National Funeral Trust

Solvency Assessment Report
as at 24 September 2022

November 2022

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Important Notice

This report has been prepared by PricewaterhouseCoopers LLP based on the instructions provided by the Trustees of the National Funeral Trust ("the Trust") ("the Trustees") and, where appropriate, incorporates the advice of the responsible Actuary, Emma Morton, who is an employee of PricewaterhouseCoopers LLP, for the sole purpose that is set out in the Executive Summary.

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A copy of this report has been sent to Dignity Funerals Limited ("the Company") as set out in our agreement with them dated 1 November 2022. Under the basis of that agreement, the Company accepts that the work we have carried out is for the Trustees only and we do not accept any responsibility to any other party for it. In particular, we note that the Company will share this report with the FCA and will place it on its website as required by the FCA but PricewaterhouseCoopers LLP accepts no responsibility to anyone who may view the report other than the Trustees.

Contents

1. Executive summary

The purpose of this Solvency Assessment Report ("SAR") is to advise the Trustees of the National Funeral Trust ("the Trust") ("the Trustees") of the results of a Solvency Assessment completed with an effective date of 24 September 2022 ("the valuation date"). This report is produced in line with the latest FCA regulations that took effect on 29 July 2022, and follows the requirements set out by the FCA in the FCA handbook and specifically FPCOB 3.2.

The solvency assessment values a "cover level" for each plan held by the Trust. The cover level is the amount the Company will withdraw from the Trust to provide a funeral for the plan holder. The cover level is determined by the Company and provided to us for the purpose of carrying out a valuation.

In valuing the liabilities of the Trust we have only considered the plans in force at the valuation date, and have made no allowance for any financial support that may be available from the Company.

The FCA requires that liabilities are measured on a "best estimate" basis, which is a basis where there is an equal chance that actual results will be either better or worse than assumed. The FCA's definition of the "solvency level" (used in this report) is the ratio of trust assets over trust liabilities, measured on a best estimate basis.

The market value of the Trust's assets as at 24 September 2022 has been calculated to be £601.7 million (including £59 million for the discounted value of outstanding instalments for existing plans). The best-estimate liabilities of the Trust were calculated to be £463.2 million, which results in:

A **surplus** - i.e. assets less ongoing liabilities - of **£138.5 million**

A **solvency level** (as defined by the FCA) of **130%**

As at 24 September 2021 the Trust had a surplus of £177.0m on a best estimate basis corresponding to a solvency level of 137%.

This report, taken together with all associated letters and emails, has been prepared in accordance with the Technical Actuarial Standards, issued by the Financial Reporting Council, that are relevant to the scope of this work insofar as they apply. These are TAS 100 (Principles for Actuarial work) and TAS 400 (Funeral plan trusts). The latest TAS 400 publication does not yet reflect the upcoming FCA regulation, and we have therefore applied TAS 400 to the extent considered relevant to the SAR rules prescribed by the FCA.

2. Description of plans

Details of plans

Funeral plans are paid for by either a single payment at the outset or monthly instalments. Until recently, instalment payment plans have been payable over a term of up to 25 years.

The cover level valued includes:

- Funeral Director Services or “FDS” cover covering the cost of providing the funeral; and
- Disbursements covering additional services such as Doctors and Ministers fees.

We understand the FDS cover exceeds the marginal cost of providing a funeral and therefore includes an element to cover administration and profit.

The cover levels are increased each year either by a discretionary increase, where the plan holder’s funeral is guaranteed by the Company to be provided at no extra charge, or in line with increases in the Retail Prices Index (“RPI”). The Company informs us of the discretionary increases applied to cover levels each year. The split of plans between discretionary and RPI increases is shown in the table on page 6.

Since 2019, some instalment plans have been taken out alongside an insurance product offered by L&G to cover any instalments outstanding on the death of the plan holder. For older plans without insurance we have assumed that any outstanding instalments must be paid on the death of a plan holder in order for the funeral to be provided.

On cancellation of a plan the plan holder receives back the instalments paid to date, less a cancellation fee (noting that all plans were sold prior to the FCA regulations coming into effect on 29 July 2022).

The Trust was closed to new business from July 2022.

Valuation of liabilities

The liabilities valued in this valuation are the liabilities of the Trust, rather than the Company, which are based on the funeral cover levels provided in the data provided to us.

The membership data used in our valuation is effective as at 30th September 2022 (6 days after the valuation date), as this was the closest date where data was available. We do not consider the short gap between the data date and valuation date to lead to any material errors in the valuation of liabilities.

We have not considered the effects of any potential extra costs that may be borne by the Company should the actual funeral costs for guaranteed funeral plans exceed the cover levels provided.

Neither have we considered how the cover levels compare to the cost of providing a funeral on the open market or otherwise how the plans could be provided if the Company is unable to provide the funeral, including on insolvency.

3. Summary of membership data

Membership data for the valuation of the Trust's liabilities was supplied in electronic format by the Company on 7th October 2022.

The cover level is paid to the Company on death of a plan holder. This includes plans which have lapsed provided the unpaid instalments are paid by the estate of the deceased or covered by insurance.

The cover levels are either subject to discretionary increases or, in a limited number of cases, increased in line with increases in RPI, as set out below.

Group plans are those where Dignity is responsible for providing the funeral, non-group plans are those where an independent party is responsible.

	Number of plans (including lapses)	**Total cover level (£)**
FDS discretionary – group	**168,044**	**304,406,255**
FDS discretionary – non-group	**15,299**	**28,159,017**
FDS linked to RPI	**13,005**	**41,785,128**
Disbursements – discretionary	**172,443**	**181,406,268**
Disbursements linked to RPI	**23,905**	**26,383,996**
Total	**196,348**	**582,140,664**

The Company has granted the following increases to discretionary cover levels (i.e. those not linked to RPI) over the year to 24 September 2022:

FDS – group:	FDS – non-group*:	Disbursements:
6.0%	**6.0%**	**2.8%**

**Excluding a small number of non-group plans where the cover has remained fixed.*

A summary of plans split by payment type is given below:

	Number of plans	**Total cover level* (£)**	**Average cover level* (£)**
Lump Sum	126,814	381,625,411	3,009
Instalment (fully paid)	39,341	119,960,630	3,049
Instalment (outstanding)	30,193	80,554,623	2,668
Total	**196,348**	**582,140,664**	**2,965**

* FPCOB 3.2 requires disclosure of 'plan value' in this report. 'Plan value' is not defined by the FCA and so we have interpreted it to refer to cover levels (as defined in this report). However, we believe that other interpretations are possible.

Included within the figures on this page are 1,894 lapsed plans and 190 plans flagged as either "Moved away" or "Awaiting cancellation". These plans have been valued as active plans with the cover level valued in full.

Whilst we carry out reasonableness checks on the data we are not in a position to independently verify it and so we rely on what has been provided by the Company. For a relatively small number of plans the data was incomplete or invalid. After consultation with the Company we have made appropriate estimates. Any error caused by the estimates is unlikely to be material.

4. Assets

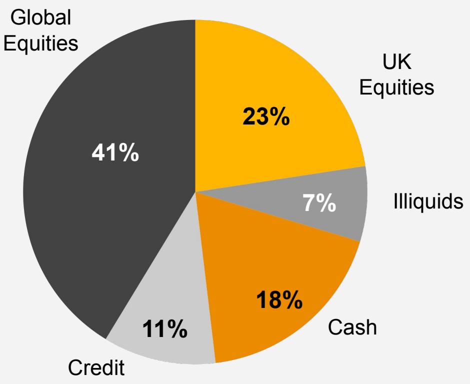
Details of the assets held by the Trust have been provided by the Company on 7 October 2022. We have also been provided with unaudited management accounts dated 26 August 2022 and 30 September 2022. Audited accounts are not available at these date and so these figures have not been independently verified. Invested assets are held with LGIM and Mercer at the valuation date.

As at 24 September 2022	£000s*	Notes
Investments	553,179	
Cash & net current liabilities	(1,969)	1
Adjusted value of Trust assets	**551,211**	
Receipt of outstanding instalments	59,113	2
Marketing expenses due to Company from outstanding instalments	(1,339)	3
Marketing recoveries due to Company	(7,307)	4
Total assets for valuation	**601,677**	

1. This is made up of: £6,016k of short term deposits and cash, plus prepayments of £222k, less accruals of £8,207k.
2. The present value of outstanding instalments, discounted at assumed rate of investment return shown on page 10.
3. The amount of outstanding acquisition costs reimbursed to the Company as plans have been sold. On cancellation, the Company returns some of these marketing expenses to the Trust.
4. Present value of the amount due to the Company in respect of marketing expenses for some plans, payable as future instalments are received.

Items 1, 3 and 4 are as at 30 September 2022 as no data was available at 24 September 2022. We do not expect the impact of using data at 30 September 2022 to be materially different to 24 September 2022.

Trust assets by asset class as at 24 September 2022



Monies deducted from Trust over year to 24 September 2022* (£m)	
Cancellation payments	25.0
Payments on death during the year	37.1
Maintenance and admin fees	2.4
Repayment of marketing expenses	10.2

**Data for 11 months to August 2022 has been scaled up to show annual figures*

5. Valuation method and assumptions

Liabilities

For the valuation we have assumed that the Trust continues to fully support existing plans and does not wind up during the lifetime of any current plan holders. Liabilities have been valued by:

1

Projecting future cover levels allowing for discretionary or RPI increases (where appropriate) between the valuation date and the date of payment.

This part of the method applies only to benefits payable on the death of a plan holder, as the projected cancellation amount of a given plan does not change.

2

Identifying future cash flows by calculating the probability of a plan holder's death and cancellation in each future time period and multiplying this by the projected value of the cover level or cancellation payment in each instance.

3

Discounting each future cash flow from the date of projected payment back to the valuation date at the assumed best estimate rate of investment return to value liabilities.

The assumptions used are shown on pages 10 and 11.

For instalment plans, if there are any outstanding instalments due when the plan holder dies, we have assumed that they are paid from the plan holder's estate, or where applicable, an insurance policy held by the Trust.

Expenses: The costs of maintaining and terminating plans have been provided by the Company. We have valued these expenses in the same way as the liabilities, including allowing for an inflationary increase.

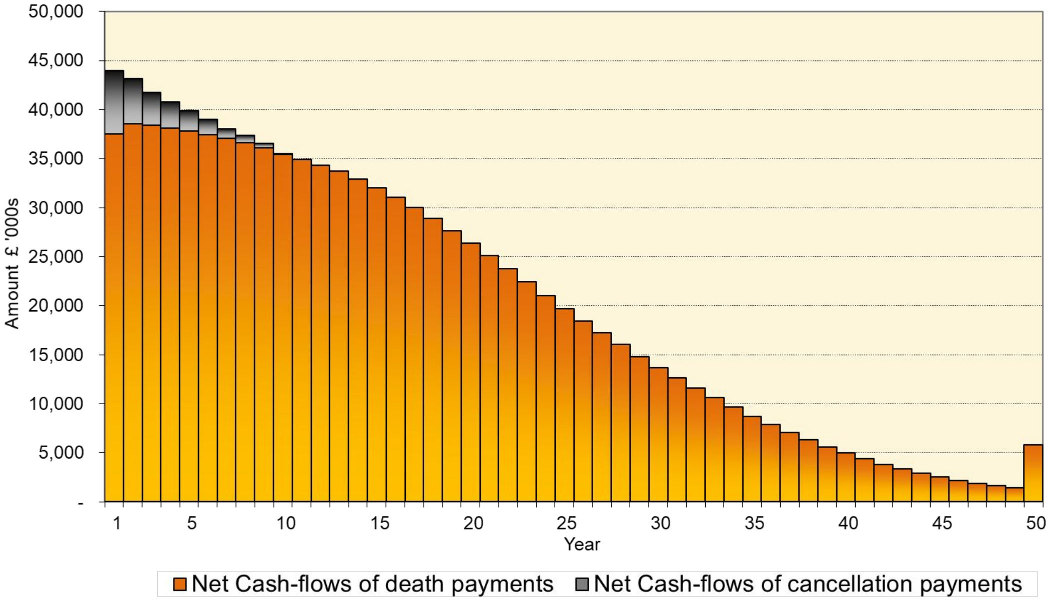
Assets

We have valued assets at their market value, with the exception that outstanding premium instalments due from existing plan holders have been valued by discounting the payments due in future years in line with the best estimate investment return.

5. Valuation method and assumptions

Expected Trust cash flows

This chart shows expected cash flows over the next 50 years using the valuation model described on the previous page.



Please note that any cash flows projected to be paid beyond year 50 have been grouped into the year 50 cash flow above.

5. Valuation method and assumptions

Financial assumptions

Discount rate

The discount rate has been derived using a deterministic, asset-led approach, and represents a best estimate of the expected long-term returns on the long-term asset strategy. At 24 September 2022, this gives an assumed return of 6.70% p.a.

This is a change in approach compared to last year. Further details on the methodology and reasons for the change have been set out in our assumptions report to the Trustees dated October 2022.

We note that the Trust has yet to fully implement its long-term asset strategy. Until this is fully completed, there will be a mismatch between the Trust's actual asset allocations and the long-term allocations used to set the discount rate assumption.

RPI inflation

The RPI assumption is calculated using the Bank of England RPI curve and the expected Trust cash flows to derive a single equivalent RPI rate. This single rate is effectively a weighted average of the market's future inflation expectations, including an allowance for higher inflation in the short-term (because the curve is downward sloping).

As of 24 September 2022, this gives an RPI rate of 3.90% p.a.. A deduction is then made of 0.25% per annum from the cash flow weighted yield to allow for supply and demand distortions in the market resulting in an RPI assumption for the valuation of 3.65% p.a.

In addition, we have made a one-off allowance for the impact that recent high levels of inflation could have on the Trust's cover levels over the next year.

Cover increases

Where linked to inflation, funeral cover is assumed to increase at 3.65% p.a. from year 2 onwards.

Where increases are discretionary, both FDS cover and Disbursement cover are assumed to increase in line with RPI at 3.65% p.a. from year 2 onwards.

We have allowed for higher increases in year 1, which reflect recent known RPI movements and the way that cover levels have been increased to allow for RPI movements in recent years. These increases are shown in the table to the right.

Expenses

Expenses are assumed to increase at 4.15% p.a. This is 0.50% p.a. higher than assumed RPI and allows for the likelihood that expenses will increase at a greater rate than RPI inflation.

We have not allowed for higher expense inflation in year 1 for simplicity and because this would not have a material impact on the liabilities.

Tax

We have assumed no tax is payable other than on a refund of surplus, as advised by the Company.

Financial assumptions summary		2022 % p.a.	2021 % p.a.
Investment return / discount rate		6.70	5.35
RPI linked cover increases	Year 1	9.75	3.55
	Year 2 onwards	3.65	
Discretionary cover increases	Year 1	11.30	3.55
	Year 2 onwards	3.65	
Expense inflation		4.15	4.05

5. Valuation method and assumptions

Demographic assumptions

Mortality

The mortality of plan holders is assumed to be in line with the English Life Tables No. 17 (“ELT 17”) tables, which has been set to reflect past experience of the Trust and is reviewed periodically.

No allowance is made for future improvements in longevity because the results are less sensitive to this assumption and any improvements would reduce the liabilities.

Cancellation

Cancellation assumptions are based on previous Trust experience. We use different assumed cancellation rates depending on the number of years since the plan was taken out, with an assumption of no further cancellations after a plan has been held for 10 years.

6. Valuation results

The results of the valuation on the best estimate basis as described on pages 10 and 11 are shown below.

As at 24 September 2022	Best Estimate Results (£000s)
Funeral Director Services	282,327
Disbursements	157,065
Present value of outstanding instalments payable on death	(8,952)
Present value of payments payable on plan cancellation	19,539
Expense reserve	13,248
Total Liabilities	**463,227**
Market value of Trust assets	551,211
Receipts of outstanding instalments	59,113
Marketing expenses due to Company from outstanding instalments	(1,339)
Marketing recoveries due to Company	(7,307)
Total Assets	**601,677**
Surplus / (deficit)	**138,450**
Solvency level	**130%**

Approximately 90% of the Trust's liabilities relate to funeral plans where Dignity is responsible for providing the funeral, with a third party responsible for providing funerals for the remaining plans. See page 6 for further information and a split of the cover levels.

7. Sensitivity analysis

Financial assumptions

The results are sensitive to the valuation assumptions, in particular to the discount rate and RPI inflation assumption. The scenarios in the table below would have an impact on the Trust's surplus and solvency level, as shown.

Assumption sensitivity *	Change in assumption	Best estimate surplus (£000s)	Impact of change (£000s)	Solvency level
Base result	-	138,450	-	130%
Discount rate	+ 1% p.a.	173,976	35,525	141%
RPI inflation assumption	+ 1% p.a.	96,474	(41,977)	119%
Life expectancy**	+ 1 year	151,134	12,683	134%

* Results show the impact on the surplus of a change in the assumption in isolation. We have assumed the value of invested assets remain unchanged.

** Sensitivity to life expectancy based on the assumption that all plan holders live one year longer.

Cancellation

The Trust had sufficient assets at the valuation date to cover a scenario where every plan holder cancelled their plan.

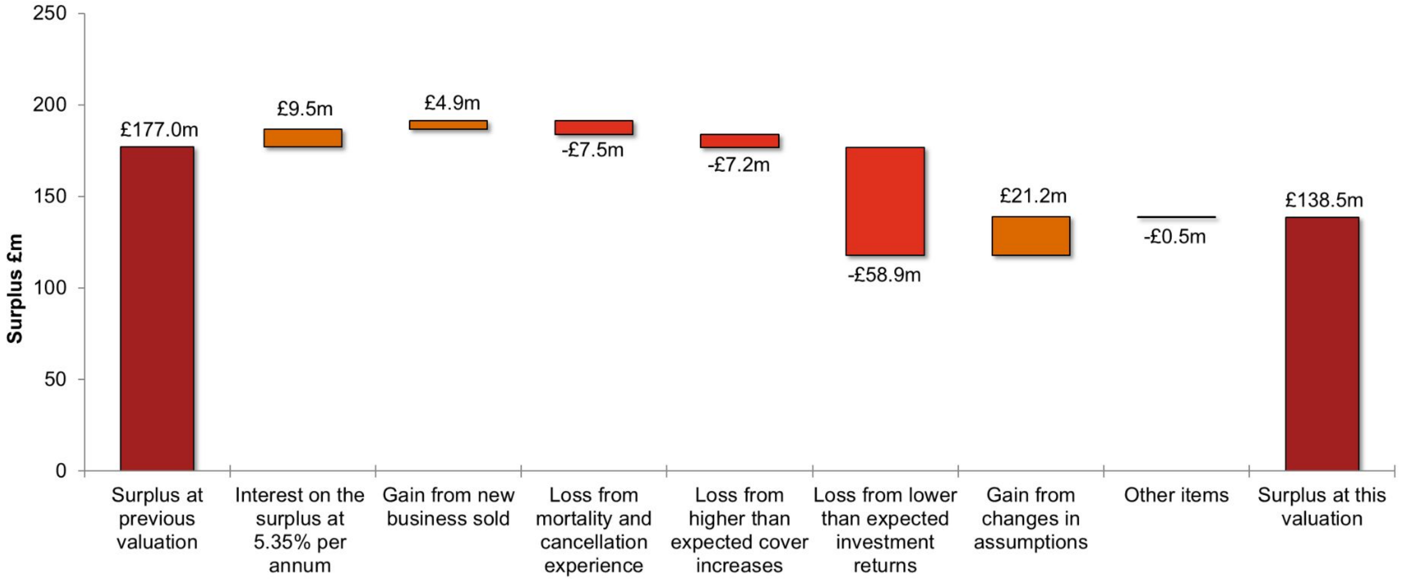
8. Risks and uncertainty

The Trust is exposed to the following risks which need to be managed appropriately:

- **Investment risk**: the risk that the actual asset returns on the Trust assets are lower than the assumed rate of return over the long term.
- **Mismatching risk**: the risk that differences between the characteristics of the liability cash flows and the Trust assets result in the value of liabilities increasing as a result of certain market conditions without a corresponding increase in the assets.
- **Currency risk**: the risk of unfavourable currency movements on any unhedged overseas assets, given the liabilities are all in GBP.
- **Manager risk**: the risk that the investment manager underperforms their given benchmarks or makes asset allocation decisions that lead to the Trust assets underperforming the liabilities.
- **Inflation risk**: the risk that a period of high inflation results in higher than expected increases to cover levels leading a deterioration of the Trust's funding position and / or the risk that cover levels are insufficient to cover the cost of providing funerals.
- **Closure to new business**: the closure of the Trust to new business in 2022 means the Trust will see lower levels of cash in-flow and new business profit than in previous years which may introduce liquidity risk and impact on the solvency level in future years.
- **Data**: the risk of errors in the underlying data which would directly impact the valuation of the Trust's liabilities.
- **Mortality**: this risk that mortality may not to follow the assumptions made meaning that payments from the Trust assets would be required sooner than expected.
- **Covenant risk:** the risk that the Company is no longer able to support the Trust or provide the funerals promised to plan holders.
- **Climate risk**: the risk that the physical consequences of climate change lead to earlier deaths than expected, and investment risk due to the effects of a transition to a lower carbon economy on the investment markets.

9. Analysis of surplus

The chart on this page sets out the key reasons for the reduction in surplus over the year, from £177.0m at 24 September 2021 to £138.5m at 24 September 2022. This reduction is primarily due to lower than expected investment returns, alongside higher assumed short term inflation expectations, partially offset by a higher discount rate assumption.



10. Conclusion

This report sets out the results of the solvency assessment of the Trust as at 24 September 2022.

As measured on the the best estimate assumptions, the results show a surplus of £138.5 million, equivalent to a solvency level of 130%.

For compliance with the documentation of the Trust and FCA regulations, we understand that the next assessment should be carried out with an effective date no later than 24 September 2023.

EmmaM.

Emma Morton

Fellow of the Institute of Actuaries

PricewaterhouseCoopers LLP

November 2022