ACTUARY (LIFE)

The Society's Chief Actuary function (SIMF20). The Chief Actuary (Life) has responsibility for the actuarial function.

COMMODITIES

Commodities refer to raw materials such as oil or precious metals like gold and silver or agricultural products such as wheat. Investment in commodities can be made in a variety of ways, for example via direct purchase, through use of exchange traded products or by investing in commodity funds.

CONTINGENT LOAN

A loan that may be made into the long-term business fund if the assets within the fund are insufficient to meet the minimum regulatory capital requirement, subject to Board agreement. Repayment of the contingent loan, with interest, is contingent or conditional upon a satisfactory solvency position being restored, where this is defined in the loan agreement.

DERIVATIVES

A generic term for financial instruments used in the management of investment and other risks, including futures contracts, forwards, swaps and options.

(INHERITED) ESTATE

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.

INFRASTRUCTURE ASSETS

Infrastructure is an alternative asset class which comprises investment in physical assets, facilities, and services considered essential to the functioning and economic productivity of a society. Examples of infrastructure assets include roads, bridges, tunnels, and drainage systems. Infrastructure projects are financed through a combination of bonds and equity shares, and therefore, a simple example of investing in infrastructure would be to buy equity shares of an infrastructure company.

INVESTMENT FUNCTION

The business function that is responsible for setting and executing the investment strategy of the long-term business fund, having taken advice where appropriate from the With-Profits Committee and the With-Profits Actuary.

LIFE ASSURANCE PROTECTION BUSINESS

Temporary assurance business and mortgage temporary assurance business.

LONG-TERM BUSINESS FUND

All of the with-profits business written by the Society, together with the Society's non-profit business. The long-term business fund is classed as a ring fenced fund under current rules. This means that the assets within the fund cannot be used to support business written by the Society outside of the ring fenced fund.

MARKET VALUE REDUCTION

A method that we use for unitised with-profits business to reduce the value of the with-profits units when they are sold by the customer. The terms of the contract will specify the circumstances when a market value reduction cannot be applied. The expression Market Value Adjuster is often used to describe the same method.

MINIMUM REGULATORY CAPITAL REQUIREMENT

That part of the regulatory capital requirements which, under the relevant UK solvency regulations, the Society is required to hold within the long-term business fund.

MISCELLANEOUS ITEMS OF SURPLUS

See definition of asset share.

NON-PROFIT BUSINESS

Those policies, written in the long-term business fund, where the policyholder has no right to participate in bonus distributions.

NON-RECURRENT EXPENSES

Expenses incurred due to activities that are not expected to recur year after year, e.g. large systems development projects.

OWN CHARGE ILLUSTRATIONS

The basis used by the Society to provide illustrations of future benefits on prescribed rates of investment return, having regard to the Society's view of future charges, expenses and insurance risk.

REGULATOR

The Financial Conduct Authority and Prudential Regulation Authority or any successor body.

REGULATORY CAPITAL REQUIREMENTS

The amount which the Society is required, under the relevant UK solvency regulations, to hold in respect of the long term business fund in addition to the liabilities of the fund. This amount may be held either within the long-term business fund, or outside of the long-term business fund.

SELECTED RETIREMENT DATE

The date specified in the policy document of a unitised with-profits policy as the date on which guaranteed benefits become payable. For the Personal Pension Account this is known as the target pension date.

SHADOW FUND

The notional units that represent each policy's share of the with-profits fund. The value of these units goes up and down with the value of the underlying investments in the fund.

STOCK LENDING

An arrangement by which legal ownership of an asset is sold to a counterparty, but with a short-term agreement for repurchase so that economic exposure to the original asset is retained. The counterparty will supply collateral in respect of the obligation under the repurchase agreement.

TERMINAL BONUS

A bonus that may be added to a policy when money is taken out of the with-profits fund. This could be on termination of the contract, death, switching into another fund or withdrawing part of the total investment.

TRADITIONAL WITH-PROFITS BUSINESS

With-profits business that is not unitised with-profits business or the Capital Access Bond.

UNIT-LINKED BUSINESS

Those policies where the benefits are linked to the value of units in a specifically defined fund. Some policies may contain some unitised with-profits benefits and some unit-linked benefits in which case the relevant parts of the policy form unitised with-profits and unit-linked business respectively.

UNITISED WITH-PROFITS BUSINESS

With-profits business where the benefits are expressed in terms of numbers and price of notional units. Some policies may contain some unitised with-profits benefits and some unit-linked benefits in which case the relevant parts of the policy form unitised with-profits and unit-linked business respectively.

WITH-PROFITS ACTUARY

The Society's With-Profits Actuary. The With-Profits Actuary acts as an adviser to the With-Profits Committee.

WITH-PROFITS BUSINESS

Those policies where the benefits depend on bonus additions made throughout the term of the policy and possibly a bonus addition at the end of that term.

WITH-PROFITS COMMITTEE

The subordinate committee to the Society's Board that is charged with monitoring ongoing compliance with the Principles and Practices set out in this document.

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PPFM-SUP-0124