Summary of changes to the Principles and Practices of Financial Management applying to National Provident Life with-profits policyholders as a result of the Scheme to transfer National Provident Life Limited policies to Phoenix Life Assurance Limited

Introduction

National Provident Life Limited (NPLL) has published details of how it currently manages its with-profits policies in its Principles and Practices of Financial Management (PPFM). If the Scheme outlined on these web pages and in the 'Simplifying our business' Scheme Guide is approved, all the policies in NPLL's long-term fund will transfer to Phoenix Life Assurance Limited (PLAL) and a revised version of PLAL's PPFM will apply to NPLL's with-profits business. With-profits policies currently in NPLL will be allocated to a new with-profits sub-fund of PLAL, the National Provident Life With-Profits Fund (NPL WP Fund) on 6th April 2015 and the new PPFM will be effective from this date. The structure of the PLAL PPFM, whilst different in style to the existing NPLL PPFM, is consistent with the structure used elsewhere within the Phoenix Group.

This note sets out the changes to the principles and practices guiding how the NPL WP Fund will be managed in future, compared with the principles and practices used by NPLL and set out in its PPFM, the latest version of which is dated July 2014. The majority of the changes highlighted here arise as a result of the implementation of the Scheme, should it be approved.

This note does not include an exhaustive list of the changes. It does not cover, for example, changes where the wording of a principle or a practice has changed, but its substantive meaning remains the same. Further, it does not cover places where references have been updated or superseded, or instances where a principle or practice has been moved to a different section but remains substantively unchanged. You can find a copy of the proposed revised PLAL PPFM and the draft guides to how we will manage the NPL WP Fund on our websites at www.Phoenixlife.co.uk/FM14scheme and www.NPI.co.uk/FM14scheme, under 'Technical information'. If you would like paper copies of any of these draft documents, please call 0845 266 9221.

Structure of the revised Phoenix Life Assurance PPFM

The first four chapters of the PLAL PPFM give background information including some history of the company and the types of business held.

Chapter 3, Company Background, includes a section, 3.3, covering the Scheme (called the 2015 Scheme in the PLAL PPFM) and the establishment of the new NPL WP Fund, It also explains that the 2012 Scheme includes provisions that apply to each of the with-profits funds in PLAL, including the NPL WP Fund. These cover the right to close the NPL WP Fund (as set out in 3.2.4 and 3.2.5) and the right to re-allocate non-profit policies in the NPL WP Fund to the Non-Profit Fund (as set out in 3.2.6) subject to certain policyholder protections. Section 3.4 covers the capital policy that PLAL operates.

Chapter 5 documents the guiding principles and practices adopted in managing all the with-profits funds within PLAL, including the NPL WP Fund, and which, in the event of conflict with other principles, take priority.

Each of the four with-profits funds of PLAL then has its own chapter. The principles and practices that are specific to the NPL WP Fund are detailed in chapter 9. The principles and practices that relate particularly to the Portfolio Bond, that are set out in section L of the NPLL PPFM, have been included within the appropriate principles and practices of the NPL WP Fund. This note does not comment on the principles and practices relating to the Portfolio Bond unless there has been a material change to their wording.

Changes to principles and practices

General

The principles and practices given in sections 9.4 to 9.14 and the guiding principles and practices in chapter 5 form the Principles and Practices of Financial Management for the NPL WP Fund. Except as noted below, these are substantively unchanged from the principles in the NPLL PPFM.

The guiding principles and practices apply to all the PLAL with-profits funds. Whilst there was no equivalent in the NPLL PPFM and to that extent, these guiding principles and practices are new, they do not represent a major change to the way the fund will be run compared to the current situation in NPLL. The key new points are:

- In managing the with-profits funds there is a commitment to observe the terms of the 2015 Scheme and where appropriate the 2012 Scheme.
- Each fund is operated on a stand alone basis.
- If necessary capital support will be provided by the Shareholders' Fund and the Non-Profit Fund under the capital policy.
- In the unlikely event that the Shareholders' Fund and Non-Profit Fund are unable to provide support, then support under the PLAL capital policy could be given by other with-profits funds.
- Expense apportionment is subject to the 2012 and 2015 Scheme provisions.
- Risks are not pooled across the different with-profits funds.
- Other than for vesting non-profit annuities, the powers to re-allocate non-profit policies in the with-profits funds will not be regularly used. If a re-allocation is made, it will be on commercial terms and an independent actuary will normally be appointed to consider the proposed terms and in any event where the total value of such a re-allocation exceeds a minimum size (currently £500m).

Chapter 9 – Principles and practices – National Provident Life With-Profits Fund

Throughout the principles and practices of chapter 9, the following approach has been adopted:

- The term 'conventional with-profits' or 'CWP' has been replaced by the term 'traditional with-profits' or 'TWP'.
- Reference to National Provident Life Limited has been replaced by reference to either the National Provident Life With-Profits Fund (abbreviated to the 'fund' within Section 9 of the PLAL PPFM) or Phoenix Life Assurance Limited as appropriate**.**
- Reference to the High Court Scheme has generally been replaced by reference to the 2015 Scheme.
- Reference to the Supervisory Board has been replaced by reference to either the With-Profits Committee or the Board as appropriate.
- Reference to the Capital Fund, the Earmarked Portfolio, and the Shareholder Equalisation Fund will either be removed or replaced by references to the estate or capital support provided under the capital policy as appropriate. In addition, the

principles and practices relating to the use of the Scheme Capital Account (which has nil value having been exhausted by the NPLF), and the Scheme Capital Fund, (which will be combined into the Estate) in Section I, ‘Use of the Scheme Capital Account’, of the NPLL PPFM have been removed.
- References to the Asset Share Charge Fund (which will be combined into the Estate) will either be removed or replaced by references to the Estate.

The headings below follow the headings in the revised PLAL PPFM.

Section 9.4 - Amounts Payable under a With-Profits Policy

Reference to the *Scheme Capital Fund* has been removed and reference to the *Earmarked Portfolio* and *Shareholder Equalisation Fund* has been replaced by reference to the capital support provided under the Capital Policy. Reference to the Supervisory Board has been replaced by reference to either the Board or the WPC according to their responsibilities post transfer.

Existing principle PA5, which explains that the results for a similar major line of business may be used as a guide to setting payouts on some minor lines of business has been moved from the principles to the practices. Principle PA6, which explains how asset shares have been determined historically has been removed because reference to historic smoothing practices are included in the practices.

The practices have been presented differently for consistency with the approach taken in respect of the other with-profits funds in PLAL. Wording has been updated to remove reference to the Asset Share Charge Fund and explain that the Estate (including accumulated asset share charges) to the extent that it is not needed to meet its liabilities, will be distributed to with-profits policyholders. There are minor updates to refer to assets *notionally* backing groups of policies, these changes remain consistent with the existing principles.

Section 9.5 - Annual Bonus Rates and Section 9.6 - Final Bonus Rates

References to Scheme Capital Account and the Scheme Capital Fund have been removed and references to the Earmarked Portfolio and Shareholder Equalisation Fund have been replaced by reference to capital support under the Capital Policy. Reference to the Supervisory Board has been replaced by reference to either the Board or the WPC according to their responsibilities post transfer. Otherwise the principles and practices are substantively unchanged.

Section 9.7 - Smoothing

Reference to the Supervisory Board has been replaced by reference to either the Board or the WPC according to their responsibilities post transfer. Otherwise the principle and practices are substantively unchanged.

Section 9.8 - Surrender Values

This new section combines information from several principles and practices relating to the determination of surrender values that are contained in the NPLL PPFM.

A new principle has been introduced to clarify that surrender value payouts will be set by reference to asset shares, subject to smoothing and guaranteed minimums where provided by the contract terms, this is consistent with the existing principle that applies to payouts more generally. The new principle also clarifies that surrender values may vary considerably in line with movement in asset shares.

The practices are substantively unchanged other than replacement of the statement that payouts on DA business are not set by reference to asset share by an explanation of how payouts on DA business are determined in Section 9.4 (Amounts Payable under a With-Profits Policy).

Section 9.9 - Investment Strategy

Reference to the Scheme Capital Fund has been removed and reference to the Earmarked Portfolio and Shareholder Equalisation Fund has been replaced by reference to the capital support provided under the Capital Policy. Reference to the Supervisory Board has been replaced by reference to either the Board or the WPC according to their responsibilities post transfer.

Existing principle PE2, which explains that the investment strategy for CWP, PSA and UWP business is focused on the need to maintain the security of policyholders' guaranteed benefits and that for DA and CA business, the asset strategy is primarily fixed interest securities, is a restatement of information contained in other principles and practices within this section and has therefore been removed.

Existing principle PE6, which explains that the only assets outside of the NPLF that are relied upon to maintain the investment strategy are the assets of the Scheme Capital Account has been amended to reflect the Scheme, and will explain that the investment policy will be set on the basis that no support will be provided to the fund other than that under the capital policy.

Existing practice CE3, which describes the general aim of the investment strategy and the type of assets selected for investment, has been removed because the detail for each business type is given separately. A new practice has been added to explain that investments may be direct or via collective investment schemes such as unit trusts or derivatives. Existing practice CE 15, which explains that the estate very largely covers some of the liabilities for options and guarantees, and refers to preceding practices that describe how assets backing guarantees are invested, has been removed because most of the information is contained in other practices.

Section 9.10 - Business Risks

Statements within the principles that certain risks may cause the 'financial position of the Office to seriously deteriorate' have been removed because PLAL regularly monitors its key insurance and operational risks, as set out in its guiding practices, and sets aside additional capital in respect of these risks under its capital policy.

Existing principle PF4 has been amended to state that compensation costs arising from mis-selling of policies will be met by the Non-Profit Fund or Shareholder Fund.

Existing principle PF6 relating to payments under any subordinated debt has been removed because the subordinated debt arrangement between NPLL and PLAL will collapse on transfer so that the sub-ordinated debt will no longer exist.

Existing principle PF7 relating to the potential reduction in bonuses and ultimately guaranteed benefits if certain shareholder support were exhausted has been removed because this is a highly unlikely scenario and will be covered by guiding principles and practices in 5.2 'Basic Fund Concepts'.

A new principle has been introduced to explain that annuities in payment arising as a result of policies vesting are set up in the PLAL Non-Profit Fund.

Throughout the practices reference to the Scheme Capital Fund Earmarked Portfolio and Shareholder Equalisation Fund has been removed. In addition existing practice CF4 has been amended to include reference to charges for investment management and remove reference to 2014 as that will not be relevant. Existing practice CF11, which refers to the subordinated debt issued in 2006, has been removed as this debt will not exist after the transfer. Existing practice CF6 which refers to the risk that guarantee costs could rise to the point where the estate and certain shareholder support was exhausted has been removed because the level of guarantee costs is such that capital support is expected to be provided to the fund.

Section 9.11 - Expenses and Charges

The principles and practices have been updated to reflect the 2015 Scheme which will set per policy expenses charged to the fund at the level applying at the Transfer date with future increases limited to RPI +1%. The PLAL Board will be entitled to change these fees in the future. However, any changes will need to be approved by the WPC. The fees for investment management charged to the fund will also be set by the Board. However, the Scheme will require that any changes to investment management fees are approved by the WPC. In addition, any changes to the per policy expenses or investment management fees charged to the fund are subject to regulations regarding the allocation of costs and charges to with-profits funds.

The practices have been amended to clarify that Pearl Group Services will continue to increase per policy expenses by RPI + 1%, this rate of increase also applies to Portfolio Bond business. Existing practice CG5 has been removed because the information contained within this practice, which refers to the services provided by the shareholder or other group companies, is covered by guiding practice 5.3.10.

Section 9.12 - Estate Management

The principles and practices are substantively unchanged.

Section 9.13 - New Business

The principles and practices are substantively unchanged.

Section 9.14 - Equity between the Fund and Shareholders

The principles are substantively unchanged.

The practices have been amended to reflect the replacement of the Earmarked Portfolio and the Shareholder Equalisation Fund by capital support provided under the capital policy and references to Scheme Capital Fund and Asset Share Charge Fund have been removed.

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