PHOENIX LIFE

Phoenix Life Limited

Principles and Practices of Financial Management

January 2025

Phoenix Life Limited

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Contents

1. Introduction

This document sets out the Principles and Practices of Financial Management applied in managing the with-profits business of Phoenix Life Limited as at 1 January 2025. Although Phoenix Life Limited contains policies originally issued by Standard Life Assurance Limited, this document is aimed at holders of policies that were not originally issued by Standard Life Assurance Limited and there are separate documents for the Standard Life policies.

Phoenix Life Limited's assets are divided between a large *long-term business fund* and a much smaller *Shareholder Fund*. The *long-term business fund* is internally segregated into 18 funds:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic With-Profits Fund;
- the Britannic Industrial Branch Fund;
- the Phoenix With-Profits Fund;
- the Scottish Mutual With-Profits Fund;
- the SPI With-Profits Fund;
- the SAL With-Profits Fund;
- the Pearl With-Profits Fund;
- the SERP With-Profits Fund;
- the London Life With-Profits Fund;
- the National Provident Life With-Profits Fund;
- the Heritage With-Profits Fund;
- the UK Smoothed Managed With-Profits Fund;
- the German With-Profits Fund;
- the German Smoothed Managed With-Profits Fund; and
- the Non-Profit Fund.

With-profits business is contained in each of the first 17 funds listed above. The *Board* is responsible for managing the with-profits business in most of these funds, including setting bonuses. The *With-Profits Committee* is responsible for setting investment and bonus policy for the SPI With-Profits Fund and National Provident Life With-Profits Fund only.

This Principles and Practices of Financial Management also applies to the participating Irish business previously in Phoenix Life Assured Europe dac now in Standard Life International dac (SLIDAC) which is reinsured into Phoenix Life Limited (see appendix 2 for more detail).

Unless specifically stated otherwise, where we talk about 'policies' in this document we mean both policies that participate directly in the Phoenix Life Limited funds and policies that participate in the funds via reinsurance.

Separate documents are maintained for the Principles and Practices of Financial Management for the with-profits funds that were previously part of Standard Life Assurance Limited. These are the:

- the Heritage With-Profits Fund;
- the UK Smoothed Managed With-Profits Fund;
- the German With-Profits Fund; and
- the German Smoothed Managed With-Profits Fund.

This also applies to participating European business which transferred to Standard Life International dac (SLIDAC) and was reinsured back to Standard Life Assurance Limited.

The rest of this document is applicable only for the funds listed in sections 6 to 18 and the term *with-profits funds* means the with-profits funds of Phoenix Life Limited excluding those that were previously part of Standard Life Assurance Limited.

The Principles and Practices of Financial Management:

- is used in the governance of the with-profits business within the *with-profits funds* of Phoenix Life Limited by the *Board* and the *With-Profits Committee*, with particular regard to the use of discretion in managing the *with-profits funds*; and
- provides information on the possible risks and rewards associated with a with-profits policy within a particular with-profits fund.

The Principles and Practices of Financial Management is prepared in accordance with Section 20.3 of the Conduct of Business Sourcebook which forms part of the Handbook issued by the Financial Conduct Authority (FCA).

These Principles and Practices have been drawn up in accordance with the law and regulation as Phoenix Life Limited understands it as at 1 January 2025. Should this understanding prove to have been incorrect, for example as a result of a court or regulatory ruling with retrospective effect, the Principles and Practices will be amended to comply and will be applied as if they had always been so amended.

Section 2 gives more details about the background to Principles and Practices and how and when they can be changed. Appendix 3 gives details of changes to this document since 1 January 2007.

Section 3 provides some background information on Phoenix Life Limited and its *with-profits funds*. Appendix 2 gives details of the historic schemes of transfer.

Section 4 introduces the key concepts of with-profits business and types of with-profits business. This information is key to understanding the management of the *with-profits funds*.

Section 5 documents the guiding principles and practices adopted in managing the with-profits business of Phoenix Life Limited. These guiding principles apply to all the *with-profits funds* and in the event of conflict with other principles take priority.

Sections 6 to 18 document the principles and practices adopted in each of the *with-profits funds*. Nothing in any of these sections should be inferred as applying to any other fund unless explicitly stated.

Section 19 documents the with-profits governance arrangements.

A glossary of terms and a summary of abbreviations used in the document are given in Appendix 1. Words that are defined in the glossary appear in *italics* in the main text.

Sections 1 to 4 and 19 of this document and the Appendices are background or explanatory material and therefore neither principles nor practices for the purpose of the FCA rules.

None of the contents of this document forms part of, or varies, the terms or conditions of any policy under which Phoenix Life Limited is the insurer. In the event of any inconsistency between the contents of this document and any policy, the terms and conditions of the policy prevail (except where overridden by a court order).

This document is intended to assist knowledgeable observers to understand the way in which the with-profits business of the Phoenix Life Limited *with-profits funds* is conducted and the material risks and rewards involved in effecting or maintaining a with-profits policy in a fund. It is not a comprehensive explanation either of the management of the with-profits business of a fund or of the other funds within Phoenix Life Limited or of every matter which may affect the business. In addition, no part of the document should be read as a recommendation to policyholders or potential policyholders or their advisers in relation to the effecting or maintaining of a with-profits policy. Accordingly, any person considering whether to effect or maintain a with-profits policy within a fund should seek independent financial advice.

When referring to with-profits policies, with-profits business accepted by Phoenix Life Limited under reassurance agreements is included for the purposes of determining the amount payable to the reassuring company. However, the benefits payable to the with-profits policyholders of the reassuring company are the responsibility of that company, and not Phoenix Life Limited.

Statements in this document in relation to the risks and rewards involved in effecting and maintaining a with-profits policy in a fund are by their nature forward-looking statements that are subject to a variety of uncertainties. Readers of this document should read such forward-looking statements in that context.

The contents of this document may change as the circumstances of Phoenix Life Limited and the business environment change. The document may also change to reflect changes made by Phoenix Life Limited to the management of its with-profits business. Phoenix Life Limited intends to give notice of some changes as explained in section 2 of this document, other changes will be made without notice.

Readers of this document should be aware that reading only selected sections or paragraphs in isolation may result in a misleading impression of the way in which the with-profits business of the funds is conducted and the material risks and rewards involved in effecting and maintaining a with-profits policy with the funds. The principles set out in this document and their associated practices should in particular be read together.

Phoenix Life Limited is authorised by the Prudential Regulation Authority (PRA) and regulated by the FCA and PRA.

2. Background to Principles and Practices of Financial Management

2.1 Principles and Practices

2.1.1 The principles:

- are enduring statements of the overarching standards adopted by Phoenix Life Limited in managing the *with-profits funds*; and
- describe the business model used by Phoenix Life Limited in meeting its duties to with-profits policyholders in the funds and in responding to longer-term changes in the business and economic environment.

The principles are divided into guiding principles which apply to all the *with-profits funds* (and are described in section 5) and other principles, which apply to a particular with-profits fund (and are described in sections 6 to 18).

2.1.2 The practices set out how the principles are implemented:

- describe Phoenix Life Limited’s approach to managing the funds and to responding to changes in the business and economic environment in the shorter-term; and
- contain sufficient detail to enable a knowledgeable observer to understand the material risks and rewards from effecting or maintaining a with-profits policy in the funds.

There are practices associated with each principle and these are set out below each principle.

2.2 Demonstrating Compliance with Principles and Practices

2.2.1 The *Board* produces an annual report addressed to with-profits policyholders within six months of the financial year end. This report covers Phoenix Life Limited’s compliance with its Principles and Practices of Financial Management and significant matters where discretion has been exercised, in particular where such matters relate to the competing or conflicting interests of policyholders and shareholders. Policyholders will normally be advised of the report as part of their next annual statement. The report is made available to policyholders on our website.

2.2.2 An annual report for the *Board* is produced by the *With-Profits Actuaries* on key aspects of the discretion exercised in respect of each fund (including the application of its Principles and Practices of Financial Management).

2.3 Amendments to the Principles

2.3.1 The principles are not expected to change often. However Phoenix Life Limited may amend any of the principles at any time. Any change will follow formal consultation with and take into account the opinions of the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee*. Any changes to the principles will be approved by the *Board*.

2.3.2 Policyholders will normally be provided with three months written notice in advance of any changes to the principles. The written notice will set out any proposed changes to the principles.

2.3.3 The circumstances and reasons normally leading to such amendments to the principles are likely to include:

- changes in regulations;
- to improve the management of the *with-profits funds*;
- maintaining equity between classes or groups of policyholders; and
- significant changes in the financial condition of Phoenix Life Limited.

2.4 Amendments to the Practices

2.4.1 The practices are expected to change as Phoenix Life Limited's circumstances and the business environment change. Any change will follow formal consultation with and take into account the opinions of the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee*. Any material changes to the practices will be approved by the *Board*.

2.4.2 The FCA will be provided with details of any material changes.

2.4.3 Policyholders will not be provided with any advance notification of changes to the practices, although they will be informed within a reasonable period after any material changes have been made. This notification will normally be with the next annual statement.

2.5 Summary of Amendments Made to Phoenix Life Limited's Principles and Practices of Financial Management

2.5.1 The Principles and Practices of Financial Management will normally be displayed on the www.phoenixlife.co.uk internet site and the version displayed on the internet site will normally be updated shortly after any changes have been implemented.

2.5.2 Appendix 3 gives details of amendments previously made to the Principles and Practices of Financial Management since 1 January 2007.

2.6 With-Profits Governance Arrangements

2.6.1 The with-profits governance arrangements are described in section 19.

3. Company Background

3.1 Company History and Group Structure

3.1.1 Phoenix Life Limited as it is currently constituted is the result of a series of previous business transfers. The most recent UK business transfer was in 2023 and the provisions of the court scheme used to effect that transfer (the *2023 Scheme*) replaced those of previous schemes to which Phoenix Life Assurance Limited, Phoenix Life Limited and Standard Life Assurance Limited were party.

The *2023 Scheme* became effective on its transfer date, 27 October 2023.

Other schemes have transferred European business originally written in Phoenix Life Limited or Standard Life Assurance Limited into SLIDAC. These schemes result in the transferred business being reinsured into Phoenix Life Limited.

Full details of the past court schemes and other events are set out in Appendix 2.

3.1.2 The *2023 Scheme* amended the closure provisions for each of the *with-profits funds* listed in Appendix 2 A2.23. Closure can occur when the *with-profits policy liabilities* fall below £10m (subject to annual indexation using RPI from the transfer date) in the case of the 90% With-Profits Fund and the 100% With-Profits Fund or below £50m (subject to annual indexation using RPI from the transfer date) in all other cases. Upon the closure date policies may be

- transferred to the Non-Profit Fund and with-profits policies will be converted to non-profit with a schedule of future guaranteed bonus additions, or
- transferred to the Non-Profit Fund and with-profit policies converted to unit-linked policies investing in unit linked funds,
- transferred to another with-profits fund, or
- a combination of these.

Closure will only occur if the *Board* concludes, having taken advice from the relevant With-Profits Actuaries and the With-Profits Committee, that closing the With-Profits Fund is fair and in the best interests of policyholders of the relevant With-Profits Fund.

Where a ‘may terminate’ point has been passed for any with-profits fund but the decision is taken not to close the fund, the *Board* will state this fact along with any relevant explanation in its annual report to with-profits policyholders.

On the closure of a with-profits fund with reinsured Irish business from SLIDAC, the reinsurance will terminate and SLIDAC will use the termination amount it receives to set up benefits in the SLIDAC Non-Profit Fund.

3.1.3 In accordance with the *2023 Scheme* Phoenix Life Limited continues to have the right to re-allocate any non-profit policy in any of the *with-profits funds* of Phoenix Life Limited to the Non-Profit Fund provided that:

- such re-allocation is not contrary to the terms of the policy, and has been approved by the With-Profits Committee; and
- in the opinion of the *Board*, having obtained appropriate actuarial advice, assets:
  - with a market value which is fair and equitable (in the context of the risks being re-allocated to the Non-Profit Fund in respect of the policy); or
  - with a market value which is consistent with an amount (where such an amount can be calculated) that Phoenix Life Limited would have charged in consideration of the assumption of the risk in respect of a new policy which it issued on the same terms as the policy to be re-allocated from the

relevant with-profits fund to the Non-Profit Fund (subject to appropriate adjustment to reflect differences in expenses or commission incurred),

are being transferred or re-allocated from the relevant with-profits fund to the Non-Profit Fund.

In respect of the SPI With-Profits Fund, separate provisions apply in relation to the provision of non-profit annuities (including non-profit deferred annuities). For these, the assets transferred from the SPI With-Profits Fund to the Non-Profit Fund shall be based on the annuity rates being used by Phoenix Life Limited or any other authorised insurer in the Phoenix Group or, if unavailable, on rates consistent with those generally available in the market. If the *With-Profits Actuary* considers that the amount that would be transferred exceeds that which is reasonable based on the rates generally available in the market, then they may recommend that the annuity benefit be provided from the SPI With-Profits Fund and the *With-Profits Committee* shall have the right to require that the annuity benefit be provided from the SPI With-Profits Fund or not.

3.1.4 The *2023 Scheme* also includes provisions relating to the workings of the funds, the allocation of tax, the shareholders share of surplus, and investment and bonus policy. These have been incorporated into this document.

In particular, in relation to the investment policy, the provisions continue to allow further hypothecation of the assets in the *with-profits funds* where this would not be inappropriate having regards to the interests of relevant policyholders. For example this may involve the matching of non *asset share* liabilities more accurately, the hypothecation of different equity (and property) backing ratios to further classes or groups of policies or through the hypothecation of fixed interest assets by *term remaining* within *asset shares* to reduce the volatility of policyholder returns near *maturity*.

3.1.5 The *Buffer Reserve* as described in sections 9 and 10 and appendix 2 continues under the *2023 Scheme*.

3.1.6 As a consequence of the *2023 Scheme* the Principles and Practices of Financial Management was updated. Changes were made to incorporate any changes in the *2023 Scheme.*

3.2 Capital Policy

3.2.1 The *2023 Scheme* provides for Phoenix Life Limited to maintain a specific capital policy.

3.2.2 The capital policy seeks to ensure that the company would be able to withstand a number of internally specified stress scenarios.

3.2.3 The capital policy also seeks to ensure that each with-profits fund has sufficient assets to meet its liabilities. Section 3.3 describes to the capital support available to with-profits funds.

3.2.4 Under the requirements of the *2023 Scheme* Phoenix Life Limited must

- hold sufficient assets to satisfy the Scheme Capital Quantity and Scheme Capital Quality tests, and
- conduct its business so that there is no significant foreseeable risk that a *Capital Event* arises and requires actions to be taken in its With-Profits Funds (that would not be in accordance with the 2023 Scheme).

3.2.5 The Scheme Capital Quantity Test states that Phoenix Life Limited must hold sufficient assets in excess of liabilities to:

- meet its *Solvency Capital Requirement* (*SCR*) in internally specified scenarios consistent with the Board's risk appetite, and
- in those stress scenarios, provide any support needed by With-Profits Funds in accordance with section 3.3.

3.2.6 The risk appetite for the purpose of the Scheme Capital Quantity Test is specified as a 'less than 1-in-10 chance of failing to meet its SCR in one year' but this can be changed from time to time as described in 3.2.12.

3.2.7 The Scheme Capital Quality Test states that Phoenix Life Limited shall hold assets in the Non-Profit Fund and the *Shareholder Fund* such that in stress scenarios considered appropriate by the *Board*, Phoenix Life Limited can:

- maintain compliance of the *Matching Adjustment Fund* with the relevant Solvency II regulations, and
- meet anticipated liquidity demands that would arise in those stress scenarios including provision of support to *with-profits funds* as contemplated in section 3.3 below in the form of assets that would be appropriate for the *with-profits funds* to hold.

3.2.8 If, in the reasonable opinion of the *Board* (having regard to the advice of the *Chief Actuary*), a *capital event* arises, Phoenix Life Limited shall identify and take actions that, in the reasonable opinion of the *Board* (having regard to the advice of the *Chief Actuary*) are necessary for Phoenix Life Limited to cease to experience a *capital event*. For the London Life With-Profits Fund there are historic scheme requirements to be met before interventions can be made. For the SPI With-Profits Fund and National Provident Life With-Profits Fund the *Board* does not have powers to take such actions as this is a matter for the *With-Profits Committee*.

3.2.9 Phoenix Life Limited shall not take any actions that would result in the business of each with-profits fund not being conducted in accordance with the Scheme Principles of Financial Management of the *2023 Scheme*, unless the *Board* considers that the actions otherwise permitted would be insufficient for the *capital event* to cease.

3.2.10 Where this is the case, Phoenix Life Limited may take additional actions that would result in the business of a *with-profits fund* not being conducted in accordance with the *2023 Scheme* provided that

- in the reasonable opinion of the *Board* (having regard to the advice of the *Chief Actuary* and the relevant *With-Profits Actuaries*), such actions treat policyholders fairly and are only taken to the extent that they are necessary after taking into account the actual and/or expected impact of the actions permitted under 3.2.9 and
- such actions shall be limited to changing the asset mix for with-profits policies allocated or reinsured to that *with-profits fund*, as necessary for Phoenix Life Limited to cease to experience a *capital event.*

3.2.11 Phoenix Life Limited shall notify the regulators as soon as reasonably practicable after it has determined that a *capital event* has occurred or is reasonably likely to occur.

3.2.12 The *2023 Scheme* provides that the *Board* may change the Scheme Capital Quantity Test and/or the Scheme Capital Quality Test in order to reflect a change to the risk appetite or stress scenarios which the *Board* has set for Phoenix Life Limited as a whole.

To the extent that a change in risk appetite would have the effect of reducing the amount of assets required to be held by Phoenix Life Limited under the Scheme Capital Quantity Test, Phoenix Life Limited shall be required to obtain a certificate from an independent actuary to the effect that, in their opinion, the proposed changes to the Scheme Capital Quantity Test are unlikely to have a material adverse effect on the interests of the holders of policies of Phoenix Life Limited overall.

3.2.13 A *Capital Event* arises if Phoenix Life Limited is unduly exposed to a risk of being unable to meet its *SCR*, or its capital needs (as determined in accordance with regulatory requirements to be adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due).

3.3 Capital Support

In the unlikely event that the *with-profits asset value* of any of the *with-profits funds* falls below (or is likely to fall below) the *threshold amount* for that fund, support will be provided to that fund by way of a loan or other contribution arrangement from the Non-Profit Fund or the *Shareholder Fund* to the extent that the *Board* determines there are assets in those funds available to make such a loan.

The loan would be repayable with the approval of the *Board* if the *with-profits asset amount* is more than the *threshold amount*.

Whether or not interest would be payable by the fund on any loan received, and the interest rate payable if applicable, will vary depending on the *with-profits fund* receiving the loan.

The terms for any such loan (including the rate of return and the manner of repayment) will be determined as the *Board* thinks fit, provided that the relevant *With-Profits Actuary* has certified to the *with-profits committee* that the terms of such arrangements are, in the opinion of the relevant *With-Profits Actuary*, no less favourable than arm's length commercial terms and will not detrimentally affect the reasonable expectation of the holders of with-profits policies in the relevant *with-profits fund*.

In the event that any of the *with-profits funds* cannot meet its regulatory capital requirements from its own resources, the With-Profits Committee can recommend, or in the case of the SPI With-Profits Fund request, that the *Board* holds additional capital in the Non-Profit Fund or the *Shareholder Fund* to meet any shortfall. To the extent that the *Board* does not or cannot make sufficient assets available, then it will be necessary to take other actions within the relevant *with-profits fund* to ensure that it can meet its regulatory capital requirements from its own capital resources.

This document does not cover the capital support agreements in respect of the former Standard Life Assurance Limited business.

3.4 Main inter fund agreements – risk transfer arrangements

3.4.1 This document does not cover any of the internal arrangements in respect of the former Standard Life Assurance Limited business.

3.4.2 The Britannic With-Profits Fund transfers the unit-linked liability and associated expense risk under most unitised life and pensions business to the Non-Profit Fund.

3.4.3 The Phoenix With-Profits Fund transfers the unit liability for non-profit unit-linked policies and certain expense risks to the Non-Profit Fund.

3.4.4 The Non-Profit Fund transfers certain mortality risks associated with Progressive Protection Plan, Fair Share Whole Life and Linkplan to the Phoenix With-Profits Fund.

3.4.5 The Non-Profit Fund transfers the With-Profits Performance Fund and With-Profits Pension Fund element of former Alba Life former Crusader policies invested in these notional funds to the Alba With-Profits Fund.

3.4.6 The Non-Profit Fund transfers the Pension With-Profits Fund element of former Swiss Life personal pension plan and free standing AVC policies to the 90% With-Profits Fund.

3.4.7 The Non-Profit Fund transfers the *unitised* with-profits and *smoothed return* business investment and guarantee risks of former Scottish Mutual Assurance Limited business to the Scottish Mutual With-Profits Fund.

3.4.8 The Non-Profit Fund transfers the *unitised* with-profits investment and guarantee risks and unit-linked guaranteed annuity option risk in respect of former Scottish Provident Limited business to the SPI With-Profits Fund.

3.4.9 With-profits liabilities of unitised with-profits pensions and capital account policies originally issued by NPI are fully reinsured on original terms from the Phoenix Life Limited Non-Profit Fund to the Pearl With-Profits Fund.

3.4.10 The SPI With-Profits Fund transfers some of the expense risks under *traditional* with-profits business to the Non-Profit Fund.

3.4.11 The 90% With-Profits Fund transfers the expense risks under the ex Swiss with-profits business to the Non-Profit Fund other than in the event of major regulatory change.

3.4.12 The SAL With-Profits Fund transfers the risks of the *unitised* with-profits bonds written between October 1997 and December 1998, and the unitised with-profits pensions (excluding the final salary unitised with-profits group pension policies) into the Phoenix With-Profits Fund.

3.4.13 The SAL With-Profits Fund transfers the risks of some of the with-profits life endowments written after September 1988 (‘Endowment Assurance’, ‘Economy Mortgage Plan’, ‘Economy Plan’ and ‘Moneymaker’) to the 100% With-Profits Fund.

3.4.14 The SAL With-Profits Fund transfers the risks of the property linked liabilities to the Non-Profit fund.

3.4.15 The Pearl With-Profits Fund transfers the unit liability for non-profit unit-linked policies to the Non-Profit Fund.

3.4.16 The National Provident Life With-Profits Fund transfers the liability for certain *unitised* with-profits investment known as Portfolio Bond to the Pearl With-Profits Fund.

3.4.17 The London Life With-Profits Fund reinsures the basic and bonus annuity payments for the Secure Pension Plus with-profits annuity to the Pearl With-Profits Fund.

3.4.18 Annuity payments for pre 1 January 2000 pension annuities are reinsured from the National Provident Life With-Profits Fund to the Pearl With-Profits Fund.

3.4.19 Unitised with-profits element of Portfolio and Investment Bonds originally issued by NPI are reinsured from the Phoenix Life Limited Non-Profit fund to the Pearl With-Profits Fund.

3.4.20 The unit-linked liabilities for policies in the National Provident Life With-Profits Fund are reassured to the Non-Profit Fund.

3.5 Main intra group agreements

3.5.1 This document does not cover any of the intra group arrangements in respect of the former Standard Life Assurance Limited business.

3.5.2 Phoenix Life Limited has agreements with Phoenix Group Management Services (PGMS) to provide management services to the *with-profits funds*.

3.5.3 Standard Life International dac reinsures its with-profits business into Phoenix Life Limited.

3.6 Other significant arrangements

3.6.1 There are agreements between PGMS and Diligenta Limited, under which PGMS sub-contracts to Diligenta some of the services it provides for policies in the with-profits funds.

3.6.2 Where PGMS provide services to Phoenix Life Limited but have in turn outsourced provision of those services to other providers, PGMS still retains responsibility for providing all services, even in the event of a failure of these other providers. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the *with-profits funds* would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

3.6.3 Phoenix Life Limited uses its *investment managers* to provide investment management services for the *with-profits funds,* either directly or via collective investment structures. Different *investment managers* may be used for the different types of investments. The fees payable by Phoenix Life Limited under this agreement vary for each *with-profits fund* depending on asset mix. The investment management arrangements can typically be terminated with three years notice or six months if the underperformance termination clause is invoked.

3.6.4 There is an agreement with HSBC under which HSBC provides accounting and other administrative services in relation to the investments.

3.7 Management services agreements

3.7.1 This document does not cover any of the management services agreements in respect of the former Standard Life Assurance Limited business.

3.7.2 The agreements provide specified policy and corporate administration services associated with business as usual activity in return for specified charges, based on unit charges and policy volumes. The unit charges are subject to annual increases linked to movements in an external index, such as the Retail Prices Index (RPI) or National Average Earnings Index (NAE).

3.7.3 There are additional activities that the service provider will provide on request to Phoenix Life Limited. These are charged on different bases, usually related to the actual costs incurred by the service provider.

3.7.4 Costs associated with day to day administrative problems are borne by the service provider. Compensation costs for pensions review and mortgage endowment reviews remain with Phoenix Life Limited, whilst the costs for undertaking these reviews are met by either Phoenix Life Limited or the service provider, depending on the cause and the terms of each agreement.

3.7.5 Most agreements are for a set period with the option to review and continue at the end of the period. The extent to which unit charges can or will change on any review are specified in each agreement. The exception to this is the contract between Phoenix Life Limited and PGMS. In respect of the former Phoenix Assurance Limited, Bradford, Phoenix Life & Pensions, Scottish Mutual, Scottish Provident business and Phoenix & London Assurance Limited business, it is a perpetual agreement and in respect of the former Swiss Life and Pearl business it is also a perpetual agreement but under which the charges may be amended in the event of major regulatory change. It is also a perpetual agreement in respect of most of the former Britannic Assurance unitised with-profits life and pension business.

3.7.6 Termination rights are provided based only on certain specific events (such as material or persistent breach, persistent failure to meet service standards, insolvency).

3.7.7 Service levels and performance under the management services agreements are regularly reviewed.

4 Key Concepts of With-Profits Business

4.1 Workings of a With-Profits Fund

Each with-profits fund in Phoenix Life Limited is operated as a stand-alone fund. This means that on the whole, the policyholders of one fund are not affected by the state or operation of another fund. This is described in more detail in section 5.

The premiums paid in respect of each policy go into the fund, which is then used to pay out the policy benefits as defined in the policy conditions. The costs of managing the fund and tax are paid out of the fund, together with an amount each year to the shareholders, where applicable. The fund is invested in a variety of different types of investments and the return earned on these investments increases or decreases the value of the fund.

In order to help the *Board* (or the *With-Profits Committee* in the case of the SPI With-Profits Fund) to determine the level of bonuses to pay and the fair distribution of any surplus arising, *asset shares* are generally calculated. More details are given in section 4.3.

The fund is subject to a number of inherent risks that arise from a range of factors, including product design (for example the provision of guarantees to policyholders), selling and marketing practices, interest rate and market fluctuations and demographic changes. Phoenix Life Limited makes provisions which it considers to be appropriate for the risks which it identifies in relation to the business within each fund. There can be no assurance that all risks which might emerge have been identified nor that the provisions for identified risks will prove to be adequate. In addition, the risks to which the fund is exposed inevitably change over time.

4.2 Types of With-Profits Business

There are two main types of with-profits business – *traditional* and *unitised*. Details of some of the common features of these are given below. Not all *with-profits funds* contain all the different types of contract and there are also additional types of with-profits business such as *smoothed return* and *deposit administration* business. Within Phoenix Life Limited there are many different types of policies, some of which may operate differently or may have particular or special features, not all of which are referred to below.

4.2.1 ***Traditional*** **With-Profits Business**

Policies are eligible to participate in the distribution of surplus in the fund by the addition of *annual* and *final bonus*es.

Policies can be written as life or pension policies.

Life policies include endowment assurances and whole life policies.

Pension policies include retirement annuity policies where the benefit is in the form of an annuity payable from the selected retirement age and endowment type policies where the benefit is in the form of a cash sum at the selected retirement age. Endowment type policies may have an option to convert the cash sum into annuity benefits on fixed terms. For pension business on death before retirement premiums may be refunded either with or without interest, an early termination value may be paid or there may be no benefit paid, depending on the terms and conditions of the policy.

For life policies, the benefit payable at *maturity* (for endowment assurances) or on death (or, if applicable, terminal illness or critical illness) includes:

- a guaranteed amount, the sum assured;
- *annual bonuses*, which may be added to each year as part of the *annual bonus* declaration and which increase the guaranteed benefit; and
- *final bonus*, which may be added on death (or, if applicable, terminal illness or critical illness) or *maturity* claims.

Some endowment assurances have an additional sum assured that is payable on death before *maturity* but this is not eligible for bonuses. Some endowment assurances have a guaranteed minimum death benefit which is a minimum amount of benefit payable on death (but not on *maturity*). This guaranteed minimum death benefit is not eligible for bonuses.

For pension policies, the benefit at selected retirement age includes:

- a guaranteed amount, the basic annuity or a sum that will be used to purchase an annuity at retirement;
- *annual bonuses*, which may be added to each year as part of the *annual bonus* declaration and which increase the guaranteed benefit; and
- *final bonus*, which may be added on retirement (either increasing the annuity payable or increasing the cash sum available to purchase an annuity depending on the type of policy).

A proportion can be taken as a lump sum and the rest of the benefit being a reduced annuity or being used to purchase an annuity.

The death benefit for pension policies does not participate in bonuses unless the benefit is based on the early termination value.

At retirement, when the annuity comes into payment, the policy becomes non-profit and may be transferred to the Non-Profit Fund subject to the conditions in paragraph 3.1.3 or may remain in the relevant with-profits fund. Reinsured Irish business would be transferred to the SLIDAC Non-Profit Fund or remain in the relevant SLIDAC with-profits fund.

For both life and pension policies, to receive the benefit, regular premiums must be maintained except for some whole of life assurances where premiums are designed to cease at a specified age, and some policies paid by a single premium. Otherwise if premiums cease and certain criteria (that are explained in the terms and conditions of each policy) have been met:

- a *surrender value* may be paid or a transfer value may be paid to another pension provider; or
- the policy will be made paid-up and the benefits due at *maturity*, retirement or earlier death will be reduced. Depending on the policy terms, future bonuses may or may not be added.

If the criteria are not met, then the policy will lapse with no value.

Traditional with-profits business is sometimes referred to as conventional with-profits business.

4.2.2 Life Regular Premium *Unitised* With-Profits Business

A proportion of each premium less charges buys with-profits units and, where *annual bonus* is declared, either:

- the price of the with-profits units increases at the daily equivalent of the current *annual bonus* rate (but subject to any rounding in the unit prices); or
- the bonuses purchase additional units.

The benefit payable at *maturity* or on death (or, if applicable, terminal illness or critical illness) includes:

- the value of the with-profits units;
- bonus units, if applicable; and
- any *final bonus*, which may be added.

Some types of policy might have a guaranteed minimum death benefit which is a minimum amount of benefit payable on death (or, if applicable, terminal illness or critical illness), but not on *maturity*. The cost of providing the guaranteed minimum death benefit is generally met by cancelling units each month based on the sum at risk.

If premiums cease and certain criteria (that are explained in the terms and conditions of each policy) have been met:

- a *surrender value* may be paid; or
- the policy will be made paid-up and the guaranteed minimum death benefit will no longer apply.

The *surrender value* may include an element of *final bonus*. On surrender, the value of each with-profits unit and bonus unit may be reduced by the application of a *market value reduction*. If the criteria are not met then the policy will lapse with no value.

For certain policies, with-profits units can be switched to buy units in a unit-linked fund. If this is done, then the value of with-profits units will usually be calculated in the same way as for a *surrender value*.

4.2.3 Life Single Premium *Unitised* With-Profits Business

These are similar to the above, except that only one premium is payable at the start of the policy. Policies are whole of life assurance single premium bonds where the benefit is payable on death. Some policies also provide for the benefit to be payable upon surrender at a specified guarantee date or dates. The type of policy and the date at which it was taken out determines the guarantee dates applicable for that policy.

The benefit payable on surrender at a guarantee date is the same as at *maturity* above. Some policies provide for an uplifted benefit to be paid on death.

The *surrender value* (withdrawal value) for claims, at other than a guarantee date, may include an element of *final bonus*. The value of each with-profits unit and bonus unit may be reduced by the application of a *market value reduction*. Any *market value reduction* is calculated by reference to the underlying fair value and in some cases allowing for *smoothing*.

4.2.4 Pension *Unitised* With-Profits Business

Under these policies the benefit is payable at the selected retirement age or earlier death. For some policies a range of dates around the selected retirement age applies. Otherwise they are similar to life *unitised* with-profits business.

Premiums may be single or regular contributions from an employee or employer, payments for policies contracted out of the state second pension or transfers from other pension providers. The business may be split into sections, such as for contributions, for payments as a result of contracting out or for transfers in.

At retirement, the benefit is available to purchase an annuity. A proportion of the benefit can usually be taken in a cash form at retirement.

4.3 *Asset Share* Methodology

The purpose of *asset share* calculations is to assess the contribution a policy, or group of policies, has made to its with-profits fund since the policy, or policies, started. The *asset share* calculation is therefore intended to represent the effect of the historical cashflows on the fund as a result of the policy, or group of policies.

Asset shares are not normally calculated for each individual policy. Rather the *asset shares* are calculated for a limited number of specimen policies, or groups of specimen policies, and these are then taken to be representative of the business generally.

Asset shares are calculated by accumulating premiums paid at the rates of investment return earned on the assets, after allowing for charges, such as expenses, mortality and morbidity costs, cost of guarantees, cost of capital, distributions to shareholders and tax as appropriate.

The exact components of *asset share* calculations and practices relating to *asset shares* vary by the type of business. For each of the *with-profits funds* in Phoenix Life Limited, details of how *asset shares* will be calculated in the future are given in its principle 4 and the associated practices.

Asset shares are used to guide policy *payouts* and bonus declarations because they provide a good indication of the appropriate level of total *payouts* in respect of a policy or groups of policies.

Asset shares can decrease as well as increase and, at any time, may be greater or less than the contractual guaranteed benefits due under the policy.

The following table describes the possible elements credited or charged to *asset shares*.

Element		Description of Allowance
(a)	Premiums	Premiums paid under the policy
(b)	Investment return	Investment return on assets backing *asset shares* (before investment expenses)
(c)	Investment expenses	Investment expenses incurred in maintaining investments
(d)	Initial expenses	Administrative expenses incurred in setting up policies, including commissions
(e)	Renewal expenses	Administrative expenses incurred in maintaining policies and paying claims
(f)	Other expenses	Project and other one-off expenses incurred
(g)	Tax on investment return	Tax charge on investment return
(h)	Tax relief on expenses	Tax relief on expenses
(i)	Mortality & morbidity costs	Costs of providing mortality and morbidity benefits
(j)	Early terminations	Effect of surrender and lapse experience
(k)	Paid-up policies	Effect of policies becoming paid-up experience
(l)	Partial and regular withdrawals	Effect of partial and regular withdrawals during policy lifetime
(m)	Surrenders at *protected dates*	Effect of surrender at guarantee date experience
(n)	Annuity payments	Annuity payments made under the policy
(o)	Charges for the cost of guarantees	Charges for the costs of providing guarantees to both with-profits and non-profit policies in the fund
(p)	Charges for the cost of capital	Charges for the cost of providing capital to support guarantees and new business strain
(q)	Distributions to shareholders	The shareholder share of the distributed surplus
(r)	Tax on distributions to shareholders	The tax associated with the shareholder share of the distributed surplus
(s)	Profit and losses from other business	Effect of experience of other business profits and losses including from non-profit business in the fund
(t)	*Estate* distribution or charge	Future distributions from or charges to the *estate*
(u)	Exceptional items	Enhancements or charges for exceptional items

Mortality and morbidity costs reflect that the amounts payable on death or serious illness are generally more than the underlying *asset share*, but this may not always be the case and, for some products, where the underlying *asset share* exceeds the amount payable, the cost becomes negative and adds to the *asset share*.

Asset shares may take into account profit and losses from the experience of early terminations, such as surrenders and lapses and policies becoming paid-up. For example profits occur where the early termination value is less than the underlying *asset share* and conversely for losses.

The precise approach to calculating *asset shares* differs between funds, and between products within funds depending upon, amongst other things, the historical practices.

4.4 Initial *Asset Shares*

4.4.1 The initial *asset shares* used when the funds were transferred into Phoenix Life Limited were in most cases the closing *asset shares* in the transferring company. Details of how those *asset shares* were calculated are not included here. Not all the above items may necessarily have applied at all times for all types of policy in the past. Different practices, often more approximate, may have been used in the past and the practice is generally to continue to use the results of these practices when determining the effect of those years on the *asset shares* of specimen policies.

4.4.2 The calculation of the *asset shares* for certain policies as at 1 January 2006 where they did not exist previously was specified in the *2005 Scheme*.

4.4.3 *Asset shares* were calculated for all Swiss Life IB Fund endowment policyholders transferring to the 90% With-Profits Fund as at 31 December 2005 on the basis of Swiss Life's then current Principles and Practices of Financial Management. Appropriate bonus rates were then determined based on an enhancement of these *asset shares* by 100%. A bonus reserve valuation was then carried out using the bonus rates determined as above, and the resulting values were the starting point for the development of *asset shares* within the 90% With-Profits Fund from 31 December 2005.

4.4.4 *Asset shares* for Swiss Life OB Fund Pensions With Profit Fund units were calculated as at 31 December 2005 using the Principles and Practices of Financial Management of Swiss Life. The resulting values were the starting point for the development of *asset shares* within the 100% With-Profits Fund from 31 December 2005.

4.4.5 *Asset shares* for other Swiss Life OB Fund with-profits policies were calculated as at 31 December 2005 using the Principles and Practices of Financial Management of Swiss Life. The resulting *asset shares* were then scaled up to be equal to the available assets in the Swiss Life OB Fund after allowing for other liabilities, including liabilities for other policy types in accordance with the *2005 Scheme*. The resulting values were the starting point for the development of *asset shares* within the 90% With-Profits Fund from 31 December 2005.

4.4.6 For former Swiss Life policies in the 100% With-Profits Fund, the individual policy *asset share* at the date of transfer into Phoenix Life Limited was calculated using a prospective (forward looking) valuation to apportion the assets of the Swiss Life With Profit Fund between the in force policies in an appropriate manner. For former Bradford policies, the individual policy *asset share* at the date of transfer into Phoenix Life Limited was the original individual policy *asset share* increased by 88.5% to apportion the assets attributable to with-profits policies between the in force policies in an appropriate manner. In each case, from 31 December 2005 onwards these *asset shares* will be accumulated as described in this document allowing for premiums, expenses, investment returns and other items from that date forwards.

4.4.7 The calculation of the *asset shares* for Century policies as at 1 January 2007 was specified in the *2006 Scheme*.

Initial *asset shares* for Century with-profits policies were calculated using a bonus reserve valuation as at 31 December 2006 adjusted so that at that date the value of the transferring assets equalled the bonus reserve valuation liabilities of the transferring business. The bonus reserve valuation was calculated using the future bonus relationships indicated by Century's Court Order in 2001 (see paragraph 9.1.2). The bonus reserve valuation included a liability in respect of expected future shareholder transfers.

The transferring assets included the agreed value of the non-profit business which existed, prior to the *2006 Scheme*, in the Century With Profit Fund and the transfer of assets worth £2.549m to the Britannic With-Profits Fund.

The adjustment took place after assets were set aside to either improve values for surrendering policies or to smooth any anticipated discontinuities in policy *payouts* which would arise if then current *annual* and *final bonus* scales were maintained. The amounts of assets set aside were determined by the Century Board before the Effective Date of the *2006 Scheme* after taking advice from the Century With Profits Committee and the Century With Profits Actuary.

4.4.8 The calculation of the *asset shares* for the former Scottish Mutual Assurance Limited policies and former Scottish Provident Limited policies were specified at the time of demutualisation on 1 January 1992 and 1 August 2001 respectively.

5 Principles and Practices – Guiding Principles

In managing Phoenix Life Limited and its *with-profits funds*, a number of guiding principles are applied. These guiding principles are considered when applying the other principles and practices set out in this document. Should a situation arise in which there is a conflict between one or more principles or practices, the fund is managed in order that the guiding principles are applied. The guiding principles are part of the principles of financial management used in managing each fund. The guiding principles and their associated practices are shown below.

Principle 5.1 Legal Requirements

Phoenix Life Limited and its *with-profits funds* are managed in accordance with Phoenix Life Limited's then current understanding of all legal and regulatory requirements.

This includes a commitment to observe all contractual terms set out in policy documents, all guaranteed commitments and other obligations including:

- sound and prudent financial management of the *with-profits funds;*
- treating customers fairly;
- meeting solvency requirements; and
- the terms of the *2023 Scheme.*

Practices

5.1.1 Periodic valuations of the assets and liabilities of Phoenix Life Limited and each fund are carried out to establish the solvency level and the level of excess assets within a fund, if any. These valuations are currently carried out quarterly and changes from one period to the next are analysed. In between periodic valuations solvency is monitored on an approximate basis allowing for market movements and other known changes.

5.1.2 As described in section 3.2, the *Board* aims to maintain an internal margin over and above the minimum solvency standard required by the regulations.

5.1.3 If the internal margin is breached then no action will be taken to reduce the capital of Phoenix Life Limited, such as the payment of dividends, until the breach has been rectified. Immediate action to restore the internal margin will be considered. Immediate action means that changes may be made to, but are not restricted to, investment strategy, bonus declarations and *surrender values*.

5.1.4 The capital requirements and the capital available are regularly assessed and monitored to ensure that adequate levels of capital are maintained.

5.1.5 Key insurance risks and operational risks are regularly monitored.

5.1.6 Treating customers fairly from a financial perspective is achieved through the monitoring of compliance with the Principles and Practices of Financial Management.

5.1.7 The *long-term business fund* is operated in accordance with the *2023 Scheme,* (see Appendix 2). These govern practices relating to the following:

- maintenance of separate assets for each fund;
- allocation of surplus between policyholders and shareholders;
- allocation of tax between funds; and
- the *Buffer Reserve* as it affects the Britannic With-Profits Fund and the Britannic Industrial Branch Fund.

Principle 5.2 Basic Fund Concepts

Subject only to Principle 5.1, the interests of with-profits policyholders extend to, but are also limited to, the assets of the fund to which the policy belongs (other than in respect of the shareholders' entitlement to a share of the cost of bonuses as indicated in the Principles for each fund and the *Buffer Reserve* for the Britannic With-Profits Fund and Britannic Industrial Branch Fund).

Each of the *with-profits funds* is operated as a stand-alone fund and investment and bonus policy set accordingly. Separate revenue accounts and balance sheets are maintained for each fund within the *long-term business fund*.

Assets may be loaned by, or made available by a contribution arrangement with, the Non-Profit Fund and *Shareholder Fund* to eliminate any deficit in the *with-profits funds*. For the purposes of managing the funds the assets of the *with-profits funds* will be treated as being permanently increased from shareholder resources to the extent that there is no realistic prospect of the deficit being reversed. However, this does not preclude the repayment of such loans should the actual experience be such that surplus emerges and repayment becomes due under the terms of the loans.

In the highly unlikely event that the assets of any of the with-profits funds of Phoenix Life Limited, the surplus assets in the Non-Profit Fund and the surplus assets in the *Shareholder Fund* are insufficient to enable that with-profits fund to meet its guaranteed benefits, then assets from the other with-profits funds would be used, but only to the extent that such assets were not required to meet the guaranteed benefits in the other with-profits funds.

Items of income and outgo (revenue items) within Phoenix Life Limited are allocated to funds in a manner which is considered fair. The allocation methodology is regularly reviewed by the *Board* or in the case of the SPI With-Profits Fund the *With-Profits Committee*, and may change.

Premiums are directly associated with a specific policy and are allocated to the fund which contains that policy.

Separate asset pools are maintained in respect of each fund and the investment income and gains arising are allocated to originating asset pools. Policy benefits and claim payments are directly associated with a specific policy and are allocated to the fund which contains that policy.

The overall aim when apportioning expenses to different funds is to reflect the actual costs incurred in respect of each fund, always maintaining consistency with the *2023 Scheme* and with any commitments made to the *regulator*.

Expenses allocated to the *long-term business fund* which are not directly attributable to a fund, are allocated across the funds in the following way:

- Where significant value added projects are undertaken or the benefits are not clearly attributable to a particular fund, the *Board* or in the case of the SPI With-Profits Fund the *With-Profits Committee*, determines a fair and reasonable apportionment, for example in proportion to the fees paid to the outsourced service providers or in proportion to the benefits which may accrue from the expenditure or in proportion to another key driver of the cost.
- Other costs directly incurred by Phoenix Life Limited, but which are not directly incurred by a fund, are allocated in a fair and reasonable way based on the drivers of those costs.

	Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the *Shareholder Fund* or Non-Profit Fund, and the with-profits funds would only be affected if the *Shareholder Fund* or Non-Profit Fund had insufficient excess assets to bear the losses. Should the agreement with PGMS be terminated then, in circumstances where the interests of with-profits policyholders in a *with-profits fund* (or funds) had not been the cause of such termination, Phoenix Life Limited would aim to manage its business in such a way that expenses would be allocated to that (or those) *with-profits fund(s)* as if the agreement with PGMS had continued in full force, and that (or those) *with-profits fund(s)* would only be affected if the *Shareholder Fund* or Non-Profit Fund had insufficient excess assets to support this aim. Subject to Principle 5.1, the tax allocated to each of the *with-profits funds* is assessed as the amount of tax which the with-profits fund would have incurred had it been the whole of the *long-term business fund* of Phoenix Life Limited.

Practices

5.2.1 The *Buffer Reserve* is available to support the Britannic Industrial Branch Fund and the Britannic With-Profits Fund. Its mechanics are covered in sections 9.12 and 10.12.

5.2.2 Shareholder's entitlements and other potential benefits are covered in the principles and associated practices for each fund.

5.2.3 Each with-profits fund is operated as a stand-alone fund. In formulating investment and bonus policy for a particular with-profits fund, no account is taken of the availability of potential support from outside the fund, except to the extent that the *2023 Scheme* requires such consideration to be taken or support existed and was being utilised at 27 October 2023, or is drawn down in the future, or where the *Board* decides is otherwise appropriate.

5.2.4 The assets, liabilities and capital requirements of each fund are reviewed no less frequently than four times a year, using realistic assumptions and generally accepted methodologies. If the assets and liabilities are materially different action is taken. This action may include, but is not restricted to, changes to investment strategy, bonus declarations, *asset shares* and *surrender values*. In this context, materiality is determined by the *Board* or in the case of the SPI With-Profits Fund the *With-Profits Committee*.

5.2.5 In the event that the *with-profits asset value* of any of the *with-profits funds* falls below (or is likely to fall below) the *threshold amount* for that fund support will be provided to that fund by way of a loan or other contribution arrangement from the Non-Profit Fund or the *Shareholder Fund* to the extent that the *Board* determines there are assets in those funds available to make such a loan.

The loan would be repayable with the approval of the *Board* if the *with-profits asset value* is more than the *threshold amount*.

In considering whether to approve any such transfer or repayment to the *Board* shall have regard to matters including, but not limited to:

- the presumption that any support will be repaid to the extent that the *with-profits asset value* is greater than the *threshold amount,*
- the *Scheme Capital Policy,*
- the financial needs of the relevant *with-profits fund*,
- the company's duty to treat its customers fairly, and
- advice from the With-Profits Actuary.

Whether or not interest would be payable by the fund on any loan received, and the interest rate payable if applicable will vary depending on the *with-profits fund* receiving the loan.

5.2.6 In the event that any of the *with-profits funds* cannot meet its regulatory capital requirements from its own capital resources, the *With-Profits Committee* can recommend, or in the case of the SPI With-Profits Fund request, that the *Board* holds additional capital in the Non-Profit Fund or the *Shareholder Fund* to meet any shortfall. To the extent that the *Board* does not or cannot make sufficient assets available, then it will be necessary to take other actions within the relevant with-profits fund to ensure that it can meet its regulatory capital requirements from its own capital resources.

5.2.7 The assets of one with-profits fund may be used to support another with-profits fund in Phoenix Life Limited if the fund which is to provide the support has sufficient assets to cover its contractual obligations and, both the following unlikely situations prevail:

- there are no surplus assets available in the Non-Profit Fund and *Shareholder Fund*; and
- the regulatory regime has been ineffective. The regulatory regime is aimed at ensuring that life assurance companies do not become insolvent on a Companies Act basis and there are prudential margins and intervention points incorporated into the PRA's rules that are aimed at preventing this.

Similarly the assets of one with-profits fund may be required to be used to support another fund in Phoenix Life Limited if Phoenix Life Limited has become insolvent on a Companies Act basis.

5.2.8 Should a fund trigger the fund closure provisions incorporated into the *2023 Scheme*, then the fund will be closed in accordance with those provisions. See paragraphs 3.1.2. On closure of the 90% With-Profits Fund, Alba With-Profits Fund, Phoenix With-Profits Fund or the SPI With-Profits Fund, the reinsured Irish business from SLIDAC will be recaptured and transferred to the SLIDAC Non-Profit Fund.

5.2.9 Future non-profit annuities arising from policies in the *with-profits funds* may remain in the with-profits fund or, alternatively may be set up in the Non-Profit Fund using the open market option under such policies or the powers incorporated in the *2023 Scheme* to re-allocate non-profit policies. Where the latter is the case the *With-Profits Committee* will periodically review the terms to ensure that they are consistent with the fair treatment of the with-profits policyholders. See paragraph 3.1.3.

5.2.10 Other than for the non-profit annuities per paragraph 5.2.9, 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 is expected that it would be on commercial terms with the Non-Profit Fund receiving an adequate return for the risks it was taking on. If the total value of such a re-allocation exceeds a minimum size (currently £500m), then an independent actuary will normally be appointed to consider the proposed terms, unless the *With-Profits Committee* decided that the terms were clearly fair and equitable and that no such review was therefore needed.

5.2.11 The allocation of revenue items and the underlying methodology is reviewed at least once a year by the *With-Profits Committee*.

5.2.12 The allocation methods and any changes are approved by the *Board* or in the case of the SPI With-Profits Fund the *With-Profits Committee*. Changes would typically be due to:

- changes in regulations; and
- maintaining equity between the *with-profits funds* and the shareholders.

5.2.13 Most revenue account items are directly received or incurred in respect of one fund and so are directly allocated to that fund.

5.2.14 Expenses allocated to the *long-term business fund* that are directly incurred by or associated with a particular fund are allocated to that fund. This includes commission, the charges made under the Management Services Agreements by PGMS and the fees payable to the *investment managers* in connection with the management of the investments of the fund, or any fees payable to third parties for services.

5.2.15 The *Board* may approve limiting expenses charged to *asset shares* where this is felt to be fairer. Any such expenses not charged to *asset shares* will fall to the *estate*.

5.2.16 Other charges and benefits relating to business risks as described in the principles and associated practices for each fund are allocated to the relevant fund to which that risk relates as determined by the *Board* (or the *With-Profits Committee* for the SPI With-Profits Fund).

5.2.17 The *Board* (or the *With-Profits Committee* for the SPI With-Profits Fund) may also change the method of apportioning expenses between funds if it was possible to do so without ceasing to treat customers fairly and to do so assisted in meeting one of Phoenix Group's other corporate objectives. However such changes would only be made if they were consistent with the *2023 Scheme* and with any commitments made to our *regulator*.

5.2.18 Fines levied by the regulators or costs incurred on the instruction of the regulator will be charged to the *Shareholder Fund* or a particular fund within the *long-term business fund* in accordance with guidance from our *regulator* and the terms of the *2023 Scheme*.

5.2.19 In particular, actual regulatory penalties (fines) and compensation payments relating to events which occurred after 31 July 2009 are paid directly from the *Shareholder Fund* and so will impact neither *asset shares* nor the excess assets in the with-profits funds.

5.2.20 The principles and associated practices for each fund give more information on expenses and charges that are specific to that fund.

5.2.21 Tax will be attributed to each with-profits fund, so far as is practicable, on the basis that the 100% With-Profits Fund, the Scottish Mutual With-Profits Fund, the SPI With-Profits Fund, SERP Fund, London Life With-Profits Fund and National Provident Life With-Profits Fund are separate mutual life assurance companies and each of the other *with-profits funds* is a separate proprietary life assurance company.

5.2.22 The tax allocated to one or more of the *with-profits funds* may be reduced if the *Board* believes this to be necessary to treat customers fairly in accordance with *regulator's* rules.

5.2.23 If any tax benefits are allocated to a with-profits fund in accordance with paragraph 5.2.20, the *With-Profits Committee* will recommend to the *Board* whether these benefits should accrue to the *estate* or should be credited to the asset shares of policies within that fund or to the asset share of a group of policies within that fund.

5.2.24 Phoenix Life Limited has issued subordinated loan notes (debt). The *with-profits funds* are managed so that the discretionary benefits under with-profits policies are calculated and paid disregarding, to the extent necessary to treat customers fairly, any liability Phoenix Life Limited may have to make payments under these subordinated loan notes.

Principle
5.3 Fair Treatment

Phoenix Life Limited aims to treat its with-profits policyholders fairly. The approach used may involve the pooling of risks and rewards across and within policy classes and sometimes across generations of policyholders. We do not pool risks across the different *with-profits funds* in Phoenix Life Limited. Different risks may be pooled at different levels.

The overall aim when determining the bonus rates to apply to different with-profits policies is to broadly reflect the actual profits, losses and costs incurred over the lifetime of the policies, but allowing for any pooling and *smoothing*.

Costs may be recovered from policies directly, for example by the cancellation of units of *unitised* policies, or indirectly via bonuses and early termination values.

Practices

5.3.1 With-profits business in each with-profits fund is split into various types of business and classes when determining benefits and bonuses. The primary aim is to ensure fair treatment of policyholders at this broad level.

5.3.2 Risks and rewards are pooled at different levels. Some are pooled at fund level, others are pooled at type of business, class and bonus series levels.

5.3.3 Within this pooling, experience is aggregated. This aggregation includes:

- Combining large and small policies, with the only differentiation between the policy benefits being set at the policy outset via the sum assured, annuity or product charges, thus having the same bonus rates applied regardless of policy size.
- Mortality, morbidity and surrender experience are based on investigations which cover various groups and types of policies.
- *Asset share* models and assumptions contain approximations, but are not intended to prejudice the overall fair treatment of policyholders.

5.3.4 The broad level of fair treatment means some cross subsidy between different groups of policyholders, but this is an inherent feature of the with-profits business and is not considered prejudicial to the overall fair treatment of policyholders.

5.3.5 Where costs are specific to a class of policy then, allowing for approximations, such costs will be taken into account in assessing the bonuses added to that policy class and in assessing the early termination value payable.

5.3.6 Where costs are not specific to a single policy class, they will be apportioned across the policy classes to which they are relevant in a reasonable manner.

5.3.7 Implicit charges for mortality, sickness and other benefits will generally reflect Phoenix Life Limited's own or insurance industry actual claims experience. Explicit charges for such benefits will be determined in line with policy conditions and, where this requires periodic reviews in the light of experience, such reviews will be carried out and charges adjusted accordingly.

5.3.8 The way in which charges are apportioned between or allocated to policies or classes of policy and between different funds or subsidiary companies could, subject to the *2023 Scheme,* be changed if the *Board* (or the *With-Profits Committee* for the SPI With-Profits Fund) considered that this was necessary to enable it to continue to treat customers fairly.

5.3.9 Charges for guarantees or *smoothing* may be made annually or by retention from *maturity* or early termination values, or costs may impact any *estate* in the relevant *with-profits fund,* or by a combination of these methods.

5.3.10 Where the shareholder or other group companies provide services to the *with-profits funds*, they may make commercial profits from the arrangements and this will be additional to any share of bonus. Examples of such arrangements are:

- Management services agreement with PGMS.
- The terms for transfers of vesting annuities out of the *with-profits funds*.
- Interest charged on loan arrangements from the Non-Profit Fund or the *Shareholder Fund* to a with-profits fund under the capital policy. See section 3.8 Capital Policy.
- Business reassured to the Non-Profit Fund from the *with-profits funds*.

If assets are traded between a *with-profits fund* and the Non-Profit Fund or between a *with-profits fund* and the *Shareholder Fund*, then this will be done at fair value.

In addition the *with-profits funds* are charged tax as if they were stand alone entities. The Non-Profit Fund pays the difference between the tax for Phoenix Life Limited as a whole and the total allocated to the *with-profits funds*. This will normally result in the Non-Profit Fund paying a different amount of tax than if it was a stand alone entity.

Where there are material transactions that involve both shareholder and with-profits policyholder interests these are considered by the appropriate governance committees including the *With-Profits Committee* before implementation. This will include any changes to commercial arrangements with PGMS, as well as the terms of any transactions between the *with-profits funds* and the Non-Profit Fund.

6 Principles and Practices – 90% With-Profits Fund

The Principles and Practices given in sections 6.4 to 6.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the 90% With-Profits Fund. Sections 6.1 to 6.3 give background information specific to the 90% With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the 90% With-Profits Fund.

6.1 Fund History

6.1.1 The 90% With-Profits Fund comprises with-profits business that was transferred into it from Swiss Life and from Britannic Unit Linked Assurance.

6.1.2 Swiss Life ceased issuing new with-profits policies in 1992 (apart from policies arising from options on existing with-profits business). The with-profits business of Swiss Life included policies written on its own account and policies transferred in by previous court schemes from Pioneer Mutual Insurance Company and the former UK branch of Swiss Life (a company based in Switzerland). Pioneer Mutual had itself been formed through the merger of the Stamford Mutual Insurance Company, the Blackburn Assurance Company and the Pioneer Life Assurance Company.

6.1.3 The with-profits funds within Swiss Life were internally separated into three sub-funds, the OB Fund, the IB Fund and the With Profit Fund. The OB Fund contained all of the Ordinary Branch policies emanating from the former Pioneer Mutual together with any subsequent new policies of such type, including the Pension With-Profits Fund element of personal pension plan and free standing additional voluntary contribution (AVC) policies. The IB Fund contained all of the Industrial Branch policies emanating from the former Pioneer Mutual together with any subsequent new policies of such type. The With Profit Fund contained a small number of *traditional* life policies of the type that had been written prior to the merger with Pioneer Mutual.

6.1.4 Originally the with-profits (Pension With-Profits Fund) element of Libra Personal Pension Plans and similar policies was transferred to the 100% With-Profits Fund but as part of the *2009 Scheme* it was transferred to the 90% With-Profits Fund. The with-profits business in the Swiss Life OB Fund and the IB Fund was transferred into the 90% With-Profits Fund, whilst the business in the Swiss Life With Profit Fund was transferred into the 100% With-Profits Fund. See appendix paragraphs A2.3 and A2.11.

6.1.5 Britannic Unit Linked Assurance (BULA) was formed in 1982 as a wholly owned subsidiary of Britannic Assurance and until 2005 was used mainly as the vehicle for its unit-linked business with unit liabilities being passed from Britannic Assurance to Britannic Unit Linked Assurance by way of a reassurance treaty. Britannic Unit Linked Assurance wrote little business in its own right.

The life business of Allianz Cornhill Insurance plc (ACI) was transferred to Britannic Unit Linked Assurance by way of an insurance business transfer scheme in 2005. As a result of this, Britannic Unit Linked Assurance acquired the with-profits business that had previously been sold by ACI. This business was contained separately in the Britannic Unit Linked Assurance With Profits Fund and transferred to the 90% With-Profits Fund as part of the *2006 Scheme*.

6.1.6 In 2022 policies sold in Ireland were transferred to PLAE, an Irish company within the Group, and immediately reinsured back into the 90% With-Profits Fund. Subsequently from 1 January 2025 these policies transferred from PLAE to SLIDAC, another company within the Group. They remain reinsured into the 90% With-Profits Fund. SLIDAC is responsible for paying claims under these policies. For as long as the reinsurance remains in force, amounts payable to SLIDAC on these policies under the reinsurance will continue to reflect participation in the 90% With-Profits Fund at the same level as before.

6.2 Types of Business

The with-profits policies transferred from Swiss Life are mainly *traditional* endowments and whole life policies. In addition, there are a substantial number of non-profit Industrial Branch policies which are paid-up and on which the sum assured is very small in comparison to the with-profits policies.

Former Swiss Life Libra Personal Pension Plans and similar policies are written in the Non-Profit Fund. However, any investment through these contracts in former Swiss Life Pension With-Profits Fund *unitised* with-profits units is reassured to the 90% With-Profits Fund under an internal reinsurance agreement. Only the operation of the with-profits (former Pension With-Profits Fund) units is described here.

The former Britannic Unit Linked Assurance with-profits policies are mainly *traditional* endowments and whole life policies. There are some with-profits deferred annuities. When these come into payment, they no longer participate in profits (in accordance with the policy conditions) and are transferred to the Non-Profit Fund. Former Britannic Unit Linked Assurance low cost endowment policies constructed as a with-profits endowment plus term assurance are separated into those constituents, with just the with-profits component allocated to the 90% With-Profits Fund, albeit they are single policies. Other non-profit rider benefits are similarly separated. Some former Britannic Unit Linked Assurance non-profit policies have options to convert to a with-profits policy. When such options are exercised the policy and an appropriate amount of assets are transferred to the 90% With-Profits Fund.

6.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 6.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under with-profits policies is *asset share* calculations which are carried out for certain specimen policies. The amounts payable will allow for a fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es.

In putting into practice the aims set out in the guiding principles and in the application of the with-profits principles generally, various approximations are applied in a number of different areas, the major ones being described in paragraph 6.4.4. The *Board* endeavours to ensure that these approximations:

- are applied consistently;
- have a broadly neutral effect between policyholder and shareholder interests and between the different *with-profits funds*;
- where appropriate, have a broadly neutral effect over time (that is between one generation of policyholders and another); and
- for the larger classes of business, are of broadly neutral effect within that class.

This may mean that for some smaller classes of business, a different result would result if less approximate methods were used.

Any of the assumptions used in previous years (such as investment returns, charges and allocations of miscellaneous profits and losses) can be changed at any time:

- should they be shown to have been incorrect;
- should legal or regulatory change render it necessary to do so; or
- if their continued application unchanged could put at risk the achievement of the aims set out in the guiding principles in section 5.

Changes to the methods used to determine the amounts payable under a with-profits policy are controlled by:

- requesting and considering the advice of the *Chief Actuary* and the *With-Profits Actuary* and the opinion of the *With-Profits Committee* before making any changes;
- assigning to the *Chief Actuary* the executive responsibility to continue to apply the currently agreed methods until advised differently; and
- following legal or regulatory requirements to obtain independent expert input where necessary.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Bonuses can only be declared if there is surplus available for distribution.

Asset shares are only calculated for certain specimen policies for the purpose of determining the amounts payable under with-profits policies.

Should the excess assets in the fund be exhausted then we intend, if at all possible, that any further losses arising from that point onwards in respect of former Swiss Life OB Fund policies will not affect the amounts payable to former Swiss Life IB Fund policies or former Britannic Unit Linked Assurance policies in the fund.

Practices

***Asset Share* Methodology**

6.4.1 The basic method for *asset shares* calculations for with-profits business in the fund uses an apportionment of actual investment returns net of tax and the actual underlying experience.

Asset shares are generally not smoothed. In particular, the investment returns and experience elements contributing to *asset shares* are not smoothed, other than that inherent in the processes used in the derivation of the assumption or in respect of large profits and losses from other business per paragraph 6.4.2(s).

6.4.2 The following table describes the elements currently credited or charged to *asset shares* for specimen policies.

Element		*Traditional* **With-Profits Business**	*Unitised* **With-Profits Business**
(a)	Premiums	Premiums paid under the policy	Premiums paid under the policy
(b)	Investment return	Allocated return Note (b)	Allocated return Note (b)
(c)	Investment expenses	Note (c)	Implicit in product charges
(d)	Initial expenses	Actual allocated Note (d)	Implicit in product charges
(e)	Renewal expenses	Actual allocated Note (e)	Implicit in product charges Note (e)
(f)	Other expenses	Actual allocated Note (f)	Not charged Note (f)
(g)	Tax on investment return	Actual allocated Note (g)	Actual allocated Note (g)
(h)	Tax relief on expenses	Actual allocated Note (h)	Implicit in product charges
(i)	Mortality & morbidity costs	Experience Note (i)	Implicit in product charges
(j)	Early terminations	Not charged Note (j)	Not charged
(k)	Paid-up policies	Not charged	Not applicable
(l)	Partial and regular withdrawals	Not applicable	Not applicable
(m)	Surrenders at *protected dates*	Not applicable	Not applicable
(n)	Annuity payments	Not applicable	Not applicable
(o)	Charges for the cost of guarantees	Charged Note (o)	Charged Note (o)
(p)	Charges for the cost of capital	Note (p)	Charged Note (p)
(q)	Distributions to shareholders	Sometimes Note (q)	Not applicable
(r)	Tax on distributions to shareholders	Not charged	Not applicable
(s)	Profit and losses from other business	Profits or losses are credited Note (s)	Not charged
(t)	*Estate* distribution or charge	Note (t)	Note (t)
(u)	Exceptional items	Not applicable	Not applicable

Notes

(b) Investment return

This is based on the total return, income and capital gains / losses, made on the assets of the fund.

The investment strategy is described in section 6.9. In accordance with this, different proportions of each type of asset are attributed to the specimen with-profits policies. Current practice is for all specimen policies of a particular product type to have the same proportions of each type of asset. However different product types may have different proportions of each type of asset.

The return attributed to each specimen policy is then the weighted average return from each asset type using those proportions.

For former Swiss Life *traditional* with-profits policies the return on fixed interest securities will be that of the subclass of such securities issued by the UK government with a time to redemption which matches most closely the *term remaining* of the specimen policy. For former Swiss Life *unitised* with-profits policies the return on fixed interest securities is not differentiated by *term remaining* and the same return is allocated across all specimen policies. Any difference in return between UK government fixed interest securities and the other fixed interest securities within the *asset share* is applied as a uniform percentage adjustment across the fixed interest part of the *asset shares* of all policies, irrespective of the *term remaining*.

A return may be attributed on some types of asset, particularly derivative securities, to the class of policy, if any, in respect of which they have been specifically purchased.

The ratio of overseas equities to UK equities and of government guaranteed to other fixed interest securities is the same for all specimen former Britannic Unit Linked Assurance policies.

The ratio of overseas equities to UK equities and of government guaranteed to other fixed interest securities is the same for all specimen former Swiss Life policies.

(c) Investment expenses

For former Swiss Life *traditional* with-profits policies, actual investment expenses are charged based on those allocated in respect of the fund in accordance with section 6.11. For former Britannic Unit Linked Assurance policies, investment expenses are not charged to *asset shares* and investment management costs in respect of these will be borne by the excess assets within the fund.

The investment expenses are expressed as a percentage charge to be applied to the assets.

(d) Initial expenses

Initial expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 6.11.

(e) Renewal expenses

Renewal expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 6.11.

For former Swiss Life *unitised* with-profits pension policies the annual management charge of 0.875% is deducted within the *asset share* calculation.

(f) Other expenses

Project and other one-off expenses incurred are included in the actual renewal expenses charged to *asset shares*.

Significant future project, additional activity and other one-off costs will only be charged to *asset shares* following approval by the *Board*.

For former Swiss Life *traditional* with-profits business such other expenses will only apply if the additional expenses arise from major regulatory change.

(g) Tax on investment return

Tax on both income and capital gains is charged to the specimen *asset shares* of life policies. It is calculated by applying the current rates applicable to life insurance companies in respect of income and gains attributable to policyholders to the different elements of the investment return, less the tax relief on expenses at the applicable rate. Approximate allowance is made for any deferment in tax payment or relief.

No tax is currently charged to the *asset shares* of pension policies.

The tax attributable to the *asset shares* of all types of policy is subject to change should there be a change in relevant tax rules or rates.

(h) Tax relief on expenses

Tax relief due on the actual expenses charged is allowed for in those classes of business that are subject to tax. Where the tax relief in respect of expenses is deferred this is allowed for. The rates of tax relief are the average rates applicable.

(i) Mortality and morbidity costs

Amounts to cover the cost of payments in excess of *asset share* on death or illness are deducted.

Where a life policy is designed to pay a benefit on death that exceeds *asset share* at that time, an annual charge is made to cover the cost of making those enhanced payments.

The estimated annual cost of providing such benefits is determined periodically from an analysis of recent actual costs incurred and from other insurance industry and national statistics. These costs are expressed as rates dependent upon various factors including age. The charge on each specimen policy in each year is determined by applying the appropriate mortality rate to the current difference between the benefit payable on death and the *asset share*.

(j) Early terminations

It is not current practice to attribute to the *asset share* of specimen policies any differences between the amount paid on the early termination of with-profits policies and their estimated *asset share*.

(o) Charges for the cost of guarantees

For *traditional* with-profits business no explicit charge is currently made and all costs of meeting guarantees will reduce the excess assets in the fund. This does not preclude the possibility that such a charge may be introduced in the future if it was appropriate.

The costs of meeting guarantees for the unitised with-profits business is periodically assessed and any change in such expected costs that is not offset by a change in the value of the backing assets may be allocated to the asset shares through a guarantee charge.

(p) Charges for the cost of capital

No charge is currently made to the fund for the cost of capital. However, from time to time, one or more loan agreements may be in place in accordance with section 5.2. Interest at a commercial rate will be payable on such loans. Where part of such a loan is required to eliminate a deficit in the fund, then the interest payable on that part of the loan will not be charged to *asset shares*. Where part of such a loan is not required to cover a deficit, then a deduction will be made from *asset shares* to reflect the excess of the interest payable on that part of the loan above the return achieved by the fund from investing that part of the loan.

No charge is currently made to the fund for any capital that it is necessary to retain in the Non-Profit Fund and *Shareholder Fund* in order that Phoenix Life Limited continues to have adequate capital in accordance with paragraph 5.2.6.

The *asset shares* of specimen policies do not receive any credit for the return earned on excess assets held within the fund.

(q) Distributions to shareholders

The cost of distributions to shareholders resulting from the cost of bonus allocated to policies is charged to *asset shares* for former Swiss Life OB Fund bonus series C policies and former Britannic Unit Linked Assurance policies only. It is not charged for other policy types and such costs are met from the excess assets in the fund.

(s) Other business profit or losses

For former Swiss Life *traditional* with-profits policies, it is the practice to allocate an estimated amount to *asset shares* of specimen life policies in respect of any other business profits or losses arising in a year, expressed each year as an addition to the investment return.

Profits and losses from non-profit business are not currently added to *asset shares* as the only remaining non-profit policies in the fund are paid-up former with-profits policies, from which profits are expected to be minimal. Any profits or losses arising on the non-profit business will increase or reduce the excess assets in the fund.

Some larger business profits or losses may be spread over a number of future years.

The *asset shares* for former Swiss Life OB Fund policies include an allowance for a proportion of the actuarially assessed value of future profits from the non-profit business in the Swiss Life OB Fund at the date of transfer into Phoenix Life Limited calculated consistently with the *2005 Scheme*.

Expected profits or losses from changes in the proportion of ex Swiss Life IB Fund policies not expected to claim are added to or deducted from the asset shares of ex Swiss Life IB and ex Swiss Life OB life policies as miscellaneous surplus or miscellaneous losses.

Nothing is added for former Britannic Unit Linked Assurance policies.

(t) *Estate* distribution or charge

For former Swiss Life *traditional* with-profits policies and former Britannic Unit Linked Assurance policies, *asset shares* may be increased by distributions from the *estate* or reduced by charges from the *estate.* However, these *estate* distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 6.12.

Former Swiss Life *unitised* with-profits policies do not share in any *estate* distribution or charge.

6.4.3 For *traditional* with-profits policies the specimen policies are policies which are about to reach *maturity*.

Both single premium and regular premium specimen policies may be used. Specimen policies generally reflect the average size remaining in force for the year of issue. Generally specimen endowment policies of the terms which contain a significant volume of policies are used. For other terms approximations may be used. Where *final bonus* rates are shared by policies of different years of issue or different premium types, the specimen policies may be grouped or otherwise averaged.

Asset shares are generally not calculated for specimen whole of life, altered and paid-up policies, though may be for former Britannic Unit Linked Assurance policies. As a result the target ranges described in sections 6.6 and 6.8 do not apply to policies of these types.

For *unitised* with-profits pensions business, the specimen policies referred to are tranches of units issued within calendar years to give *final bonus* rates which are applied to units within the policy.

6.4.4 Various approximations are inherent in the *asset share* method described above and in the general applications of the principles in practice. These include:

- Investment returns are calculated monthly but may be applied uniformly over the period within the model which is usually quarterly or six-monthly.
- The investment return itself is only calculated approximately during the course of a year (by the use of appropriate indices) and is updated after the end of each year to reflect the actual performance earned.
- Carrying out the calculations (and hence changing *final bonus* rates) only infrequently (such as twice a year or annually),
- An inevitable time delay before actual experience is reflected in bonus rates and their application to policies,
- The use of bonus rates determined using a specimen policy of one type to policies of another type (such as the use of *final bonus* rates determined for standard endowment policies for some whole of life policies).

- Where the premium rate for a specimen policy changed in the middle of a year of issue, the *final bonus* may be based on either the pre or the post change rate.
- The use of specimen policies will usually mean that small premium policies receive more than *asset share* per unit premium (as many administration costs are independent of premium size) and large premium policies less.
- The use of specimen policies only for selected terms of policy and the interpolation of *final bonus* rates for intermediate terms will mean that the amounts paid on policies of those intermediate terms will not necessarily equal the target proportion of *asset share*. Similarly the *final bonus* rate calculated for the longest term specimen policy is applied to any policies that claim after a longer term.
- For policies, which have earlier been made paid-up, the use of *final bonus* rates applicable to policies, which have been premium paying throughout. Or, alternatively, the application to both types of policy of *final bonus* rates calculated using both model paid-up policies and model premium paying throughout policies. Similarly bonuses will only be approximate for policies that have been altered in other ways.
- Determining bonus rates by reference to *asset shares* is a relatively recent development. Most of the in force *traditional* life policies commenced before such an approach was established practice. When the *asset share* basis was implemented it was necessary to quantify such items as investment returns, investment mixes, expenses and business profits from many years into the past. Best endeavours were made using all available historic information but some of the amounts are inevitably best estimates rather than accurate amounts.
- Profits or losses arising from policies that were formerly in the Swiss Life IB Fund are particularly difficult to assess as many deaths that occur are not notified, or are notified at a later date.
- For former Swiss Life IB Fund policies, premium tax relief and associated increased sums assured and relief sums assured are allowed for in an approximate manner.

Some of these approximations, as well as others not listed, will also be present in the calculations of the excess assets of the fund from time to time.

6.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in section 6.12.

6.4.6 Documented procedures exist that set out how the *asset share* calculations described above are to be carried out and how the parameters to be used in the calculation are to be derived each year. A permanent record is kept of the historic parameters used. Some of the instructions for the detailed computations are embedded within a number of computer programs.

6.4.7 Any change to the practices used, including those used to determine the excess assets in the fund, would be subject to the procedure described in principle 6.4.

Any material changes to the historical parameters used would, if a result of the identification of a past inaccuracy, be notified to the *Board* and the *With-Profits Committee* at the time of the next recommended change in bonus rates. If considered appropriate, any changes may be phased in over a period rather than implemented at once.

Any proposed changes to the historical parameters for other reasons would be subject to the same processes as a change in practice.

6.4.8 *Asset share* practices are not guaranteed and may be changed in future.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

6.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

6.4.10 The amount payable on *traditional* with-profits policies on *maturity* is the total of:
- the sum assured;
- the *annual bonuses* added whilst the policy has been in force; and
- *final bonus*, if any.

The amount payable at *maturity* on former Swiss Life Pension With-Profits Fund investments is the total of:
- the value of the with-profits units; and
- *final bonus*, if any.

The rate, if any, of *final bonus* which applies to a particular policy class, date of issue and date of *maturity* or retirement is currently determined in most cases with reference to the *asset share* of a representative range of specimen policies.

6.4.11 Bonuses are reviewed regularly at least once a year.

The timing of *annual bonus* reviews is described in paragraph 6.5.4.

The timing of *final bonus* reviews is described in paragraph 6.6.8.

6.4.12 The timing of *final bonus* declarations may be varied.

6.4.13 *Final bonus*es are expected to, but are not guaranteed to, apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. Additional reviews would normally only be in response to exceptional investment market movements.

6.4.14 *Final bonus* reviews also affect the amount of *final bonus* paid on *non-protected exits* (surrenders) for policies where the *surrender value* calculation makes explicit use of the current *final bonus* scale.

6.4.15 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared.

Principle 6.5	***Annual Bonus* Rates**
	If the value of assets is more than reasonably sufficient to enable the fund to meet the aims described in the guiding principles in section 5, then *annual bonuses* are likely to be added. In circumstances where the value of assets is fairly close to the minimum amount required to enable the fund to meet the aims described in the guiding principles, low or nil rates of *annual bonus* are likely to be added for most classes of with-profits policy. Conversely, if the value of assets is more than reasonably sufficient, higher rates of *annual bonus* are likely to be added for many classes. Separate *annual bonus* rates are applied to different policy classes to reflect the different aspects of the products, including tax treatment, country of issue, form of benefit and extent of guaranteed benefit. Currently there is no differentiation between different dates of issue, although this may be done in the future if it helped to better satisfy the aims described in the guiding principles in section 5. Although most classes of new business are no longer accepted, other than under options on existing policies, alternative products might at some time be introduced into which existing customers could switch their benefits at their discretion, which might receive different bonus rates.

Practices

6.5.1 *Annual bonus* rates currently take the form set out in the tables below. There are linkages applying to the rates on different types of former Swiss Life *traditional* with-profits policies issued prior to 21 May 1974 and these are also set out below.

Former Swiss Life OB Fund business		
Bonus series	**Policies included**	**Bonus type**
Stamford	Policies issued on or before 20 May 1974 that were then insured by Stamford Mutual	Simple. A percentage applied to the sum assured only. The rate is expressed as R per £100 sum assured for linkage purposes.
Blackburn	Policies issued on or before 20 May 1974 that were then insured by Blackburn	Simple. A percentage applied to the sum assured only. The rate is determined as 1.5 x R – 0.10 per £100 sum assured.
Pioneer Life Simple	Policies issued on or before 20 May 1974 that were then insured by Pioneer Life and entitled to the standard rate of simple bonus	Simple. A percentage applied to the sum assured or annuity only. The rate is determined as 1.5 x R + 0.30 per £100 sum assured.
Pioneer Life Double	Policies issued on or before 20 May 1974 that were then insured by Pioneer Life and entitled to twice the standard rate of simple bonus	Simple. A percentage applied to the sum assured only. The percentage is double that applied to the Pioneer Life Simple.

Former Swiss Life OB Fund business (continued)		
Bonus series	**Policies included**	**Bonus type**
Pioneer Life Compound	Policies issued on or before 20 May 1974 that were then insured by Pioneer Life and entitled to compound bonus	Compound. A single percentage applying to both the sum assured or annuity and the attaching bonus. The rate is determined as the lesser of R + 1.30 or 1.5 x R + 0.30 per £100 sum assured and bonuses.
Series A	Policies issued by Pioneer Mutual between 21 May 1974 and 31 December 1990 and originally receiving simple bonus	Simple. A percentage applied to the sum assured only.
Series B	Policies issued by Pioneer Mutual between 21 May 1974 and 31 December 1990 and originally receiving compound bonus	Compound. A single percentage applying to both the sum assured and the attaching bonus.
Series C	Policies issued by Swiss Pioneer Life or Swiss Life (UK) on or after 1 January 1991	Compound. A single percentage applying to both the sum assured and the attaching bonus.

Former Swiss Life IB Fund business		
Bonus series	**Policies included**	**Bonus type**
M	Policies issued by Pioneer Mutual from 21 May 1974	Simple. A percentage applied to the sum assured only.
S	Policies with periodical cash payments issued on or before 20 May 1974 that were then insured by Stamford Mutual	Simple. A percentage applied to the sum assured only. The rate is one half of the rate for the former Swiss Life IB bonus series A.
B	Policies with periodical cash payments issued on or before 20 May 1974 that were then insured by Blackburn	Simple. A percentage applied to the sum assured only. The rate is the same as for the former Swiss Life IB bonus series A.
P	Policies with periodical cash payments issued on or before 20 May 1974 that were then insured by Pioneer Life	Simple. A percentage applied to the sum assured only. The rate is the same as for the former Swiss Life IB bonus series A.
A	All other policies issued on or before 20 May 1974	Simple. A percentage applied to the sum assured only.

Former Swiss Life Pension With-Profits Fund business		
Bonus series	**Policies included**	**Bonus type**
Pension With-Profits Fund	All policies with an investment in the former Swiss Life Pension With-Profits Fund.	Compound. Bonus is added as an increase in the unit price.

Former BULA policies		
Bonus series	**Policies included**	**Bonus type**
Life	All life policies	Compound. Different percentages applying to both sum assured and the attaching bonus.
Pension	All pension policies	Compound. Different percentages applying to both fund and the attaching bonus.

For all policy types the circumstances most likely to generate future increases in *annual bonus* rates would be favourable future investment performance.

6.5.2 For each class of business, the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target. For *unitised* with-profits pension policies, there is a guaranteed minimum *annual bonus* rate of 4.00%.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

6.5.3 Where the financial position of the fund is weak the *Board* may decide not to increase the *annual bonus,* or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus buffer* being above the 25% target.

6.5.4 Currently for *traditional* with-profits business *annual bonus* rates are reviewed towards the end of each year, with changes taking effect from 1 January for other than former Britannic Unit Linked Assurance policies where changes take effect from 1 April for the previous calendar year. However, rates may be reviewed at other times should the *Board* consider this to be necessary to continue to adhere to the principles.

Currently for *unitised* with-profits business *annual bonus* rates are reviewed in time for the new rates to take effect from the 1 January.

6.5.5 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

6.5.6 For former Swiss Life IB Fund policies, the increased sum assured arising from the premium tax relief is increased each year after considering changes in the RPI index and short term interest rates.

Principle 6.6	***Final Bonus* Rates**
	Subject to the guiding principles set out in section 5, *final bonus* may be added to policies when they terminate or when benefits are encashed for other purposes, with the aim of ensuring, if they do not already do so, that benefits reflect fairly a share in the profits (and losses) which have been generated within the fund whilst the policy has been in force. Separate *final bonus* rates are applied to different policy classes to reflect the different aspects of the products, including tax treatment, country of issue, form of benefit and extent of guaranteed benefit (although not the presence or absence of guaranteed annuity options). For most policy classes, differentiation is also made between different dates of issue and different periods in force. On death and on early termination, the *final bonus* added may be higher or lower than indicated above, for reasons explained in the practices.

Practices

6.6.1 For each specimen policy, we determine a proportion of *asset share* that it is appropriate to use to best meet the guiding principles. This proportion will vary from time to time, may be greater or less than 100% and may vary by class of policy, date of issue, *term remaining* to a date at which a guarantee or option applies or other relevant factor.

For each specimen policy the following are compared:

(i) the appropriate proportion of each specimen policy's *asset share* (the *asset share* for this purpose being inclusive of any enhancement as described in paragraph 6.4.2); and

(ii) the total of the sum assured and the *annual bonuses* already added to that specimen policy (or the value of units for a *unitised* policy).

If (i) is the larger, then a *final bonus* is normally set for the specimen policy using the methods described below. If (ii) is the larger, then no *final bonus* will normally be set for that specimen policy.

The target for the proportion in (i) above is 100%. The proportion used for particular specimen policies may be affected by *smoothing* (see section 6.7). The aim is to maintain the proportions in (i) within the range 80% to 120% for most specimen policies before the effects of *smoothing*.

For each specimen policy where a *final bonus* is to be set, the excess of (i) over (ii), after any *smoothing*, is expressed as set out in the tables below.

Former Swiss Life OB Fund business		
Bonus series	**Policies included**	**Excess of (i) over (ii) expressed as:**
Stamford	Policies issued on or before 20 May 1974 that were then insured by Stamford Mutual	A percentage of the sum assured
Blackburn	Policies issued on or before 20 May 1974 that were then insured by Blackburn	A percentage of the sum assured

Former Swiss Life OB Fund business (continued)		
Bonus series	**Policies included**	**Excess of (i) over (ii) expressed as:**
Pioneer Life Simple	Policies issued on or before 20 May 1974 that were then insured by Pioneer Life and entitled to the standard rate of simple bonus	A percentage of the sum assured or annuity
Pioneer Life Double	Policies issued on or before 20 May 1974 that were then insured by Pioneer Life and entitled to twice the standard rate of simple bonus	A percentage of the sum assured
Pioneer Life Compound	Policies issued on or before 20 May 1974 that were then insured by Pioneer Life and entitled to compound bonus	A percentage of the sum assured or annuity and attaching *annual bonus*
Series A	Policies issued by Pioneer Mutual between 21 May 1974 and 31 December 1990 and originally receiving simple bonus	A percentage of the attaching *annual bonus* for each year in force as a with-profits policy, subject to the exclusion of a number of years.
Series B	Policies issued by Pioneer Mutual between 21 May 1974 and 31 December 1990 and originally receiving compound bonus	A percentage of the sum assured and attaching *annual bonus* for each year in force as a with-profits policy, subject to the exclusion of a number of years.
Series C	Policies issued by Swiss Pioneer Life or Swiss Life (UK) on or after 1 January 1991	A percentage of the sum assured and attaching *annual bonus* for each year in force as a with-profits policy, subject to the exclusion of a number of years.

Former Swiss Life IB Fund business		
Bonus series	**Policies included**	**Excess of (i) over (ii) expressed as:**
M, S, B, P and A	All policies	The amount required to make the total bonus, including *annual bonus* but excluding the special bonus declared at 31 December 1990, equal to a specified percentage of the sum assured for each complete year the policy has been in force, subject to a maximum number of years.

Former Swiss Life Pension With-Profits Fund business		
Bonus series	**Policies included**	**Excess of (i) over (ii) expressed as:**
Pension With-Profits Fund	All policies with an investment in the former Swiss Life Pension With-Profits Fund	A percentage of the value of units

Former BULA business		
Bonus series	**Policies included**	**Excess of (i) over (ii) expressed as:**
Life endowments	All life endowment policies	A percentage of the sum assured and attaching *annual bonus*.
Life whole life	All whole life policies	A percentage of the sum assured and attaching *annual bonus*.
Pensions	All pension policies	A percentage of the fund and attaching *annual bonus*.

This is then the new *final bonus* rate for all policies of the same type and duration in force as the specimen policy.

Where a rate is not derived for every duration, the rates applicable for other durations are determined by interpolation or extrapolation between the rates derived as above.

6.6.2 For former Swiss Life OB Fund business, the *final bonus* rates are determined based on a linkage between bonus rates declared in respect of different bonus series applying to business issued prior to 21 May 1974. The linkage is based on the rate declared on Stamford policies, represented by T in the table below.

Bonus linkage for policies issued prior to 21 May 1974		
Bonus series	**Amount payable**	***Final Bonus* based on each**
Stamford	T	£100 original sum assured
Blackburn	1.5 x T	£100 original sum assured
Pioneer simple	1.5 x T	£100 original sum assured
Pioneer double	3.0 x T	£100 original sum assured
Pioneer compound	T	£100 original sum assured and attaching *annual bonus*

6.6.3 For former Swiss Life IB Fund business, *final bonus* rates for business issued prior to 21 May 1974, that is bonus series A, B, P and S, are subject to a minimum rate based on the *annual bonus* rate declared for former Swiss Life IB Fund bonus series A as set out in the table below.

Minimum *final bonus* rates for bonus series A, B, P and S if the *annual bonus* rate for bonus series A is at least 1.25%		
Complete years in force	**Bonus Series A, B and P (% of sum assured)**	**Bonus Series S (% of sum assured)**
20 – 24 years	40%	20%
25 – 29 years	50%	25%
30 – 34 years	60%	30%
35 – 39 years	70%	35%
40 – 44 years	80%	40%
45 – 49 years	90%	45%
50 – 54 years	100%	50%
55 – 59 years	110%	55%
60 – 64 years	120%	60%
65 years or more	130%	65%

If the *annual bonus* rate for bonus series A is less than 1.25%, then the minimum *final bonus* rates for bonus series A, B, P and S are reduced in proportion.

6.6.4 For former Swiss Life IB Fund business entitled to periodic cash payments, a *final bonus* is declared on each cash payment. *Final bonus* rate changes are prorated based on changes in the normal former Swiss Life IB Fund business *final bonus* rates, except that there is a linkage between the *annual bonus* rate declared for former Swiss Life IB Fund bonus series A and the minimum *final bonus* rates on periodic cash payments for series B, P and S.

The linkage is based on the *annual bonus* rate for series A. If this is at least 1.25%, then the minimum *final bonus* rates for series B, P and S are as set out in the table below.

Minimum *final bonus* rate on cash payments for bonus series B, P and S if the *annual bonus* rate for bonus series A is at least 1.25%	
Cash payment policy type	***Final bonus* rate (% of cash payment)**
Bonus series S and B, with cash payments every 10 years	10.0%
Bonus series S and B – other	5.0%
Bonus series P, in force for 20 - 24 years	10.0%
Bonus series P, in force for 25 - 29 years	12.5%
Bonus series P, in force for 30 years or more	15.0%

If the *annual bonus* rate for bonus series A is less than 1.25%, then the minimum *final bonus* rates on cash payments for bonus series B, P and S are reduced in proportion.

6.6.5 For former Swiss Life *unitised* with-profits Pension With-Profits Fund policies, the *final bonus* rate is currently differentiated by the calendar year in which the units were issued.

Final bonus and a *market value reduction* may apply at the same time to former Swiss Life *unitised* with-profits Pension With-Profits Fund units.

6.6.6 For former Britannic Unit Linked Assurance policies, *final bonus*es take the form of a percentage increase in the total payable from the sum assured and *annual bonuses*. Different rates are used for pension policies, whole life policies, and for endowment policies where a scale of rates depending on policy term is used to broadly reflect the differences in *asset shares* between those groups.

6.6.7 Other than for former Britannic Unit Linked Assurance whole life policies, *final bonus* is paid on death claims on *traditional* whole life and endowment policies at the rate that applied to endowment policies which commenced at the same time and reached *maturity* at the date of death.

For former Britannic Unit Linked Assurance whole life policies, the *final bonus* is calculated to distribute the excess, if any, of the *asset shares* over the sum assured and declared *annual bonuses*.

For *unitised* with-profits policies, the *final bonus* scale applies on a death claim.

6.6.8 For all classes of policy *final bonus* rates may be changed at any time. At times when the value of the excess assets in the fund is not changing rapidly, this is likely to mean that changes, if any, are made one or two times per year, normally from 1 January and 1 July. However, a sudden change in the value of those excess assets (such as because of a significant change in the value of equity share markets) may cause *final bonus* rates to be changed on other occasions. Changes to *surrender* and transfer values may be less frequent than changes to *final bonus* rates for maturities.

6.6.9 As the value of assets change every day but *final bonus* rates are only recalculated infrequently, there will frequently and inevitably be times when, if *asset shares* were recalculated for the specimen policies, then *final bonus*es would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the proportion of *asset shares* at the latest *final bonus* review was near the top or bottom of the range described in paragraph 6.6.1, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle 6.7 ***Smoothing***

Smoothing refers to the practice of limiting the change in *final bonus* rates on any one occasion so that the benefits paid to policyholders differ from those which would otherwise apply and also to the practice of limiting the frequency of such changes. *Smoothing* means that the value on similar policies maturing at different times either vary little (between changes in *final bonus* rates) or change by no more than a specified amount over a given period. *Smoothing* is applied to all classes of policy which are eligible for *final bonus* and to all types of claim. However, more frequent and generally smaller changes are made to some classes of *unitised* with-profits policies.

Smoothing is intended to have a neutral effect over time. In other words, if applying the limitation on changes in the rate of *final bonus*, results for a period in different amounts of discretionary benefits than would otherwise have been paid, then in a subsequent period discretionary benefits would be adjusted by a broadly equal and opposite amount when circumstances and the practices allow.

Other than on death or early termination, the aim at all times is to pay policy benefits that are close to those described under section 6.6. Accordingly, *smoothing* is limited and *final bonus* rates and total policy benefits may change by relatively large amounts both on any one occasion and over a 12 month or longer period. The cost of *smoothing* is not expected to be material at any time and so no specific upper limit is imposed on it.

The *smoothing* principles also generally underlie the *market value reductions*, which may apply to the *unitised* policies. However, these principles are not necessarily applied when determining the amount payable on *traditional* policies, which are terminated significantly early.

Practices

6.7.1 For all classes of policy where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* or retirement values, it is done by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* classes of policy where *surrender value* bases changes are normally made twice a year, *smoothing* is applied by limiting the change in the immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as *term remaining* which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5, larger changes in *final bonus* rates and *surrender values* will sometimes be made.

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing*. Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules,

6.7.2 The period over which *smoothing* will be of neutral effect on a class of policies is indirectly determined by the application of the above practices.

6.7.3 Applying *smoothing* does mean that on occasions more or less than the target proportion of *asset share* is paid out. This difference will reduce or increase the excess assets of the fund. There is no particular maximum accumulated cost of or benefit to the fund, which is allowed, although no *smoothing* accumulation would be allowed to build up which was inconsistent with the achievements of the objectives set out in the guiding principles in section 5.

6.7.4 For *traditional* with-profits policies the approach to *surrender values* described in section 6.8 depends upon a number of factors. In some cases, changes in these factors may lead to quite large proportionate changes in values for policies with a long time to go to *maturity* or retirement. *Smoothing* is not necessarily applied to these changes. These changes may also take place at different times to the changes in *final bonus* rates. Where the method uses the *final bonus* rates payable at *maturity* or retirement on other policies, the *final bonus* rates will allow for *smoothing* as described in paragraph 6.7.1.

6.7.5 For *unitised* with-profits business, *surrender values* will target a proportion of *asset share*, as described in section 6.8. *Surrender values* on *unitised* policies may be subject to the application of a *market value reduction*. *Market value reductions* are regularly reviewed, at least monthly and may be revised to reflect market movements between normal *final bonus* reviews. Also it is probable that during a period of adverse conditions, *unitised final bonuses* might be changed sooner and possibly also more frequently than might apply to the *traditional* business.

6.7.6 Any cost to the fund of payments under *unitised* with-profits pension policies to which a *market value reduction* does not apply, does not affect the remaining value of the policies concerned. Rather, it reduces the value of the excess assets in the fund (although the value of the excess assets in the fund is increased by any deductions made from *asset shares* for guarantees as described in paragraph 6.4.2(o)).

Principle
6.8 ***Surrender Values***

The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies or groups of specimen policies in aggregate achieve a target *payout ratio* over time.

Practices

6.8.1 *Non-protected exits* refer to surrenders and transfers for pension business.

6.8.2 For *traditional* policies that surrender early, the aim is to make payments that are in aggregate and over time, across all specimen policies that are used for determining surrender bases, the targeted proportion of *asset share*. This proportion is currently 100%.

6.8.3 Actual surrender payments on individual policies will not generally be in line with the target proportion because:

- Individual *asset shares* are not calculated or held on the administration systems for use in *surrender value* calculations. Rather *surrender values* are calculated in a variety of ways for different types of policy. Typically *surrender values* are based on a discounted value of the guaranteed sum at *maturity* or retirement (reduced to allow for non-payment of future premiums in the case of annual premium policies) including attaching *annual bonus*, together with an allowance, where appropriate for *final bonus*.
- Specimen policies are used to determine the parameters in the *surrender value* calculations. The outcome for a particular individual policy may be different from that of the specimen policy.
- There are a limited number of parameters that may be altered in the surrender formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.
- As the value of assets are changing every day but the parameters in the *surrender value* formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were to be recalculated, then it would be found that, in effect, *surrender values* were being based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate.

6.8.4 For the reasons given above, it is expected that *surrender values*, when expressed as a proportion of *asset share*, will fall in a wide range around the target proportion. However, the parameters in the *surrender value* bases are reviewed periodically with the aim that the majority of *surrender values* for the range of specimen policies that are analysed, will fall within the range of 80% to 120% of *asset share*, before the effects of *smoothing*.

6.8.5 In some cases, values in excess of the upper limit of the range may be payable when policies are surrendered close to *maturity* and the *asset share* of the relevant specimen policy is less than the guaranteed benefits at *maturity*, or the *maturity payout* is in excess of the *asset share* due to *smoothing*.

6.8.6 For *traditional* with-profits policies the method used to derive the *surrender* or transfer value may not involve the explicit application of *final bonus*. Where the value paid is larger than the discounted value of the guaranteed sum assured and *annual bonuses* already added, an element equivalent to *final bonus* will be implicit in the value. For the purposes of determining the shareholder's entitlement to profit in respect of any surrender or transfer, it may be deemed an appropriate proportion of the value paid as representing *final bonus*.

6.8.7 For *unitised* policies, a *market value reduction* will be applied to claims in respect of full or partial discontinuances or special benefit enhancements in most circumstances where the calculation described in section 6.6 results in a shortfall of the determined proportion of *asset share* (after any guarantee charge described in 6.4.2(o)) relative to the value of units. The amount of the *market value reduction* will not exceed the amount of the shortfall. As the value of assets are changing every day but *market value reductions* are only reviewed periodically, there will inevitably often be times when, if the *asset share* for the specimen policies were to be recalculated then *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10%, compared to that assumed when *market value reductions* were last reviewed, would be allowed before there would be an additional *market value reduction* review.

6.8.8 *Final bonus* on surrenders are normally reviewed and changed with the same frequency as *final bonus* rates for the relevant policy type (see paragraph 6.6.8) although reviews and changes for *traditional* life policies may sometimes be less frequent or implemented later than the corresponding *final bonus* rate change. Where bulk surrenders of *unitised* with-profits pension policies are being made at a time when investment values are falling then *market value reductions* may be reviewed more frequently. For former Swiss Life Pension With-Profits Fund units, *market value reductions* are reviewed on a regular basis, usually monthly.

6.8.9 The percentages described in paragraphs 6.8.2 and 6.8.4 may be changed at any time, as may the methods of calculation. However, before any changes are made, the *Board* will formally consult with and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee*.

Principle 6.9 **Investment Strategy**

Overall, the strategy will be to invest in fixed interest securities but with exposure to equity shares and commercial property, either directly or through vehicles such as unit trusts, OEICS or derivatives when and to the extent to which this is possible without unduly putting at risk the fund's ability to meet guaranteed benefits as they arise. Although the assets are invested and managed as a single pool, different investment returns may be apportioned to different groups of policies as described below. The returns attributed to former BULA policies will reflect an exposure to volatile assets that is consistent with past practice. Some cash or equivalent assets will be held for liquidity purposes. For former Swiss Life policies when the assets in the fund are significantly in excess of the value of the guaranteed benefits then the exposure to equity and property investments could be high and the exposure to such assets could significantly exceed the exposure to fixed interest securities.

From time to time assets outside the fund may be relied upon to provide some or all of a margin against future adverse change in investment markets. The investment strategy is, however, based upon the intention that the fund will meet its aims using only the assets of the fund after repayment of any loans or other financial support received.

Derivatives may be used from time to time to make changes in investment dispositions more rapidly or cheaply than could be done directly through the markets. They may also be used from time to time to reduce the risk of loss, for example from share price falls, interest rate changes or exchange rate fluctuations.

The proportion of shares and property deemed to be held for the purpose of allocating investment returns may differ between different products, between originating company, dates of issue or terms remaining to reflect the different risks to both the specific policyholders and to policyholders and the shareholder more generally. For some with-profits policies with relatively high guaranteed benefits, this may mean that no returns on shares or property will be allocated. The proportion of shares and property deemed to be allocated to different groups of policies will in aggregate be broadly consistent with amount of equity and property investments held, excluding any such investments deemed to form part the excess assets, if any. Fixed interest securities are broadly matched to the *term remaining*.

Non-profit, non-linked policies are backed by fixed interest securities of appropriate duration.

The maximum loss, which the fund could suffer from the complete default of any one external counterparty, is limited whether through reinsurance, direct investment, stock lending or derivatives by dealing with a wide range of counterparties. This usually means that the total exposure to any one counterparty is significantly below the maximum levels for which value may be taken under our *regulator's* rules. In some cases, additional precautions such as daily *marking to market* with *deposit back* are used.

Larger, unprotected exposures are permitted to sister companies (regulated UK life insurers) through internal reinsurance arrangements.

There are no assets that are not expected to be traded should that be an appropriate investment decision.

Practices

6.9.1 The investment strategy is regularly reviewed taking account of a variety of considerations, including our approach to *responsible investment*. In particular, reports from the *investment managers*, the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee,* and recommendations for change are considered and, if appropriate, implemented.

6.9.2 Guarantees to policyholders and liabilities to other creditors are not completely matched with assets that provide a similar guarantee or payment. In particular, a proportion of the assets is invested in equity shares and commercial property because it is considered that, over most longer periods of time, a better return will result. There are separate investment strategies for assets equal in amount to the aggregate *asset shares* of policies and for assets representing additional provisions for liabilities under non-profit policies, for guarantees on with-profits policies, for other liabilities and for the capital margins and excess capital. Each of these strategies is described in more detail below.

It is not possible to implement the strategies described below with absolute precision and any difference between the actual outcome and the theoretical outcome may be treated as described in paragraph 6.4.2(s).

Asset Shares

6.9.3 It is the current practice that all specimen policies of a particular class will be deemed to have the same asset mix in that the *asset shares* for all specimen policies within a class will be deemed to be invested in the same proportions of equity shares, property, fixed interest and other investments.

The asset mix will however vary by product class to reflect both the past practice and the differing nature of the guarantees given.

For former Swiss Life policies, the fixed interest assets attributed to a specimen policy will reflect the *term remaining* of that policy other than former Swiss Life Pension With-Profits Fund policies. Returns on emerging market debt do not reflect the *term remaining*, but rather reflect the overall return on such debt.

The aim is to maintain a reasonable degree of similarity between the overall duration of the fixed interest assets and the overall duration of the liabilities.

If the value of assets in the fund is more than reasonably sufficient to enable the fund to meet its aims as described in section 5, then the overall proportion of shares and property is likely to be significant. Conversely in circumstances where the value of assets is fairly close to the minimum amount required, the overall proportion of shares and property is generally likely to be low.

It is the intention that the proportion invested in equities will be reduced from current levels over time to reflect the increasing *maturity* of the business. This will be a gradual process over many years. For former Swiss Life policies a reasonably significant exposure to equities will remain. The equity exposure for former Britannic Unit Linked Assurance business will be lower reflecting past practice.

In future other changes may be made to the equity exposure for different classes of policy, or for sub-groups of policies within a class. However any such changes to the equity exposure will be made by reference the factors referred to in Principle 6.9 that is the date of issue, the *term remaining* and the level of the guaranteed benefits. Currently there is no intention to change the equity exposure for different groups or sub-groups of policies other than to reflect these factors.

6.9.4 All policies are grouped according to the specimen policy that most closely represents them and the total *asset share* for each group is determined. That total is then invested in the proportions determined for the specimen according to the rules in paragraph 6.9.3.

6.9.5 The guideline asset mix range for *asset shares* is:

	Former Swiss Life business	**Former Britannic Unit Linked Assurance business**
Fixed interest and cash	40% to 55%	65% to 75%
Equities including *private equity* and *alternative assets*	40% to 55%	25% to 35%
Property	0% to 10%	0% to 10%

From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*. For former Swiss Life business, and former Britannic Unit Linked Assurance business, the equity investments will be a mixture of UK and overseas shares, including emerging markets and may also include *private equity* and *alternative assets* such as hedge funds. Fixed interest assets will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt.

Sufficient assets would be disposable at short notice without material loss in value to meet foreseeable additional liquidity requirements.

The agreements with the *investment managers* set out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single company.
- The maximum amount that can be invested in any single asset class / industry sector / country.
- The maximum amount to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns. (These include restrictions in terms of credit quality, term/duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moody's).
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

Guarantee Reserves

6.9.6 Guarantee reserves are the additional reserves that are necessary, over and above the *asset share*, to ensure that guaranteed benefits can be met. The current practice is to invest the assets covering the guarantee reserves in a long position in fixed interest investments and a short position in equities. This aims to provide a broad match as the guarantee reserves will tend to increase or reduce as the value of the equity investments within the *asset share* fall or rise with market movements. The matching will not be perfect and any surpluses or shortfalls arising from this mismatch will act to reduce or increase amount of excess assets in the fund. The assets backing guarantee reserves will be periodically reassessed.

Other Liabilities and Excess Assets

6.9.7 Assets representing short-term liabilities are invested in cash or short-term debt. Assets representing the reserves for non-profit policies are invested in fixed interest securities of appropriate duration. Assets representing the *estate* of the 90% With-Profits Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth investments in line with the asset mix for the *asset shares*.

Miscellaneous

6.9.8 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

6.9.9 The fund does not hold any assets which are *not normally traded*.

6.9.10 Before investing in new or novel investment instruments, the *Board* would obtain the advice of the *Chief Actuary* and of the *investment managers* on the benefits and risks of the proposition. This would include an analysis of the nature and proportion of future outcomes in which the instrument would prove materially disadvantageous relative to other more traditional investments. If they were to be held in material amounts in respect of with-profits policies, the *Board* would also seek the opinion of the *With-Profits Actuary* and the *With-Profits Committee*.

Principle 6.10 Business Risks

As well as investment performance and counterparty exposure, and amounts transferred to the *Shareholder Fund* (see section 6.14), the fund's future ability to continue to pay all guaranteed benefits when due, and the amounts of *annual* and *final bonus*, will be affected by a number of other factors, 'business risks', that may arise from the existing portfolio of with-profits and non-profit business. These are listed, together with the controls which are applied, in paragraph 6.10.1.

Any compensation costs relating to business that was formerly part of the Swiss Life IB and OB Funds will be charged to this fund irrespective of where that business resides within Phoenix Life Limited. However, the amount of such costs to be charged to the fund in respect of policies that were formerly part of the Swiss Life OB Fund will be limited to a maximum amount of £2 million. Any amounts in excess of this will be met from the Non-Profit Fund or the *Shareholder Fund*.

Any compensation costs relating to business that was formerly part of the Britannic Unit Linked Assurance With Profit Fund will be charged to the fund irrespective of where that business resides within Phoenix Life Limited.

It is not currently envisaged that any business risks would be taken on in addition to those to which the fund is already exposed although, if it appears to be potentially beneficial to policyholders to do so, then this might be done or the exposure to risks to which the fund is already exposed (such as by cancelling reinsurance arrangements) could be increased. If this did take place, it would only be done if the reward was expected to be better than that from other investments with broadly equivalent risks (such as investing in shares or property). The *Board* would formally consult and take account of the opinions of the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee* before doing so.

The *Board* will annually review existing business risk exposures as part of assessing the formal regulatory capital requirement and take appropriate measures to limit risk to amounts to which it is fair for the with-profits business to remain exposed.

Practices

6.10.1 The main business risks of the fund, and the controls that are applied to those that Phoenix Life Limited can influence, include:

- Expenses of management – controlled mainly by outsourcing all business activities, including policy administration and investment management. Normal activities are outsourced on an agreed pricing basis. The main residual costs not subject to an agreed pricing basis are project activity and certain direct costs and fees.
- Failure of non-group outsourced services provider – part of the administration services provided by PGMS are sub-contracted to Diligenta, – controlled by having exit plans. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.
- Meeting minimum guaranteed policy benefits (where these costs are reasonably attributable to the fund) and the cost of *smoothing* – controlled by having an appropriate rate of *annual bonus*, limiting the extent of *smoothing* and investing primarily to meet the guarantees, all whilst ensuring that customers continue to be treated fairly.

- Fluctuations and long-term trends in death rates – fluctuations are constrained by the use of reinsurance contracts to limit exposure on any one policy.
- Changes in taxation.
- Profits or losses from investments backing non-profit business or other liabilities and from investments which represent additional capital.
- Profits or losses from the early or late termination of policies.
- Provision of compensation for past legal or regulatory infringements, especially due to inadequate sales practices – controlled in part by ensuring that compensation is only paid where a legal entitlement exists.
- The cost of additional capital needed to be held for regulatory purposes or for the optimal management of the business – controlled by regularly reviewing the level of excess capital and by ensuring that only a commercial cost for capital is being paid.
- Failure of reassurers – the reassurance credit risk is monitored.

6.10.2 Currently it is not envisaged that the fund would take on any business risks in addition to those to which it is already exposed although it may do so, if it appears to be potentially beneficial to the fund.

6.10.3 How and to what extent business profits and losses to which the fund is already exposed are incorporated in the *asset share* calculations for specimen policies and so how they affect the amounts payable under with-profits policies is described in section 6.4.

To the extent that business profits or losses are not incorporated in *asset share* calculations, they will increase or reduce the excess assets in the fund.

6.10.4 If the fund experienced or identified a particularly large business profit or loss in any one year, its incorporation in *asset share* calculations may be spread over a number of future years to avoid excessive impact on policy values in the short term.

6.10.5 There is no predetermined minimum value below which business profits or losses will not be applied, sooner or later, as a determinant of the bonuses payable under with-profits policies.

6.10.6 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

6.10.7 As described in section 6.4, no amounts are currently being attributed to *asset shares* in respect of business risk as the amounts are involved are minimal. If this were to change in the future then the outcome from all business risk will be pooled across all with-profits policies in the relevant fund, although this has not always been the practice in the past.

Principle
6.11 Expenses and Charges

Charges and expenses attributed to the fund in respect of former Swiss Life policies will be in line with the *2023 Scheme* and with the commitments made to the *regulator*.

Charges and expenses attributed to the fund in respect of former Britannic Unit Linked Assurance policies will be done in a manner that reflects as closely as is reasonably practical the costs of administering those policies, subject to the terms of the *2023 Scheme*.

Where costs are specific to a policy or class of policy then, taking into account the approximations referred to in section 6.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a single policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

6.11.1 For former Swiss Life *traditional* with-profits policies the expenses charged to the fund in any one year in respect of those policies will be:

(a) investment management expenses of 10 basis points per annum of the average market value of the assets of the fund during the year;
(b) a specified amount for each policy in force on 30 June in that year in respect of administration costs;
(c) for former Swiss Life IB Fund policies 30% of premiums received;
(d) certain other costs which are charged to the fund directly or where the fund is charged a share of Phoenix Life Limited's direct costs and which are expected to be restricted to:
- Audit Fees
- *Regulator* Fees
- ABI Fees
- Non-executive director costs
- Financial Services Compensation Scheme levies
- Any other levies incurred directly in respect of the business
- Ex-gratia payments to policyholders
- Custodian fees
- Void property costs
- Legal costs and other external costs in relation to any proceedings in connection with the policies; and

(e) compensation paid and associated costs in respect of errors and omissions pertaining to the issue and maintenance of policies currently in the fund and policies previously in Swiss Life's OB Fund or IB Fund that are not currently in the 90% With-Profits Fund insofar as such errors and omissions arose while those policies were in Swiss Life's OB Fund or IB Fund.

For with-profits units in the former Swiss Life Pension With-Profits Fund, no expenses or investment management costs are charged to the fund. All of the expenses for this type of business will be met from the Non-Profit Fund as all policy charges on the underlying contracts arise in the Non-Profit Fund.

6.11.2 The specified amounts per policy per annum referred to above will be as follows:

	Amount (£) per annum
Former Swiss Life OB Fund – Investment Type Policy	40.00
Former Swiss Life OB Fund – Other Policy	20.00
Former Swiss Life IB Fund Policy	0.30

Other than in the event of major regulatory change, these specified expenses per policy will increase in subsequent years only in line with the increase in the Retail Prices Index excluding Mortgage Interest Payments (RPIX) since 30 June 2005 plus 1.40% per annum.

6.11.3 For former BULA policies the expenses charged to the fund in any one year in respect of those policies will be:

(a) investment management expenses of 10 basis points per annum of the average market value of the assets of the fund during the year;
(b) a specified amount per annum for each policy in force on a monthly basis in respect of administration costs; and
(c) certain other costs which are charged to the fund directly or where the fund is charged a share of Phoenix Life Limited's direct costs and which are expected to be restricted to:
- Audit Fees
- *Regulator* Fees
- ABI Fees
- Financial Services Compensation Scheme levies
- Any other levies incurred directly in respect of the business
- Ex-gratia payments to policyholders
- Custodian fees
- Legal costs and other external costs in relation to any proceedings in connection with the policies.

(d) PGMS may provide additional services to the fund in respect of former Britannic Unit Linked Assurance policies. The costs for such additional services will be charged to the fund (in addition to those described in (a) to (c) above) where those services are required by the fund or where those services are expected to bring a benefit to the fund, as determined on a fair basis.

6.11.4 The specified amounts per policy per annum referred to above in respect of former Britannic Unit Linked Assurance policies will be as follows:

- £88.80 for each regular premium paying with-profits policy
- £44.40 for each single premium with-profits policy
- £44.40 for each paid-up with-profits policy

These are amounts as at 1 July 2022 and will inflate on 1 July each year in line with the change in the Retail Prices Index over the previous year for the increase in subsequent years, plus one per cent per year.

6.11.5 Costs attributable to the fund, which are not apportioned to *asset shares* or to non-profit business, will reduce the excess assets of the fund.

6.11.6 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

Principle
6.12 *Estate* Management

The aim is to manage the fund so that there is always a small excess of the value of the assets over the amount considered necessary on *market consistent* assumptions to enable it to meet the aims described in the guiding principles in section 5.

The excess at the targeted level is maintained by:

- controlling the addition of *annual* and *final bonus*es to policies;
- maintaining an appropriate investment strategy;
- limiting, where possible, the business risks faced;
- exercising discretion in other areas in moderation; and
- drawing on, or repaying, additional financial support from the Non-Profit Fund or the *Shareholder Fund* in the form of loans to the fund or otherwise.

The aim is to distribute the existing surplus and any surplus arising in the fund in future over the expected future lifetime of the currently in force policies.

Practices

6.12.1 The former Swiss Life Pension With-Profits Fund business does not have any interest in the *estate* arising in the fund and references in this section to potential benefit enhancements from *estate* distribution do not apply to this business.

6.12.2 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

6.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 6.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

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6.12.4 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;
(c) meet any costs which are charged directly to the *estate* rather than to *asset shares;*
(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and
(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

6.12.5 Any enhancement in benefits on account of the *distributable estate* referred to in 6.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

6.12.6 The amount of the *estate*, the *distributable estate*, and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

6.12.7 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to the *asset shares* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

6.12.8 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 6.12.7 be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *Board* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle 6.13 New Business

Apart from as a result of the exercise of options under existing policies, and contractual increments, new business is no longer accepted. The future business risk from this source is expected to be small.

Practices

6.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts.

Currently there are no plans to reopen the fund to new business.

Principle 6.14 Equity Between the Fund and Shareholders

The requirements of the *2023 Scheme* are such that holders of with-profits policies in the fund are entitled to receive at least 90% of the total distributable profits arising from the fund. The shareholder is entitled to receive the balance. Payments from the fund are therefore limited to those amounts required to meet obligations under policies and reassurance agreements written in the fund and to transferring to the *Shareholder Fund* the shareholders' share of the divisible profits. None of the divisible profits arising in the fund are attributed to the other *with-profits funds*.

If the *Board* were considering making changes to the current position, it would first request and consider the advice of the *Chief Actuary* and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee*. If it still decided to proceed, then policyholders would be notified at least three months in advance. The agreement of Phoenix Group and the High Court would also be required to make such a change.

If a position arose where either the fund required financial support from the Non-Profit Fund or *Shareholder Fund* to enable the fund to meet the target excess assets described in section 6.12, the terms on which such support is provided will be fair and reasonable to all parties, taking into account prevailing market conditions and the risks involved. If such support forms part of the fund, then it will be treated as a liability to the extent that it would otherwise increase the excess assets.

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arm's length commercial basis.

Practices

6.14.1 For former Swiss Life *unitised* with-profits policies, no transfer is made to the *Shareholder Fund* in respect of any bonuses added to these policies.

For *traditional* with-profits policies, the value of *annual bonus* added to policies, discounted at the risk free yield is determined. One ninth of that value is transferred to the *Shareholder Fund* together with one ninth of the discounted value of any *interim bonus* and one ninth of any *final bonus*. This means that the transfer to the *Shareholder Fund* is 10% of the distributed surplus.

6.14.2 Any compensation costs relating to business that was formerly part of the Swiss Life IB and OB Funds will be charged to the fund irrespective of where that business resides within Phoenix Life Limited. However, the amount of such costs to be attributed to the 90% With-Profits Fund in respect of policies that were formerly part of the Swiss Life OB Fund will be limited to a maximum amount of £2 million. Any amounts in excess of this will be met from the Non-Profit Fund or the *Shareholder Fund*.

6.14.3 Any compensation costs relating to business that was formerly part of the BULA With Profits Fund will be charged to the fund irrespective of where that business resides within Phoenix Life Limited.

6.14.4 Where mis-selling costs are charged to the fund they will be met from the excess assets in the fund so long as such excess assets exist.

6.14.5 Additional tax arising from transfers to shareholders is allocated to the fund (but is not charged to *asset shares*). In considering the allocation of tax and any tax impacts that may arise from time to time fairness between the stakeholders is considered.

6.14.6 The *Board* are not aware of any external or internal factors, which, if they were to change, would have a material effect on the apportionment of surplus as described above.

7 Principles and Practices – 100% With-Profits Fund

The Principles and Practices given in sections 7.4 to 7.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the 100% With-Profits Fund. Sections 7.1 to 7.3 give background information specific to the 100% With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the 100% With-Profits Fund.

7.1 Fund History

7.1.1 The 100% With-Profits Fund comprises with-profits business that was transferred into it from Swiss Life, PAL and Bradford.

7.1.2 PAL last issued new with-profits policies directly to new customers in the 1980s. Since that time it continued to write new with-profits business through reassurances accepted under reassurance agreements with Phoenix & London Assurance Limited (PALAL). These reassurance agreements transferred to Phoenix Life Limited at the same time as the PAL with-profits policies were transferred. PALAL ceased to issue with-profits policies to new customers in January 2002 and ceased to issue any type of policy to new customers in December 2002. As a result, no new business has been ceded under the reassurance agreements with PALAL from these dates. Existing customers continue to be able to exercise options under their policies, including those to increase premiums payable, to pay additional single premiums and to allow new members to occupational pension schemes. The exercise of any of these options is not actively solicited.

The former PAL business included *unitised* with-profits pension policies reassured from PALAL. However, this reassurance was recaptured by PALAL at the end of 2008.

From February 2011 the SAL With-Profits Fund comprises the business that was transferred into Phoenix Life Limited from the long-term business fund of PALAL under the *2011 Scheme*.

7.1.3 Bradford last issued new with-profits policies directly to new customers in 1971 and there are only a very small number of former Bradford policies remaining.

7.1.4 Swiss Life ceased issuing new with-profits policies in 1992 (apart from policies arising from options on existing with-profits business). The with-profits business of Swiss Life included policies written on its own account and policies transferred in by previous court schemes from the Pioneer Mutual Insurance Company and the former UK branch of Swiss Life (a company based in Switzerland). Pioneer Mutual had itself been formed through the merger of the Stamford Mutual Insurance Company, the Blackburn Assurance Company and the Pioneer Life Assurance Company.

7.1.5 The with-profits funds within Swiss Life were internally separated into three sub-funds, the OB Fund, the IB Fund and the With Profit Fund. The OB Fund contained all of the Ordinary Branch policies emanating from the former Pioneer Mutual together with any subsequent new policies of such type, including the Pension With-Profits Fund element of personal pension plan and free standing AVC policies. The IB Fund contained all of the Industrial Branch policies emanating from the former Pioneer Mutual together with any subsequent new policies of such type. The With-Profits Fund contained a small number of *traditional* life policies that had been written prior to the merger with Pioneer Mutual.

7.1.6 The with-profits business in the Swiss Life OB Fund and the Swiss Life IB Fund was transferred into the 90% With-Profits Fund except for the Pension With-Profits Fund element of personal pension plan and free standing AVC policies which was transferred into the Non-Profit Fund and internally reassured into the 100% With-Profits Fund. The business in the Swiss Life With Profit Fund was transferred into the 100% With-Profits Fund. As part of the *2009 Scheme*, the former Swiss Life Pension With-Profits Fund with-profits element of Libra Personal Pension Plans and similar policies is now internally reassured to the 90% With-Profits Fund rather than to the 100% With-Profits Fund.

7.2 Types of Business

The with-profits policies are mainly *traditional* endowments and whole life policies.

There are a few *traditional* with-profits deferred annuity group pension policies. When these policies mature, the annuity is set up in the Non-Profit Fund and the cost of providing the annuity is paid to Non-Profit Fund.

7.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 7.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under with-profits policies is *asset share* calculations which are carried out for certain specimen policies. The amounts payable will allow for a fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es.

In putting into practice the aims set out in the guiding principles and in the application of the with-profits principles generally, various degrees of approximation are applied in a number of different areas, the major ones being described in paragraph 7.4.4. The *Board* will endeavour to ensure that these approximations:

- are applied consistently;
- have a broadly neutral effect between policyholder and shareholder interests and between the different *with-profits funds*; and
- where appropriate, have a broadly neutral effect over time (that is between one generation of policyholders and another).

Any of the assumptions used in previous years (such as investment returns, charges and allocations of miscellaneous profits and losses) can be changed at any time:

- should they be shown to have been incorrect;
- should legal or regulatory change render it necessary to do so; or
- if their continued application unchanged could put at risk the achievement of the aims as set out in the guiding principles in section 5.

Changes to the methods used to determine the amounts payable under a with-profits policy are controlled by:

- requesting and considering the advice of the *Chief Actuary* and the *With-Profits Actuary* and the opinion of the *With-Profits Committee* before making any changes;
- assigning to the *Chief Actuary* the executive responsibility to continue to apply the currently agreed methods until advised differently; and
- following legal or regulatory requirements to obtain independent expert input where necessary.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Bonuses can only be declared if there is surplus available for distribution.

Asset shares are only calculated for certain specimen policies for the purpose of determining the amounts payable under with-profits policies.

Practices

***Asset Share* Methodology**

7.4.1 The basic method for *asset share* calculations for with-profits business in the fund uses an apportionment of actual investment returns net of tax and the actual underlying experience.

Asset shares are generally not smoothed. In particular, the investment returns and experience elements contributing to *asset shares* are generally not smoothed, other than that inherent in the processes used in the derivation of the assumptions or in respect of large profits and losses from other business per paragraph 7.4.2(s).

7.4.2 The following table describes the elements currently credited or charged to *asset shares* for specimen policies.

Element		**Description of Allowance**
(a)	Premiums	Premiums paid under the policy
(b)	Investment return	Allocated return – note (b)
(c)	Investment expenses	Actual allocated – note (c)
(d)	Initial expenses	Actual allocated – note (d)
(e)	Renewal expenses	Actual allocated – note (e)
(f)	Other expenses	Actual allocated – note (f)
(g)	Tax on investment return	Actual allocated – note (g)
(h)	Tax relief on expenses	Actual allocated – note (h)
(i)	Mortality & morbidity costs	Based on underlying experience – note (i)
(j)	Early terminations	No profits or losses are credited – note (j)
(k)	Paid-up policies	No profits or losses are credited
(l)	Partial and regular withdrawals	Not applicable
(m)	Surrenders at *protected dates*	No profits or losses are credited
(n)	Annuity payments	Not applicable
(o)	Charges for the cost of guarantees	Charged - note (o)
(p)	Charges for the cost of capital	Note (p)
(q)	Distributions to shareholders	Not applicable
(r)	Tax on distributions to shareholders	Not charged
(s)	Profit and losses from other business	Profits or losses are credited – note (s)
(t)	*Estate* distribution or charge	Distributions from or charges to the *estate* as determined – note (t)
(u)	Exceptional items	Not applicable

The way in which the above items are taken into account is described in the notes below.

(b) Investment return

This is based on the total return, income and capital gains / losses, made on the assets of the fund.

The investment strategy is described in section 7.9. In accordance with this, different proportions of each type of asset are attributed to the specimen policies. Current practice is for all specimen policies of a particular product type to have the same proportions of each type of asset. However different product types may have different proportions of each type of asset.

The return attributed to each specimen policy is then the weighted average return from each asset type using those proportions. For former PAL *traditional* with-profits life policies, the return on fixed interest securities will be that of the subclass of such securities issued by the UK government with a time to redemption which matches most closely the *term remaining* of the specimen policy. Any difference in return between UK government fixed interest securities and the other fixed interest securities within the *asset share* is applied as a uniform percentage adjustment across the fixed interest part of the *asset shares* of all policies, irrespective of the *term remaining*.

A return may be attributed on some types of asset, particularly derivative securities, to the class of policy, if any, in respect of which they have been specifically purchased.

Within each class, the ratio of UK government to other fixed interest securities is the same for all specimen policies.

For former Bradford policies, the investment return may be approximated using indices.

(c) Investment expenses

Actual investment expenses are charged based on those allocated to the fund in accordance with sections 5.2 and 7.11.

The investment expenses are expressed as a percentage charge to be applied to the assets.

(d) Initial expenses

Initial expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 7.11. For most classes, these are approximated by inflating previous values.

(e) Renewal expenses

Renewal expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 7.11.

In the past, a proportion of expenses for former PAL *traditional* life policies have been met from the excess assets and so that proportion is not taken into account when calculating the *asset shares* of specimen policies of those classes. For former PAL *traditional* life policies only 98.5% of non commission expenses will be allocated to *asset shares*.

For former Bradford policies, these are approximated by inflating previous values.

(f) Other expenses

Project and other one-off expenses incurred are included in the actual renewal expenses charged to *asset shares*.

The historic costs of establishing policy administration outsource arrangements over the period 2003 to 2005 were spread over a five year period.

Significant future project, additional activity and other one-off costs will only be charged to *asset shares* following approval by the *Board*.

(g) Tax on investment return

Tax on both income and capital gains is charged to the specimen *asset shares* of life policies. It is calculated by applying the current rates applicable to life insurance companies in respect of income and gains attributable to policyholders to the different elements of the investment return, less the tax relief on expenses at the applicable rate. Approximate allowance is made for any deferment in tax payment or relief. No tax is currently charged to the *asset shares* of pension policies. The tax attributable to the *asset shares* of all types of policy is subject to change should there be a change in relevant tax rules or rates.

(h) Tax relief on expenses

Tax relief due on the actual expenses charged is allowed for in those classes of business that are subject to tax. Where the tax relief in respect of expenses is deferred this is allowed for. The rates of tax relief are the average rates applicable.

(i) Mortality and morbidity costs

Where a *traditional* life policy is designed to pay a benefit on death that exceeds *asset share* at that time, an annual charge is made to cover the cost of making those enhanced payments.

The estimated annual cost of providing such benefits is determined periodically from an analysis of recent actual costs incurred by the fund and from other insurance industry and national statistics. These costs are expressed as rates dependent upon various factors including age. The charge on each specimen policy in each year is determined by applying the appropriate mortality rate to the current difference between the benefit payable on death and the *asset share*.

(j) Early terminations

It is the practice to attribute to the *asset share* of former PAL specimen *traditional* life policies the estimated difference between the amount paid on the early termination of such policies and their estimated *asset share* arising in a year. Such amounts are expressed as an addition to the investment return and act to increase the *asset shares* of the remaining policyholders. Such allocations are not however made in years when the target *payout* upon early termination is in excess of 100% of *asset share*. For this reason such allocations have not been made in recent years.

No such allocations are made in respect of former Bradford policies or former Swiss Life policies.

(o) Charges for the cost of guarantees

No explicit charge is currently made and all costs of meeting guarantees will reduce the excess assets in the fund. This does not preclude the possibility that such a charge may be introduced in the future if it was appropriate.

(p) Charges for the cost of capital

No charge is currently made to the fund for the cost of capital. However, from time to time, one or more loan agreements may be in place in accordance with 5.2. Interest at a commercial rate will be payable on such loans. Where part of such a loan is required to eliminate a deficit in the fund, then the interest payable on that part of the loan will not be charged to *asset shares*. Where part of such a loan is not required to cover a deficit, then a deduction will be made from *asset shares* to reflect the excess of the interest payable on that part of the loan above the return achieved by the fund from investing that part of the loan.

No charge is currently made to the fund for the capital that it is necessary to retain in the Non-Profit Fund and *Shareholder Fund* in order that Phoenix Life Limited continues to have adequate capital in accordance with paragraph 5.2.6.

The *asset shares* of specimen policies do not receive any credit for the return earned on excess assets held within the fund.

(s) Other business profit or losses

It is the practice to allocate an estimated amount to *asset shares* of specimen *traditional* life policies in respect of any other business profits or losses arising in a year, other than those described in paragraph 7.4.2(j), expressed each year as an addition to the investment return.

Profits and losses from non-profit business are not currently added as there are no longer any non-profit policies remaining in the fund.

Some larger business profits or losses may be spread over a number of future years.

At 31 December 2005, the date of transfer into Phoenix Life Limited, a one-off addition was made to the *asset shares* of *traditional* life policies in Bradford representing the actuarially assessed value of future profits from non-profit business in Bradford.

(t) *Estate* distribution or charge

For former PAL *traditional* life policies (both direct written and reassurances accepted), *asset shares may be* increased by distributions from the *estate* or reduced by charges to the *estate*. However, these *estate* distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 7.12.

Former Bradford and former Swiss Life policies do not share in any estate distribution or charge.

7.4.3 The specimen policies are *traditional* policies which generally reflect the average size remaining in force for the year of issue for the terms which contain a significant volume of policies. For other terms approximations may be used. Where *final bonus* rates are shared by policies of different years of issue or different premium types, the specimen policies may be grouped or otherwise averaged.

For former Bradford and Swiss Life policies, specimen policies are not used and the calculations are made on an individual policy basis. Similar principles are used to those described below for specimen policies but actual policy details are used rather than typical averages.

Asset shares are not calculated for specimen whole life, paid-up and altered policies. As a result the target ranges described in sections 7.6 and 7.8 do not apply to policies of these types.

7.4.4 Various approximations are inherent in the *asset share* method described above and in the general applications of the principles in practice. These include:

- Investment returns are calculated monthly but may be applied uniformly over the period within the model which is usually quarterly or six-monthly.
- The investment return itself is only calculated approximately during the course of a year (by the use of appropriate indices) and is updated after the end of each year to reflect the actual performance earned.
- Carrying out the calculations (and hence changing *final bonus* rates) only infrequently (such as half yearly or annually).
- An inevitable time delay before actual experience is reflected in bonus rates and their application to policies.
- The use of bonus rates determined using a specimen policy of one type to policies of another type. Prior to 2019 the majority of policies claiming were endowment policies and it was the practice to use final bonus rates determined for standard endowment policies for whole of life policies. From 2019 the majority of claims are expected to be on whole of life policies and the specimen policies were updated to reflect this. *Asset shares* for whole of life policies had not previously been calculated and so *asset shares* for specimen whole of life policies were derived from the benefits payable under the endowment based bonus scale, but with approximate adjustments to broadly reflect the different terms on which the whole of life policies were written.
- Where the standard office premium rate for a policy type changed in the middle of a year, the *final bonus* may be based on either the pre or the post change rate.
- The use of specimen policies will usually mean that small premium policies receive more than the target proportion of *asset share* (as many administration costs are independent of premium size) and large premium policies less.
- The use of specimen policies only for selected terms of policy and the interpolation of *final bonus* rates for intermediate terms will mean that the amounts paid on policies of those intermediate terms will not necessarily equal the target proportion of *asset share*. Similarly the *final bonus* rate calculated for the longest term specimen policy is applied to any policies that claim after a longer term.
- For policies which have earlier been made paid-up, the use of *final bonus* rates applicable to policies, which have been premium paying throughout. Or, alternatively, the application to both types of policy of *final bonus* rates calculated using both model paid-up policies and model premium paying throughout policies. Similarly bonuses will only be approximate for policies that have been altered in other ways.
- Determining bonus rates by reference to *asset shares* is a relatively recent development. Most of the in force *traditional* life policies commenced before such an approach was established practice. When the *asset share* basis was implemented it was necessary to quantify such items as investment returns, investment mixes, expenses and business profits from many years into the past. Best endeavours were made using all available historic information but some of the amounts are inevitably best estimates rather than accurate amounts.
- For former Bradford policies, additional approximations may be used, such as basing investment return on indices and inflating previous expenses.

Some of these approximations, as well as others not listed, will also be present in the calculations of the excess assets of the fund from time to time.

7.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in section 7.12.

7.4.6 Documented procedures exist that set out how the *asset share* calculations described above are to be carried out and how the parameters to be used in the calculation are to be derived each year. A permanent record is kept of the historic parameters used. Some of the instructions for the detailed computations are embedded within a number of computer programs.

7.4.7 Any change to the practices used, including those used to determine the excess assets in the fund, would be subject to the procedure described in principle 7.4.

Any material changes to the historical parameters used would, if a result of the identification of a past inaccuracy, be notified to the *Board* and the *With-Profits Committee* at the time of the next recommended change in bonus rates. If considered appropriate, any changes may be phased in over a period rather than implemented at once.

Any proposed changes to the historical parameters for other reasons would be subject to the same processes as a change in practice.

7.4.8 *Asset share* practices are not guaranteed and may be changed in future.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

7.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

7.4.10 The amount payable on *traditional* with-profits policies on *maturity* is the total of:

- the sum assured;
- the *annual bonuses* added whilst the policy has been in force; and
- *final bonus*, if any.

The rate, if any, of *final bonus* which applies to a particular policy class, date of issue and date of *maturity* or retirement is currently determined in most cases with reference to the *asset share* of a representative range of specimen policies.

7.4.11 Bonuses are reviewed regularly at least once a year.

The timing of *annual bonus* reviews is described in paragraph 7.5.6.

The timing of *final bonus* reviews is described in paragraph 7.6.4.

7.4.12 The timing of *final bonus* declarations may be varied.

7.4.13 *Final bonus*es are expected to, but are not guaranteed to, apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. Additional reviews would normally only be in response to exceptional investment market movements.

7.4.14 *Final bonus* reviews also affect the amount of *final bonus* paid on *non-protected exits* (surrenders) for policies where the *surrender value* calculation makes explicit use of the current *final bonus* scale.

7.4.15 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared.

Principle 7.5	***Annual Bonus* Rates**
	If the value of assets is more than reasonably sufficient to enable the fund to meet the aims described in section 5, then *annual bonuses* are likely to be added. In circumstances where the value of assets is fairly close to the minimum amount required to enable the fund to meet its aims described in section 5, low or nil rates of *annual bonus* are likely to be added. In circumstances where the value of assets for a particular class of policy is fairly close to the minimum amount required to enable the fund to meet the aims described in section 5 for that class of policy, then low or nil rates of *annual bonus* are likely to be added for that class of with-profits policy. Separate *annual bonus* rates are applied to different policy classes to reflect the different aspects of the products, including tax treatment and extent of guaranteed benefit (although no differentiation is made between policies of the same class with and without guaranteed annuity options). Currently no differentiation is made between different dates of issue, although this may be done in the future if it helped to better satisfy the aims described in section 5. Although most classes of new business are no longer accepted, other than under options on existing policies, alternative products might at some time be introduced into which existing customers could switch their benefits at their discretion, which might receive different bonus rates.

Practices

7.5.1 The *Board* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in paragraphs 7.5.2 to 7.5.6.

7.5.2 *Annual bonus* rates currently take the form set out in the table below.

Bonus series	Policies included	Bonus type
PAL Life	All former PAL *traditional* life policies	Compound. A percentage of the sum assured and a separate percentage of the attaching bonus.
Bradford	All former Bradford policies	Compound. A single percentage applying to both the sum assured and the attaching bonus.
Swiss Life	All former Swiss Life *traditional* with-profits policies transferred into the fund	Compound. A single percentage applying to both the sum assured and the attaching bonus.

7.5.3 For each class of business, the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

7.5.4 At present, for former PAL *traditional* life policies relatively high amounts of *annual bonus* are declared, both in relation to current interest rates and current inflation rates, and also in relation to many other life offices. The *Board* does not expect to increase *annual bonus* rates significantly, if at all, for a number of years.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

7.5.5 Where the financial position of the fund is weak, the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

7.5.6 Currently *annual bonus* rates are reviewed towards the end of each year, with changes taking effect from 1 January.

However, rates may be reviewed at other times should it be considered necessary to continue to adhere to the principles.

7.5.7 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

Principle 7.6 ***Final Bonus* Rates**

Final bonus may be added to policies when they terminate or when benefits are encashed for other purposes, with the aim of ensuring, if they do not already do so, that benefits reflect fairly and proportionately a share in the profits (and losses) which have been generated within the fund whilst the policy has been in force. Where policy benefits include an amount resulting from excess assets in the fund (see section 7.12) then this is also reflected in the *final bonus*.

Separate *final bonus* rates are applied to different policy classes to reflect the different aspects of the products, including tax treatment, form of benefit and extent of guaranteed benefit. Differentiation is also made between different dates of issue and different periods in force. On death and on early termination, the *final bonus* added may be higher or lower than indicated above for reasons explained in the practices. For former Bradford and Swiss Life *traditional* policies the *final bonus* rates are individually calculated by reference to the individual *asset share*.

Practices

7.6.1 For each specimen policy, we determine a proportion of *asset share* that it is appropriate to use to best meet the guiding principles. This proportion will vary from time to time, may be greater or less than 100% and may vary by class of policy, date of issue, *term remaining* to a date at which a guarantee or option applies or other relevant factor.

For each specimen policy the following are compared:

(i) the appropriate proportion of each specimen policy's *asset share* (the *asset share* for this purpose being inclusive of any enhancement as described in paragraph 7.4.2); and

(ii) the total of the sum assured and the *annual bonuses* already added to that specimen policy.

If (i) is the larger, a *final bonus* for the specimen policy will normally be set using the methods described below. If (ii) is the larger, then no *final bonus* will normally be set for that specimen policy.

The target for the proportion in (i) above is 100%. The proportion used for particular specimen policies may be affected by *smoothing* (see section 7.7). The aim is to maintain the proportions in (i) within the range 80% and 120% for most specimen policies before the effects of smoothing.

For each specimen policy where a *final bonus* is to be set, the excess of (i) over (ii), after any *smoothing*, is expressed as follows:

Bonus series	Policies included	Excess of (i) over (ii) expressed as:
PAL Life	All former PAL *traditional* life policies	A percentage of the sum assured
Bradford	All former Bradford policies	An addition to the sum assured and attaching bonus
Swiss Life	All former Swiss Life *traditional* with-profits policies transferred into the fund	An addition to the sum assured and attaching bonus

This is then the new *final bonus* rate for all policies of the same type and duration in force as the specimen policy.

Where a rate is not derived for every duration, the rates applicable for other durations are determined by interpolation or extrapolation between the rates derived as above.

7.6.2 The original term for *final bonus* rates is currently differentiated by year.

7.6.3 For all classes of policy *final bonus* rates may be changed at any time. At times when the value of the excess assets in the fund is not changing rapidly, this is likely to mean that changes, if any, are made twice per year, normally from 1 January and 1 July. However, a sudden change in the value of those excess assets (such as because of a significant change in the value of equity share markets) may cause *final bonus* rates to be changed on other occasions. Changes to *surrender* and transfer values may be less frequent than changes to *final bonus* rates for maturities.

7.6.4 As the value of the assets are changing every day but *final bonus* rates are recalculated infrequently, there will frequently and inevitably be times when, if the *asset share* were recalculated for the specimen policies, then *final bonus*es would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the proportion of *asset shares* at the latest *final bonus* review was near the top or bottom of the range described in paragraph 7.6.1, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle
7.7 ***Smoothing***

Smoothing refers to the practice of limiting the change in *final bonus* rates on any one occasion so that the benefits paid to policyholders differ from those, which would otherwise apply. *Smoothing* is applied to all classes of policy which are eligible for *final bonus* and to all types of claim apart from former Bradford and Swiss Life policies.

Smoothing is intended to have a neutral effect over time. In other words, if applying the limitation on changes in the rate of *final bonus,* results for a period in different amounts of discretionary benefits than would otherwise have been paid, then in a subsequent period discretionary benefits would be adjusted by a broadly equal and opposite amount when circumstances and the practices allow.

Other than on death or early termination, the aim is at all times to pay policy benefits that are close to those described under section 7.6. Accordingly, *smoothing* is not particularly vigorous and *final bonus* rates may change by relatively large amounts both on any one occasion and over a 12 month or longer period. The cost of *smoothing* is not expected to be material at any time and so no specific upper limit is imposed on it.

These principles are not necessarily applied when determining the amount payable on *traditional* policies, which are terminated significantly early.

Practices

7.7.1 No *smoothing* is applied to *maturity* values on former Bradford and Swiss Life policies as these policies receive benefits based on an individually calculated *asset share* due to the small number of such policies.

For other policies, where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* or retirement values by limiting the change in final bonus rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For these policies, *surrender* value bases are normally reviewed twice a year and *smoothing* is applied by limiting the change in immediate *surrender* value for specimen policies. Normally the *surrender* value for specimen model policies will not change by more than 10% at each six monthly review. *Surrender* values may change in between reviews because in many cases the *surrender* values are calculated using formulae that depend upon factors such as *term remaining* which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5, sometimes larger changes are made in *final bonus* rates and *surrender* values.

If there has been a significant change in premium rates then larger changes than those described above may be made so that the *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing*. Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

7.7.2 Applying *smoothing* does mean that, on occasions, more or less than the target proportion of *asset share* is paid out. This difference will reduce or increase the excess assets of the fund. There is no particular maximum accumulated cost of or benefit to the fund, which is allowed, although no *smoothing* accumulation would be allowed to build up which was inconsistent with the achievements of the objectives of the guiding principles set out in section 5.

Principle 7.8	***Surrender Values***
	The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies or groups of specimen policies in aggregate achieve a target *payout ratio* over time.

Practices

7.8.1 *Non-protected exits* refer to surrenders and transfers for pension business.

7.8.2 For policies that surrender early, the aim is to make payments that are, in aggregate and over time, across all specimen policies that are used for determining surrender bases, a targeted proportion of *asset share*. This proportion is currently 100%. For former PAL *traditional* life policies (including reassurances accepted) the *asset share* allows for the enhancements described in paragraph 7.4.2.

7.8.3 Actual surrender payments on individual policies will not generally be in line with the target proportion because:

- Individual *asset shares* are not calculated or held on the administration systems for use in *surrender value* calculations. Rather *surrender values* are calculated in a variety of ways for different types of policy. Typically *surrender values* are based on a discounted value of the guaranteed sum at *maturity* or retirement (reduced to allow for non-payment of future premiums in the case of regular premium policies) including attaching *annual bonus*, together with an allowance, where appropriate for *final bonus*.
- Specimen policies are used to determine the parameters in the *surrender value* calculations. The outcome for a particular individual policy may be different from that of the specimen policy.
- There are a limited number of parameters that may be altered in the surrender formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.
- As the value of assets are changing every day but the parameters in the *surrender value* formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate.

7.8.4 For the reasons given above it is expected that *surrender values*, when expressed as a proportion of *asset share*, will fall in a wide range around the target proportion. The parameters in the *surrender value* bases are reviewed periodically with the aim that the majority of *surrender values* for the range of specimen policies that are analysed, will fall within the range of 80% to 120% of *asset share* for former PAL *traditional* policies, including reassurances of this type accepted and 100% of *asset share* for former Bradford and Swiss Life With Profit Fund policies, before the effects of *smoothing*.

7.8.5 In some cases, values in excess of the upper limit of the range may be payable when policies are surrendered close to *maturity* and the *asset share* of the relevant specimen policy is less than the guaranteed benefits at *maturity,* or the *maturity payout* is in excess of the *asset share* due to *smoothing*.

7.8.6 The method used to derive the *surrender value* may not involve the explicit application of *final bonus*. Where the value paid is larger than the discounted value of the guaranteed sum assured and *annual bonuses* already added, an element equivalent to *final bonus* will be implicit in the value.

7.8.7 *Final bonuses* on surrenders are normally reviewed and changed with the same frequency as *final bonus* rates for the relevant policy type (see paragraph 7.6.4) Reviews and changes may sometimes be less frequent or implemented later than the corresponding *final bonus* rate change.

7.8.8 The percentages described in paragraphs 7.8.2 and 7.8.4 may be changed at any time, as may the methods of calculation. However, before any changes are made, the *Board* will formally consult with and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee*.

Principle
7.9 Investment Strategy

Overall, the strategy will be to invest in fixed interest securities but with exposure to equity shares and commercial property, either directly or through vehicles such as unit trusts, OEICS or derivatives when and to the extent to which this is possible without unduly putting at risk the fund's ability to meet guaranteed benefits as they arise. Some cash or equivalent assets will be held for liquidity purposes. When the assets in the fund are significantly in excess of the value of the guaranteed benefits then the exposure to equity and property investments could be high and the exposure to such assets could significantly exceed the exposure to fixed interest securities.

From time to time assets outside the fund may be relied on to provide some or all of a margin against future adverse change in investment markets. The investment strategy is, however, based upon the intention that the aims will be met using only the assets of the fund after repayment of any loans or other financial support received.

Derivatives may be used from time to time to make changes in investment dispositions more rapidly or cheaply than could be done directly through the markets. They may also be used from time to time to reduce the risk of loss, for example from share price falls, interest rate changes or exchange rate fluctuations.

The proportion of shares and property held at any time may differ between different products, dates of issue or *terms remaining* to reflect the different risks to both the specific policyholders and to policyholders and the shareholder more generally. For some with-profits policies with relatively high guaranteed benefits, this may mean that no shares or property will be held. Fixed interest securities are broadly matched to the *term remaining.*

The maximum loss, which the fund could suffer from the complete default of any one external counterparty, whether through reinsurance, direct investment, stock lending or derivatives is restricted by dealing with a wide range of counterparties. This usually means that the total exposure to any one counterparty is significantly below the maximum levels for which value may be taken under our *regulator's* rules. In some cases, additional precautions such as daily *marking to market* with *deposit back* are used.

Larger, unprotected exposures are permitted to sister companies (regulated UK life insurers) through internal reinsurance arrangements.

There are no assets that are not expected to be traded should that be an appropriate investment decision.

Practices

7.9.1 The investment strategy is regularly reviewed taking account of a variety of considerations, including our approach to *responsible investment*. In particular, reports from the *investment managers,* the *Chief Actuary,* the *With-Profits Actuary* and the *With-Profits Committee,* and recommendations for changes are considered and, if appropriate, implemented.

7.9.2 Guarantees to policyholders and liabilities to other creditors are not completely matched with assets that provide a similar guarantee or payment. In particular, a proportion of assets are invested in equity shares and commercial property because it is considered that, over most longer periods of time, a better return will result. There are separate investment strategies for assets equal in amount to the aggregate *asset shares* of policies and for assets representing additional provisions for liabilities under non-profit policies, for guarantees on with-profits policies, for other liabilities and for the capital margins and excess capital. Each of these strategies is described in more detail below.

It is not possible to implement the strategies described below with absolute precision and any difference between the actual outcome and the theoretical outcome may be treated as described in paragraph 7.4.2(s).

Asset Shares

7.9.3 It is the current practice that all specimen policies of a particular class will be deemed to have the same asset mix in that they will be deemed to be invested in the same proportions of equity shares, property, fixed interest and other investments.

The asset mix may however vary by product class to reflect both the past practice and the differing nature of the guarantees given.

For former PAL *traditional* with-profits life business, the fixed interest assets attributed to a specimen policy will reflect the *term remaining* of that policy. Returns on emerging market debt do not reflect the *term remaining*, but rather reflect the overall return on such debt.

The aim is to maintain a reasonable degree of similarity between the overall duration of the fixed interest assets and the overall duration of the liabilities.

If the value of assets in the fund is more than reasonably sufficient to enable the fund to meet its aims for the fund, as described in the guiding principles in section 5, then the overall proportion of shares and property is likely to be significant. Conversely in circumstances where the value of the assets is fairly close to the minimum amount required, the overall proportion of shares and property is generally likely to be low.

It is the intention that the proportion invested in equities will be reduced from current levels over time to reflect the increasing *maturity* of the business. This will be a gradual process over many years. A reasonably significant exposure to equities will remain.

In future other changes to the equity-backing ratio for different classes of policy, or for sub-groups of policies within a class, may be made. However any such changes to the equity-backing ratio will be made by reference the factors referred to in Principle 7.9, that is the date of issue, the *term remaining* and the level of the guaranteed benefits. There is currently no intention of changing the equity-backing ratio for different groups or sub-groups of policies other than to reflect these factors.

7.9.4 All policies are grouped according to the specimen policy that most closely represents them and the total *asset share* for each group is determined. The total is then invested in the proportions determined for the specimen according to the rules in paragraph 7.9.3.

7.9.5 The guideline asset mix range for *asset shares* is:

	Former PAL Life	**Former Bradford**	**Former Swiss Life With Profit Fund**
Fixed interest and cash	40% to 55%	40% to 55%	40% to 55%
Equities including *private equity* and *alternative assets*	40% to 55%	40% to 55%	40% to 55%
Property	0% to 10%	0% to 10%	0% to 10%

From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*. The equity investments will be a mixture of UK and overseas shares, including emerging markets and may also include *private equity* and *alternative assets* such as hedge funds. Fixed interest assets will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt.

Sufficient assets would be disposable at short notice without material loss in value to meet foreseeable additional liquidity requirements.

The agreements with the *investment managers* set out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single company.
- The maximum amount that can be invested in any single asset class / industry sector / country.
- The maximum amount to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns. (These include restrictions in terms of credit quality, term/duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moody's).
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

Guarantee Reserves

7.9.6 Guarantee reserves are the additional reserves that are necessary, over and above the *asset share*, to ensure that guaranteed benefits can be met. The current practice is to invest the assets covering the guarantee reserves in fixed interest investments. This does not provide a perfect match as the guarantee reserves will tend to increase / reduce as the value of the equity and property investments within the *asset share* fall / rise with market movements. Any surpluses or shortfalls arising from this mismatch will act to reduce or increase amount of excess assets in the fund.

Other Liabilities and Excess Assets

7.9.7 Assets representing short-term liabilities are invested in cash or short-term debt. Assets representing the *estate* of the 100% With-Profits Fund are mostly invested in fixed interest securities. However if the *estate* is large in relation to the potential risks facing the fund then part of the *estate* may be invested in line with the asset mix for the *asset shares*.

Miscellaneous

7.9.8 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

7.9.9 The fund does not hold any assets which are *not normally traded*.

7.9.10 Before investing in new or novel investment instruments, the *Board* would obtain the advice of the *Chief Actuary* and the *investment managers* on the benefits and risks of the proposition. This would include an analysis of the nature and proportion of future outcomes in which the instrument would prove materially disadvantageous relative to other more traditional investments. If these are to be held in material amounts in respect of with-profits policies, the *Board* would also seek the opinion of the *With-Profits Actuary* and the *With-Profits Committee*.

Principle 7.10 Business Risks

As well as investment performance and counterparty exposure the fund's future ability to continue to pay all guaranteed benefits when due will be affected by a number of other factors 'business risks' that may arise from running off the existing portfolio. These are listed, together with the controls which are applied, in paragraph 7.10.1.

It is not currently envisaged that any business risks would be taken on in addition to those to which the fund is already exposed although, if it appears to be potentially beneficial to policyholders to do so, then this might be done or the exposure to risks to which the fund is already exposed (such as by cancelling reinsurance arrangements) could be increased. If this did take place, it would only be done if the reward was expected to be better than that from other investments with broadly equivalent risks (such as investing in shares or property). The *Board* would formally consult and take account of the opinions of the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee* before doing so.

The *Board* will annually review existing business risk exposures as part of assessing the formal regulatory capital requirement and take appropriate measures to limit risk to amounts to which it is fair for the with-profits business to remain exposed.

Practices

7.10.1 The main business risks of the fund, and the controls that are applied to those that Phoenix Life Limited can influence, include:

- Expenses of management – controlled mainly by outsourcing all business activities, including policy administration and investment management. Normal activities are outsourced on an agreed pricing basis. The main residual costs not subject to an agreed pricing basis are project activity and certain direct costs and fees.
- Failure of non-group outsourced services provider – part of the administration services provided by PGMS are sub-contracted to Diligenta– controlled by having exit plans. PGMS is liable for any additional cost of providing these services which might arise if Diligenta were to default. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.
- Meeting minimum guaranteed policy benefits (where these costs are reasonably attributable to the fund) and the cost of *smoothing* – controlled by having an appropriate rate of *annual bonus*, limiting the extent of *smoothing* and investing primarily to meet the guarantees, all whilst ensuring that customers continue to be treated fairly.
- Fluctuations and long-term trends in death rates – fluctuations are constrained by the use of reinsurance contracts to limit exposure on any one policy.
- Changes in taxation.
- Profits or losses from investments backing non-profit business or other liabilities and from investments which represent additional capital.
- Profits or losses from the early or late termination of policies.
- Provision of compensation for past legal or regulatory infringements.
- The cost of additional capital needed to be held for regulatory purposes or for the optimal management of the business – controlled by regularly reviewing the level of excess capital and by ensuring that only a commercial cost for capital is being paid.

- Failure of reassurers – the reassurance credit risk is monitored.

7.10.2 Currently it is not envisaged that the fund would take on any business risks in addition to those to which it is already exposed although it may do so, if it appears to be potentially beneficial to the fund.

7.10.3 How and to what extent business profits and losses to which the fund is already exposed are incorporated in the *asset share* calculations for specimen policies and so how they affect the amounts payable under with-profits policies is described in section 7.4.

To the extent that business profits or losses are not incorporated in *asset share* calculations, they will increase or reduce the excess assets in the fund.

7.10.4 If the fund experienced or identified a particularly large business profit or loss in any one year, its incorporation in *asset share* calculations may be spread over a number of future years to avoid excessive impact on policy values in the short term.

7.10.5 There is no predetermined minimum value below which business profits or losses will not be applied, sooner or later, as a determinant of the bonuses payable under with-profits policies.

7.10.6 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

7.10.7 As described in section 7.4, no amounts are currently being attributed to *asset shares* in respect of business risk as the amounts are involved are minimal. If this were to change in the future then the outcome from all business risk will be pooled across all with-profits policies in the fund, although this has not always been the practice in the past.

Principle 7.11 Expenses and Charges

These are governed by guiding Principle 2 in section 5.

In addition, charges and expenses attributed to the fund in respect of former Swiss Life policies will be in line with the *2023 Scheme* and with the commitments made to the *regulator*.

Where costs are specific to a policy or class of policy then, taking into account the approximations referred to in section 7.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a single policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

Former Swiss Life Policies

7.11.1 For former Swiss Life With Profit Fund policies, the expense charged to the fund in any year is a specified amount for each policy in force on 30 June in that year. The specified amount is £20, increased in line with the increase in the Average Earnings Index from 30 June 1989 to 30 June 2010. Thereafter the specified amount increases in line with increases in Average Weekly Earnings which replaced the Average Earnings Index.

7.11.2 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

Former PAL and Bradford Policies

7.11.3 The main expenses that are apportioned to the *asset shares* of specimen with-profits policies relate to the fees paid to PGMS in connection with all business activities. The PGMS charges are mainly expressed as an annual amount per policy, irrespective of type (other than non-profit annuities, for which the fee is lower), increasing each year by RPI + 1%. For policies with more than one benefit, including premium increments, the charge is only made once. They are apportioned on this basis.

Additional fees are payable for certain other one-off activities and developments. Such costs are generally apportioned in proportion to the PGMS fees.

Fees are also payable to the *investment managers* in connection with the management of the investments. These amounts are expressed as a percentage of the investments under management. Where investments are via a collective investment vehicle operated by the *investment managers*, the total fees payable to the *investment managers* are not materially different than if those investments were directly held.

Commission is also payable to intermediaries on some contracts.

7.11.4 Costs attributable to the fund that are not apportioned to *asset shares* will reduce the excess assets of the fund.

Principle
7.12 ***Estate* Management**

The aim is to manage the fund so that there is always a small excess of the value of the assets over the amount considered necessary on *market-consistent* assumptions to enable it to meet the aims described in the guiding principles in section 5.

The excess at the targeted level is maintained by:
- controlling the addition of *annual bonuses* to policies;
- maintaining an appropriate investment strategy;
- limiting, where possible, the business risks faced;
- exercising discretion in other areas with moderation; and
- drawing on or repaying additional financial support from the Non-Profit Fund or *Shareholder Fund* in the form of loans to the fund or otherwise.

Where the assets of the fund are in excess of the amounts required to meet the aims described in the guiding principles in section 5, it is intended that the enhancement factor applied to *asset shares* on former PAL with-profits *traditional* life policies, both direct written and reassurances accepted, will be adjusted over time so that the excess is brought into line with the adequate but not excessive margin. Such an adjustment will not be applied to the other policies in the fund.

The effect of this approach is that within the fund:
- the amounts payable upon death, *maturity* or early termination of a former PAL with-profits *traditional* life policy (either direct written or reassurance accepted) will be significantly in excess of the amounts that would be payable had the excess assets been only sufficient to meet the minimum aims described in the guiding principles in section 5; and
- the amounts payable under other policies will not be affected by any excess assets.

Practices

7.12.1 The former Bradford and former Swiss Life business does not have any interest in the *estate* arising in the fund and references in this section to potential benefit enhancements from *estate* distribution do not apply to this business.

7.12.2 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

7.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 7.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

7.12.4 The *estate* will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;
(c) meet any costs which are charged directly to the *estate*, rather than to *asset shares*;
(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and

(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected, amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

7.12.5 Any enhancement in benefits on account of the *distributable estate* referred to in 7.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

7.12.6 The amount of the *estate*, the *distributable estate*, and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

7.12.7 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to the *asset shares* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

7.12.8 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 7.12.7 be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *Board* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle
7.13 New Business

Apart from as a result of the exercise of options under existing policies and contractual increments, new business is no longer accepted. The future business risk from this source is expected to be small.

Practices

7.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts.

Currently there are no plans to reopen the fund to new business.

Principle
7.14 Equity Between the Fund and Shareholders

The *2023 Scheme* provides that holders of with-profits policies in the fund are entitled to receive the whole of the divisible profits arising from the fund. Payments from the fund are therefore limited to those amounts required to meet obligations under policies and reassurance agreements written in the fund. None of the divisible profits arising in the fund are attributed to the other *with-profits funds*, the Non-Profit Fund or to the *Shareholder Fund*.

If the *Board* were considering making changes to the current position, it would first request and consider the advice of the *Chief Actuary* and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee*. If it decided to proceed, the *Board* would notify policyholders at least three months in advance. It would also need to seek the agreement of Phoenix Group and the High Court to make such a change.

If a position arose where the fund required financial support from the Non-Profit Fund or *Shareholder Fund*, whether in the form of a loan or otherwise, to enable it to meet the target excess assets described in section 7.12, the terms on which such support is provided will be fair and reasonable to all parties, taking into account prevailing market conditions and the risks involved. If such support forms part of the fund, then it will be treated as a liability to the extent that it would otherwise increase the excess assets (disregarding for this purpose any requirement under the relevant rules or actuarial standards to recognise as a liability the requirement to distribute any surplus).

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arm's length commercial basis.

Practices

7.14.1 Payments from the fund are limited to those amounts required to meet obligations under policies and reassurance agreements written in the fund. None of the divisible profits arising in the fund are attributed to the Non-Profit Fund or to the *Shareholder Fund*.

7.14.2 The expenses allocated will be that part of the expenses of the *long-term business fund* as a whole which are deemed to have been incurred in respect of policies written in the fund. These expenses are determined by an analysis of the costs incurred by Phoenix Life Limited including the costs under the agreements for policy administration and other services for the business written by all the funds. For former Swiss Life policies, the expenses allocated will be by reference to the specified charging structure set out in section 7.11. Phoenix Life Limited believes that it is fair that the fund should bear its share of any overheads and expense overruns to the extent that these can reasonably be attributed to the business written in that fund.

7.14.3 The *Board* are not aware of any external or internal factors, which, if they were to change, would have a material effect on the apportionment of surplus as described above.

7.14.4 Where mis-selling costs are charged to the fund they will be met from the excess assets in the fund so long as such excess assets exist.

7.14.5 When deferred annuity policies mature, the annuity is set up in the Non-Profit Fund and the reasonable cost of setting up the annuity is paid to the Non-Profit Fund.

8 Principles and Practices – Alba With-Profits Fund

The Principles and Practices given in sections 8.4 to 8.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the Alba With-Profits Fund. Sections 8.1 to 8.3 give background information specific to the Alba With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the Alba With-Profits Fund.

8.1 Fund History

The Alba With-Profits Fund comprises the business that was transferred to Phoenix Life Limited under the *2006 Scheme* from the Ordinary Long Term Fund of Alba Life Limited.

It includes business previously written by FS Assurance (FS), the Life Association of Scotland Limited (LAS) and Crusader Insurance plc (subsequently renamed Britannia Life Assurance (BLA)) as well as Britannia Life Limited (BLL). These were merged in 1994 through a transfer, under a scheme made under Section 49 of the Insurance Companies Act 1982.

Alba announced its closure to new business on 4 December 1997 and finally closed to all new business in July 1998.

Alba was previously called Britannia Life Limited, the name changed on 6 December 1999 following its acquisition by Britannic Assurance from the Britannia Building Society.

On 4 December 2003, Alba entered into an agreement with Britannic Assurance whereby a basis was agreed upon which Britannic Assurance would provide capital support for Alba to manage its deficit. In April 2006 Britannic Assurance sold Alba to Resolution Life Limited and the capital support agreement with Britannic Assurance was replaced by an equivalent one with Resolution Life Limited. Although this agreement has ceased, the fund continues to be managed under equivalent practices as described in section 8.3.

In 2022 policies sold in Ireland were transferred to PLAE, an Irish company within the Group, and immediately reinsured back into the Alba With-Profits Fund. Subsequently from 1 January 2025 these policies transferred from PLAE to SLIDAC, another company within the Group. They remain reinsured into the Alba With-Profits Fund. SLIDAC is responsible for paying claims under these policies. For as long as the reinsurance remains in force, amounts payable to SLIDAC on these policies under the reinsurance will continue to reflect participation in the Alba With-Profits Fund at the same level as before.

8.2 Types of Business

The with-profits business in the Alba With-Profits Fund is split into different classes for the purposes of allocating *annual bonuses*, *final bonus*es and interest payments based on a declared rate of return. The split into classes depends primarily on:

- The type of product and the method by which it participates in profits, that is *traditional* with-profits business, *unitised* with-profits business, *deposit administration business* or *controlled funding arrangements*.
- The classification for tax purposes, that is life assurance business, general annuity business, pensions business or overseas business.
- Whether the business is regular premium paying or single premium.
- Whether or not the business fully participates in the experience of the fund.

In practice, the with-profits business within the Alba With-Profits Fund falls within two broad groupings – *Fully Participating business* and *Investment Smoothing business*.

8.2.1 Fully Participating Business

This comprises:

***Traditional* With-Profits Life and Pension (former BLL Bonus Series B)**

These are *traditional* with-profits contracts covering:

- all life *traditional* with-profits business (mainly endowments and whole of life contracts); and
- pension *traditional* with-profits business (mainly deferred annuity and cash contracts) arising from the former Britannia Life Limited which are currently being awarded bonus under Bonus Series B.

***Traditional* With-Profits Pension (other than former BLL Bonus Series B)**

These are *traditional* with-profits contracts covering all pension *traditional* with-profits business (mainly deferred annuity and cash contracts) except those arising from the former Britannia Life Limited which are currently being awarded bonus under Bonus Series B.

***Unitised* With-Profits (written prior to 1 January 1994)**

These are contracts which are wholly or partially invested in a notional fund consisting of with-profits units and which were taken out prior to 1 January 1994. With-profits units arising from premium increases and additional premiums made on or after 1 January 1994 where these are written under a new policy number, are included in the *unitised* with-profits (written on or after 1 January 1994) category below.

***Deposit Administration* (former LAS / BLA / Crusader)**

These are *deposit administration* contracts arising from former Crusader Insurance plc, former Britannia Life Assurance and the former Life Association of Scotland.

***Controlled Funding Arrangements* (former LAS / BLL / FS)**

These are *controlled funding arrangements* which arose from the former FS Assurance and the former Life Association of Scotland.

8.2.2 *Investment Smoothing Business*

This comprises:

***Unitised* With-Profits (written on or after 1 January 1994)**

These are contracts which are wholly or partially invested in a notional fund consisting of with-profits units and which were taken out on or after 1 January 1994. It also includes with-profits units arising from premium increases and additional premiums made on or after 1 January 1994, in respect of policies originally written before 1 January 1994, where the premium increases and additional premiums have been written under a new policy number.

***Unitised* Capital Guaranteed Fund**

These are contracts which are wholly or partially invested in a notional fund consisting of with-profits units. Contracts are group pension arrangements or buyouts arising from group pension arrangements.

***Deposit Administration* (former FS/BLL)**

These are *deposit administration* contracts arising from FS Assurance and Britannia Life Limited.

Controlled Funding Arrangements (former BLA / Crusader)

These are *controlled funding arrangements* which arose from Britannia Life Assurance / Crusader Insurance plc.

Former Crusader With-Profits Performance Fund and With-Profits Pension Fund

These are contracts which are wholly or partially invested in notional funds consisting of with-profits units.

Former Crusader Growth Bonus Series H

These policies were originally former Britannia Life Assurance / Crusader Insurance special 10 year endowments. The maturity proceeds at the end of 10 years were left invested and have then received Growth Bonus Series H bonuses.

8.3 Capital Support to the Fund

8.3.1 (a) History

Alba and Resolution Life Limited entered into an agreement in April 2006, under which Resolution Life Limited agreed to provide capital support for Alba’s business and Alba gave certain undertakings in respect of the management and operation of its business. The agreed requirements for the management and operation of Alba’s business were reflected in Alba’s Principles and Practices of Financial Management. The agreement aimed to take account of the interests of all stakeholders, including policyholders of Alba and Resolution Life Limited’s shareholders.

The long-term aim of the capital support agreement is for Alba to be able to support its own risk-based capital from its own resources.

This agreement replaced a previous agreement dated December 2003 between Alba and Britannic Assurance, the then owner of Alba. The terms for the management of the Alba business remain principally unchanged.

This agreement ceased when the business of Alba was transferred into Phoenix Life Limited. However, the *2023 Scheme* provides that the policies then operating in respect of the Alba with-profits business were carried forward within Phoenix Life Limited. The key points of this are given in the rest of this paragraph and are incorporated into the Principles and Practices for the Alba With-Profits Fund in sections 8.4 to 8.14.

(b) Management of the business

The *Board* will seek to manage the fund such that it is able to meet its regulatory capital requirements without drawing down further capital from the Non-Profit Fund or *Shareholder Fund*.

Maturity payouts will be targeted at 100% of asset shares. For classes of policy that participate fully in the profits and losses of the Alba With-Profits fund the asset share targeted is after deduction of any guarantee charges (see below).

At least once a year, calculations will be made to establish if there is a deficit in the fund. A deficit exists if the assets in the fund are insufficient to cover its liabilities.

If there is a deficit, then guarantee charges may be applied. Guarantee charges will only be made to the extent needed to eliminate the deficit in the fund, and will in any event be subject to the following limits:
(a) guarantee charges will not exceed 10% of asset shares in total unless the liabilities (allowing for the application of a 10% guarantee charge) exceed the assets by more than £92m; and
(b) guarantee charges will not exceed 25% of asset shares in total.

If, following the application of guarantee charges, the experience of the fund is favourable and there is no longer a deficit, then previously applied guarantee charges will be removed, in accordance with the above rules, to the extent that is possible without re-creating a deficit.

Surrender payouts will be targeted at 100% of assets shares, after any guarantee charge. However if there is a deficit in the fund, consideration will be given to paying less than 100% of asset shares to fairly balance the interests of continuing policyholders against those exiting the fund.

Exposure to equities was nil, however from January 2017 the Board agreed that some exposure to equities could be introduced and this is described further in 8.9.4 below.

Under the capital support agreement exposure to property was maintained at around 15% of the fund. This has subsequently been reduced slightly to allow for the run off of the fund. In 2022 the *Board* agreed to reduce the property exposure further with offsetting increases in other types of growth assets. Also a *short position* in property may be held giving an overall lower exposure.

Subject to the property and equity exposures, investment policy will be a matched investment policy. This will be based on high grade fixed interest investments as determined by the *Board*.

8.3.2 *Capital Support Arrangements*

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

The loan, capital support agreement and the management of the business described above are generally referred to as the *Capital Support Arrangements* subsequently in sections 8.4 to 8.14.

Principle
8.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The guaranteed benefits provide a minimum *payout* level.

Different bonuses are declared for different classes of with-profits business, reflecting the specific fund within which the business is written, tax, type of with-profits business and product features.

An existing class would only be split in exceptional circumstances. Exceptional circumstances would include but are not limited to cases where:

- premium rates within the class have been changed historically over a period of time and this needs to be reflected in differential bonus rates; and
- there is a distinct divergence in the experience of products sharing the same bonus series.

Within classes, bonuses may be further differentiated by series, with additional series being added on a timely basis.

Bonus policy can be affected by a variety of factors including investment returns and prospects, actual and expected expense levels, the cost of guarantees, the financial position of the fund and changes in provisions generally.

The main guide used for determining the amounts payable under a with-profits policy is *asset share* calculations and the amounts payable will allow for a policy's fair share of any surplus distributed, which may be in the form of annual or final bonuses or smoothed returns.

The degree of approximation used in the application of *asset share* methods will be consistent with the overall fair treatment of all with-profits policyholders.

These methods may be refined from time to time with the impact reported to and approved by the *Board*. The *Board* retains control over any changes to these methods. Such changes may include changes to the historical aspects of the calculations as a result of:

- Changes in regulations.
- Improvements in the degree of approximations.
- Maintaining equity between classes or groups of policyholders.
- Significant changes in the financial condition of Phoenix Life Limited.

Practices

***Asset Share* Methodology**

8.4.1 Payout amounts are determined by reference to *asset share* calculations.

Asset shares aim to assess a policyholder's fair share of the assets of fund and are an accumulation of the various elements of the experience of the fund relevant to the particular class of business during the lifetime of the policy.

This section should be read in conjunction with the targeting process described in sections 8.6 and 8.12.

8.4.2 The contribution of the elements is described in more detail below, for both *Fully Participating business* and *Investment Smoothing business* separately.

Element		*Fully Participating Business*	*Investment Smoothing Business*
(a)	Premiums	Premiums paid Note (a)	Premiums paid Note (a)
(b)	Investment return	Allocated return Note (b)	Allocated return Note (b)
(c)	Investment expenses	Actual allocated Note (c)	Actual allocated Note (c)
(d)	Initial expenses	Actual allocated Note (c)	Actual allocated Note (c)
(e)	Renewal expenses	Actual allocated Note (c)	Actual allocated Note (c)
(f)	Other expenses	Actual allocated Note (c)	Actual allocated Note (c)
(g)	Tax on investment return	Actual allocated Note (g)	Actual allocated Note (g)
(h)	Tax relief on expenses	Actual allocated Note (g)	Actual allocated Note (g)
(i)	Mortality & morbidity costs	Experience Note (i)	Experience Note (i)
(j)	Early terminations	included through item (t) below	included through item (t) below
(k)	Paid-up policies	Not applicable	Not applicable
(l)	Partial and regular withdrawals	Not applicable	Not applicable
(m)	Surrenders at *protected dates*	Not applicable	Not applicable
(n)	Annuity payments	Not applicable	Not applicable
(o)	Charges for the cost of guarantees	included through item (t) below	included through item (t) below
(p)	Charges for the cost of capital	Sometimes Note (p)	Not charged Note (p)
(q)	Distributions to shareholders	Charged Note (q)	Sometimes Note (q)
(r)	Tax on distributions to shareholders	Not applicable	Not applicable
(s)	Profit and losses from other business	included through item (t) below	included through item (t) below
(t)	*Estate* distribution or charge	Charged Note (t)	Not charged
(u)	Exceptional items	Not applicable	Not applicable

The way in which the above items are taken into account is described in the notes below, together with how they vary by type of business. Where charged is used in the table above this means both charged and / or credited depending on whether it is a loss or profit.

Notes

(a) Premiums

Premiums paid under the policy. For *unitised* business, it is the premiums used to purchase units which are net of any premium related policy charges. These charges include any reduced, nil or enhanced allocation percentages, additional initial unit charges and a bid / offer spread.

(b) Investment return

The investment return resulting from the asset allocation applied to the particular class or sub-class of business as outlined in section 8.9.

(c) Expenses

This is the actual expenses, including commission and project, additional activity and one-off costs, incurred by the fund allocated to the particular class of business, unless the *Board* approves limiting the expenses allocated where this is appropriate. The impact of project and one-off costs may be spread over a number of years. Significant future project, additional activity and one-off costs will only be charged to asset shares following approval by the Board.

For *unitised* business, the expenses are implicit in the product charges specified in the policy terms and conditions and updated from time to time. These charges include an annual management charge, policy fees and risk benefit charges.

No new business is being written in the fund other than to honour policy options. Where *traditional* with-profits new policies are written for this reason, initial expenses are generally based on inflated previous year's initial expenses and including allowance for commissions.

(g) Tax

Allowance for the relevant rate of tax on the respective investment classes is applied together with tax relief on expenses, where appropriate.

(i) Mortality and morbidity costs

Charge for mortality and other risk benefits where applicable. For *deposit administration* business and *controlled funding arrangements* this reflects the cost of risk benefits and also the value of retirement benefits paid. For *unitised* business these are generally applied through cancelling units.

(p) Charges for the cost of capital

This is the charge for holding risk based capital which is currently zero. The cost of capital is applied to the *asset share* by an addition to or deduction from the rate of investment return applied in the year in which it arises. Not charged to *Investment Smoothing business* or *deposit administration* (former LAS / Crusader / BLA) business.

(q) Shareholder transfers

This is calculated as up to one ninth of the cost of bonus paid to policyholders each year, as described in section 8.14.

(t) *Estate* distribution or charge

Asset shares for *Fully Participating deposit administration* business (specified in 8.2.1) are not increased by distributions from the *estate*. Instead *payouts* for these policies are enhanced by a *final uplift* to allow for any *distributable estate* (described in 8.6). Asset shares may be reduced by any charges to the *estate*.

Asset shares for all other *Fully Participating* business may be increased by distributions from the *estate* or reduced by charges to the *estate*. Where a distribution is made, this is not guaranteed and may be removed. Where a charge is being made, this will be calculated in accordance with 8.3.1(b) above. It is our current practice not to apply any charges to business sold after June 2004. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

8.4.3 *Asset shares* are calculated for representative specimen policies when setting bonus rates. Specimen policies are chosen to represent the business and include a range of policy terms and years of entry. The primary emphasis in selecting specimen policies is the size of premium or sum assured. There is however a degree of averaging, particularly for those terms where there are relatively few policies. For *unitised* with-profits business, specimen policies are for each year of purchase of units.

8.4.4 A degree of approximation within *asset share* calculations is required where data is not fully available or is only available in a pooled form, to the extent that such approximation accords with the experience available from existing historical data. This is particularly the case for *traditional* with-profits paid-up policies (especially pensions), *Unitised* Capital Guaranteed Fund policies, deposit administration policies and controlled funding arrangements. Where historical data is not available, relevant industry experience is used instead.

8.4.5 *Asset share* calculations may be refined from time to time. The impact of any changes is reported to the *Board*. The method, assumptions and parameters used in *asset share* calculations can only change after due consideration by the *Board*. Such changes and refinements can be made retrospectively. Retrospective changes to the assumption basis are unlikely to be made prior to 2004 due to the introduction of the capital support agreement at that time.

8.4.6 Procedure notes are maintained by PGMS. For each bonus review appropriate documentation is produced and provides an audit trail of the process, including sources of data, source and derivation of assumptions, backing calculations, notes and correspondence. This audit trail normally includes retaining electronic copies of the systems and calculations used for the review.

8.4.7 For *traditional* whole life policies, *final bonuses* and *surrender value* bases may be set with reference to those applicable for endowments.

Principle
8.5 ***Annual Bonus* rates**

Annual bonuses, other than those guaranteed to date, will only be added to any class of with-profits business if and to the extent that the *Board* considers it prudent to do so, taking account of the financial position of the fund.
In cases where *final bonus* rates do not apply, *smoothing* of the *annual bonus* rates is used as a mechanism to adhere to section 8.4 where applicable.

In changing economic circumstances, the constraints on setting *annual bonuses* are the level of existing guaranteed benefits, the level of assets in the fund, the financial position of the fund and the need to retain management flexibility.

Practices

8.5.1 For *traditional* with-profits and *unitised* with-profits business where *annual bonus* is guaranteed, this will continue to be paid in accordance with the policy conditions. Consideration will be given to a future declaration of non-guaranteed *annual bonus* only if there is sufficient surplus in the fund and then taking into account the factors set out in the following paragraphs.

8.5.2 For each class of *traditional* with-profits and *unitised* with-profits business, the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected *final bonus* broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target. For certain *unitised* with-profits pension business written prior to 1 August 1992 business there is a guaranteed minimum annual bonus rate of 4% per annum.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

8.5.3 Where the financial position of the fund is weak, the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

8.5.4 For *traditional* with-profits business, *annual bonuses* are normally reviewed once a year. *Interim bonus* rates are set with reference to the most recent *annual bonus* rate declared and any future anticipated direction of these rates. The *annual bonus* rate may, however, eventually be set at a level that differs from the *interim rate*.

For *unitised* with-profits business, *annual bonuses* are normally reviewed once a year. *Interim bonus* rates are not applicable to this type of business as *annual bonus* rates are declared in advance.

8.5.5 For *controlled funding arrangements* (former BLA/Crusader), benefits are based on the individual scheme *asset share* and no *annual bonus* additions are made.

For other policies not eligible for *final bonus*, *annual bonus* will be set at a level which, using realistic assumptions but disregarding any *estate* distribution, will bring the projected *asset share* and the value of projected policy benefits broadly in line over a five year period.

Annual bonuses are normally reviewed once a year. Changes in annual bonuses are limited to maintain a smooth progression.

8.5.6 For former Crusader Growth Bonus Series H business, the *annual bonus* rate is based on short-term interest rates less tax and less an annual management charge of 0.5% per annum to cover expenses. The rate is declared in advance, added daily to the unit price and is normally reviewed twice a year from 1 January and 1 July. If the calculated rate is within 0.5% of the current *annual bonus* rate, then the current *annual bonus* rate is maintained. If the calculated rate is not within 0.5% of the current *annual bonus* rate, then the *annual bonus* rate is set equal to the calculated rate rounded to the nearer 0.25%. The *annual bonus* rate may be reviewed at any time due to changing investment conditions. It is not expected the *annual bonus* will be less than zero, other than in exceptional circumstances.

8.5.7 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

8.5.8 Different bonus scales may apply to the same contract depending on whether regular or single premiums are paid.

Principle
8.6 ***Final Bonus* rates**

Final bonus rates are used as a mechanism to adhere to section 8.4, where applicable. As such, they will be based on the difference, if positive, between the amount determined to ensure fairness to policyholders and the value of guaranteed benefits. *Final bonus*es may increase or decrease and may also be nil. *Final bonus*es can be reviewed at any time.

Final bonus is subject to *smoothing*.

In changing economic circumstances, the constraints on setting *final bonus* rates are the level of existing guaranteed benefits, the level of assets in the fund, the financial position of the fund and the need to retain management flexibility.

Practices

8.6.1 No *final bonus* is payable on *Unitised* Capital Guaranteed Fund, *Investment Smoothing deposit administration*, *controlled funding arrangements*, former Crusader With-Profits Performance Fund and With-Profits Pension Fund and former Crusader Growth Bonus Series H classes of business. Therefore, the rest of this section 8.6 is not applicable to them.

Fully Participating deposit administration business (specified in 8.2.1) is eligible for a *final uplift* as described in 8.6.9.

8.6.2 For all Fully participating business (defined in 8.2.1), *final bonus* (and for *Fully Participating deposit administration* business the *final uplift)* will be set with the aim that all the assets of the fund including any *distributable estate* will be distributed to policyholders after meeting emerging costs.

8.6.3 For all *traditional* with-profits business, *final bonuses* are determined for representative specimen policy maturities based on the difference, if positive, between *asset share* calculations described in section 8.4 subject to the comments below and the value of guaranteed benefits. If this difference is negative, *final bonus* rates will be nil and *maturity payouts* will be the guaranteed benefits.

The resulting rates are reviewed and adjusted, if appropriate, to take account of the actual profile of maturities over a period, generally six or twelve months from the date at which the bonus rates are to be set.

The above calculations are generally based on specimen policies with terms which contain a significant volume of policies. For other terms approximations may be used.

8.6.4 For *unitised* with-profits business (written prior to 1 January 1994), *asset share* values, as described in section 8.4, and the value of units are calculated for a representative specimen policy for each year of purchase assuming unit purchase at 1 July of each calendar year. *Final bonus* rates and *market value reductions* are set for each calendar year by calculating the movement required to obtain equality between the specimen *asset shares* and specimen value of units.

The *final bonus* rates and *market value reductions* so calculated are then applied to all units purchased in that calendar year.

8.6.5 For *unitised* with-profits business (written on or after 1 January 1994), *asset share* values, as described in section 8.4, and the value of units are calculated for a representative specimen policy for each year of purchase assuming unit purchase at 1 July of each calendar year. *Final bonus* rates and *market value reductions* are set for each calendar year by calculating the movement required to obtain equality between the specimen *asset shares* and specimen value of units. The *final bonus* rates and *market value reductions* so calculated are then applied to all units purchased in that calendar year.

8.6.6 *Final bonus* rates are set taking account of recent economic experience in accordance with paragraphs 8.6.2 to 8.6.4 above.

8.6.7 Where the benefits are expressed in the form of a pension rather than cash, the *asset share* described in section 8.4 is converted to an equivalent annuity by using annuity rates. The *final bonus* then calculated is expressed as an annuity. For the majority of products conversion rates set out in the contract when the policy was taken out are used. For former Crusader Self-Employed Deferred Annuities taken out before 1977 current annuity rates are used.

8.6.8 Restrictions on the movement in *final bonus* rates for maturities due to *smoothing* are described more fully in section 8.7.

8.6.9 The *final uplift* is a different form of bonus to the other types of bonus described. *Payouts* for *Fully Participating deposit administration* policies may be enhanced by a *final uplift* to allow for any *distributable estate.*

8.6.10 No *final bonus* or *final uplift* will be declared where there is insufficient surplus available on a statutory basis in the fund to cover the cost of bonus and the associated transfer to the *Shareholder Fund*.

In deciding whether a *final bonus* or *final uplift* will be declared, consideration will be given as to whether funds require to be transferred into the fund under the terms of the *Capital Support Arrangements*.

8.6.11 *Final bonus* rates and *market value reductions* may be changed at any time, They are normally set twice yearly from 1 January and 1 July, but would be reviewed more frequently in periods of volatile economic conditions. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the *maturity payout ratios* at the latest *final bonus* review were near the top or bottom of the range described in paragraph 8.7.1, a lower level of investment return variance may lead to an additional *final bonus* review.

8.6.12 *Market value reductions* are not applied at *maturity* or death.

8.6.13 Different *final bonus* scales may apply to the same contract depending on whether regular or single premiums are paid.

Principle
8.7 ***Smoothing***

At *protected dates*, *smoothing* protects the amount payable from day to day investment fluctuations. *Smoothing* applies across groups of policyholders and restricts movements in equivalent *payouts* between different generations of policyholders. The aim is to bring *maturity payouts* into line with the target proportion of the relevant *asset share* in a reasonable period of time.

Smoothing leads to profits and losses which are anticipated to offset each other over time. In the short term, if these were to become excessive, then the *smoothing* policy would be reviewed. *Smoothing* is intended to be neutral over the long term.

The aim is to minimize the cost of *smoothing* subject to treating customers fairly.

For all business except *traditional* business, the amounts payable at times other than *protected dates* will take account of day to day market movements and as a result may have a *market value reduction* applied. For *traditional* business, *surrender values* will have a degree of *smoothing*.

Practices

8.7.1 The long-term target *maturity payout ratio* is 100% of *asset share* as described in section 8.4. The target range for *maturity payout ratios* is to be between 80% and 120% of *asset share before the effects of smoothing*.

8.7.2 For *traditional* policies and *unitised* with-profits policies, where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* or retirement values, by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement payout compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies and *unitised* with-profits policies*, surrender* value bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender* value for specimen policies. Normally the *surrender* value for specimen model policies will not change by more than 10% at each six monthly review. *Surrender* values may change in between reviews because in many cases the *surrender* values are calculated using formulae that depend upon factors such as *term remaining* which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender* values.

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and *surrender* bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For all fully participating policies, both *maturity* and retirement values, and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing*. Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

For other business except c*ontrolled funding arrangements*, a *smoothing account* is calculated by comparing the notional face value of contracts (the accumulation of the declared interest rates) within the particular class of business to the asset share (the accumulation of investment returns less management charge and shareholder transfers). An over-riding practice is to remove any deficit in the *smoothing account* as quickly as terms and conditions allow which is consistent with treating customers fairly as described in section 8.5.5, and subject to the constraint of maintaining *payout ratios* within the target range.

8.7.3 *Smoothing* is expected to be neutral over the remaining lifetime of the with-profits business within the fund.

8.7.4 Where a partial surrender is allowed under policy conditions and business is maintained on a tranche basis, only the surrender of one or more complete tranches is permissible at any given time. If all tranches were sold at the same time then *smoothing* would be the same for each. Where tranches are sold at different times, *smoothing* would be independent.

8.7.5 The cost of *smoothing* claim values is allowed for in the *estate* distribution or charge item as described in paragraph 8.4.2(t) and so is not met by all classes.

8.7.6 There are no specific limits applied to the cost of *smoothing*. However, this cost is expected to be limited as such costs are expected to be neutral over the remaining lifetime of the with-profits business in the fund.

Principle 8.8	***Surrender Values***
	Non-protected exit values will be set to ensure that there is no adverse effect on the interests of continuing policyholders.
	Market value reductions may be adjusted for non-investment related items as well as investment related items.

Practices

8.8.1 For any contract where exit values are guaranteed through the policy terms and conditions then that guaranteed value will form the minimum amount to be paid.

8.8.2 For all *traditional* with-profits business, *non-protected exit* values will be set to ensure that there is no adverse effect on the interests of continuing policyholders. *Surrender values* are targeted at 100% of *asset share*. The target range for *payout ratios* is to be between 80% and 120% of *asset share*.

The basis for the *surrender* value formulae is determined by targeting the target proportion of *asset share* for representative specimen policies..

Actual *surrender* payments on individual policies will not generally be in line with the target proportion because*:*

• Individual *asset shares* are not calculated or held on our administration systems for use in *surrender* value calculations. Rather *surrender* values are calculated in a variety of ways for different types of policy. Typically *surrender* values are based on a discounted value of the guaranteed sum at *maturity* or retirement (reduced to allow for non-payment of future premiums for regular premium policies) together with an allowance, where appropriate, for *final bonus*.

• Specimen policies are used to determine the parameters in the *surrender* value calculations. The outcome for a particular individual policy may be different from that of the specimen policy.

• There are a limited number of parameters that may be altered in the *surrender* formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.

• As the value of assets are changing every day but the parameters in the *surrender* value formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender* values would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate.

8.8.3 For all *unitised* with-profits business, the target *payout ratio* for *non-protected exit* values is 100% of *asset share*. Exit values are set using the *asset share* methods described in section 8.4. On surrender, the value of units is compared to the value of the *asset share* calculated. If the value of units is greater than the *asset share* a *market value reduction* is applied to bring the proceeds down to this level. If the opposite is true, the policyholder will be attributed a *final bonus* to bring the proceeds up to the *asset share*. The target range for *payout ratios* is to be between 80% and 120% of *asset share* before the effects of *smoothing*.

The calculation of *market value reductions* and *final bonus*es are described in section 8.6.

8.8.4 For *Unitised* Capital Guaranteed Fund business, early exit values for individual policyholders are the value of units attaching to the policy less any surrender charge as detailed in the policy terms and conditions, to cover unrecouped initial expenses, less any *market value reduction* applicable.

The target *payout ratio* for *non-protected exit* values is 100% of *asset share*.

Market value reductions are calculated using the *smoothing account* described in section 8.7. When the *smoothing account* is negative, a *market value reduction* may be applied and is set at a level which would reduce the total face unit value of all contracts within this class of business to the total *asset shares* of this class of business, as described in section 8.4, based on the *smoothing account*. This reduction is then applied to any individual policyholder on early exit. The target range for *payout ratios* is to be between 80% and 120% of *asset share*.

8.8.5 For *deposit administration* (former FS / BLL) business, early exit values are the account value less any *market value reduction* applicable.

The target *payout ratio* for *non-protected exit* values is 100% of *asset share*.

Market value reductions are based on the *asset share* methods described in section 8.4, are scheme specific and may be applied on scheme termination and may be applied to any individual policyholder exit. The total account values for the specific scheme are compared to the value of the scheme *asset share*. If this total account value is greater than the *asset share*, a *market value reduction* may be applied to bring the proceeds down to this level, based on the *smoothing account* as in section 8.7. The target range for *payout ratios* is to be between 80% and 120% of *asset share*.

8.8.6 For fully participating *deposit administration* business (specified in 8.2.1), the target *payout ratio* for *non-protected exit* values is 100% of *asset share* plus any *final uplift* required to reflect any *estate* distribution. The target range for *payout ratios* is to be between 80% and 120% of *asset share* plus any *final uplift*.

Exit values for individual policyholders are the account value plus any *final uplift* attaching to the individual policy.

Early exit terms for this class of business on bulk surrender are normally set out in policy terms. For former Crusader Versatile Plans, this is the account value. For former Crusader Nestegg Plans written prior to 1 January 1988, this is the account value and payment may be spread over a two year period. For former Crusader Emeritus Plans, the early exit value is the account value less an explicit surrender charge to cover unrecouped initial costs. For former LAS Laserplan and Long Term Accumulation System business, the early exit value is the account value less an explicit surrender charge to cover unrecouped initial costs. In all cases, the account value may be increased by a *final uplift* to reflect any *estate* distribution

For former Crusader Nestegg business written on or after 1 January 1988, a *market value reduction* may be applied to the account value in addition to an explicit surrender charge. *Market value reductions* are calculated using the *smoothing account* described in section 8.7. When the *smoothing account* is negative a *market value reduction* may be applied and is set at a level that would reduce the total face unit value of all contracts within this class of business to the total *asset shares* of this class of business as described in section 8.4, based on the *smoothing account*. This reduction may then applied to any terminating scheme.

8.8.7 For c*ontrolled funding arrangements*, generally the target *payout ratio* for *non-protected exit* values is 100% of *asset share*. The target range for *payout ratios* is generally to be between 80% and 120% of *asset share*.

For individual withdrawals the early exit value is determined by the specific scheme rules governing the *controlled funding arrangement* and is not dependent on the value of purchased pensions.

A full scheme surrender of a former LAS and former FS/BLL *controlled funding arrangement* is the sum of the values of the pensions purchased.

A full scheme surrender of a former Crusader *controlled funding arrangement* is based on an *asset share* methodology as described in section 8.4 less a charge for early termination to cover unrecouped initial costs.

8.8.8 For former Crusader With-Profits Performance Fund and With-Profits Pension Fund business, early exit values for individual policyholders are the value of units attaching to the policy less any surrender charge as detailed in the policy terms and conditions, to cover any unrecouped initial costs, less any *market value reduction*.

The target *payout ratio* for *non-protected exit* values is 100% of *asset share*.

Market value reductions are calculated using the *smoothing account* described in section 8.7. When the *smoothing account* is negative a *market value reduction* may be applied and is set at a level that would reduce the total face unit value of all contracts within this class of business to the total *asset shares* of this class of business as described in section 8.4, based on the *smoothing account*. This reduction may then be applied to any terminating policy. Separate *market value reductions* are calculated for the With-Profits Performance Fund business and the With-Profits Pension Fund business. The target range for *payout ratios* is to be between 80% and 120% of *asset share*.

8.8.9 For former Crusader Growth Bonus Series H, the surrender value is the full value of the benefits and no *market value reduction* is applicable.

8.8.10 *Non-protected exit* value methodology is normally reviewed annually by the *With-Profits Actuary* in line with these principles and practices. However more frequent reviews may take place, in particular in response to significant market movements.

Principle
8.9 Investment Strategy

The fund will take investment risk only to the extent that there is a high degree of certainty that the fund is sufficiently strong to absorb adverse experience. In general, the size and timing of guaranteed benefits determines the investment freedom and risk tolerance.

The degree of matching of assets with liabilities for the fund will be high, meaning that the fund will substantially be invested in high-grade fixed interest investments of appropriate term and credit quality. Actual holdings will be diverse and subject to limits as to the amount held in any given stock or credit quality.

Asset allocation will vary by class of business but this does not preclude these allocations being the same at any given time.

The use of derivatives in the fund is permitted for efficient portfolio management or to reduce investment risk.

No assets that would *not normally* be traded are allowed.

Practices

8.9.1 For former Crusader With-Profits Performance Fund and With-Profits Pension Fund business, investment is made in appropriate former Alba LAS internal linked funds of Phoenix Life Limited. This is currently a mixture of managed and money market funds.

For former Crusader Growth Bonus Series H business, the asset mix is 100% in short-term cash deposits.

The rest of this section does not apply to these types of business.

8.9.2 The Alba With-Profits Fund primarily maintains three pools of investment assets. These are called the Growth Fund, Matched Fund and Foreign Currency Fund. The Growth Fund backs the asset shares, the Matched Fund backs the guarantee reserve and non-profit business and the Foreign Currency Fund is used to back the relatively small amount of Euro and US dollar denominated business. The Matched Fund also backs the *estate*. Additional asset pools may be maintained for *swaps* and *swaptions* or they may be held within the main asset pools.

These investments are managed by the *investment managers* in accordance with an investment mandate specified by the *Board* taking account of a variety of considerations, including our approach to *responsible investment*.

8.9.3 The degree of matching of assets with liabilities for the fund will be high so that the expected cash flow arising from claims is well matched to the cash flow arising from assets with limited risk. This will mean that the fund will substantially be invested in fixed interest investments, such as British Government gilts, other government and supranational bonds and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt. Investment in *swaps* and *swaptions* may be made to reduce the risk from interest rate movements. Variable interest securities, such as index linked gilts may be held to back liabilities that are linked to inflation. A short position in property assets and / or non-government fixed interest securities may be held outside of asset shares to match the liability for guarantee costs.

8.9.4 From January 2017 equity investments were introduced into the Growth Fund.

8.9.5 There is some exposure to property investments in the Growth Fund through property unit trusts and collective investments. The percentage exposure will be reviewed by the *Board* from time to time.

8.9.6 The asset mix varies by class (and sub-class). The current guideline asset mix range for *asset shares* is shown below (with the expected end 2025 guideline asset mix in brackets):

Class / Sub-class	**Fixed Interest and cash** %	**Property** %	**Equities** including *private equity* and *alternative assets* %
Traditional with-profits life and pensions (former BLL Series B)	45% to 55% (40% to 55%)	15% to 25% (0% to 10%)	25% to 35% (40% to 55%)
Traditional with-profits pensions (other than former BLL Series B)	100% (100%)	0% (0%)	0% (0%)
Unitised with-profits business (written prior to 1 January 1994)	45% to 55% (40% to 55%)	15% to 25% (0% to 10%)	25% to 35% (40% to 55%)
Unitised with-profits business (written on or after 1 January 1994)	45% to 55% (40% to 55%)	15% to 25% (0% to 10%)	25% to 35% (40% to 55%)
Unitised Capital Guaranteed Fund	60% to 75% (60% to 75%)	5% to 15% (0% to 10%)	10% to 20% (25% to 35%)
Deposit admin (former FS / BLL)	60% to 75% (60% to 75%)	5% to 15% (0% to 10%)	10% to 20% (25% to 35%)
Deposit admin (former BLA / Crusader)* -former Nestegg, Emeritus and Versatile business	80% to 90% (80% to 90%)	5% to 10% (0% to 5%)	5% to 10% (10% to 20%)
Deposit admin (former LAS) -former Long Term Accumulation (LTA) business	80% to 90% (80% to 90%)	5% to 10% (0% to 5%)	5% to 10% (10% to 20%)
Deposit admin (former LAS) - former LAS Laserplan business	100% (100%)	0% (0%)	0% (0%)
Controlled funding arrangements - former Crusader (Growth Pension Fund)	45% to 55% (40% to 55%)	20% to 30% (0% to 10%)	20% to 30% (40% to 55%)
Controlled funding arrangements - former FS/BLL and LAS	90% to 95% (90% to 95%)	0% to 5% (0% to 5%)	0% to 5% (5% to 10%)

* For *deposit administration* former BLA / Crusader business, the fixed interest investment is split 23% cash, 23% short-dated (less than 5 years) fixed interest and 38% fixed interest, invested in the same way as the other fixed interest assets in the Growth Fund.

From time to time the asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*.

8.9.7 The type and degree of risk acceptable for investments in the fund is as follows.

Fixed Interest Assets

The credit risk arising from investing in non gilts is managed in a number of ways:

- There are limits on the proportion of total fixed interest that can be invested in non-gilts. There are limits on the exposure to any one bond issuer.
- All bond issuers must generally have a credit rating of BBB- or higher. Unrated bonds, or bonds with a credit rating lower than BBB-, can only be owned with the approval of the *Investment Committee*.
- The above limits and criteria may be relaxed where changes in market conditions mean that they would otherwise be breached, subject to approval by of the *Investment Committee.*

Fixed interest assets in both the Growth Fund and the Matched Fund must be denominated in sterling.

The Foreign Currency Fund is relatively small and consists of Euro and US dollar denominated government bonds with terms typically less than 10 years.

Property Assets

The majority of the property investment is through property unit trusts and collective investments. This allows the fund a controlled exit from property investment in line with the run off of its business.

Equity Assets

With the exception of private equity and some *alternative assets*, investments are predominantly listed and traded on recognised stock exchanges.

The assets are widely diversified.

The investment guidelines cover:

- Benchmarks
- Exposures, such as minimum and maximum number of holdings and maximum exposure to any one counterparty
- Currency matching and localisation
- The liquidity position
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

Other

Swaps and *swaptions* may be held to reduce the risk from interest rate movements. These do not affect the investment returns credited to *asset shares*.

The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

8.9.8 Assets representing the *estate* of the Alba With-Profits Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth investments in line with the asset mix for the *asset shares*.

8.9.9 Should the value of the assets of the fund fall below a trigger point, the level of which is agreed from time to time by the *Board*, then sufficient assets would be transferred from the *Shareholder Fund* or from the Non-Profit Fund in order to maintain the solvency of the fund.

8.9.10 The *Capital Support Arrangements* set out the basis upon which assets are transferred to the fund to support it.

8.9.11 Investment strategy is reviewed by the *Board* at least once a year.

The *Board* would be required to approve the consideration of any new asset or liability instruments.

8.9.12 A fixed charge over some of the fund's assets has been provided to SLIDAC as security under the reassurance arrangement and, whilst these assets are held in separately identifiable accounts, this is not expected to impact the overall investment strategy of the fund.

Possible Future Changes

8.9.13 If it is considered by the *Board* to be in the best interests of the policyholders, further hypothecation of the assets in the fund may be introduced. For example this may involve the hypothecation of different property or equity backing ratios to further classes or groups of policies or the hypothecation of fixed interest assets by *term remaining* within *asset shares* to reduce the volatility of policyholder returns near *maturity*.

Principle
8.10 Business Risks

UK life insurance businesses are subject to a number of inherent risks that arise from a range of factors, including product design (such as the provision of guarantees to policyholders), selling and marketing practices, interest rate and market fluctuations and demographic changes. Phoenix Life Limited makes provisions which it considers to be appropriate for the risks which it identifies in relation to its with-profits businesses. There can be no assurance that all risks which might emerge have been identified or that the provisions for identified risks will prove to be adequate. In addition, the risks to which the with-profits businesses are exposed will inevitably change over time.

The long-term aim is for the fund to support its own capital requirements from its own resources. Thus the fund will not undertake any new business risks unless the *Board* are of the view that to do so will reduce risk while maintaining or reducing capital requirements.

Risks, as determined by the *Board* to be in connection with the fund's insurance business, are attributable to the *asset shares* of those classes of policyholder who share fully in the profits and losses of the fund, except that future costs and compensation attributable to pension mis-selling are attributable to the Non-Profit Fund and costs and compensation arising from mortgage endowment mis-selling are attributable to the Non-Profit Fund.

The *Capital Support Arrangements* set out the extent to which capital is provided to the fund where the fund has insufficient capital to meet business risks.

Business risks are controlled by the Risk Committee of Phoenix Life Limited which normally meets monthly and the Audit and Compliance Committee of the *Board* which normally meets at least three times a year.

Practices

8.10.1 *Investment Smoothing business*, that is *unitised* with-profits business (written on or after 1 January 1994, Unitised Capital Guaranteed Fund business, *deposit administration* (former FS and BLL) business, *controlled funding arrangements* (former BLA/Crusader), former Crusader With-Profits Performance Fund and With-Profits Pension Fund business and former Crusader Growth Bonus Series H business, are not exposed to any business risk other than the investment of assets. The other with-profits policy classes that form the *Fully Participating business*, are exposed to business risks and the remainder of this section gives details.

8.10.2 Policyholders are exposed to business risks associated with the fund. All business risk is pooled across with-profits policyholders who bear this risk. This exposure includes any profits and losses in respect of:

- maintaining all non-profit business within the fund;
- maintaining all with-profits business within the fund; and
- the acquisition of new business within the fund.

This will include, but is not limited to, increases in per policy expenses.

In particular, this business is exposed to the risk of policyholders with annuity benefits within the fund living longer than expected and to the cost of meeting claims under policies with guaranteed annuity options.

8.10.3 The material risks affecting with-profits business are summarised as follows:

- Potential insolvency of provider, that is the inability to fulfil payment of contractual guaranteed benefits.
- Capital requirements of provider to maintain solvency may limit distributions available to policyholders.
- Investment returns achieved. This is linked to the investment strategy.
- Investment strategy may be restricted due to capital requirements.
- Cost of policy guarantees and options.
- The levels of expenses and charges.
- The levels of taxation.
- Changes to the regulatory environment.
- Infrastructure risks including mis-selling.
- Mortality and morbidity risks.
- Reinsurance credit risk.
- Persistency risks.
- Operational risks including failure of third party service providers, including third party administrators and reassurers.
- Business being written on unprofitable terms due to changes in economic experience.
- Allocations and charges between shareholders and *with-profits funds*.
- Non-profit business.
- Post A-day the cap on annuities arising on pensions policies was withdrawn and annuities were increased to the uncapped level. Previously any withheld amount was released to surplus each year.

Regular reviews are performed to monitor these risks.

8.10.4 Future mis-selling costs and compensation and expenses in respect of the mortgage endowment review and from the pensions review are met entirely by the Non-Profit Fund. Any other costs and compensation in respect of the mis-selling of policies in the fund will be paid for from the fund.

8.10.5 The fund has no appetite to take on any future additional business risk. Rather it is committed to reducing this type of risk as far as reasonably possible within the constraint of obtaining any risk reduction at a reasonable cost.

8.10.6 The approach described in section 8.12 will determine the amount and limits of any profits or losses from business risk which will be used in the calculation of the amount payable under *Fully Participating* policies. The practice is to spread the present value of all expected future profits and losses from business risks over the future claim values of business that participates in business risk.

8.10.7 Business risk from outsourcing administration and services is limited by the terms of the relevant contracts with the outsourcing companies.

8.10.8 Business risk from outsourcing administration and services is subject to ongoing review based on the service standards in the relevant contracts with the outsourcing companies.

8.10.9 Business risk from outsourcing administration and services is limited in that PGMS is liable for any additional cost of providing these services which might arise if the outsourcer were to default. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses

8.10.10 Business risk from annuity reassurance is limited by holding assets matching the equivalent liabilities in a custodial account under the terms of the reassurance agreement in order to allow Phoenix Life Limited to recapture the assets in the event of insolvency of the reassurer. However, in the event of insolvency of the reassurer, there still remains a risk of not being able to fully recapture the assets.

8.10.11 Any business risk that is new would be considered by the *Board* in the context of its benefit to policyholders and would have to carry a lower risk than an equivalent existing risk. As a benchmark, quotations based on the risk, and also any similar risk where available, would be sought to establish the cost of the risk and also for comparison purposes. This applies equally to the renewal of an existing business risk.

8.10.12 New with-profits business is exposed to investment (and thus guarantee) and other business risks. These risks are appropriately disclosed.

8.10.13 Some of the risks of improving annuitant mortality and the impact of low interest rates, especially where these impact on guarantees have been mitigated through reassurance.

8.10.14 Since January 2011, in accordance with paragraph 5.2.9, any annuities coming into payment are transferred to the Non-Profit Fund, and the fund pays the Non-Profit Fund a premium in respect of the liability transferred. After such transfer, all the risks in relation to the transferred annuities are borne by the Non-Profit Fund.

8.10.15 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our regulator and will be approved by the *Board*.

Principle 8.11	Expenses and Charges
	Policies will either be charged product charges or be charged amounts which represent a fair share of the actual costs or a sub-set of the actual costs.
	This approach will be adjusted where necessary in order to continue to treat customers fairly.
	Product charges may be either explicit or implicit.
	Where actual costs are used and where costs are specific to a policy or policy class, then taking into account the approximations referred to in section 8.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

8.11.1 *Unitised* with-profits business (written on or after 1 January 1994) and Unitised Capital Guaranteed Fund business has been accepted under an inter-fund arrangement with the Non-Profit Fund. As such the fund accepts the risks associated with the investment of assets only.

The charges taken from these policies are product specific but in general are an annual management charge of 1% of fund value and a combination of policy fees, a bid / offer spread, nil or reduced allocation periods, reduced or enhanced allocation rates, application of capital units with an increased management charge, risk benefit charges and surrender charges.

Charges on these policies may be altered in future if necessary. The remainder of this section does not apply to these policies.

8.11.2 Former Crusader With-Profits Performance Fund and With-Profits Pension Fund business has been accepted under an inter-fund arrangement with the Non-Profit Fund. As such the fund accepts the risks associated with the investment of assets only.

The charges taken from the policies are product specific but in general are an annual management charge of 1% of fund value and a combination of a bid / offer spread, reduced or enhanced allocation rates, risk benefit charges and surrender charges.

Charges on these policies may be altered in future if necessary. The remainder of this section does not apply to these policies.

8.11.3 *Unitised* with-profits business (written prior to 1 January 1994) has been accepted under an inter-fund arrangement with the Non-Profit Fund. As such the fund accepts the risks associated with the investment of assets as well as any differences between charges taken from and expenses (including commission) apportioned to this business.

The charges taken from the policies are product specific but in general are an annual management charge of 1% of fund value and a combination of policy fees, a bid / offer spread, nil or reduced allocation periods, reduced or enhanced allocation rates, application of capital units with an increased management charge, risk benefit charges and surrender charges.

Charges on these policies may be altered in future if necessary.

8.11.4 For other business, there are no specific charges, rather any allowance for expenses is taken through the calculation described in section 8.4 or any interest additions for *deposit administration business* or in determining the *annual bonus* rate for former Crusader Growth Bonus Series H business as described in section 8.5, or in the premium rates when guaranteed benefits are purchased for *controlled funding arrangements*.

8.11.5 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

Fees will increase by RPI + 1% each year.

8.11.6 The costs apportioned to any particular group of policies will only change:

- if the formulaic bases of cost charging are altered to reflect a change in the underlying cost of the activities supporting that group of policies; or
- if the apportioned costs are allocated on a basis which more fairly reflects the costs of the group.

Principle
8.12 ***Estate* Management**

The overall aim of the management of the fund will be to ensure there are sufficient assets to meet the liabilities as they fall due. Being a closed fund means that total assets are targeted to be paid out over the lifetime of the existing business.

Practices

8.12.1 *Investment Smoothing business*, that is *unitised* with-profits business (written on or after 1 January 1994), Unitised Capital Guaranteed Fund business, *deposit administration* (former FS and BLL) business, controlled funding arrangements (former BLA / Crusader), former Crusader With-Profits Performance Fund and With-Profits Pension Fund business and former Crusader Growth Bonus Series H business, are not exposed to the *estate*. However, there is an indirect exposure to the *estate* in that the position of the *estate* may impact any future investment strategy of the fund as a whole (see section 8.9).

The rest of this section does not apply to *Investment Smoothing* business.

The other with-profits policy classes, that is *Fully Participating* business, are exposed to the *estate* and the remainder of this section gives details.

8.12.2 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

The *estate* is expected to be paid out over the lifetime of the existing policyholders. In practice this will be done by including the *estate* in *asset shares* for the purposes of determining *final bonus* rates and *surrender values* using the approach described in 8.12.4 to 8.12.6 below.

8.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 8.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

8.12.4 The estate in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;
(c) meet any costs which are charged directly to the *estate* rather than to *asset shares*;
(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and
(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

8.12.5 Any enhancements in benefits on account of the *distributable estate* referred to in 8.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values* or by applying a *final uplift* for *Fully Participating deposit administration* business. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

8.12.6 The amount of the *estate,* the *distributable estate,* and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

8.12.7 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to *asset shares* to restore the *estate* to a target minimum level as described in section 8.3.1(b). However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

8.12.8 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin.

Except where the management of the fund in accordance with the *Capital Support Arrangements* per section 8.3 indicates otherwise, transfers back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund, after the cost of bonuses (including shareholders' share), permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *Board* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle
8.13 New Business

The fund is closed to new business. Some new business remains with policy options under existing contracts to effect new policies being honoured.

Practices

8.13.1 The minimum amount of new business is transacted consistent with treating customers fairly. This takes the form of:

- increments to existing policies where there is a contractual obligation;
- new members to certain existing pension scheme arrangements; and
- buyouts and continuation options arising out of group pension scheme arrangements.

Principle 8.14	**Equity between the Fund and Shareholders**
	Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or be consistent with terms which would be available for such services on an arm's length commercial basis. Shareholder owned funds receive not more than 10% of the fund's distributable surplus, as laid down in the *2023 Scheme*. Any proposed change to this, although unlikely, would require the agreement of the *Board* and would be subject to approval by our *regulator* and the High Court.

Practices

8.14.1 For Unitised Capital Guaranteed Fund, *deposit administration* (former FS / BLL), former Crusader With-Profits Performance Fund and With-Profits Pension Fund business and former Crusader Growth Bonus Series H business, no transfer to shareholders is made from bonuses declared or interest added on this business. For other classes, one ninth of the cost of bonuses allocated to policyholders is transferred out of the fund each year.

8.14.2 The cost of bonuses for determining the shareholders' transfer, subject to comments below, includes the value of any *annual bonuses* declared, *interim bonus*es paid in anticipation of any *annual bonus* declaration and *final bonus*es paid.

For *traditional* with-profits business the value of *annual bonus* is based on the risk free rate (after tax).

For *unitised* with-profits business (written prior to 1 January 1994), the value of *annual bonus* is the increase in unit value due to the daily application of the *annual bonus* rate. Where a *market value reduction* applies this reduces the value of the *final bonus.* Where a *market value reduction* has the effect of reducing *annual bonuses* previously added, then there is a corresponding reduction in the cost of bonus.

For *unitised* with-profits business (written on or after 1 January 1994), only the cost of *final bonus* (and not the cost of *annual bonus*) is included in the cost of bonus.

For fully participating *deposit administration)* business (specified in 8.2.1), the cost of bonus is the interest additions, above any guaranteed additions, to the fund value and *final uplift* paid, other than for former Crusader business (Emeritus, Versatile and Nestegg contracts) where the cost of bonus is half of the interest additions, above any guaranteed additions, to the fund value and half of the *final uplift* paid. Where a *market value reduction* has the effect of reducing *annual bonuses* or interest previously added, then there is a corresponding reduction in the cost of bonus.

For *controlled funding arrangements*, the cost of bonuses is the discretionary amount of cash bonus declared once per annum to increase scheme benefits. There are no *final bonus*es.

8.14.3 Certain *unitised* with-profits pension policies written prior to 1 August 1992 contain a guarantee that the unit price will increase by 4% per annum. Long Term Accumulation system and Versatile policyholders have certain guaranteed interest additions. No shareholder transfers are made in respect of these guaranteed elements.

8.14.4 The shareholders pay any extra tax that is generated as a result of any distribution to a shareholder owned fund.

8.14.5 A change in the underlying basis on which the shareholders' share is calculated will not change the division of profit between the with-profits policyholders and the shareholders. It will however change the amount of profit distributed.

8.14.6 The following factors will have an impact on the balance between the shareholder share of the distributable surplus and that of the fund:

- tax/other imposts;
- distributions in anticipation of surplus;
- the approach for with-profits policies with both entitlement to *final bonus* or *final uplift,* and which will incur a *market value reduction*; and
- guaranteed bonuses.

9 Principles and Practices – Britannic With-Profits Fund

The Principles and Practices given in sections 9.4 to 9.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the Britannic With-Profits Fund. Sections 9.1 to 9.3 give background information specific to the Britannic With-Profits Fund. Subsequently in this section the use of the term ‘the fund’ generally means the Britannic With-Profits Fund.

9.1 Fund History

The Britannic With-Profits Fund comprises the business that was transferred to Phoenix Life Limited under the *2006 Scheme* from the Ordinary Branch With Profits Fund of Britannic Assurance (BA) and the with-profits policies in the With Profit Fund of Century Life.

9.1.1 **Britannic Assurance**

Britannic Assurance’s origins dated back to 1866 when it was founded in Birmingham as the British Workman’s Mutual Assurance Company Limited. Its business spread rapidly throughout Lancashire, Yorkshire and the rest of the United Kingdom. In 1905 it began to trade as Britannic Assurance.

Britannic Assurance wrote both general insurance and long-term insurance business. The latter included life assurance business, general annuity business, pensions business and permanent health insurance business. The majority of the business was transacted in the United Kingdom, however small amounts of business were transacted in the Channel Islands, Isle of Man and Eire.

In 1997, following detailed investigations into the historical development and financial strength of Britannic Assurance’s long-term fund, the structure of the long-term fund was changed to clarify the future interests of policyholders and shareholders. The restructure was reviewed by an independent actuary and the Department of Trade and Industry, the then regulator of insurance business in the United Kingdom.

Before the restructure the long-term fund of Britannic Assurance comprised an Industrial Branch Fund and an Ordinary Branch Fund, which both contained with-profits and non-profit business. Under the restructure:

- Two non-profit funds, the Ordinary Branch Life Non Profit Fund and the Ordinary Branch Pensions Non Profit Fund, were established. Some of the Ordinary Branch non-profit business was transferred into these new funds. Shareholders are entitled to all distributable surplus arising in these funds.
- The Ordinary Branch With Profits Fund was established. All of the Ordinary Branch with-profits business was allocated to this fund, together with the Ordinary Branch non-profit business that was not transferred to either the Ordinary Branch Life Non Profit Fund or the Ordinary Branch Pensions Non Profit Fund. In respect of the Ordinary Branch With Profits Fund, not less than 90% of the surplus distributed each year was allocated to with-profits policyholders, with the balance available for transfer to the Britannic Assurance shareholder fund.
- In respect of the Industrial Branch Fund, not less than 90% of the surplus distributed each year was allocated to with-profits policyholders, with the balance available for transfer to the Britannic Assurance shareholder fund.

In addition:

- Certain assets were transferred to the Ordinary Branch Life Non Profit Fund and the Ordinary Branch Pensions Non Profit Fund. These assets were referred to as the Shareholders' Retained Capital, which was not available for distribution to policyholders and could, subject to certain restrictions, be distributed to shareholders. It was available to support the solvency of the long-term fund of Britannic Assurance.
- A *Buffer Reserve* was established, being an amount of assets attributable to the Industrial Branch Fund that could be used to support the liabilities arising in the Ordinary Branch With Profits Fund as well.
- A special bonus was declared.

In March 2003 Britannic Assurance withdrew from actively writing new business.

All business transferred from Britannic Assurance is administered by PGMS.

Under the *2006 Scheme* the *Buffer Reserve* referred to above became the *Buffer Reserve* in Phoenix Life Limited referred to in paragraph 3.3.4 and section 9.12.

9.1.2 Century Life

From its establishment in 1983 until 2005, Century was part of the Century Group, which acquired 21 companies or blocks of business during this period. The most significant of these acquisitions were: Sentinel Life (Sentinel) in 1989, National Employers Life Assurance Company and associated companies (NEL) in 1992, CCL Assurance also in 1992, Prosperity Life Assurance (Prosperity) in 1994, Old Mutual Life Assurance Company in 2000 and National Australia Life in 2003.

Century Group consolidated the legal structure of its life funds by transferring policies to Century following each acquisition.

By 2001 Century had 11 sub-funds which made administration of the acquired policies time consuming and complex. Therefore, in April 2001 Century undertook a reconstruction of these funds by way of a Court Order, which reduced the number of funds in Century to just two, by transferring all existing policies into either the Non Profit Fund, which included *traditional* non-profit and unit-linked policies, or the With Profit Fund, which included *traditional* with-profits and non-profit and unit-linked policies.

Apart from a period between September 1992 and April 1994, Century has been closed to new business since 1989.

Century Group was acquired by the Britannic Group in April 2005.

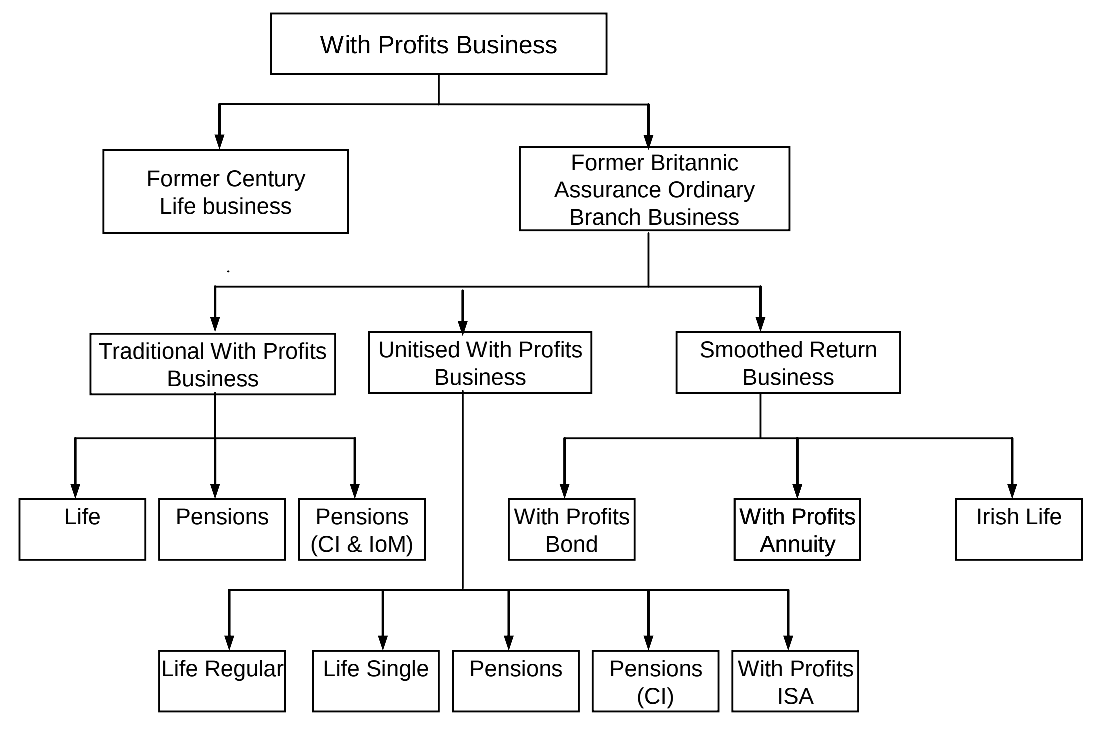
All business transferred from Century is administered by PGMS.

9.2 Types of Business

The with-profits business in the fund is split into different classes for the purposes of allocating *annual bonuses*, *final bonus*es and *smoothed returns* as appropriate. The split primarily depends on:

- The type of product and the method by which it participates in profits, that is *traditional* with-profits business, *unitised* with-profits business or *smoothed return* business.
- The classification for tax purposes that is life assurance business, general annuity business, pension business, overseas life assurance business or Individual Savings Account business.
- Whether the business is regular premium paying or single premium.
- Whether the business formed part of Century With Profit Fund immediately prior to the effective date of the *2006 Scheme*. The former Century business is all *traditional* with-profits business.

The diagram below shows the types of business and the some of the different classes within the Britannic With-Profits Fund.



CI = Channel Islands; IoM = Isle of Man; ISA = Individual Savings Account

Within bonus classes there may be additional splits into bonus series, in particular the former Century business is split into various bonus classes and series. The bonus classes and series are listed in paragraphs 9.4.10 to 9.4.13.

9.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholder will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle
9.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under a with-profits policy is *asset share* calculations and the amounts payable will allow for a policy's fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es or *smoothed returns*.

The degree of approximation used in the application of these methods aims to be consistent with the overall fair treatment of all with-profits policyholders.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Different bonuses are declared for different classes of with-profits business, reflecting the original company within which the business was written, tax, type of with-profits business and product features. New bonus classes would be required if a new type of product were developed. An existing class would normally only be split in exceptional circumstances. Within classes, bonuses may be further differentiated by series.

Bonus policy can be affected by a variety of factors including the financial and solvency position of Phoenix Life Limited, the financial strength of the fund, the expected cost of guarantees, actual and expected investment returns and expenses, the likelihood of changes in the level of provisions and the constraints which increases in guaranteed benefits may place on the fund, particularly in relation to investment strategy. These factors, together with the aim to retain flexibility in the operation of the fund, constrain *annual* and *final bonus* declarations, *smoothed return* declarations and the *smoothing* policy. These constraints also apply in changing economic conditions.

Bonuses can only be declared if there is surplus available for distribution.

Practices

***Asset Share* Methodology**

9.4.1 The basic method for *asset share* calculations for with-profits business uses actual investment returns net of tax and for expenses, mortality and morbidity benefits, uses the actual underlying experience for *traditional* with-profits business and uses product charges for *unitised* with-profits and *smoothed return* business.

Asset shares are not smoothed. In particular the investment returns and experience elements contributing to *asset shares* are not smoothed, other than that inherent in the processes used in the derivation of the assumptions, or in respect of initial expenses as described in paragraph 9.4.2(d).

Initial *asset shares* for former Century with-profits business were calculated as described in paragraph 4.4.7.

9.4.2 The following table describes the elements credited or charged to *asset shares* for *traditional* with-profits (both former Britannic Assurance and former Century), *unitised* with-profits and *smoothed return* business.

Element		***Traditional* With-Profits Business**	***Unitised* With-Profits Business**	***Smoothed Return* Business**
(a)	Premiums	Premiums paid Note (a)	Premiums paid Note (a)	Premiums paid Note (a)
(b)	Investment return	Allocated return Note (b)	Allocated return Note (b)	Allocated return Note (b)
(c)	Investment expenses	Actual allocated Note (c)	Implicit in product charges	Implicit in product charges
(d)	Initial expenses	Actual allocated Note (d)	Implicit in product charges	Implicit in product charges
(e)	Renewal expenses	Actual allocated Note (e)	Implicit in product charges	Implicit in product charges
(f)	Other expenses	Actual allocated Note (f)	Not charged Note (f)	Not charged
(g)	Tax on investment return	Actual allocated Note (g)	Actual allocated Note (g)	Actual allocated Note (g)
(h)	Tax relief on expenses	Actual allocated Note (g)	Implicit in product charges	Implicit in product charges
(i)	Mortality & morbidity costs	Experience Note (i)	Note (i)	Implicit in product charges
(j)	Early terminations	Charged Note (j)	Not charged	Not charged
(k)	Paid-up policies	Charged Note (k)	Not applicable	Not applicable
(l)	Partial and regular withdrawals	Not applicable	Note (l)	Note (l)
(m)	Surrenders at *protected dates*	Not applicable	Note (m)	Note (m)
(n)	Annuity payments	Not applicable	Not applicable	Sometimes Note (n)
(o)	Charges for the cost of guarantees	Note (o)	Note (o)	Implicit in product charges
(p)	Charges for the cost of capital	Not charged	Not charged	Implicit in product charges
(q)	Distributions to shareholders	Note (q)	Implicit in product charges	Implicit in product charges
(r)	Tax on distributions to shareholders	Not charged	Not charged	Implicit in product charges
(s)	Profit and losses from other business	Not charged	Not charged	Not charged
(t)	*Estate* distribution or charge	Note (t)	Note (t)	Note (t)
(u)	Exceptional items	Not applicable	Not applicable	Not applicable

The way in which the above items are taken into account is described in the notes below, together with how they vary by type of business. Where charged is used in the table above this means both charged and / or credited depending on whether it is a loss or profit.

Notes

(a) Premiums

Premiums are those paid under the policy. For *traditional* with-profits business, they exclude any extra premiums for non-standard policies, as the extra charges are deemed to cover the additional risks, whilst for *unitised* with-profits business they are included as the charges for the extra risk are met by cancelling units per (i) below.

(b) Investment return

For business other than former Century business and Euro-denominated *smoothed return* business, the investment return credited to *asset shares* is based on the return earned by the Growth Fund. For the former Century business the investment return credited to *asset shares* is based partially on the return earned by the Growth Fund and partially on the return earned by the Matched Fund. For Euro-denominated *smoothed return* business, the investment return credited to *asset shares* is based on the return earned by the Euro Fund. The Growth Fund, Matched Fund and Euro Fund are described in section 9.9.

The investment returns are expressed as a percentage return to be applied.

These investment returns are before any deduction for investment expenses which are allowed for separately.

(c) Investment expenses

Actual investment expenses are charged, based on those allocated in respect of the Growth Fund, Matched Fund and Euro Fund, where applicable, in accordance with sections 5.2 and 9.11, subject to a small reduction for former Britannic *traditional* with-profits business.

The investment expenses are expressed as a percentage charge to be applied to the assets.

(d) Initial expenses

No new business is being written in the fund other than to honour policy options. Where new policies are written for this reason, initial expenses are generally based on previous initial expenses inflated at RPI+2% per annum and including allowance for commissions.

In 2007, the *Board* reviewed the costs allocated to *asset shares*. The *Board* concluded, having received the advice of the *With-Profits Committee*, that in order to protect policyholders from the effects of disproportionately high distribution costs, initial expenses charged to *asset shares* from 1998 should be restricted to be less than the costs actually incurred in those years. The restriction was assessed to reduce the impact of expenses to be more consistent with that applying for earlier years of entry.

(e) Renewal expenses

Renewal expenses are based on PGMS per policy charges with an uplift to cover direct costs and including allowance for commissions. These expenses are allocated in accordance with sections 5.2 and 9.11.

(f) Other expenses

For both former Britannic Assurance and Century *traditional* with-profits business, significant future project, additional activity and other one-off costs will only be charged to *asset shares* following approval by the *Board*.

For *unitised* with-profits business, the product charges include some allowance for project and one-off expenses. However no additional charges are made to *asset shares*.

Any other adjustments to the expenses charged to the fund are not charged to *asset shares*.

(g) Tax on investment return

The tax on investment income allows for the different treatment of franked and unfranked income and also unrecoverable foreign tax. The tax on investment gains, whether realised or unrealised, includes an element of discounting representing the deferral of the actual payment. The element of discounting is regularly reviewed and takes into account the expected turnover rate of the investments and the level of unrealised gains. The rates of tax (before discounting) are based on those underlying the tax allocated to the fund in accordance with section 5.2.

(h) Tax relief on expenses

Tax relief due on the actual expenses charged is allowed for. Where the tax relief in respect of acquisition expenses is spread, this is allowed for. The rates of tax relief are based on those underlying the tax allocated to the fund in accordance with section 5.2.

(i) Mortality and morbidity costs

For *traditional* with-profits business, the charge is based on the underlying experience and is approximated by applying a percentage of a standard published mortality table. The percentage applied varies by calendar year and is based on the results of mortality investigations carried out from time to time. For morbidity costs (where applicable), the experience is approximated by applying a percentage of rates charged by the reassurer.

For some *unitised* with-profits business, these costs are charged explicitly in the product charges on a monthly basis, based on the sum at risk, by cancelling units. The sum at risk is the excess of the guaranteed minimum death benefit over the shadow fund value and value of any unit-linked units (if applicable). Any profits or losses from the explicit charges not reflecting the actual underlying experience and costs are not credited to *asset shares*. For other *unitised* with-profits business, the costs are implicit in the product charges and no explicit monthly charge is applied.

(j) Early terminations

For *traditional* with-profits life business, the profits and losses arising from surrenders currently accumulate in the *estate*. The surrender profits/losses on with-profits business may be applied to *asset shares* by an addition to or deduction from the rate of investment return applied in the year in which the profit or loss arises or may be accumulated in the *estate* and applied as part of a distribution of the *estate* in a later year.

(k) Paid-up policies

Any profits or losses arising from policies becoming paid-up are treated as in note (j).

(l) Partial and regular withdrawals

These are reflected in *asset share* calculations only to the extent that part of the policy has been cancelled. Specifically no profits or losses resulting from partial or regular withdrawals are credited. The proportion of the policy withdrawn is reflected in both the underlying *asset share* and remaining policy values.

(m) Surrenders at *protected dates*

These are reflected in *asset share* calculations only to the extent that part of the policy has been cancelled. Specifically no profits or losses resulting from surrenders or withdrawals at protected (guarantee) dates are credited.

(n) Annuity payments

For *smoothed return* with-profits annuity business, these reflect the pension annuity payments made under the policy.

(o) Charges for the cost of guarantees

The cost of guarantees is currently not charged to *asset shares* and the cost is borne by the *estate*. Should the cost increase leading to an erosion of the *estate*, or should the *estate* no longer be able to bear the cost, a charge may be introduced to *asset shares* in future. See section 9.12.

(q) Distributions to shareholders

For former Britannic Assurance *traditional* with-profits business, the cost of distributions to shareholders resulting from the cost of bonus allocated to policies is charged to *asset shares*. The cost of bonus is as described subsequently in section 9.14, using the basis applicable at the time.

For former Century *traditional* with-profits business, the cost of distributions to shareholders resulting from the cost of bonus allocated to policies is not charged to *asset shares,* as an estimate of the future costs reduced the initial *asset shares*.

(t) *Estate* distribution or charge

For traditional with-profits and unitised with-profits business, asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate*. However, these estate distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 9.12.

Current practice is that *smoothed return* business does not participate in any *estate* distribution or charge.

Former Britannic Assurance *asset shares* and policy shadow funds (for *unitised* with-profits business) were enhanced to reflect the cost of the 1997 special bonus. For *traditional* with-profits business, the enhancement is approximate.

9.4.3 *Asset shares* are calculated for representative specimen policies when setting bonus rates, *smoothed returns* and *surrender value* bases for *non-protected exits.* Specimen policies are chosen to represent the business and include a range of policy terms and years of entry. The primary emphasis in selecting specimen policies is the size of premium or sum assured. There is however a degree of averaging, particularly for those terms where there are relatively few policies.

For *unitised* with-profits business, individual policy shadow funds are used as a proxy for *asset shares* in determining the amounts payable on *non-protected exits* as described in section 9.8.

For *smoothed return* business, individual unsmoothed policy values are used as a proxy for *asset shares* in determining the amounts payable on *non-protected exits* as described in section 9.8.

9.4.4 *Asset share* models contain some approximations, but these approximations do not prejudice the overall fair treatment of with-profits policyholders. Whilst only minor approximations are employed in *asset share* calculations, no investigations are carried out on the level of approximation built into the resulting *asset shares*.

For *traditional* whole life policies, bonuses and *surrender value* bases may be set with reference to those applicable for endowments, however we do currently set these separately.

Policies that have been subject to alterations, including any surrender of bonus or child endowment option conversions and for former Century business on becoming paid-up, do not yield robust *asset share* calculations. For these policies bonuses are based on those for an equivalent unaltered policy with approximate adjustments to reflect the differing premium and benefit payment histories.

In support of the current practice that bonus rates for Channel Islands and Isle of Man pension with-profits business are the same as those for the corresponding pensions business, *asset share* calculations for this business mirror those for the corresponding pensions business.

For *unitised* with-profits business, the shadow funds are priced on a weekly or daily basis depending on the type of product. These use a daily estimated investment return. The tracking difference between this estimated return and the actual investment return over a period is regularly reviewed and adjustments are made to the current shadow price to reflect any divergence.

For *smoothed return* business, for Britannic With-Profits Bond business and the Irish Life business, the unsmoothed policy values are determined on a daily basis using a daily estimated investment return. The tracking difference between this estimated return and the actual investment return over a period is regularly reviewed and adjustments are made to the current unsmoothed policy values to reflect any divergence.

9.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed and the treatment of Channel Islands and Isle of Man pensions business feed through to the *estate* as described in section 9.12.

9.4.6 *Asset share* practices are documented.

Asset share and bonus policies are documented at a high level in various *Board* (and previously Britannic Assurance Board) reports and reports on *asset share* investigations that have been undertaken from time to time.

Detailed specifications relating to the *asset share* calculations and the bonus calculations only exist to a varying degree, but the coding within the models used in the processes are viewable and thus document the calculations.

Asset share assumptions are documented and this tends to include references to their source of derivation.

For each bonus review appropriate documentation is produced and provides an audit trail of the process, including sources of data, source and derivation of assumptions, backing calculations, notes and correspondence. This audit trail normally includes retaining electronic copies of the systems and calculations used for the review.

9.4.7 *Asset share* models, processes and documentation are subject to a continual process of development, improvement and refinement. Significant effects are reported to and considered by the *Board*.

9.4.8 *Asset share* practices are not guaranteed and may be changed in future.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

9.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

9.4.10 For former Britannic Assurance *traditional* with-profits business:

Separate *annual bonus* scales are declared for the following classes:
- Life *traditional* with-profits business
- Pensions *traditional* with-profits business
- Pensions *traditional* with-profits business (Channel Islands and Isle of Man).

Separate *final bonus* scales are declared for the following classes:
- Life *traditional* with-profits endowment business
- Life *traditional* with-profits whole of life business
- Life *traditional* with-profits whole of life fully paid business
- Pensions *traditional* with-profits business
- Pensions *traditional* with-profits business (Channel Islands and Isle of Man).

These scales have separate rates for single premium business.

The current practice is for the bonus rates for pension *traditional* with-profits business (Channel Islands and Isle of Man) to be the same as those for the corresponding pension *traditional* with-profits business.

9.4.11 For former Century *traditional* with-profits business:

Separate *annual bonus* scales are declared for the following classes:
- Former NEL Simple bonus business
- Former NEL Compound bonus business
- Former Sentinel Simple bonus business
- Former Sentinel Compound bonus business
- Former Prosperity life business.

Separate *final bonus* scales are declared for the following classes:
- Former NEL Simple bonus business
- Former NEL Compound bonus business

- Former Sentinel Simple bonus business
- Former Sentinel Compound bonus life business
- Former Sentinel Compound bonus deferred annuity business.

For former Prosperity life business, there is *no final bonus* and none is expected in the future.

9.4.12 For *unitised* with-profits business:

Separate *annual bonus* scales are declared for the following classes of business:
- Life regular premium *unitised* with-profits business
- Life single premium *unitised* with-profits business
- Pensions *unitised* with-profits business
- Pensions *unitised* with-profits business (Channel Islands)
- Individual Savings Account *unitised* with-profits business.

Separate *final bonus* scales are declared for:
- Life regular premium *unitised* with-profits business
- Life single premium *unitised* with-profits business
- Pensions *unitised* with-profits business
- Pensions *unitised* with-profits business (Channel Islands)
- Individual Savings Account *unitised* with-profits business.

The current practice is for the bonus rates for pensions *unitised* with-profits business (Channel Islands) to be the same as those for the corresponding pensions *unitised* with-profits business, though this is not guaranteed.

9.4.13 For *smoothed return* business, separate *smoothed returns*, declared returns and *annual and final bonuses*, where applicable, are declared for each class of business:
- Britannic With-Profits Bond business and within this class, separate *smoothed returns* are declared for each policy series
- With-profits annuity business and within this class, separate declared returns are declared for each policy month and year of entry
- Irish Life with-profits bond business and within this class, separate *smoothed returns*, *annual* and *final bonuses* are declared for each policy series.

9.4.14 Bonuses and *smoothed returns* are reviewed regularly at least once a year.

For other than *smoothed return* business, *annual bonuses* and are reviewed annually and are declared in arrears in March / April of the following year to which the bonus relates, other than Individual Savings Account *unitised* with-profits business, where *annual bonuses* are declared in advance and are reviewed at least once a year. *Final bonus*es are declared in advance and are reviewed at least twice a year, normally from 1 January (towards the end of December for most *unitised* with-profits business) and 1 July (towards the end of June for most *unitised* with-profits business).

For *smoothed return* business, other than with-profits annuity business, *smoothed returns* and any *annual* and *final bonus*es, are declared in advance, and are reviewed at least twice a year, normally on a quarterly basis.

For with-profits annuity business, declared investment returns are set at policy anniversaries for the following year.

9.4.15 The timing of *final bonus* declarations may be varied.

9.4.16 *Final bonus*es and *annual bonuses* declared in advance are expected to, but are not guaranteed to, apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. Additional reviews would normally only be in response to exceptional investment market movements.

9.4.17 *Final bonus* reviews also consider the amount of *final bonus* paid on *non-protected exits* (surrenders).

9.4.18 Bonuses and *smoothed returns* are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared.

Principle
9.5 ***Annual Bonus* Rates**

The aim is to set *annual bonuses* at a prudent level, balancing the benefit to policyholders of increased guarantees, the aim for an element of *final bonus*, the flexibility of the operation of the fund and its ability to ensure the guarantees can be met in future. *Annual bonuses* may increase or decrease from declaration to declaration and may also be nil. *Annual bonuses* can only be declared if there is sufficient surplus available.

Practices

9.5.1 For *smoothed return* business where there are *annual bonuses*, these are related to the *smoothed returns* and are covered in section 9.7 which covers *smoothing*. The rest of this section does not apply to this business.

9.5.2 The *Board* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in the following paragraphs.

9.5.3 For each class of business, the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

9.5.4 Where the financial position of the fund is weak, the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

9.5.5 For former Century policies (excluding Prosperity policies), the aim is to maintain current levels of *annual bonus* unless so doing would lead to a material risk that significant groups of policyholders would receive payments in excess of *asset shares* on account of guaranteed benefits. Prosperity policies have no *final bonuse*s, so we set *annual bonuses* to target projected *final bonus* headroom of 0%.

9.5.6 *Annual bonuses* can only be declared if there is sufficient surplus available.

9.5.7 The *asset share* comparisons are performed for representative specimen policies grouped according to the level at which different bonus rates are declared.

9.5.8 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

9.5.9 For former Britannic Assurance *traditional* with-profits business, *annual bonus* rates are rounded and expressed as a percentage of the sum assured or the basic annuity and the rates depend on year of entry.

For former Century *traditional* with-profits business, *annual bonus* rates are expressed as a percentage of the sum assured or the basic annuity for simple bonus policies, as a percentage of the sum assured or the basic annuity plus attaching bonuses for compound bonus policies, or as a percentage of the sum assured and a percentage of the attaching bonuses for former Prosperity life business.

For *unitised* with-profits business, *annual bonuses* rates are rounded and expressed as a percentage rate per annum of the with-profits and bonus units, allowing for the period the units have been in force during the year.

Principle
9.6 *Final Bonus* Rates

The aim is to set *final bonus* rates so that specimen policy *payouts* achieve a target *payout ratio*. These *final bonus* rates are then adjusted for *smoothing* as described in section 9.7. *Final bonus*es for a policy may increase or decrease from declaration to declaration and may also be nil. *Final bonus*es will be reviewed regularly, but can be reviewed at any time.

Practices

9.6.1 For *smoothed return* business where there are *final bonuses*, these are related to the *smoothed returns* and are covered in section 9.7 which covers *smoothing*. The rest of this section does not apply to this business.

9.6.2 The current long-term target *payout ratio* for maturing policies is 100% of *asset share*.

In this context *maturity* includes retirement at selected retirement age for pensions business and surrender or withdrawal at a guarantee date for *unitised* with-profits business. The guaranteed benefit of *traditional* deferred annuity business used in the comparisons is the capital value of the basic annuity and *annual bonuses* payable from the retirement age.

9.6.3 The actual *payout ratio* for maturing policies at any one time will not necessarily be equal to the target portion due to:

- the level of accumulated guarantees; or
- the effects of *smoothing*.

9.6.4 *Final bonuses* are determined by comparing projected *asset shares* with the corresponding guaranteed benefits, together with any *interim bonus*, for maturities in the period under consideration. These projected *asset shares* allow for the actual experience to date and expected future experience, including expected future investment return and where relevant, shareholder transfers in respect of the *final bonus* being determined. The *final bonuses* actually declared are based on these figures after adjusting for *smoothing* as described in section 9.7.

9.6.5 The projections supporting *final bonus* investigations are based on actual experience up to five months in advance of the start date of the declaration. The projections generally consider policies maturing during the calendar year in which the *final bonus* rates apply.

9.6.6 *Final bonus* declarations are also informed by comparisons of projected *asset shares* and corresponding projected benefits for maturities in subsequent *final bonus* periods and over the next couple of years.

9.6.7 The *asset share* comparisons are performed for representative specimen policies, grouped according to the level at which different bonus rates are declared. The primary focus is on performing the calculations for specimen policies at the terms which contain a significant volume of policies. For other terms approximations may be used.

For former Century business, the *final bonus* is based on a rate multiplied by a duration factor and the grouping combines all policies and terms within the relevant bonus class.

9.6.8 For former Britannic Assurance *traditional* with-profits life assurance business, *final bonus* rates are rounded and expressed as a percentage of the sum assured and the rates depend on duration and for whole of life policies on premium paying term. Rounding may mean that resulting *payout ratios* deviate slightly from the target.

For former Britannic Assurance *traditional* with-profits pensions business, *final bonus* rates are rounded and expressed as a percentage of the basic annuity and *annual bonus* and the rates depend on duration. For 1981 and 1970 years of entry, there are additional rates to reflect significant pricing and product design changes that occurred in these years.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

9.6.9 For former Century former NEL with-profits business, *final bonus* rates are expressed as a percentage of the sum assured or basic annuity. The *final bonus* is this rate multiplied by the duration the policy has been in force. There is also a second tier / additional *final bonus* rate, which is expressed as a percentage of the sum assured. The second tier / additional *final bonus* is this rate multiplied by the duration the policy has been in force since 1 April 1996.

For former Century former Sentinel with-profits business, *final bonus* rates are expressed as a percentage of the sum assured or basic annuity and *annual* and *interim bonuses.* The *final bonus* is this rate multiplied by the duration to the first policy anniversary after 31 March 1998.

For former Century former Prosperity with-profits business, no *final bonus* is payable and none is expected in the future.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

9.6.10 For *unitised* with-profits business, *final bonus* rates are rounded and expressed as a percentage of the with-profits units and may vary by month and year of purchase. The rates may be negative, but overall the *final bonus* on a policy is subject to a minimum of nil.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

9.6.11 *Final bonus* scales are determined by reference to maturing representative specimen policies.

For former Britannic Assurance *traditional* with-profits life assurance business, the *final bonus* payable on a death claim (or terminal or critical illness claim, if applicable) is calculated as follows:

- For an endowment assurance, it is the *final bonus* rate for a policy maturing at the same duration completed, multiplied by the proportion of the original term completed, applied to the sum assured.
- For a whole life assurance, it is the *final bonus* rate based on policy commencement year and total number of premiums contracted to be paid, but applied to the smaller of the office premium multiplied by the completed duration and the sum assured.

For former Century with-profits life assurance business, the *final bonus* payable on a death claim is calculated based on the duration the policy has been in force at the time of death.

For *unitised* with-profits business, the *final bonus* scale applies on a death claim (or terminal or critical illness claim, if applicable) as well.

Some endowment assurances have an additional sum assured payable on death but this is not eligible for bonuses. Also any guaranteed minimum death benefit is not eligible for bonuses. Similarly for *traditional* with-profits pensions business, where the death benefit is a return of premiums this is not eligible for bonuses.

9.6.12 *Final bonus*es are declared in advance and are made in anticipation of a surplus arising. *Final bonus*es can only be declared if there is an expectation of such surplus arising.

9.6.13 *Final bonus* reviews also consider the amount of *final bonus* payable on surrenders of *traditional* business, based on section 9.8.

9.6.14 For all classes of policy *final bonus* rates may be changed at any time. At times when the value of the excess assets in the fund is not changing rapidly, this is likely to mean that changes, if any, are made one or two times per year, normally from 1 January and 1 July. However, a sudden change in the value of those excess assets (such as because of a significant change in the value of equity share markets) may cause *final bonus* rates to be changed on other occasions. Changes to *surrender* and transfer values may be less frequent than changes to *final bonus* rates for maturities.

9.6.15 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on maturities may deviate from the target *payout ratios* during the period between reviews. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the *maturity payout ratios* at the latest *final bonus* review were near the top or bottom of the range described in paragraph 9.7.2, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle 9.7	***Smoothing***
	The aim is to smooth with-profits policy *payouts* at *protected dates* to manage the *volatility* of with-profits policy *payouts*. The effect of *smoothing* may have a positive or negative effect on with-profits policy *payouts*. *Smoothing* leads to profits and losses which are anticipated to offset each other over time. In the short-term, if these profits or losses were to become excessive, then the *smoothing* policy would be reviewed. For all business except *traditional* with-profits business, the *non-protected exit* values will take account of day to day investment market movements and as a result may have a *market value reduction* applied. For *traditional* with-profits business, *non-protected exit* values will have a degree of *smoothing*.

Practices

Traditional **and** ***Unitised*** **With-Profits Business**

9.7.1 *Final* and *interim bonus*es are declared in advance and are expected to, but are not guaranteed to, apply until the next planned review date. Additional reviews would normally only occur in response to exceptional investment market movements. Thus with-profits policyholders leaving at *protected dates* are not impacted by day to day investment fluctuations. This forms part of the *smoothing* process.

9.7.2 *Final bonus* reviews take into account the current *maturity payout ratios* and the long-term target *payout ratio* per paragraph 9.6.2. The aim is to ultimately bring *maturity payout ratios* for representative specimen policies in line with the long-term target *payout ratio* in a smoothed manner based on the guidelines as described in paragraph 9.7.3. The target range for *payout ratios* is to be between 80% and 120% of *asset share* before the effects of smoothing.

In this context *maturity* includes retirement at selected retirement age for pensions business and surrender or withdrawal at a guarantee date for *unitised* with-profits business.

9.7.3 For *traditional* and *unitised* with-profits policies where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* and retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies and *unitised* with-profits policies, *surrender value* bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as term remaining which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values.*

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing*. Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

9.7.4 The *smoothing* of *maturity* values from declaration to declaration primarily focuses on specimen maturities at terms which contain a significant volume of policies. The effect on the aggregate position for maturities, incorporating all relevant business for the class of with-profits business and grouped according to the level at which different bonus rates are declared, is also considered. As *final bonus* rates are rounded, this may result in slight deviations from the target position.

9.7.5 In adverse conditions, where the level of guaranteed benefits exceeds the target proportion of the relevant *asset shares*, no *final bonus*es may be warranted. In this situation, the guaranteed benefits provide a floor for *maturity payouts*. This provides further protection against day to day investment fluctuations and may further limit movements in *maturity payouts* for similar policies, as a result of bonus declarations.

9.7.6 *Smoothing* leads to profits and losses which are anticipated to offset each other over time. Costs may arise under paragraph 9.7.5, but such costs are the cost of guarantees and not the cost of *smoothing*. The *smoothing* policy is not specifically constrained by a limit on the short-term profits and losses of *smoothing*, but should these become excessive, the *smoothing* policy may be revised. The profits and losses from *smoothing* and costs from guarantees feed through to the *estate* and are effectively dealt with by principle 9.12 and its associated practices.

9.7.7 As the *final bonus* payable on life assurance business death claims (or terminal or critical illness claims, if applicable) is based on the *final bonus* scale for maturities, there is a similar element of *smoothing* operating on *payouts* for death claims.

Some endowment assurances have an additional sum assured payable on death but this not eligible for bonuses. Also any guaranteed minimum death benefit is not eligible for bonuses. Similarly for *traditional* with-profits pensions business, where the death benefit is a return of premiums this is not eligible for bonuses. These are not smoothed.

9.7.8 For *unitised* with-profits business, *surrender values* will target a proportion of *asset share*, as described in section 9.8. *Surrender values* may be subject to the application of a *market value reduction* and where this is the case, they will reflect day to day market movements.

***Smoothed Return* Business**

9.7.9 The *smoothed* and declared investment returns are derived from the actual investment returns netted down for tax adjusted only for *smoothing*. *Smoothed* and declared investment returns may be positive, negative or nil. There is no maximum amount by which *smoothed* and declared investment returns may alter at any declaration. They do not explicitly take into account *payout ratios* or movements in equivalent term *payouts* or annuity incomes.

9.7.10 The *smoothed* and declared investment returns are based on a historic geometric average of monthly investment returns, net of tax.

The calculations supporting *smoothed* and declared investment return investigations are based on actual investment returns up to five months in advance of the start date of the declaration.

To avoid *smoothed* and declared investment returns being affected by the actual investment returns before a policy series started and to ensure that each policy series started from a neutral *smoothing* position, a long-term rate of return was assumed for the period before the policy series started. The use of the long-term rate of return extended to the date the policy series closed, other than for Irish Life business which originally only had a single series and used an average approach. The long-term rate is reviewed at least once a year.

The *smoothed return* declarations also consider the relationships between the guaranteed benefits, the smoothed benefits and the underlying unsmoothed values and *asset shares*.

The *smoothing* mechanism is not guaranteed and may be revised, especially if *payouts* fall outside the target ranges as described in paragraphs 9.7.11 and 9.7.12.

The resulting rates of *smoothed* and declared returns and any associated *annual bonus* are rounded.

The period over which returns are averaged, the periods for which the long-term rate of return is used and the detailed application varies by class of *smoothed return* business as follows:

(a) Britannic With-Profits Bond

The *smoothing* period is five years. New policy series were started each calendar quarter.

(b) With-Profits Annuity

The *smoothing* period is five years. New policy series were started each month.

(c) Irish Life With-Profits Bond

The *smoothing* period is three years. The business is split into two series, one for policies issued before September 2002 and one for policies issued from September 2002. For the post September 2002 series, the *smoothed return* may be increased above that calculated as described above and applied to the pre September 2002 series. This addition is reviewed by considering projections to the next guarantee date. The addition to the *smoothed return* is not guaranteed and may change at any review of *smoothed returns* and may be nil or negative.

9.7.11 The current long-term target *payout ratio* is 100% of *asset share*. The target range for *payout ratios* is to be between 80% and 120% of *asset share*.

9.7.12 *Payout ratios* for smoothed policy values and annuity incomes within 10% of the target *payout ratio* could be described as the normal situation. That is for the target *payout ratio* of 100%, a *payout ratio* between 90% and 110%.

Where smoothed policy values and annuity incomes are between 10% and 20% above or below the target *payout ratio*, the *smoothing* mechanism will be reviewed and may be revised.

Where smoothed policy values and annuity incomes are not within 25% of the target *payout ratio*, then the *smoothed return* may be adjusted with the aim of keeping within the target range. In addition the *smoothing* mechanism will be reviewed and would normally be revised.

Due to the exceptional investment returns in 2008 which caused the payout ratios for the Euro-denominated Irish Life With-Profits Bond business to become excessive, the smoothing mechanism for this business was adjusted from 1 April 2009. The adjustment meant that half of the negative investment return for 2008 was applied as a one off reduction to the smoothed value and the remaining half of the investment return for 2008 flowed through the smoothing mechanism as normal.

9.7.13 There are underlying guaranteed policy values and these depend on the type of business as follows:

(a) Britannic With-Profits Bond

The guaranteed policy value is currently set at 75% of the previous highest smoothed policy value, after adjusting for any withdrawals. For the non-IFA variant the guaranteed value is subject to a minimum of the contribution.

(b) With-Profits Annuity

The underlying guaranteed annuity income level is increased such that it is not less than 75% of the total annuity income following the yearly review.

(c) Irish Life With-Profits Bond

As part of the smoothed investment return declaration, an *annual bonus* is declared. The *annual bonus* rate (before annual management charge) would normally be based on two thirds of the smoothed investment return (before annual management charge) and is subject to a minimum of the annual management charge, that is the *annual bonus* rate net of the annual management charge is subject to a minimum of nil. This *annual bonus* increases the underlying guaranteed policy value. The relationship between the smoothed investment return and the *annual bonus* is not guaranteed. There is no maximum amount by which *annual bonus* rates may alter at any declaration. The *annual bonus* rate is normally only revised on an annual basis, but this is not guaranteed. At each smoothed investment return declaration the *annual bonus* is reviewed and may be revised.

Annual bonus declarations also consider the relationship between the smoothed and guaranteed policy values. The aim is that the smoothed value should provide a significant element of *final bonus*. If the *final bonus* element is considered to be too high or too low, then the *annual bonus* calculation may be adjusted.

The *final bonus* represents the difference between the smoothed value and the guaranteed value.

9.7.14 In exceptional circumstances the actual *smoothed* or declared return declared may be less than that derived from the net actual investment returns adjusted only for *smoothing*. This may only occur on the advice of the *With-Profits Committee*, where profits available from the fund are insufficient to cover the *smoothed* or declared investment returns due to be applied.

9.7.15 In adverse conditions, the level of guaranteed policy values or guaranteed annuity income levels may exceed smoothed values or annuity income levels based solely on the declared investment returns. Thus the guaranteed policy values and guaranteed annuity income levels provide a floor for *payouts* at *protected dates* and provide further protection against investment fluctuations.

9.7.16 *Smoothing* leads to profits and losses which are anticipated to offset each other over time. Costs may arise under paragraph 9.7.15, but such costs are the cost of guarantees and not the cost of *smoothing*. The *smoothing* policy is not specifically constrained by a limit on the short-term profits and losses of *smoothing*, but should these become excessive, the *smoothing* policy may be revised. The profits and losses from *smoothing* and costs from guarantees feed through to the *estate* and are effectively dealt with by section 9.12.

9.7.17 Non-protected exit values will target a proportion of *asset share*, as described in section 9.8. For Britannic With-Profits Bonds and Irish Life With-Profits Bonds, *surrender values* may be subject to the application of a *market value reduction* and where this is the case, they will reflect day to day market movements. However before a *market value reduction* is applied, a small margin is allowed and this provides a small element of protection from day to day market movements. For the with-profits annuity, the terms for converting into a fixed annuity will reflect market conditions at the time of conversion.

9.7.18 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on maturities may deviate from the target *payout ratios* during the period between reviews. Normally an investment return variation of up to 10% compared to that assumed when the *smoothed returns* were last reviewed, would be allowed before there would be an additional review of *smoothed returns*. However, where the *payout ratios* at the latest review of *smoothed returns* were near the top or bottom of the range described in paragraph 9.7.11, a lower level of investment return variance may lead to an additional review of *smoothed returns*.

Principle
9.8 ***Surrender Values***

The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies achieve a target *payout ratio*.

Practices

***Traditional* With-Profits Business**

9.8.1 For life business *non-protected exits* refer to *surrenders* and policies becoming paid-up. For pensions business *non-protected exits* refer to transfers, early and late retirements and policies becoming paid-up.

Surrender values are targeted in the long term at 100% of *asset share*. The target range for surrenders is 80% of *asset share* to 120% of *asset share*, before the effects of *smoothing*.

9.8.2 The basis for the *surrender value* formulae is determined by targeting the target proportion of *asset share* for representative specimen policies.

9.8.3 *Surrender values* are calculated by formulae based on discounting the policy benefits. The formulae include an allowance for *final bonus*.

9.8.4 The approach of discounting policy benefits ensures that *surrender values* take some account of the value of the policy guarantees and produce a reasonable progression of *surrender values* into the prospective *maturity* value.

9.8 5 In determining the basis used to discount the policy benefits, the *Board* will ensure that in aggregate payments to surrendering policyholders do not materially adversely affect the interests of continuing policyholders.

9.8.6 For whole life policies, the basis for *surrender values* is based on a similar approach to that used for endowments. For altered policies the *surrender values* include approximate adjustments to reflect the alterations made to the policy.

For former Britannic Assurance *traditional* with-profits retirement annuity business, the high level of the policy guarantees compared to *asset shares* is such that the *surrender values* may exceed the upper limit of the target range.

9.8.7 For life assurance business, but not for pensions business, surrender profits or losses may be recycled into the *asset shares* of continuing policies, although this would be done in an approximate way, as described in section 9.4.

9.8.8 Paid-up policy benefits are determined such that value of the paid-up policy benefits target similar *payout ratios* to surrenders. Paid-up policies cease to participate in profits, other than for former Century former NEL and some former Sentinel business.

9.8.9 Some policies have surrender and paid-up policy calculations specified in the policy conditions. These represent a minimum basis that is applied.

9.8.10 *Surrender value* and paid-up policy value bases will normally be reviewed once a year. However more frequent reviews might take place, in particular in response to significant investment market movements. *Surrender values* and paid-up policy values may also change more regularly following a review of *final bonus* rates.

9.8.11 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

***Unitised* With-Profits Business**

9.8.12 *Non-protected exits* refer to surrenders and withdrawals, other than those at a guarantee date, transfers, early or late retirements and any excess regular withdrawals. For *unitised* with-profits business, *surrender values* (that is *non-protected exit* values), other than those at a guarantee date, are determined with reference to the full value of units and the target *payout ratio*. The full value of units comprise the with-profits units, bonus units, *interim bonus* and any *final bonus* that would be payable assuming it was a surrender at a *protected date*.

9.8.13 The target *payout ratio* is 100% using the underlying shadow fund as a proxy for the *asset share* excluding any element relating to the distribution of the *estate*. The target range is for surrender *payout ratios* to be between 80% and 120% of *asset share*.

9.8.14 *Surrender values* are the lower of the full value of the units and the shadow fund, as determined on an individual policy basis. If the resulting *surrender value* is less than the full value of the units, *a market value reduction* has been applied. The *market value reduction* acts by firstly reducing any *final bonus* and then once any *final bonus* has been eliminated, reduces the value of the with-profits and bonus units, so that the *surrender value* is equal to the shadow fund.

The resulting *surrender value* may be subject to withdrawal charges to cover unrecovered initial costs or the administration costs of processing the surrender.

9.8.15 *Unitised* with-profits business paid-up policy values are the with-profits units and bonus units added to date and they continue to participate in profits.

9.8.16 *Surrender value* bases will normally be reviewed once a year, although *surrender values* for a policy may change on a weekly or daily basis due to movements in the value of the shadow fund and reviews of *final bonus* rates. However more frequent reviews might take place, in particular in response to significant adverse market movements.

9.8.17 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

***Smoothed Return* Business**

9.8.18 For *smoothed return* with-profits bond business, the target *payout ratio* is 100% of the *asset share* as represented by the unsmoothed policy value. The target range is for surrender *payout ratios* to be between 80% of *asset share* and 120% of *asset share*.

The *surrender value* is the lower of the smoothed policy value and the unsmoothed policy value increased by a small margin, on an individual policy basis. If the resulting *surrender value* is less than the smoothed value, a *market value reduction* has been applied. For Irish Life business, if the *surrender value* is less than the guaranteed policy value, a *market value reduction* is also considered to have been applied, even if the *surrender value* is not less than the smoothed policy value. The resulting *surrender value* may be subject to withdrawal charges to cover unrecovered initial costs. *Non-protected exits* refer to surrenders and withdrawals, other than those at a guarantee date, and any excess regular withdrawals. For Irish Life business, all regular withdrawals are considered as *non-protected exits*.

9.8.19 The terms for converting the with-profits annuity into a fixed annuity are based on the target *payout ratio* of the underlying policy *asset share* and the annuity basis for new business at the time. The target *payout ratio* is currently 100%. The target range is for *payout ratios* to be between 80% and 120% of *asset share*.

9.8.20 *Surrender value* bases will normally be reviewed once a year, although *surrender values* for a policy may change on a daily basis due to movements in the value of the unsmoothed policy value. However more frequent reviews might take place, in particular in response to significant adverse market movements.

9.8.21 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

Principle 9.9 Investment Strategy

The fund will take investment risk only to the extent that there is a high degree of certainty that the fund is sufficiently strong to absorb adverse experience. Within this constraint the primary objective of the strategy will be to achieve the best long-term investment return. The size and timing of guaranteed benefits and other liabilities determine the investment freedom and risk tolerance.

Investments will be spread over a number of asset classes and within these asset classes the actual holdings will normally be diversified and of an appropriate quality. Derivatives are normally only used for efficient portfolio management or to reduce investment risk.

The fund may hold assets which are *not normally traded*, but will not normally seek to increase its exposure to such type of assets.

The investment strategy will be reviewed regularly to ensure it remains appropriate.

Practices

9.9.1 The fund maintains three pools of investment assets. These are called the Growth Fund, the Matched Fund and the Euro Fund.

These investments are managed by the *investment managers* in accordance with an investment mandate specified by the *Board*.

The Growth Fund backs the former Britannic with-profits business *asset shares* and a proportion of the former Century with-profits business *asset shares*. The Matched Fund backs the remaining proportion of the former Century with-profits business *asset shares* and the non a*sset share* liabilities of the fund. The Euro Fund backs the Euro-denominated with-profits business *asset shares*. This is described in more detail subsequently.

9.9.2 Currently the same mix of assets is held for all former Britannic with-profits policies in the fund, other than for Euro-denominated business, and the same investment performance is used when working out *asset shares*. This may change in the future if it would be fairer to hold different mixes of assets for different groups of with-profits policyholders.

Currently the same mix of assets is held for all Euro-denominated business and the same investment performance is used when working out *asset shares*. This may change in the future if it would be fairer to hold different mixes of assets for different groups of with-profits policyholders.

Former Century *asset shares* are invested 30% in the Growth Fund and 70% in the Matched Fund fixed interest assets. The allocation to the Growth Fund may reduce over time as the outstanding term of the former Century policies reduces relative to the other business of the fund or if maintaining the exposure would, when combined with paragraph 9.5.5, lead to a material increase in the cost of guarantees for the former Century business. The exposure of the former Century *asset shares* to the Growth Fund is reviewed at least one a year.

9.9.3 The investment assets are spread over a number of different asset classes, which may include:

- Property
- Approved fixed interest securities, such as British Government gilts and other government and supranational bonds
- Other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt
- Approved variable interest securities, such as British Government index-linked gilts
- Other variable interest securities, such as variable rate corporate bonds
- United Kingdom equity shares
- Overseas equity shares, such as European, United States of America, Japanese, Asia Pacific and emerging markets
- Loans secured by mortgage
- Cash, such as short term deposits and money market funds
- Derivatives
- *Private equity*
- *Alternative assets* such as hedge funds.

The investments may be direct or via collective investment schemes such as unit trusts.

With the exception of property, loans secured by mortgages, *private equity* and some *alternative assets*, investments are predominately listed and traded on a recognised stock exchange.

The actual investments held are widely diversified within these asset classes.

The investment guidelines cover:

- Asset class allocation ranges
- Benchmarks
- Credit ratings and durations of fixed interest securities. Specifically other fixed interest securities should be at least investment grade and an overall average credit rating is specified. Unrated or non-investment grade other fixed interest securities can only be held with the approval of the *Board*.
- Exposures, such as minimum and maximum number of holdings and maximum exposure to any one counterparty
- Currency matching and localisation
- Stock lending
- The liquidity position
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

A consideration when setting the investment guidelines is to minimise any reduction in the value of the investment assets for solvency purposes.

The investment strategy and guidelines differ between the three pools of investment assets and reflect the different liabilities they are backing.

9.9.4 The investment strategy is regularly reviewed taking account of a variety of considerations, including our approach to *responsible investment*. In particular, reports from the *investment managers*, the *Chief Actuary*, the *With-Profits Actuary* and *the With-Profits Committee*, and recommendations for change are considered and, if appropriate, implemented.

9.9.5 The introduction of any new asset or liability instruments into the investment strategy will only occur following approval by the *Board*. Such instruments are only likely to be permitted for efficient portfolio management or to reduce investment risk.

9.9.6 The fund may include assets that are *not normally traded,* although currently there are none.

Any future assets which would *not normally* be traded will only be acquired following a review by the *With-Profits Committee* and approval by the *Board*. Any acquisition of such assets would be made after considering the run-off position of the fund, the management of the *estate* and the ultimate need at some future time to realise such assets.

9.9.7 The *Board* reviews the investment strategy at least once a year. However more frequent reviews might take place, in particular in response to adverse market movements or significant changes in the operating environment. The *Board* documents the investment strategy, provides investment ranges to the *investment managers* and monitors the position.

9.9.8 The three pools of investment assets, the Growth Fund, the Matched Fund and the Euro Fund are reviewed at least once a year and monies are transferred between them in order to rebalance them to their respective liabilities.

9.9.9 Growth Fund

(a) The Growth Fund supports the *asset shares* of the fund (excluding the Euro-denominated business). The primary objective for the Growth Fund is to achieve the highest possible long-term rate of return, subject to the constraints described.

(b) The investment strategy of the Growth Fund is to have an equity-backing ratio which balances the expected higher returns with the risks of adverse market movements, the risk-based capital requirements and the management and potential distribution of the *estate*. The fund also holds a small proportion of alternative assets, such as hedge funds. The fixed interest assets held will be chosen having regard to the expected liability cashflows.

(c) The risk appetite for the investment strategy is considered by examining the ability of the fund to withstand severe adverse market movements and still meet guaranteed commitments to policyholders.

(d) The proportion of the assets backing *asset shares* invested in equities, including *private equity*, property and *alternative assets* may change in the future as a consequence of practices 9.9.4and 9.9.10(c) . It would also change if the *Board*'s long-term view of the merits of equity and property investments relative to other asset classes was to change.

9.9.10 **Matched Fund**

(a) The Matched Fund supports the liabilities of the fund (other than the *asset shares*) and part of the *asset shares* of the former Century business. The Matched Fund also includes the *estate*. The primary objective of the Matched Fund is to invest in assets which as closely as possible meet the expected liability cashflow requirements.

(b) The investment strategy for the Matched Fund is set by examining the profile of liabilities to be matched. These liabilities include the provision for policy guarantees to the extent that these might not be supported by *asset shares*. The provision for guarantees may be matched by short positions in growth assets such as equities and property. These positions would be effective matches for relatively small movements in equity and property markets but would need adjustment in the event of significant market movements. These positions are reviewed at least once a year.

(c) Assets representing the *estate* of the Britannic With-Profits Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth investments in line with the asset mix for the *asset shares*.

9.9.11 **Euro Fund**

(a) The Euro Fund supports the Euro-denominated business in the fund. The primary objective of the Euro Fund is to achieve the highest possible long-term Euro-denominated rate of return, subject to the constraints described.

(b) The investment strategy for the Euro Fund is set with reference to the asset strategy for the Growth Fund, adjusted to give a higher equity exposure and a Euro bias, that is exposure is based more on European equities and bonds rather than on United Kingdom equities and bonds. The higher equity exposure recognises that there are additional charges levied on this business to allow a higher exposure whilst maintaining policy guarantees.

Asset Shares

9.9.12 The guideline asset mix ranges for *asset shares* are:

	Former Britannic Assurance Sterling business	**Former Britannic Assurance Euro business**	**Former Century business**
Fixed interest and cash	40% to 55%	35% to 55%	80% to 90%
Equities including *private equity* and *alternative assets*	40% to 55%	45% to 65%	10% to 15%
Property	0% to 10%	0%	0% to 5%

From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*. Fixed interest will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging markets debt.

Possible Future Changes

9.9.13 If it is considered by the *Board* to be in the best interests of the policyholders, further hypothecation of the assets in the fund may be introduced. For example this may involve the hypothecation of different equity-backing ratios to different classes or groups of policies or the hypothecation of fixed interest assets by *term remaining* within *asset shares* to reduce the volatility of policyholder returns near *maturity*. Currently no such changes are planned.

Principle
9.10 Business Risks

The *Board* aims to manage its business in a prudent manner, having regard to both the risks and rewards of which it is aware. The *Board* will also have regard to the availability of suitable capital and the amount required in light of the risks being undertaken. Some business risks are outside the control of Phoenix Life Limited.

Risks determined by the *Board* to arise in connection with the insurance business of the fund are attributed to the fund. Costs and benefits are attributed in the same manner.

Unless specifically passed through to *asset share* calculations, the impact of business risks is borne by the *estate*. Thus with-profits policyholders are exposed through bonuses, following from sections 9.4 and 9.12, to the profits and losses of the fund.

Practices

9.10.1 Infrastructure risks

(a) As the unit charges under the management services agreement are subject to annual increases linked to movements in the Retail Prices Index (RPI), the fund is exposed to the risk of higher than expected inflation.

Costs associated with day to day administrative problems are borne by PGMS.

(b) Pensions review and mortgage endowment review compensation costs are allocated to the fund.

Ongoing pensions review administration costs are included in the PGMS unit charges, while the mortgage endowment review administration costs are treated as additional activity costs.

Explicit reserves have been established to cover the expected costs.

(c) Compensation and mis-selling costs have been and will continue to be allocated to the fund. Any costs associated with large scale reviews triggered by *regulator* guidance or directives would also be allocated to the fund.

(d) The PGMS charges are currently VAT exempt. Phoenix Life Limited retains the risk of increase in charges due to changes in VAT rules, including any retrospective changes.

9.10.2 As the fund is running off, there is a risk that the fixed costs will not be reduced in line with the reducing policy volumes. This is partially mitigated by agreements for the provision of administration services, but this risk has not been entirely eliminated.

9.10.3 Management services are provided to the fund by PGMS. In the event of the failure of PGMS, substantial costs would be incurred in securing an alternative supplier, especially as PGMS and / or its sub-contractors own the infrastructure assets. The financial viability of PGMS is regularly monitored. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

9.10.4 The fund contains non-profit business and the profits or losses arising in respect of this business fall to the fund.

9.10.5 There are no material reassurance treaties applicable to the fund which would have a material impact in the event of the reassurer failing. There is a material internal arrangement whereby the fund's property linked liabilities in respect of *unitised* business are transferred to the Non-Profit Fund. Consequently the fund is materially at risk from any failure of the Non-Profit Fund. Future new reassurance or similar arrangements (where the fund would be exposed to the failure of the reassurer) will only be entered into to reduce the risk within the business and where they are cost / benefit justified.

9.10.6 Mortality, morbidity and persistency experience may impact *asset shares* or charges directly, but can also have an indirect effect, such as causing the level of expense charges to vary, other than the service level charges from PGMS. However, the structure of the PGMS service level charges in respect of *unitised* with-profits business means that there is some lapse risk associated with the overall level of these charges. Experience is regularly investigated. The potential impact of variations in experience is also considered.

9.10.7 Although the fund is no longer actively seeking new business, there remains some risk in respect of any new business arising and from the exercising of policy options.

9.10.8 Investment management services are provided to the fund by the *investment managers*. Failures at the *investment managers* might result in losses or costs to the fund, either through losses in the investments being managed or in securing an alternative supplier.

9.10.9 Other business risks which potentially impact the fund and the amounts payable under with-profits policies are explicitly or implicitly covered under the other principles and their associated practices, but are summarised here as follows:

- Solvency risks
- Investment risks
- Expense and charges risks
- Mortality and morbidity risks
- Persistency risks
- Taxation risks
- Guarantee risks
- Regulatory risks
- Bonus declaration risks
- *Estate* management and distribution risks.

9.10.10 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

9.10.11 Risks undertaken by the fund are approved by the *Board*. They consider the scale of such risks and the cost / benefit justification, having regard to the availability of suitable capital and the amount required in light of the risks being undertaken. They also aim to ensure that risks are undertaken which are, in their opinion, to the advantage of with-profits policyholders.

The *Board* approves to what extent these risks pass to *asset shares*. The balance of these risks feed through to the *estate*. The profits and losses from risks which pass to *asset shares* affect the amounts payable under with-profits policies. The profits and losses from risks that feed through to the *estate* only indirectly affect the amounts payable under with-profits policies, as part of any distribution of or charge to the *estate* as described in section 9.12.

9.10.12 Business risks are regularly monitored and they form part of the key insurance risk and operational risk management processes. The risk based capital requirements are assessed with regard to the business risks being undertaken.

Business risks attributed to the fund are reviewed at least once a year by the *With-Profits Committee*.

Principle
9.11 Expenses and Charges

Policies will either be charged product charges or be charged amounts which represent a fair share of the actual costs or a sub-set of the actual costs.

This approach will be adjusted where necessary in order to continue to treat customers fairly.

Product charges may be either explicit or implicit.

Where actual costs are used and where costs are specific to a policy or policy class, then taking into account the approximations referred to in section 9.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

9.11.1 Expenses and charges applied to *asset shares* are product charges for *unitised* with-profits business and *smoothed return* business and actual costs for *traditional* with-profits business as described in section 9.4.

9.11.2 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

9.11.3 The costs apportioned to any particular group of policies will only change:

- if the formulaic bases of cost charging are altered to reflect a change in the underlying cost of the activities supporting that group of policies; or
- if the apportioned costs are allocated on a basis which more fairly reflects the costs of the group.

Principle 9.12	***Estate* Management** The combined *estate* of the Britannic Industrial Branch Fund and the Britannic With-Profits Fund (including the *Buffer Reserve*) should lie in a target range. If the *estate* falls outside the target range then either the target *payout ratio* (in section 9.6) will be changed or *asset shares* (in section 9.4) will be adjusted, to maintain the *estate* within the target range where possible. In addition, subject to the above, the *estate* (excluding any element relating to the *Buffer Reserve*) of the fund should be less than an upper target amount.

Practices

9.12.1 The former Britannic Assurance *smoothed return* business, that is, Irish Life, with-profits annuity and Britannic With-Profits bond business, does not have any interest in the *estate* arising in the fund and references in this section to potential benefit enhancements from *estate* distribution do not apply to this business.

9.12.2 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

9.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 9.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

9.12.4 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;
(c) meet any costs which are charged directly to the *estate* rather than to *asset shares*;
(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and
(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

9.12.5 Any enhancements in benefits on account of the *distributable estate* referred to in 9.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

9.12.6 The amount of the *estate,* the *distributable estate,* and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

9.12.7 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to *asset shares* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

9.12.8 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 9.12.7 above be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *Board* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

9.12.9 The assets comprising the *Buffer Reserve* are currently split between the Britannic With-Profits Fund and the Britannic Industrial Branch Fund, and the amount of the *Buffer Reserve* is tracked by means of a notional segregation of the assets of that fund.

9.12.10 The *Buffer Reserve* is available to support both the Britannic Industrial Branch Fund and the Britannic With-Profits Fund in meeting their liabilities and covering their capital requirements.

9.12.11 We will consider enhancements to benefits on account of any *distributable estate* in the Britannic Industrial Branch Fund and the Britannic With-Profits Fund if the combined assets of the funds, including the *Buffer Reserve*, exceed the combined capital requirements of the funds. The amount of enhancement will be determined separately for each fund. A further assessment will then be carried out using the combined assets, liabilities and capital requirements of both funds, including the *Buffer Reserve*, to establish if any amount from the *Buffer Reserve* can be regarded as *distributable estate*.

9.12.12 If this calculation shows that part or all of the *Buffer Reserve* can be regarded as *distributable estate*, then an appropriate share will be apportioned to each fund, such apportionment currently being by reference to *asset shares* of policies which have an interest in the *estate*. To the extent that the *distributable estate* arising from the *Buffer Reserve* is used to enhance claim payments or *asset shares* then assets will be transferred from the *Buffer Reserve* to each of these funds to meet the costs of these enhancements.

Principle
9.13 New Business

The fund is no longer actively seeking new business. Policy options under existing contracts to effect new policies are honoured.

Practices

9.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts. This includes recurring single premium payments for personal pension policies used to contract out of the state second pension.

Currently there are no plans to reopen the fund to new business.

Principle
9.14 Equity Between the Fund and Shareholders

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arm's length commercial basis.

Shareholders receive no more than one ninth of the cost of bonuses distributed to policyholders, as laid down in the *2023 Scheme*. Any change to the one ninth limit would require the agreement of the *Board* and would be subject to approval by our *regulator* and the High Court.

Practices

9.14.1 The following services are provided to the fund:
- product provision (annuity products by the Non-Profit Fund);
- reassurance of property linked benefits by the Non-Profit Fund; and
- administration services by PGMS.

9.14.2 Shareholders will only provide services to the fund on commercial terms, that is if there is an adequate return for the risks involved in providing the services. The profit margin for shareholders is acceptable to the fund if:
- the cost for the fund is consistent with the terms available from other providers; or
- the profit margin is consistent with the risks borne and there are reasonably foreseeable circumstances in which the shareholder could make a loss.

9.14.3 The allocation of profits between policyholders and shareholders is laid down in the *2023 Scheme* which states that not less than 90% of the surplus being distributed from the fund is allocated to policyholders. Current practice is to distribute exactly 90% of such surplus to policyholders, leaving the remaining 10%, being one ninth of the cost of bonus, to be transferred to shareholders.

The division of profits between with-profits policyholders and shareholders does not change as a result of changes in the underlying basis used to determine the cost of bonus as described in paragraph 9.14.5 to 9.14.7. The transfer to shareholders remains one ninth of the cost of bonus as determined in accordance with the underlying basis.

In respect of the *smoothed return* with-profits bond business and the with-profits annuity business, the shareholder one ninth share of the cost of bonus is restricted if the accumulated cost of capital element contained within the annual management charge less past transfers (including associated tax) is not sufficient to fully fund the one ninth cost.

9.14.4 The shareholder transfer associated with the distribution of profits from the fund can only take place following the published annual actuarial investigation of the long-term business of Phoenix Life Limited carried out in accordance with the requirements of the Financial Services and Markets Act 2000 (or equivalent subsequent legislation). The *Board* is responsible for the distribution of profits and no transfer to shareholders can take place without its authority.

9.14.5 For all *traditional* with-profits business, the cost of bonus is the increase in the liabilities using a risk free discount rate (net of tax as appropriate), as a result of the bonus declaration together with cost of bonus paid on claims since the previous actuarial investigation as follows:

(a) Life assurance *traditional* with-profits business

- The cost of *annual bonus* is the value of any *annual bonus* added, discounted using the above basis.

- The cost of *final bonus* is the value of any *final bonus* paid on death or *maturity* or where applicable terminal or serious illness. The cost of any *interim bonus* paid on such claims is the value of the *interim bonus* added, discounted using the above basis.

- The cost of *interim bonus* or *final bonus* on a policy becoming paid-up for a reduced sum assured is the value of any bonus added, discounted using the above basis.

- The cost of *interim bonus* on surrender is the value of that bonus discounted using the above basis and the cost of *final bonus* is the value of the *final bonus* element of the *surrender value*.

- If the policy has not paid premiums up to the policy anniversary following the previous valuation date, then where applicable, the cost of *annual bonus* is reduced to reflect that only a proportion of that year's *annual bonus* is included in the claim value.

(b) Pensions *traditional* with-profits business (including Channel Islands and Isle of Man business)

- The cost of *annual bonus* is the capital value, at the selected retirement age using the above basis, of the *annual bonus* added discounted using the above basis.

- The cost of any *interim bonus* paid on retirements is the capital value, at the retirement date using the above basis.

- On retirement, the cost of *final bonus* is the excess of the capital value of the annuity, *annual bonus*, *interim bonus* and *final bonus* on the commencement basis, less the capital value of the annuity, *annual bonus* and *interim bonus* on the above basis, subject to a minimum of nil.

- The cost of any *interim bonus* or *final bonus* on a policy becoming paid-up for a reduced annuity is the capital value, at the selected retirement age using the above basis, of the *interim bonus* or *final bonus* added, discounted using the above basis.

- The cost of any *interim bonus* on transfer is the capital value, at the selected retirement age using the above basis, of any *interim bonus* added, discounted using the above basis and the cost of any *final bonus* is the capital value, at the selected retirement age using the transfer basis, of the *final bonus* added.

- If the policy has not paid premiums up to the policy anniversary following the valuation date, then where applicable, the cost of *annual bonus* is reduced to reflect that only a proportion of that year's *annual bonus* is included in the claim value.

9.14.6 For *unitised* with-profits business, the cost of bonus is the increase in the liabilities as a result of the bonus declaration together with cost of bonus paid on claims since the previous actuarial investigation as follows:

- The cost of *annual bonus* is the value of the bonus units added.
- The cost of *interim bonus* paid on claims is the value of the bonus units added.
- The cost of *final bonus* paid on claims is the value of the *final bonus* paid. The *final bonus* is the amount after the application of any *market value reduction*, subject to a minimum of nil.
- The cost of bonus is reduced if the application of a *market value reduction* reduces the claim value of the bonus and *interim bonus* units.

9.14.7 For *smoothed return* business, the cost of bonus is the increase in the liabilities as a result of the bonus declaration together with cost of bonus paid on claims since the previous actuarial investigation as follows:

(a) *Smoothed return* with-profits bonds (this includes Britannic With-Profits Bond and Irish Life business).

- The cost of *annual bonus* (where applicable) is the value of the *annual bonus* added to increase the guaranteed fund.
- Where there is no *annual bonus*, the cost of bonus arising from an increase in the value of the guaranteed benefits, is any increase in the guaranteed fund, relative to the higher of the guaranteed fund at the previous valuation date and the original smoothed value.
- For claims, the cost of bonus is the excess of the amount paid less the higher of the original smoothed value and the guaranteed fund at the time of claim, subject to a minimum of nil.
- The cost of bonus is reduced if the application of a *market value reduction* reduces the claim value below the guaranteed fund, but only to the extent that previous increases in the value of guaranteed benefits have generated a cost of bonus in the past.

(b) With-profits annuity

- The cost of bonus in respect of the declared investment return depends on whether it is added in the form which is only paid for the next policy year or in a form which increases the guaranteed benefits. In the former case it is the value of the additional payment for the next policy year on the published valuation basis, but using a risk free discount rate, whilst in the latter case it is the capital value of the increase in the additional guaranteed benefits on the published valuation basis, but using a risk free discount rate.

9.14.8 Where distributions to policyholders are made in anticipation of a surplus arising, these only contribute to the cost of bonus at the next actuarial investigation and only generate an allocation to shareholders at that time.

9.14.9 Any taxation arising from the distribution of profits from the fund to the shareholders is borne by the fund, except in relation to former Century former Prosperity business.

10 Principles and Practices – Britannic Industrial Branch Fund

The Principles and Practices given in sections 10.4 to 10.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the Britannic Industrial Branch Fund. Sections 10.1 to 10.3 give background information specific to the Britannic Industrial Branch Fund. Subsequently in this section the use of the term 'the fund' generally means the Britannic Industrial Branch Fund.

10.1 Fund History

The Britannic Industrial Branch Fund comprises the business that was transferred to Phoenix Life Limited under the *2006 Scheme* from the Industrial Branch Fund of Britannic Assurance (BA).

Britannic Assurance's origins dated back to 1866 when it was founded in Birmingham as the British Workman's Mutual Assurance Company Limited. Its business spread rapidly throughout Lancashire, Yorkshire and the rest of the United Kingdom. In 1905 it began to trade as Britannic Assurance.

Britannic Assurance wrote both general insurance and long-term insurance business. The latter included life assurance business, general annuity business, pensions business and permanent health insurance business. The majority of the business was transacted in the United Kingdom, however small amounts of business were transacted in the Channel Islands, Isle of Man and Eire.

In 1997, following detailed investigations into the historical development and financial strength of Britannic Assurance's long-term fund, the structure of the long-term fund was changed to clarify the future interests of policyholders and shareholders. The restructure was reviewed by an independent actuary and the Department of Trade and Industry, the then regulator of insurance business in the United Kingdom.

Before the restructure the long-term fund of Britannic Assurance comprised an Industrial Branch Fund and an Ordinary Branch Fund, which both contained with-profits and non-profit business. Under the restructure:

- Two non-profit funds, the Ordinary Branch Life Non Profit Fund and the Ordinary Branch Pensions Non Profit Fund, were established. Some of the Ordinary Branch non-profit business was transferred into these new funds. Shareholders are entitled to all distributable surplus arising in these funds.
- The Ordinary Branch With Profits Fund was established. All of the Ordinary Branch with-profits business was allocated to this fund, together with the Ordinary Branch non-profit business that was not transferred to either the Ordinary Branch Life Non Profit Fund or the Ordinary Branch Pensions Non Profit Fund. In respect of the Ordinary Branch With Profits Fund, not less than 90% of the surplus distributed each year was allocated to with-profits policyholders, with the balance available for transfer to the Britannic Assurance Shareholder Fund.
- In respect of the Industrial Branch Fund, not less than 90% of the surplus distributed each year was allocated to with-profits policyholders, with the balance available for transfer to the Britannic Assurance Shareholder Fund.

In addition:

- Certain assets were transferred to the Ordinary Branch Life Non Profit Fund and the Ordinary Branch Pensions Non Profit Fund. These assets were referred to as the Shareholders' Retained Capital, which was not available for distribution to policyholders and could, subject to certain restrictions, be distributed to shareholders. It was available to support the solvency of the long-term fund of Britannic Assurance.
- A *Buffer Reserve* was established, being an amount of assets attributable to the Industrial Branch Fund that could be used to support the liabilities arising in the Ordinary Branch With Profits Fund as well.
- A special bonus was declared.

In March 2003 Britannic Assurance withdrew from actively writing new business.

All business transferred from Britannic Assurance is administered by PGMS.

Under the *2006 Scheme* the *Buffer Reserve* referred above became the *Buffer Reserve* in Phoenix Life Limited referred to in paragraph 3.1.5 and section 10.12.

10.2 Types of Business

The Britannic Industrial Branch Fund comprises:

- Industrial Assurance Business – Business sold under the Industrial Assurances Act 1923 before 1 December 2001.
- Home Service Business – Business sold since 1 December 2001 where premiums were initially received in cash by collectors at intervals more frequent than once every two months. This business would have previously been sold under the Industrial Assurances Act 1923.

All of this business is now currently paid by means other than the home collection of cash.

This is *traditional* life assurance business.

The rights of former British Legal Closed Fund policyholders are the same as those for former Britannic Assurance policyholders and the bonus rates applying are the same as those for former Britannic Assurance policies which entered in 1926.

For policies issued from April 1979 to March 1984 that are eligible for Life Assurance Premium Relief, the sum assured reflected the rate of relief applicable during that time. Where the premium paid by the policyholder has not been increased to reflect the reductions in the rate of relief since the policy started, a shortfall deduction is made at the time of claim to reflect this.

For policies issued before April 1979 that are eligible for Life Assurance Premium Relief, the increased sum assured benefit is increased each year to reflect the relief received for that year. This increased sum assured benefit is not eligible for bonuses, but the rate of *annual bonus* added to the basic sum assured includes an allowance to reflect this.

For policies issued before decimalisation in 1971 where the premium did not convert exactly, a decimalisation adjustment is made at the time of claim to reflect this.

10.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances the shareholder will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 10.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with guiding principles.

The main guide used for determining the amounts payable under a with-profits policy is *asset share* calculations and the amounts payable will allow for a policy's fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es.

The degree of approximation used in the application of these methods aims to be consistent with the overall fair treatment of all with-profits policyholders.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Different bonuses are declared for different classes of with-profits business, reflecting tax, type of with-profits business and product features. New bonus classes would be required if a new type of product were developed. An existing class would normally only be split in exceptional circumstances. Within classes, bonuses may be further differentiated by series.

Bonus policy can be affected by a variety of factors including the financial and solvency position of Phoenix Life Limited, the financial strength of the fund, the expected cost of guarantees, actual and expected investment returns and expenses, the likelihood of changes in the level of provisions and the constraints which increases in guaranteed benefits may place on the fund, particularly in relation to investment strategy. These factors, together with the aim to retain flexibility in the operation of the fund, constrain *annual* and *final bonus* declarations and the *smoothing* policy. These constraints also apply in changing economic conditions.

Bonuses can only be declared if there is surplus available for distribution.

Practices

***Asset Share* Methodology**

10.4.1 The basic method for *asset shares* calculations for *traditional* with-profits business uses actual investment returns net of tax and the actual underlying experience.

Asset shares are not smoothed. In particular the investment returns and experience elements contributing to *asset shares* are not smoothed, other than that inherent in the processes used in the derivation of the assumptions, or in respect of initial expenses as described in paragraph 10.4.2(d).

10.4.2 The following table describes the elements credited or charged to *asset shares* for *traditional* with-profits business.

Element		Description of Allowance
(a)	Premiums	Premiums paid under the policy – note (a)
(b)	Investment return	Growth Fund return – note (b)
(c)	Investment expenses	Actual allocated – note (c)
(d)	Initial expenses	Actual allocated – note (d)
(e)	Renewal expenses	Actual allocated – note (e)
(f)	Other expenses	Not charged – note (f)
(g)	Tax on investment return	Actual allocated – note (g)
(h)	Tax relief on expenses	Actual allocated – note (h)
(i)	Mortality & morbidity costs	Based on underlying experience – note (i)
(j)	Early terminations	Profits and losses based on underlying surrender and lapse experience are credited – note (j)
(k)	Paid-up policies	Approximate effect allowed for by increasing the rate of early terminations in (j) above
(l)	Partial and regular withdrawals	Not applicable
(m)	Surrenders at *protected dates*	Not applicable
(n)	Annuity payments	Not applicable
(o)	Charges for the cost of guarantees	Not charged – note (o)
(p)	Charges for the cost of capital	Not charged
(q)	Distributions to shareholders	Actual incurred – note (q)
(r)	Tax on distributions to shareholders	Not charged
(s)	Profit and losses from other business	No profits or losses are credited
(t)	*Estate* distribution or charge	Distributions from or charges to the *estate* as determined – note (t)
(u)	Exceptional items	Not applicable

Notes

(a) Premiums

The premiums allow for the effect of Life Assurance Premium Relief and the benefits correspondingly so, including any increased sum assured and shortfall deductions.

The premiums allow for the effects of decimalisation and the benefits correspondingly allow for decimalisation adjustments.

(b) Investment return

The investment return element allocated to *asset shares* is based on the Growth Fund as described in section 10.9.

The investment returns are expressed as a percentage return to be applied.

These investment returns are before any deduction for investment expenses which are allowed for separately.

(c) Investment expenses

Actual investment expenses are charged, based on those allocated in respect of the Growth Fund in accordance with sections 5.2 and 10.11, subject to a small reduction.

The investment expenses are expressed as a percentage charge to be applied to the assets.

(d) Initial expenses

No new business is being written in the fund other than to honour policy options. Where new policies are written for this reason, initial expenses are generally based on previous initial expenses inflated at RPI+2% per annum and including allowance for commissions.

In 2007, the *Board* reviewed the costs allocated to *asset shares*. The *Board* concluded, having received the advice of the *With-Profits Committee*, that in order to protect policyholders from the effects of disproportionately high distribution costs, initial expenses charged to *asset shares* from 1997 should be restricted to be less than the costs actually incurred in those years. The restriction was assessed to reduce the impact of expenses to be more consistent with that applying for earlier years of entry.

(e) Renewal expenses

Renewal expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 10.11.

(f) Other expenses

Significant future project, additional added activity and other one-off costs will only be charged to *asset shares* following approval by the *Board*.

Any other adjustments to the expenses charged to the fund are not charged to *asset shares*.

(g) Tax on investment return

The tax on investment income allows for the different treatment of franked and unfranked income and also unrecoverable foreign tax. The tax on investment gains, whether realised or unrealised, includes an element of discounting representing the deferral of the actual payment. The element of discounting is regularly reviewed and takes into account the expected turnover rate of the investments and the level of unrealised gains. The rates of tax (before discounting) are based on those underlying the tax allocated to the fund in accordance with section 5.2.

(h) Tax relief on expenses

Tax relief due on the actual expenses charged is allowed for. Where the tax relief in respect of acquisition expenses is spread, this is allowed for. The rates of tax relief are based on those underlying the tax allocated to the fund in accordance with section 5.2.

(i) Mortality and morbidity costs

The charge based on the underlying experience is approximated by applying a percentage of a standard published mortality table. The percentage applied varies by calendar year and is based on the results of mortality investigations for the fund as carried out from time to time. There are no morbidity costs associated with this business.

(j) Early terminations

The profits and losses arising from surrenders currently accumulate in the *estate*. This may be allowed for via adjustments to the investment returns.

(o) Charges for the cost of guarantees

The cost of guarantees is currently not charged to *asset shares* and the cost has been borne by the *estate*. Should the cost increase leading to an erosion of the *estate*, or should the *estate* no longer be able to bear the cost, a charge may be introduced to *asset shares* in future. See section 10.12.

(q) Distributions to shareholders

The cost of distributions to shareholders resulting from the cost of bonus allocated to policies is charged to *asset shares*. The cost of bonus is as described subsequently in section 10.14, using the basis applicable at the time.

(t) *Estate* distribution or charge

Asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate*. However, these *estate* distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 10.12.

Asset shares are enhanced to reflect the cost of the 1997 special bonus. However, the enhancement is approximate.

10.4.3 *Asset shares* are calculated for representative specimen policies when setting bonus rates and setting *surrender value* bases for *non-protected exits*. Specimen policies are chosen to represent the business and include a range of policy terms and years of entry. The primary emphasis in selecting specimen policies is the size of premium or sum assured. There is however a degree of averaging, particularly for those terms where there are relatively few policies.

10.4.4 *Asset share* models contain some approximations, but these approximations do not prejudice the overall fair treatment of with-profits policyholders. In particular the complications due to Life Assurance Premium Relief and decimalisation are subject to approximate methods. Whilst only minor approximations are employed in *asset share* calculations, no investigations are carried out on the level of approximation built into the resulting *asset shares*.

For whole life policies, bonuses and *surrender value* bases may be set with reference to those applicable for endowments, however we do currently set these separately.

10.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in section 10.12.

10.4.6 *Asset share* practices are documented.

Asset share and bonus policies are documented at a high level in various *Board* (and previously Britannic Assurance Board) reports and reports on *asset share* investigations that have been undertaken from time to time.

Detailed specifications relating to the *asset share* calculations and the bonus calculations only exist to a varying degree, but the coding within the models used in the processes are viewable and thus document the calculations.

Asset share assumptions are documented and this tends to include references to their source of derivation.

For each bonus review appropriate documentation is produced and provides an audit trail of the process, including sources of data, source and derivation of assumptions, backing calculations, notes and correspondence. This audit trail normally includes retaining electronic copies of the systems and calculations used for the review.

10.4.7 *Asset share* models, processes and documentation are subject to a continual process of development, improvement and refinement. Significant effects are reported to and considered by the *Board*.

10.4.8 *Asset share* practices are not guaranteed and may be changed in future.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

10.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

10.4.10 A single *annual bonus* scale covers all the with-profits business.

Separate final bonus scales are declared for endowment policies, whole of life premium paying policies and whole of life fully paid policies.

10.4.11 Bonuses are reviewed regularly at least once a year.

Annual bonuses are reviewed annually and are declared in arrears in March / April of the following year to which the bonus relates.

*Final bonus*es, which are declared in advance, are reviewed at least twice a year, normally from 1 January and 1 July.

10.4.12 The timing of *final bonus* declarations may be varied.

10.4.13 *Final bonus*es are expected to, but are not guaranteed to, apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. Additional reviews would normally only be in response to exceptional investment market movements.

10.4.14 *Final bonus* reviews also consider the amount of *final bonus* paid on *non-protected exits* (surrenders).

10.4.15 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared.

Principle
10.5 ***Annual Bonus* Rates**

The aim is to set *annual bonuses* at a prudent level, balancing the benefit to policyholders of increased guarantees, the aim for an element of *final bonus*, the flexibility of the operation of the fund and its ability to ensure the guarantees can be met in future. *Annual bonuses* may increase or decrease from declaration to declaration and may also be nil. *Annual bonuses* can only be declared if there is sufficient surplus available.

Practices

10.5.1 The *Board* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in the following paragraphs.

10.5.2 For each class of business, the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

10.5.3 Where the financial position of the fund is weak, the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

10.5.4 The *asset share* comparisons are performed for representative specimen policies grouped according to the level at which different bonus rates are declared.

10.5.5 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

10.5.6 *Annual bonus* rates are rounded and expressed as a percentage of the sum assured and the rates depend on year of entry.

Principle
10.6 ***Final Bonus* Rates**

The aim is to set *final bonus* rates so that specimen policy *payouts* achieve a target *payout ratio*. These *final bonus* rates are then adjusted for *smoothing* as described in section 10.7. *Final bonus*es for a policy may increase or decrease from declaration to declaration and may also be nil. *Final bonus*es will be reviewed regularly, but can be reviewed at any time.

Practices

10.6.1 The current long-term target *payout ratio* for maturing policies is 100% of *asset share*.

10.6.2 The actual *payout ratio* for maturing policies at any one time will not necessarily be equal to the target *payout ratio* due to:

- the level of accumulated guarantees; or
- the effects of *smoothing*.

10.6.3 *Final bonus*es are determined by comparing projected *asset shares* with the corresponding guaranteed benefits together with any *interim bonus*, for maturities in the period under consideration. The projected *asset shares* allow for the actual experience to date and expected future experience, including expected future investment return and shareholder transfer in respect of the *final bonus* being determined. The *final bonus*es actually declared are based on these figures after adjusting for *smoothing* as described in section 10.7.

10.6.4 The projections supporting *final bonus* investigations are based on actuarial experience up to five months in advance of the start date of the declaration. The projections generally consider policies maturing during the calendar year in which the *final bonus* rates apply.

10.6.5 *Final bonus* declarations are also informed by comparisons of projected *asset shares* and corresponding projected benefits for maturities in subsequent *final bonus* periods and over the next couple of years.

10.6.6 The *asset share* comparisons are performed for representative specimen policies, grouped according to the level at which different bonus rates are declared. The primary focus is on performing the calculations for specimen policies at the terms which contain a significant volume of policies. For other terms approximations may be used.

10.6.7 *Final bonus* rates are rounded and expressed as a percentage of the sum assured and the rates depend on duration, and for whole of life policies on premium paying term. Rounding may mean that resulting *payout ratios* deviate slightly from the target.

10.6.8 *Final bonus* scales are determined by reference to maturing representative specimen policies. The *final bonus* payable on a death claim is calculated as follows:

- For an endowment assurance, it is the *final bonus* rate for a policy maturing at the same duration completed, multiplied by the proportion of the original term completed, applied to the sum assured.
- For a whole life assurance, it is the *final bonus* rate based on policy commencement year and total number of premium contracted to be paid, but applied to the lower of the office premium multiplied by the completed duration and the sum assured.

Some endowment assurances have an additional sum assured payable on death but this not eligible for bonuses.

10.6.9 *Final bonus*es are declared in advance and are made in anticipation of a surplus arising. *Final bonus*es can only be declared if there is an expectation of such surplus arising.

10.6.10 *Final bonus* reviews also consider the amount of *final bonus* payable on surrenders, based on section 10.8.

10.6.11 For all classes of policy *final bonus* rates may be changed at any time. At times when the value of the excess assets in the fund is not changing rapidly, this is likely to mean that changes, if any, are made one or two times per year, normally from 1 January and 1 July. However, a sudden change in the value of those excess assets (such as because of a significant change in the value of equity share markets) may cause *final bonus* rates to be changed on other occasions. Changes to *surrender* and transfer values may be less frequent than changes to *final bonus* rates for maturities.

10.6.12 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on maturities may deviate from the target *payout ratios* during the period between reviews. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the *maturity payout ratios* at the latest *final bonus* review were near the top or bottom of the range described in paragraph 10.7.2, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle
10.7 ***Smoothing***

The aim is to smooth with-profits policy *payouts* at *protected dates* to manage the *volatility* of with-profits policy *payouts*. The effect of *smoothing* may have a positive or negative effect on with-profits policy *payouts*.

Smoothing leads to profits and losses which are anticipated to offset each other over time. In the short term, if these profits or losses were to become excessive, then the *smoothing* policy would be reviewed.

Non-protected exit values will have a degree of *smoothing*.

Practices

10.7.1 *Final* and *interim bonus*es are declared in advance and are expected to, but are not guaranteed to, apply until the next planned review date. Additional reviews would normally only occur in response to exceptional adverse investment market movements. Thus with-profits policyholders leaving at *protected dates* are not impacted by day to day investment fluctuations. This forms part of the *smoothing* process.

10.7.2 *Final bonus* reviews take into account the current *maturity payout ratios* and the long-term target *payout ratio* per paragraph 10.6.1. The aim is to ultimately bring *maturity payout ratios* for representative specimen policies in line with the long-term target *payout ratio* in a smoothed manner based on the guidelines as described in paragraphs 10.7.3. The target range for *payout ratios* is to be between 80% and 120% of *asset share* before the effect of *smoothing*.

10.7.3 For *traditional* policies where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* and retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies *surrender value* bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as *term remaining* which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values.*

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their maturity date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values, and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing.* Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

10.7.4 The *smoothing* of *maturity* values from declaration to declaration primarily focuses on specimen maturities at terms which contain a significant volume of policies. The effect on the aggregate position for maturities, incorporating all relevant business for the class of with-profits business and grouped according to the level at which different bonus rates are declared is also considered. As *final bonus* rates are rounded, this may result in slight deviations from the target position.

10.7.5 In adverse conditions, where the level of guaranteed benefits exceeds the target proportion of the relevant *asset shares*, no *final bonus*es may be warranted. In this situation, the guaranteed benefits provide a floor for *maturity payouts*. This provides further protection against day to day investment fluctuations and may further limit movements in *maturity payouts* for similar policies, as a result of bonus declarations.

10.7.6 *Smoothing* leads to profits and losses which are anticipated to offset each other over time. Costs may arise under paragraph 10.7.5, but such costs are the cost of guarantees and not the cost of *smoothing*. The *smoothing* policy is not specifically constrained by a limit on the short-term profits and losses of *smoothing*, but should these become excessive, the *smoothing* policy may be revised. The profits and losses from *smoothing* and costs from guarantees feed through to the *estate* and are effectively dealt with by section 10.12.

10.7.7 As the *final bonus* payable on death claims is based on the *final bonus* scale for maturities, there is a similar element of *smoothing* operating on *payouts* for death claims.

Some endowment assurances have an additional sum assured payable on death but this not eligible for bonuses and is not smoothed.

Principle
10.8 ***Surrender Values***

The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies achieve a target *payout ratio*.

Practices

10.8.1 *Non-protected exits* refer to surrenders and policies becoming paid-up.

Surrender values are targeted in the long-term at 100% of *asset share* (as described below). The target range for surrenders is 80% of *asset share* to 120% of *asset share* before the effect of *smoothing*.

10.8.2 The basis for the *surrender value* formulae is determined by targeting the target proportion of *asset share* for representative specimen policies.

10.8.3 *Surrender values* are calculated by formulae based on discounting the policy benefits. The formulae include an allowance for *final bonus*.

10.8.4 The approach of discounting policy benefits ensures that *surrender values* take some account of the value of the policy guarantees and produce a reasonable progression of *surrender values* into the prospective *maturity* value.

10.8.5 In determining the basis used to discount the policy benefits, the *Board* will ensure that in aggregate payments to surrendering policyholders do not materially adversely affect the interests of continuing policyholders.

10.8.6 For whole life policies, the basis for *surrender values* is based on a similar approach to that used for endowments.

10.8.7 Surrender profits or losses may be recycled into the *asset shares* of continuing policies although this would be done in an approximate way, as described in section 10.4.

10.8.8 Paid-up policy benefits are determined such that the value of the paid-up policy benefits target similar *payout ratios* to surrenders. Paid-up policies cease to participate in profits.

10.8.9 Some policies have surrender and paid-up policy calculations specified in the policy conditions. Additionally the regulations specify certain *surrender value* and paid-up policy value calculations. These represent a minimum basis that is applied.

10.8.10 *Surrender value* and paid-up policy value bases will normally be reviewed once a year. However more frequent reviews might take place, in particular in response to significant investment market movements. *Surrender values* and paid-up policy values may also change more regularly following a review of *final bonus* rates.

10.8.11 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

Principle 10.9	**Investment Strategy**
	The fund will take investment risk only to the extent that there is a high degree of certainty that the fund is sufficiently strong to absorb adverse experience. Within this constraint the primary objective of the strategy will be to achieve the best long-term investment return. The size and timing of guaranteed benefits and other liabilities determine the investment freedom and risk tolerance. Investments will be spread over a number of asset classes and within these asset classes the actual holdings will normally be diversified and of an appropriate quality. Derivatives are normally only used for efficient portfolio management or to reduce investment risk. The fund may hold assets which are *not normally traded*, but will not normally seek to increase its exposure to such type of assets. The investment strategy will be reviewed regularly to ensure it remains appropriate.

Practices

10.9.1 The fund maintains two pools of investment assets. These are called the Growth Fund and the Matched Fund.

These investments are managed by the *investment managers* in accordance with an investment mandate specified by the *Board*.

The Growth Fund backs the with-profits business *asset shares.* The Matched Fund backs the non *asset share* liabilities of the fund. This is described in more detail subsequently.

10.9.2 Currently the same mix of assets is held for all with-profits policies in the fund and the same investment performance is used when working out *asset shares*. This may change in the future if it would be fairer to hold different mixes of assets for different groups of with-profits policyholders.

10.9.3 The investment assets are spread over a number of different asset classes, which may include:

- Property
- Approved fixed interest securities, such as British Government gilts and other government and supranational bonds
- Other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt
- Approved variable interest securities, such as British Government index-linked gilts
- Other variable interest securities, such as variable rate corporate bonds
- United Kingdom equity shares
- Overseas equity shares, such as European, United States of America, Japanese and Asia Pacific
- Loans secured by mortgage
- Cash, such as short term deposits and money market funds
- Derivatives
- *Private equity*
- *Alternative assets* such as hedge funds.

The investments may be direct or via collective investment schemes such as unit trusts.

With the exception of property, *private equity*, loans secured by mortgages and some *alternative assets*, investments are predominately listed and traded on a recognised stock exchange.

The actual investments held are widely diversified within these asset classes.

The investment guidelines cover:
- Asset class allocation ranges
- Benchmarks
- Credit ratings and durations of fixed interest securities. Specifically other fixed interest securities should be at least investment grade and an overall average credit rating is specified. Unrated or non-investment grade other fixed interest securities can only be held with the approval of the *Board*.
- Exposures, such as minimum and maximum number of holdings and maximum exposure to any one counterparty
- Currency matching and localisation
- Stock lending
- The liquidity position.
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

A consideration when setting the investment guidelines is to minimise any reduction in the value of the investment assets for solvency purposes.

The investment strategy and guidelines differ between the two pools of investment assets and reflect the different liabilities they are backing.

10.9.4 The investment strategy is regularly reviewed taking account of a variety of considerations, including our approach to *responsible investment*. In particular, reports from the *investment managers*, the *Chief Actuary*, the *With-Profits Actuary* and *the With-Profits Committee*, and recommendations for change are considered and, if appropriate, implemented.

10.9.5 The introduction of any new asset or liability instruments into the investment strategy will only occur following approval by the *Board*. Such instruments are only likely to be permitted for efficient portfolio management or to reduce investment risk.

10.9.6 The fund may include assets that are *not normally traded*, although currently there are none.

Any future assets which would *not normally* be traded will only be acquired following a review by the *With-Profits Committee* and approval by the *Board*. Any acquisition of such assets would be made after considering the run-off position of the fund, the management of the *estate* and the ultimate need at some future time to realise such assets.

10.9.7 The *Board* reviews the investment strategy at least once a year. However more frequent reviews might take place, in particular in response to adverse market movements or significant changes in the operating environment. The *Board* documents the investment strategy, provides investment ranges to the *investment managers* and monitors the position.

10.9.8 The two pools of investment assets, the Industrial Branch Growth Fund and the Industrial Branch Matched Fund are reviewed at least once a year and monies are transferred between them in order to rebalance them to their respective liabilities.

10.9.9 **Growth Fund**

(a) The Growth Fund supports the *asset shares* of the fund. The primary objective for the Growth Fund is to achieve the highest possible long-term rate of return, subject to the constraints described.

(b) The risk appetite for the investment strategy is considered by examining the ability of the fund to withstand severe adverse market movements and still meet guaranteed commitments to policyholders.

(c) The investment strategy of the Growth Fund is to have an equity-backing ratio which balances the expected higher returns with the risks of adverse market movements, the risk-based capital requirements and the management and potential distribution of the *estate*. The fund also holds a small proportion of alternative assets, such as hedge funds. The fixed interest assets held will have regard to the expected liability cashflows.

(d) The proportion of the assets backing *asset shares* invested in equities, including *private equity*, property and *alternative assets* may change in the future as a consequence of practices 10.9.4 and 10.9.10(b) and (c). It would also change if the *Board*'s long-term view of the merits of equity and property investments relative to other asset classes was to change.

10.9.10 **Matched Fund**

(a) The Matched Fund supports the liabilities of the fund other than the *asset shares*. The Matched Fund also includes the *estate*. The primary objective of the Industrial Branch Matched Fund is to invest in assets which as closely as possible meet the expected liability cashflow requirements.

(b) The investment strategy for the Matched Fund is set by examining the profile of liabilities to be matched. These liabilities include the provision for policy guarantees to the extent that these might not be supported by *asset shares*. The provision for guarantees may be matched by short positions in growth assets such as equities and property. These would be effective matches for relatively small movements in equity and property markets but would need adjustment in the event of significant market movements. These positions are reviewed at least once a year.

(c) Assets representing the *estate* of the Britannic Industrial Branch Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth investments in line with the asset mix for the *asset shares*.

Asset Shares

10.9.11 The guideline asset mix range for *asset shares* is:

	All business
Fixed interest and cash	40% to 55%
Equities including *private equity* and *alternative assets*	40% to 55%
Property	0% to 10%

From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*. Fixed interest will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt.

Possible Future Changes

10.9.12 If it is considered by the *Board* to be in the best interests of the policyholders, further hypothecation of the assets in the fund may be introduced. For example this may involve the hypothecation of different equity-backing ratios to different classes or groups of policies or the hypothecation of fixed interest assets by *term remaining* within *asset shares* to reduce the volatility of policyholder returns near *maturity*. Currently no such changes are planned.

Principle 10.10	**Business Risks**
	The *Board* aims to manage its business in a prudent manner, having regard to both the risks and rewards of which it is aware. The *Board* will also have regard to the availability of suitable capital and the amount required in light of the risks being undertaken. Some business risks are outside the control of Phoenix Life Limited. Risks determined by the *Board* to arise in connection with the insurance business of the fund are attributed to the fund. Costs and benefits are attributed in the same manner. Unless specifically passed through to *asset share* calculations, the impact of business risks is borne by the *estate*. Thus with-profits policyholders are exposed through bonuses, following from sections 10.4 and 10.12, to the profits and losses of the fund.

Practices

10.10.1 Infrastructure risks

(a) As the unit charges under the management services agreement are subject to annual increases linked to movements in the Retail Prices Index, the fund is exposed to the risk of higher than expected inflation.

Costs associated with day to day administrative problems are borne by PGMS.

(b) Compensation and mis-selling costs have been and will continue to be allocated to the fund. Any costs associated with large scale reviews triggered by *regulator* guidance or directives would also be allocated to the fund.

(c) The PGMS charges are currently VAT exempt. Phoenix Life Limited retains the risk of increase in charges due to changes in VAT rules, including any retrospective changes.

10.10.2 As the fund is running off, there is a risk that the fixed costs will not be reduced in line with the reducing policy volumes. This is partially mitigated by agreements for the provision of administration services, but this risk has not been entirely eliminated.

10.10.3 Management services are provided to the fund by PGMS. In the event of the failure of PGMS, substantial costs would be incurred in securing an alternative supplier, especially as PGMS and / or its sub-contractors own the infrastructure assets. The financial viability of PGMS is regularly monitored. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

10.10.4 The fund contains non-profit business and the profits or losses arising in respect of this business fall to the fund.

10.10.5 There are no material reassurance treaties applicable to the fund which would have a material impact in the event of the reassurer failing. Future new reassurance arrangements (where the fund would be exposed to the failure of the reassurer) will only be entered into to reduce the risk within the business and where they are cost / benefit justified.

10.10.6 Mortality and persistency experience may impact *asset shares* or charges directly, but can also have an indirect effect, such as causing the level of expense charges to vary, other than the service level charges from PGMS. Experience is regularly investigated. The potential impact of variations in experience is also considered.

10.10.7 Although the fund is no longer actively seeking new business, there remains some risk in respect of any new business arising and from the exercising of policy options.

10.10.8 Investment management services are provided to the fund by the *investment managers*. Failures at the *investment managers* might result in losses or costs to the fund, either through losses in the investments being managed or in securing an alternative supplier.

10.10.9 Other business risks which potentially impact the fund and the amounts payable under with-profits policies are explicitly or implicitly covered under the other principles and their associated practices, but are summarised here as follows:

- Solvency risks
- Investment risks
- Expense and charges risks
- Mortality risks
- Persistency risks
- Taxation risks
- Guarantee risks
- Regulatory risks
- Bonus declaration risks
- *Estate* management and distribution risks.

10.10.10 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

10.10.11 Risks undertaken by the fund are approved by the *Board*. They consider the scale of such risks and the cost / benefit justification, having regard to the availability of suitable capital and the amount required in light of the risks being undertaken. They also aim to ensure that risks are undertaken which are, in their opinion, to the advantage of with-profits policyholders.

The *Board* approves to what extent these risks pass to *asset shares*. The balance of these risks feed through to the *estate*. The profits and losses from risks which pass to *asset shares* affect the amounts payable under with-profits policies. The profits and losses from risks that feed through to the *estate* only indirectly affect the amounts payable under with-profits policies, as part of any distribution of or charge to the *estate* as described in section 10.12.

10.10.12 Business risks are regularly monitored and they form part of the key insurance risk and operational risk management processes. The risk based capital requirements are assessed with regard to the business risks being undertaken.

Business risks attributed to the fund are reviewed at least once a year by the *With-Profits Committee*.

Principle
10.11 Expenses and Charges

Policies will be charged amounts which represent a fair share of the actual costs or a sub-set of the actual costs.

This approach will be adjusted where necessary in order to continue to treat customers fairly.

Where actual costs are used and where costs are specific to a policy or policy class, then taking into account the approximations referred to in section 10.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

10.11.1 Expenses and charges applied to *asset shares* are actual costs as described in section 10.4.

10.11.2 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

10.11.3 The costs apportioned to any particular group of policies will only change:

- if the formulaic bases of cost charging are altered to reflect a change in the underlying cost of the activities supporting that group of policies; or
- if the apportioned costs are allocated on a basis which more fairly reflects the costs of the group.

Principle
10.12 ***Estate* Management**

The combined *estate* of the Britannic Industrial Branch Fund and the Britannic With-Profits Fund (including the *Buffer Reserve*) should lie in a target range. If this *estate* falls outside the target range then either the target *payout ratio* (in section 10.6) will be changed or *asset shares* (in section 10.4) will be adjusted, to maintain the *estate* within the target range where possible.

In addition, subject to the above, the *estate* (excluding any element relating to the *Buffer Reserve*) of the Britannic Industrial Branch Fund should be less than an upper target amount.

Practices

10.12.1 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

10.12.2 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 10.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

10.12.3 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;
(c) meet any costs which are charged directly to the *estate* rather than to *asset shares*;
(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and
(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

10.12.4 Any enhancements in benefits on account of the *distributable estate* referred to in 10.12.3(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

10.12.5 The amount of the *estate,* the *distributable estate,* and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

10.12.6 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to *asset shares* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

10.12.7 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 10.12.6 above be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *Board* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

10.12.8 The assets comprising the *Buffer Reserve* are currently split between the Britannic With-Profits Fund and the Britannic Industrial Branch Fund, and the amount of the *Buffer Reserve* is tracked by means of a notional segregation of the assets of that fund.

10.12.9 The *Buffer Reserve* is available to support both the Britannic Industrial Branch Fund and the Britannic With-Profits Fund in meeting their liabilities and covering their capital requirements.

10.12.10 We will consider enhancements to benefits on account of any *distributable estate* in the Britannic Industrial Branch Fund and the Britannic With-Profits Fund if the combined assets of the funds, including the *Buffer Reserve*, exceed the combined capital requirements of the funds. The amount of enhancement will be determined separately for each fund. A further assessment will then be carried out using the combined assets, liabilities and capital requirements of both funds, including the *Buffer Reserve*, to establish if any amount from the *Buffer Reserve* can be regarded as *distributable estate*.

10.12.11 If this calculation shows that part or all of the *Buffer Reserve* can be regarded as *distributable estate*, then an appropriate share will be apportioned to each fund, such apportionment currently being by reference to *asset shares* of policies which have an interest in the *estate*. To the extent that *distributable estate* arising from the *Buffer Reserve* is used to enhance claim payments or *asset shares* then assets will be transferred from the *Buffer Reserve* to each of these funds to meet the cost of these enhancements.

Principle
10.13 New Business

The fund is no longer actively seeking new business. Policy options under existing contracts to effect new policies are honoured.

Practices

10.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts.

Currently there are no plans to reopen the fund to new business.

Principle 10.14	**Equity Between the Fund and Shareholders** Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arm's length commercial basis. Shareholders receive no more than one ninth of the cost of bonuses distributed to policyholders, as laid down in the *2023 Scheme*. Any change to the one ninth limit would require the agreement of the *Board* and would be subject to approval by our *regulator* and the High Court.

Practices

10.14.1 Administration services are provided to the fund by PGMS.

10.14.2 Shareholders will only provide services to the fund on commercial terms, that is, if there is an adequate return for the risks involved in providing the services. The profit margin for shareholders is acceptable to the fund if:

- the cost for the fund is consistent with the terms available from other providers; or
- the profit margin is consistent with the risks borne and there are reasonably foreseeable circumstances in which the shareholder could make a loss.

10.14.3 The allocation of profits between policyholders and shareholders is laid down in the *2023 Scheme* which states that not less than 90% of the surplus being distributed from the fund is allocated to policyholders. Current practice is to distribute exactly 90% of such surplus to policyholders, leaving the remaining 10%, being one ninth of the cost of bonus, to be transferred to shareholders.

The division of profits between with-profits policyholders and shareholders does not change as a result of changes in the underlying basis used to determine the cost of bonus as described in paragraph 10.14.5. The transfer to shareholders remains one ninth of the cost of bonus as determined in accordance with the underlying basis.

10.14.4 The shareholder transfer associated with the distribution of profits from the fund can only take place following the published annual actuarial investigation of the long-term business of Phoenix Life Limited carried out in accordance with the requirements of the Financial Services and Markets Act 2000 (or equivalent subsequent legislation). The *Board* is responsible for the distribution of profits and no transfer to shareholders can take place without its authority.

10.14.5 The cost of bonus is the increase in the liabilities using a risk free discount rate (net of tax as appropriate), as a result of the bonus declaration together with cost of bonus paid on claims since the previous actuarial investigation as follows:

- The cost of *annual bonus* is the value of any *annual bonus* added, discounted using the above basis.
- The cost of *final bonus* is the value of any *final bonus* paid on death or *maturity*. The cost of any *interim bonus* paid on such claims is the value of the *interim bonus* added, discounted using the above basis.
- The cost of *interim bonus* or *final bonus* on a policy becoming paid-up for a reduced sum assured is the value of any bonus added, discounted using the above basis.
- The cost of *interim bonus* on surrender is the value of that bonus discounted using the above basis and the cost of *final bonus* is the value of the *final bonus* element of the *surrender value*.

- If the policy has not paid premiums up to the policy anniversary following the previous valuation date, then the cost of *annual bonus* is reduced to reflect that only a proportion of that year's *annual bonus* is included in the claim value.

10.14.6 Where distributions to policyholders are made in anticipation of a surplus arising, these only contribute to the cost of bonus at the next actuarial investigation and only generate an allocation to shareholders at that time.

10.14.7 Any taxation arising from the distribution of profits from the fund to the shareholders is borne by the fund.

11 Principles and Practices – Phoenix With-Profits Fund

The Principles and Practices given in sections 11.4 to 11.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the Phoenix With-Profits Fund. Sections 11.1 to 11.3 give background information specific to the Phoenix With-Profits Fund. Subsequently in this section the use of the term ‘the fund’ generally means the Phoenix With-Profits Fund.

11.1 Fund History

The Phoenix With-Profits Fund comprises the business that was transferred into Phoenix Life Limited from the long-term business fund of Phoenix Life & Pensions Limited (PLP) under the *2006 Scheme*.

PLP traces its history back to Royal Life Insurance Limited (RLI), which was created in 1981 to receive, by transfer under the Insurance Companies Act 1974, the UK life insurance businesses of Royal Insurance Company Limited. This included business from Law Union and Rock Insurance Company Limited and Liverpool and London and Globe Insurance Company Limited which was transferred into Royal Insurance Company Limited in 1964.

RLI was a company within the Royal Insurance Group, which merged with the Sun Alliance and London Insurance Group in 1996. In 1998, RLI was renamed Royal & Sun Alliance Life and Pensions (RSALP). RSALP was bought by RLG With Profit Holdings Limited, a company in the Resolution Life Group in 2004. RSALP changed its name to PLP in 2005.

PLP closed to new business in 2002, although it continues to issue policies under options on existing policies, including the acceptance of new members to existing pension arrangements and the issue of immediate annuities in respect of vesting pensions.

In 2022 policies sold in Ireland were transferred to PLAE, an Irish company within the Group, and immediately reinsured back into the Phoenix With-Profits Fund. Subsequently from 1 January 2025 these policies transferred from PLAE to SLIDAC, another company within the Group. They remain reinsured into the Phoenix With-Profits Fund. SLIDAC is responsible for paying claims under these policies. For as long as the reinsurance remains in force, amounts payable to SLIDAC on these policies under the reinsurance will continue to reflect participation in the Phoenix With-Profits Fund at the same level as before.

11.2 Types of Policy

The with-profits contracts in the fund mainly fall into the following categories:
- *traditional* endowments and whole life policies
- *traditional* pension policies funding for cash, most of which have guaranteed annuity options
- single premium *unitised* with-profits whole life bonds
- *unitised* with-profits pension policies

11.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 11.4 **Amounts Payable Under a With-Profits Policy**

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under with-profits policies is *asset share* calculations which are carried out for certain specimen policies. The amounts payable will allow for a fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es.

In putting into practice the aims set out in the guiding principles and in the application of the with-profits principles generally, various degrees of approximation are applied in a number of different areas, the major ones being described in paragraph 11.4.4. The *Board* endeavours to ensure that these approximations:
- are applied consistently;
- have a broadly neutral effect between policyholder and shareholder interests and between the different *with-profits funds*;
- where appropriate, have a broadly neutral effect over time (that is between one generation of policyholders and another); and
- for the larger classes of business, are of broadly neutral effect within that class.

This may mean that for some smaller classes of business, a different result would result if less approximate methods were used.

Any of the assumptions used in previous years (such as investment returns, charges and allocations of miscellaneous profits and losses) can be changed at any time:
- should they be shown to have been incorrect; or
- should legal or regulatory change render it necessary to do so; or
- if their continued application unchanged could put at risk the achievement of the aims as set out in the guiding principles in section 5.

Changes to the methods used to determine the amounts payable under a with-profits policy are controlled by:
- requesting and considering the advice of the *Chief Actuary* and the *With-Profits Actuary* and the opinion of the *With-Profits Committee* before making any changes;
- assigning to the *Chief Actuary* the executive responsibility to continue to apply the currently agreed methods until advised differently; and
- following legal or regulatory requirements to obtain independent expert input where necessary.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Bonuses can only be declared if there is surplus available for distribution.

Asset shares are only calculated for certain specimen policies for the purpose of determining the amounts payable under with-profits policies.

Charges for guarantees or *smoothing* may be made annually or by a retention from *maturity* or early termination values (or by a combination of both methods). The basis on which the charges will be determined are described in paragraph 11.4.2(o) below.

Practices

Asset Share Methodology

11.4.1 The basic method for *asset share* calculations for with-profits business uses an apportionment of actual investment returns net of tax and the actual underlying experience.

Asset shares are generally not smoothed. In particular the investment returns and experience elements contributing to *asset shares* are generally not smoothed, other than that inherent in the processes used in the derivation of the assumptions or in respect of large profits and losses from other business per paragraph 11.4.2(s).

11.4.2 The following table describes the elements currently credited or charged to *asset shares* for specimen policies.

Element		**Description of Allowance**
(a)	Premiums	Premiums paid under the policy
(b)	Investment return	Allocated return – note (b)
(c)	Investment expenses	Actual allocated – note (c)
(d)	Initial expenses	Actual allocated – note (d)
(e)	Renewal expenses	Actual allocated – note (e)
(f)	Other expenses	Actual allocated – note (f)
(g)	Tax on investment return	Actual allocated – note (g)
(h)	Tax relief on expenses	Actual allocated – note (h)
(i)	Mortality & morbidity costs	Based on underlying experience – note (i)
(j)	Early terminations	No profits or losses are credited – note (j)
(k)	Paid-up policies	No profits or losses are credited
(l)	Partial and regular withdrawals	No profits or losses are credited other than as described in note (o) below
(m)	Surrenders at *protected dates*	No profits or losses are credited
(n)	Annuity payments	Not applicable
(o)	Charges for the cost of guarantees	Charged – note (o)
(p)	Charges for the cost of capital	See note (p)
(q)	Distributions to shareholders	Actual incurred – note (q)
(r)	Tax on distributions to shareholders	Not charged
(s)	Profit and losses from other business	Profits or losses are credited – note (s)
(t)	*Estate* distribution or charge	Distributions from or charges to the *estate* as determined - note (t)
(u)	Exceptional items	Not applicable

The way in which the above items are taken into account is described in the notes below.

(b) Investment return

Each year the total return, income and capital gains / losses, made on the assets of the fund is determined. For growth investments as described in section 11.9, this is done in aggregate. For fixed interest securities, the returns are sub-divided according to the time to redemption of the security.

The investment strategy is described in section 11.9. In accordance with this, different proportions of each type of asset are notionally attributed to the specimen with-profits policies depending upon a number of factors, in particular:

- the *term remaining*, and
- the anticipated relative size of the guaranteed benefits and the *asset share* at such a date.

The return attributed to each specimen policy is then the weighted average return from each asset type using those proportions. Other than for *traditional* with-profits Buy As You Earn (BAYE) pension policies and unitised with-profits pension solutions policies, the return on fixed interest securities that do not form part of the growth investments described in section 11.9 will be that of the subclass of such securities issued by the UK government with a duration which matches most closely the *term remaining* of the specimen policy. For with-profits bonds and *unitised* with-profits pension policies without guaranteed annuity rates, the *term remaining* is adjusted as described in paragraph 11.9.9. Any difference in return between UK government fixed interest securities and the other fixed interest securities within the *asset share* is applied as a uniform percentage adjustment across the fixed interest part of the *asset shares* of all policies, irrespective of the *term remaining*.

The return on some types of asset, particularly derivative securities, may be attributed to the class of policy, if any, in respect of which they are deemed to have been purchased.

The ratio of overseas equities to UK equities is the same for all specimen policies. The ratio of UK government to other fixed interest securities is the same for all specimen policies.

(c) Investment expenses

Actual investment expenses are charged based on those allocated to the fund in accordance with sections 5.2 and 11.11.

The investment expenses are expressed as a percentage charge to be applied to the assets.

(d) Initial expenses

Initial expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 11.11.

(e) Renewal expenses

Renewal expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 11.11.

A small number of policies (Pensions Solutions and Lifestyle Bond series) are subject to an explicit regular charge for expenses and shareholder's profits and the impact of expenses on the *asset shares* of specimen policies of this type is limited to those charges.

For those policy classes where there is an explicit policy fee or other charge collected by cancellation of units or other reduction in benefits, only the expenses not covered by these fees or charges, if any, are apportioned to the *asset shares* of the specimen policies for these classes.

(f) Other expenses

Project and other one-off expenses incurred are included in the actual renewal expenses charged to *asset shares*.

The historic costs of establishing policy administration outsource arrangements over the period 2003 to 2005 were spread over a five year period.

Significant future project, additional activity and other one-off costs will only be charged to *asset shares* following approval by the *Board*.

(g) Tax on investment return

The tax charged to classes of policy subject to tax is calculated by applying the current rates applicable to life insurance companies in respect of income attributable to policyholders to the different elements of the investment return. Approximate allowance is made for any deferment in tax payment, particularly in respect of tax on unrealised capital gains (which is charged at a discounted rate to reflect the average expected period until it is payable).

(h) Tax relief on expenses

Tax relief due on the actual expenses charged is allowed for in those classes of business that are subject to tax. Where the tax relief in respect of expenses is deferred this is allowed for. The rates of tax relief are the average rates applicable.

(i) Mortality and morbidity costs

Amounts to cover the cost of payments in excess of *asset share* on death or illness are deducted.

Where a policy class is designed to pay a benefit on death or illness which exceeds *asset share* at that time, and where no explicit charge for benefit is applicable, an annual charge is made to cover the cost of making those enhanced payments.

The estimated annual cost of providing such benefits is determined periodically from an analysis of recent actual mortality and illness rates experienced by policyholders and / or from insurance industry and national statistics. These costs are expressed as rates dependent upon various factors including age.

The charge on each specimen policy in each year is then determined by applying the appropriate rate to the current difference between the benefit payable on death or illness and the *asset share*.

Some pension policies provide either no benefit at all on death or only a return of premiums paid, with or without interest. For the specimen policies representing such classes, a credit to *asset share* is calculated using similar principles.

(j) Early terminations

It is not the current practice to attribute to the *asset share* of specimen policies any differences between the amount paid on the early termination of with-profits policies and their estimated *asset share*.

(o) Charges for the cost of guarantees

The costs of meeting guarantees in the fund are periodically assessed.

Charges for guarantee costs have been deducted from asset shares in past years. However no such charges have been made since 2013. No charges for guarantees are currently being made. In the event of the assets in the fund being insufficient to cover its liabilities, then any past guarantee charges will be restored.

Further charges for guarantee costs will not be reintroduced unless the assets of the fund are insufficient to cover its liabilities. Such a charge would not exceed 1% of the asset share per annum (or an equivalent amount expressed in different terms, for example as a percentage of premium).

The charge for guarantees cannot be negative.

(p) Charges for the cost of capital

From time to time, one or more loan agreements may be in place in accordance with section 5.2. Further details may be found in section 11.3. Interest at a commercial rate will be payable on such loans. Where part of such a loan is required to eliminate a deficit in the fund, then the interest payable on that part of the loan is not currently charged to *asset shares*. Where part of such a loan is not required to cover a deficit, then a deduction is currently made from *asset shares* to reflect the excess of the interest payable on that part of the loan above the return achieved by the fund from investing that part of the loan.

No charge is currently made to the fund for the capital that it is necessary to retain in the Non-Profit Fund and *Shareholder Fund* in order that Phoenix Life Limited continues to have adequate capital.

The *asset shares* of specimen policies do not receive any credit for the return earned on excess assets held within the fund.

(q) Distributions to shareholders

The cost of distributions to shareholders resulting from the cost of bonus allocated to policies is charged to *asset shares*.

(s) Other business profit or losses

It is the current practice to attribute to the *asset share* of most specimen policies in most classes any other business profits or losses arising in a year, other than the costs of any compensation payable as a result of policies mis-sold, expressed each year as an addition or reduction to the investment return.

Some larger business profits or losses may be spread over a number of future years.

These practices may be changed if the *Board* consider it necessary to do so to enable the fund to meet the objectives set out in the guiding principles in section 5.

(t) *Estate* distribution or charge

Asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate.* However, these estate distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 11.12.

11.4.3 For *traditional* with-profits business, the primary focus is on performing the calculations for specimen policies at the terms which contain a significant volume of policies. For other terms approximations may be used.

For *unitised* with-profits business, the specimen policies are for every past year (month, in the case of with-profits bonds) of commencement.

Separate single premium and regular premium specimen policies are used. Policies generally reflect the average size and policyholder age for the year of issue and term. Where *final bonus* rates or *market value reductions* are shared by policies of different years of issue or different premium types, the specimen policies may be grouped or otherwise averaged.

For *unitised* with-profits pensions business other than Profit Plus Fund (*PPF)* policies, regular premium *final bonus* rates and *market value reductions* are set by averaging single premium *final bonus* rates and *market value reductions*. The retirement year of the specimen policies used to set *final bonus rates* and *market value reductions* is chosen to be representative of the underlying business.

Asset shares are not calculated for specimen whole life, paid-up and altered policies. As a result the target ranges described in sections 11.6 and 11.8 do not apply to policies of these types.

11.4.4 Various approximations are inherent in the *asset share* method described above and in the general applications of the Principles in practice. These include:

- Investment returns are calculated monthly but may be applied uniformly over the period within the model which is usually quarterly or six-monthly.
- The investment return itself is only calculated approximately during the course of a year (by the use of appropriate indices) and is updated after the end of each year to reflect the actual performance earned.
- The asset mixes used to determine investment returns may not be exactly in line with the actual assets held.
- Carrying out the calculations (and hence changing *final bonus* rates) only infrequently (such as monthly, half yearly or annually),
- An inevitable time delay before actual experience is reflected in bonus rates and their application to policies.
- The application of bonus rates determined using a specimen policy of one type to policies of another type (such as the use of *final bonus* rates determined for standard endowment policies for low start endowments and for whole life policies).
- Where the premium rate for a specimen policy changed in the middle of a year of issue, the *final bonus* may be based on either the pre or the post change rate.
- The use of specimen policies will usually mean that small premium policies receive more than *asset share* (as many administration costs are independent of premium size) and large premium policies less.
- The use of specimen policies only for selected terms of policy and the interpolation of *final bonus* rates for intermediate terms will mean that the amounts paid on policies of those intermediate terms will not necessarily equal *asset share*.
- The calculations of *final bonus*es are based on specimen policies with a typical and straightforward premium history and so the bonuses will only be approximate for policies with complex premium histories. Similarly bonuses will only be approximate for policies that have been altered in other ways.
- For policies which been made paid-up, the use of *final bonus* rates applicable to policies which have been premium paying throughout. Or, alternatively, the application to both types of policy of *final bonus* rates calculated using both specimen paid-up policies and specimen premium paying throughout policies.
- Specimen policy calculations generally assume that all policies were subject to standard terms, including sales commission.

Some of these approximations, as well as others not listed, will also be present in the calculations of the excess assets of the fund from time to time.

11.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in section 11.12.

11.4.6 The procedures have been documented that set out how the *asset share* calculations described above are to be carried out and how the parameters to be used in the calculation are to be derived each year. A permanent record is kept of the historic parameters used. Some of the instructions for the detailed computations are embedded within a number of computer programs.

11.4.7 Any change to the practices used, including those used to determine the excess assets in the fund, would be subject to the procedure described in principle 11.4.

Any material changes to the historical parameters used would, if a result of the identification of a past inaccuracy, be notified to the *Board* and the *With-Profits Committee* at the time of the next recommended change in bonus rates. If considered appropriate, any changes may be phased in over a period rather than implemented at once.

Any proposed changes to the historical parameters for other reasons would be subject to the same processes as a change in practice.

11.4.8 *Asset share* practices are not guaranteed and may be changed in future.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

11.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

11.4.10 The amount payable (or available to convert to a pension) on most *traditional* with-profits policies on *maturity* is the total of:

- the sum assured;
- the *annual bonuses* added whilst the policy has been in force; and
- *final bonus*, if any.

Exceptions are some pension policies, where the sum assured and bonuses are expressed as annual amounts of pension rather than as cash amounts.

The amount payable (or available to convert to a pension) on most *unitised* with-profits policies on *maturity* is the total of:

- the value of the units; and
- *final bonus*, if any.

Exceptions are some pension policies which may be subject to a full or limited *market value reduction* at *maturity*, where either is allowed under the policy conditions; and some with-profits bonds, which may be subject to a limited *market value reduction* at *maturity*.

Amounts payable on the encashment of policies at times other than *maturity* are determined in different ways.

The rate, if any, of *final bonus* which applies to a particular policy class, date of issue and date of *maturity* is currently determined in most cases with reference to the *asset share* of a representative range of specimen policies.

11.4.11 Bonuses are reviewed regularly at least once a year.

The timing of *annual bonus* reviews is described in paragraph 11.5.6.

The timing of *final bonus* reviews is described in paragraph 11.6.4.

11.4.12 The timing of *final bonus* declarations may be varied.

11.4.13 *Final bonus*es are expected to, but are not guaranteed to, apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. Additional reviews would normally only be in response to exceptional investment market movements.

11.4.14 *Final bonus* reviews also consider the amount of *final bonus* paid on *non-protected exits* (surrenders) for policies where the *surrender value* calculation makes explicit use of the current *final bonus* scale.

11.4.15 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared.

Principle 11.5	***Annual Bonus* Rates** In circumstances where the value of assets is fairly close to the minimum amount required to enable the fund to meet the aims described in the guiding principles, low or nil rates of *annual bonus* are likely to be added for most classes of with-profits policy. Conversely, if the value of assets is more than reasonably sufficient, higher rates of *annual bonus* are likely to be added for many classes. Separate *annual bonus* rates are applied to different policy classes to reflect the different aspects of the products, including tax treatment, country of issue, form of benefit and extent of guaranteed benefit (although no differentiation between policies of the same class with and without guaranteed annuity options). Apart from with-profits bonds, currently no differentiation is made between different dates of issue, although the *Board* may do so in the future if it helped to better satisfy the aims described in the guiding principles in section 5. Although most classes of new business, other than under options on existing policies, are no longer accepted, alternative products might at some time be introduced into which existing customers could switch their benefits at their discretion, which might receive different bonus rates.

Practices

11.5.1 The *Board* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in paragraphs 11.5.2 to 11.5.6.

11.5.2 *Annual bonuses* currently take the form of:

- additions to the sum assured (or equivalent amount) and / or to existing bonuses (*traditional* policies and *bonds not eligible for final bonus*);
- increases in the price of units (*unitised* policies except *PPF policies*); or
- additional ('bonus') units (*PPF policies*).

11.5.3 For each class of business, other than *bonds not eligible for final bonus* (see 11.5.5), the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

11.5.4 Where the financial position of the fund is weak, the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

11.5.5 For *bonds not eligible for final bonus*, *annual bonus* will be set at a level which, using realistic assumptions, will bring the projected *asset share* and the value of projected policy benefits broadly in line over a five year period. If at any time the fund is targeting payouts at a higher proportion of *asset share* than 100% on account of distributable *estate*, then this will be allowed for in the projected *asset share* used for this purpose of calculating *annual bonus* rates, and such distributable *estate* will therefore be gradually reflected in *payouts* over a five year period.

For *bonds not eligible for final bonus*, a minimum rate is set each year and the actual bonus rate set at the policy anniversary in 12 months' time cannot be less than this. Other than at times when the value of the allocated assets are changing rapidly, bonus rates for this class do not change by more than 2% (such as from 3% to less than 1% or more than 5%) in any 12 month period.

11.5.6 Currently *annual bonus* rates are reviewed as follows:

- for *traditional* policies and *PPF policies*, towards the end of each year, with changes taking effect from 1 January;
- for *unitised* policies, except *PPF policies* and *bonds not eligible for final bonus*, in time for the new rates to take effect from the 1 March; and
- for *bonds not eligible for final bonus*, in time for the new rates to take effect from the anniversary of issue.

However, rates may be reviewed at other times should it be considered to be necessary to continue to adhere to the Principles.

11.5.7 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

Principle
11.6 ***Final Bonus* Rates**

Subject to the guiding principles set out in section 5, *final bonus* may be added to policies when they terminate or when benefits are encashed for other purposes, with the aim of ensuring, if they do not already do so, that benefits reflect fairly a share in the profits (and losses) which have been generated within the fund whilst the policy has been in force. Some series of *bonds not eligible for final bonus* have been issued and for these policies, *annual bonus* rates alone will be used to achieve the aim described earlier in this paragraph.

Separate *final bonus* rates are applied to different policy classes to reflect the different aspects of the products, including tax treatment, country of issue, form of benefit and extent of guaranteed benefit (although not the presence or absence of guaranteed annuity options). For most policy classes, differentiation is made between different dates of issue and different periods in force. On death and on early termination, the *final bonus* added may be higher or lower than indicated above, for reasons explained in the Practices.

Practices

11.6.1 For each specimen policy, we determine a proportion of *asset share* that it is appropriate to use to best meet the guiding principles. This proportion will vary from time to time, may be greater or lesser than 100% and may vary by class of policy, date of issue, *term remaining* to a date at which a guarantee or option applies or other relevant factor.

For each specimen policy the following are compared:

(i) the appropriate proportion of each specimen policy's *asset share* (the *asset share* for this purpose being inclusive of any enhancement as described in paragraph 11.4.2); and

(ii) the total of the sum assured and the *annual bonuses* already added to that specimen policy (or the value of units for a *unitised* policy).

If (i) is the larger, a *final bonus* for the specimen policy is normally set using the methods described below. If (ii) is the larger, no *final bonus* will normally be set for that specimen policy.

The target for the proportion in (i) is 100%. The proportion used for particular specimen policies may be affected by *smoothing* (see section 11.7). The aim is to maintain the proportions in (i) within the range 80% and 120% for most specimen policies before the effects of *smoothing*.

For each specimen policy where a *final bonus* is to be set, the excess of (i) over (ii), after any *smoothing*, is expressed as a percentage of:

- the sum assured plus *annual bonuses* for *traditional* policies;
- the value of units for *unitised* policies, including *PPF policies.*

This is then the new *final bonus* rate for all policies of the same type and duration in force as the specimen policy.

Where a rate is not derived for every duration, the rates applicable for other durations are determined by interpolation or extrapolation between the rates derived as above. For all policy classes except those in (a) to (c) below, the rates vary by duration in years.

Exceptions:

(a) For ‘Pensions Solutions’ classes, *final bonus* is calculated on a policy-by-policy basis by reference to ‘shadow’ units which change in value monthly in line with the *asset share* and / or the smoothed *asset share*.

(b) For *PPF policies*, one *final bonus* rate applies irrespective of original term. This is calculated taking into account an appropriate mix of specimen policies of different original terms.

(c) For with-profits bonds entitled to *final bonus*, the original term is currently differentiated by month.

11.6.2 *Final bonus* and *market value reductions* do not apply at the same time to any of the policies.

11.6.3 *Final bonus* is paid on death claims on *traditional* whole life and endowment policies at the rate that applied to endowment policies which commenced at the same time and reached *maturity* at the date of death.

11.6.4 For all classes of policy the *final bonus* rates may be changed at any time. At times when the value of the excess assets in the fund is not changing rapidly, this is likely to mean that changes, if any, are normally made monthly for with-profits bonds (including Lifestyle Bond) and one to two times per year (effective from 1 January and 1 July) for most other classes. However, a sudden change in the value of those excess assets (such as because of a significant change in the value of equity share markets) may cause changes to the *final bonus* rates on other occasions.

11.6.5 As the value of assets are changing every day but *final bonus* rates are only recalculated infrequently, there will inevitably often be times when, if the *asset shares* for specimen policies were recalculated, *final bonus* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the proportion of *asset shares* at the latest *final bonus* review was near the top or bottom of the range described in paragraph 11.6.1, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle 11.7 ***Smoothing***

Smoothing refers to the practice of limiting the change in *final bonus* rates on any one occasion so that the benefits paid to policyholders differ from those which would otherwise apply and also to the practice of limiting the frequency of such changes. *Smoothing* means that the value on similar policies maturing at different times either vary little (between changes in *final bonus* rates) or change by no more than a specified amount over a given period. *Smoothing* is applied to all classes of policy which are eligible for *final bonus* and to all types of claim. However, more frequent and generally smaller changes are made to some classes of *unitised* with-profits policies.

Smoothing is intended to have a neutral effect over time. In other words, if applying the limitation on changes in the rate of *final bonus* results, for a period, in different amounts of discretionary benefits than would otherwise have been paid, then in a subsequent period discretionary benefits would be adjusted by a broadly equal and opposite amount when circumstances and the practices allow.

Other than on death or early termination, the aim at all times is to pay policy benefits that are close to those described under section 11.6. Accordingly, *smoothing* is limited and *final bonus* rates and total policy benefits may change by relatively large amounts both on any one occasion and over a 12 month or longer period. The cost of *smoothing* is not expected to be material at any time and so no specific upper limit is imposed on it.

The *smoothing* principles also generally underlie the *market value reductions* which may apply to most *unitised* policies. However, these principles are not necessarily applied when determining the amount payable on *traditional* policies which are terminated significantly early.

Practices

11.7.1 For with-profits bonds and Pensions Solutions classes, *smoothing* is applied to policy benefits by means of an adjustment to the credited investment return. However, *smoothing* is only applied when *asset shares* are more than 95% for with-profits bonds or 90% for Pensions Solutions classes of the *asset share* with the *smoothing* adjustment applied to the investment return. When *smoothing* does apply, *final bonus* rates or *market value reductions* are set in relation to an investment return, including business profits and losses smoothed over three years. The smoothed investment return over the first three years of a specimen policy (or the first three years of the Pensions Solutions series) is calculated in part by reference to a deemed return in respect of the period prior to the commencement of the policy or series. This rate is determined by the *Board* from time to time.

11.7.2 For *traditional* policies and other *unitised* with-profits policies, including PPF policies where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* and retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies and other *unitised* with-profits policies, *surrender value* bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as *term remaining* which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values.*

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts,* then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values, and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing.* Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

11.7.3 The period over which *smoothing* will be of neutral effect on a class of policies is indirectly determined by the application of the above practices.

11.7.4 Applying *smoothing* does mean that on occasions, particularly for *traditional* policies, payments are more or less than the proportion of *asset share* which it is considered appropriate to pay. This difference will reduce or increase the excess assets of the fund. There is no particular maximum accumulated cost of or benefit to the fund which is allowed, although no *smoothing* accumulation would be allowed to build up which was inconsistent with the achievements of the objectives set out in the guiding principles in section 5.

11.7.5 Any cost to the fund of partial payments under *unitised* policies to which a *market value reduction* does not apply does not affect the remaining value of the policies concerned. Rather, it reduces the value of the excess assets in the fund (although the excess assets will be increased for charges levied in respect of such guarantees).

Principle 11.8	***Surrender Values***
	The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies or groups of specimen policies in aggregate achieve a target *payout ratio*.

Practices

11.8.1 *Non-protected exits* refer to surrenders and transfers for pensions business.

11.8.2 For *traditional* policies that surrender early the aim is to make payments that are, in aggregate and over time, across all specimen policies that are used for determining surrender bases, a targeted proportion of *asset share*. This proportion is currently 100%.

11.8.3 Actual surrender payments on individual policies will not generally be in line with the target proportion because:

- Individual *asset shares* are not calculated or held on the administration systems for use in *surrender value* calculations. Rather *surrender values* are calculated in a variety of ways for different types of policy. Typically *surrender values* are based on a discounted value of the guaranteed sum at *maturity* or retirement (reduced to allow for non-payment of future premiums in the case of regular premium policies) together with an allowance, where appropriate for *final bonus*.
- Specimen policies are used to determine the parameters in the *surrender value* calculations. The outcome for a particular individual policy may be different from that of the specimen policy.
- There are a limited number of parameters that may be altered in the surrender formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.
- As the value of assets are changing every day but the parameters in the *surrender value* formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate.

11.8.4 For the reasons given above, *surrender values*, when expressed as a proportion of *asset share*, are expected to fall in a range around the target proportion. The parameters in the *surrender value* bases are reviewed periodically with the aim that the majority of *surrender values* for the range of specimen policies that are analysed, will fall within the range of 80% to 120% of *asset share* before the effects of *smoothing*.

11.8.5 In some cases, values in excess of 120% of *asset share* may be payable when policies are surrendered close to *maturity* and the *asset share* of the relevant specimen policy is less than the guaranteed benefits at *maturity,* or the *maturity payout* is in excess of the *asset share* due to *smoothing.* This may also occur if the value of the guaranteed benefits is high relative to *asset share*, due to the effective maximum discount rate used in the surrender bases.

11.8.6 For *traditional* policies, the method used to derive the *surrender* or transfer value may not involve the explicit application of *final bonus*. Where the value paid is larger than the discounted value of the guaranteed sum assured and *annual bonuses* already added, an element equivalent to *final bonus* will be implicit in the value. For the purposes of determining the shareholder’s entitlement to profit in respect of any *surrender* or transfer, an appropriate proportion of the value paid is deemed as representing *final bonus*.

11.8.7 For *unitised* policies, a *market value reduction* will be applied in most circumstances where the calculation described in paragraph 11.6.1 results in a shortfall of the determined proportion *of asset share* relative to the value of units. The amount of the *market value reduction* will not exceed the amount of the shortfall. Most policies contained a date or range of dates on which no *market value reduction* or a limited *market value reduction* will apply. Some policies also allow small regular encashments to be made without a *market value reduction* applying (but otherwise the same *market value reductions* apply to partial as to full encashments). As the value of assets change every day but *market value reductions* are only reviewed periodically, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10% compared to that assumed when *market value reductions* were last reviewed, would be allowed before there would be an additional *market value reduction* review.

11.8.8 For *bonds not eligible for final bonus*, the dates, if any, at which no *market value reduction* or a limited *market value reduction* applies vary for different tranches. Most such dates have now passed.

11.8.9 For other with-profits bonds, the date at which no *market value reduction* or a limited *market value reduction* applies on encashment is the 10th anniversary of commencement. A period of three months following the 10th anniversary is allowed during which any encashment request received will also benefit from no *market value reduction* or a limited *market value reduction*. The *market value reduction* may also be limited prior to the 10th anniversary so that the encashment value represents the discounted value of the amount which would be available at the 10th anniversary. Most such dates have now passed.

11.8.10 For *PPF policies*, the *surrender value* is based on the current value of the units using the same price table as is used to allocate new units in respect of premiums paid. The price table is constructed so as to reproduce, at present, 100% of *asset share* at most longer outstanding terms whilst ensuring, whenever necessary, that the price increases smoothly to the guaranteed £1 at *maturity*.

11.8.11 The percentages described above may be changed at any time, as may the methods of calculation. However, before any changes are made, the *Board* will formally consult with and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee*.

Principle 11.9 Investment Strategy

Overall, the strategy will be to invest in fixed interest securities and growth investments (see below), either directly or through vehicles such as unit trusts, OEICS or derivatives. Growth investments will only be held to the extent to which this is possible without unduly putting at risk the fund's ability to meet guaranteed benefits as they arise. Some cash or equivalent assets may be held for liquidity purposes. Growth investments will normally consist of equity shares and commercial property. However, the *investment manager* may also choose to hold other types of investment within the growth investment category including corporate bonds, cash, total return funds, derivatives, currencies and commodities.

For certain purposes, including determining the bonus rates applicable to policies, account may be taken of assets such as future profits. A separate investment strategy is adopted in respect of the reserves held to meet guarantees.

From time to time assets outside the fund may be relied upon to provide some or all of a margin against future adverse change in investment markets. The investment strategy is, however, based upon the intention that the fund will meet its aims using only the assets of the fund after repayment of any loans or other financial support received.

Derivatives may be used from time to time to make changes in the investment dispositions more rapidly or cheaply than could be done directly through the markets. They may also be used from time to time to reduce the risk of loss, for example from share price falls, interest rate changes or exchange rate fluctuations.

There is no direct link between individual policies and specific assets. The proportion of shares and property used indirectly to determine the bonuses applicable to different policies may differ between different products, dates of issue or terms remaining to reflect the different risks to both the specific policyholders and to policyholders and the shareholder more generally. For some with-profits policies with relatively high guaranteed benefits, this may mean that few or no growth investments will be deemed to be held. Fixed interest securities that do not form part of the growth investments are deemed to be broadly matched to the *term remaining*.

Non-profit, non-linked policies are backed by fixed interest securities of appropriate duration.

Index-linked and unit-linked liabilities are either backed to the extent possible with close-matching assets or, in the case of unit-linked policies, are reinsured to the Non-Profit Fund, which does so.

The aim is to restrict the maximum loss which could be suffered from the complete default of any one external counterparty, whether through reinsurance, direct investment or derivatives by dealing with a wide range of counterparties. In some cases, additional precautions such as daily *marking to market* or *deposit back* are used.

Larger, unprotected exposures are permitted to sister companies (regulated UK life insurers) through internal reinsurance arrangements.

From time to time the growth investments may include a small number of properties which are occupied by Phoenix Life Limited or by a related company and which would not be expected to be traded.

Practices

11.9.1 There are no formal procedures in place for assets to be transferred permanently from the *Shareholder Fund* to the *long-term business fund*. Similarly within the *long-term business fund* there are no formal procedures in place for assets to be transferred permanently between the Non-Profit Fund and any of the *with-profits funds*. Formal loan arrangements as described in section 11.14 may be in place from time to time but would not normally be considered as permanently irrecoverable at any time.

11.9.2 The investment strategy is regularly reviewed taking account of a variety of considerations, including our approach to *responsible investment*. In particular, reports from the *investment managers*, the *Chief Actuary*, the *With-Profits Actuary* and *the With-Profits Committee*, and recommendations for change are considered and, if appropriate, implemented.

11.9.3 All the guarantees to policyholders and liabilities to other creditors are not completely matched with assets which provide a similar guarantee or payment. In particular, often a proportion of the assets is invested in growth investments because it is considered that, over most longer periods of time, a better return will result. Separate investment strategies are followed for assets equal in amount to the estimated aggregate *asset shares* of policies and for assets representing additional provisions for liabilities under non-profit policies, for guarantees on with-profits policies, for other liabilities and for the capital margins and excess capital. Each of these strategies is described in more detail below.

11.9.4 It is not possible to implement the strategies described below with absolute precision and any difference between the actual outcome and the theoretical outcome will be treated as described in paragraph 11.4.2(s).

11.9.5 Investment returns allocated to the *asset shares* of specimen policies will reflect the actual mix of assets held, should this be different from the theoretical mix calculated according to paragraphs 11.9.6 to 11.9.9.

Asset Shares

11.9.6 Firstly, the appropriate asset mix for a large number of specimen policies of different types, *term remaining* and commencement dates is determined. This mix is determined by the successive application of a number of rules:

(i) The proportion invested in growth investments is regularly reviewed. The asset mix is currently approximately 70% in growth investments and approximately 30% in fixed interest securities with a small balance invested in cash and / or assets such as future profits.

Unless

(ii) There are less than nine years of *term remaining*, when the mixes are changed proportionately as the *term remaining* reduces until they are 35% in growth investments and 65% in fixed interest securities with one year or less of *term remaining*.

Unless

(iii) The rate of return required from growth investments for the *asset share* of that specimen policy to grow over the *term remaining*, after the deduction of retentions and charges, to equal the projected guaranteed benefits at the *maturity date* is more than 5% per annum gross, when the proportion of growth investments above is reduced according to the table below (and the proportion in fixed interest securities increased to balance).

Rate of return required*	Reduction applied
5% - 7.5%	33%
7.5% - 10%	67%
10% or more	100%

(* For *terms remaining* of seven years or less, the dividing points of 7.5% and 10% are higher, rising to 11% and 17% respectively for terms remaining of one year or less).

For the purpose of determining the exposure to growth investments, the *term remaining* for a with-profits bond will be taken as:

- for bonds with a future guarantee date upon which no *market value reduction* will apply on surrender, the time to that guarantee date; or
- for bonds with no such guarantee, or which have passed the date upon which such a guarantee applied, 10 years.

For Buy As You Earn (BAYE) pension policies, the asset mix is 50% fixed interest securities, 25% equities and 25% property.

11.9.7 The parameters defining the asset mix may be changed from time to time. When doing so, account will be taken of the results of stochastic modelling calculations which demonstrate the range of reasonable parameter sets that satisfy the aims described in principle 11.9. From within this range, one is selected which is considered to best balance the interests of all policyholders. However, this is dependent on the fund having sufficient excess assets at the time. In anticipation that such increases will be made, the proportionate reduction for policies with less than nine years *term remaining* will be adjusted.

11.9.8 The actual proportions of different assets held will vary slightly from the specified parameters as asset values change, although the actual mixes will be reviewed at least annually and adjusted if necessary to bring the proportions more closely in line with the target.

11.9.9 All policies are grouped according to the specimen policy which most closely represents them and the asset mix for each specimen policy is obtained by applying the rules in paragraph 11.9.6 to the policies in the group. The term of the fixed interest securities that do not form part of the growth investments reflect the *term remaining*.

For the purpose of determining the duration of the fixed interest investments, the *term remaining* for a with-profits bond will be taken as:

- for bonds with a future guarantee date upon which no *market value reduction* will apply on surrender, the time to that guarantee date; or
- for bonds with no such guarantee, or which have passed the date upon which such a guarantee applied, five years.

For *unitised* with-profits pension business without guaranteed annuity rates, the fixed interest duration is frozen once a policy has reached nine years of *term remaining*.

Returns on emerging market debt do not reflect the term remaining, but rather reflect the overall return on such debt.

Guarantee Reserves

11.9.10 Firstly, the *market consistent* cost of the guarantees inherent in the with-profits policies is calculated. How this cost, net of the value of expected future guarantee charges and early termination profits, will change, as the prices of the growth investments rise and fall and as *volatility*, credit spreads and interest rates change, is then calculated. A mix of assets which will broadly change in line with the change in the net cost of the guarantees is identified. This asset mix may require a *short position* in growth investments to be adopted and a *long position* in fixed interest securities or cash. It may also require the purchase or sale of financial instruments such as equity options or to hold on average longer-term fixed interest securities.

This calculation may be done in respect of specimen policies in some cases and the results aggregated and in other cases a more approximate method is used.

As the prices of growth investments, interest rates, credit spreads and *volatility* change, and in any case periodically, the appropriate asset mix for the guarantee will be reassessed.

11.9.11 The liabilities for guaranteed annuity options are backed by fixed interest assets whose value is expected to change broadly in line with the value of the guaranteed annuity option liabilities when interest rates change. *Swaps* and /or *swaptions* may be used for this purpose.

Irrespective of the fixed interest assets actually held, the *asset share* of specimen policies with guaranteed annuity options will, to the extent that they are deemed to be invested in fixed interest securities that do not form part of the growth investments, be credited with the return on securities of duration appropriate to the *maturity* date of the specimen policy.

Non-Profit Policies, Other Liabilities, Capital and Excess Assets

11.9.12 Assets representing the reserves for non-profit policies are invested in fixed interest securities of appropriate duration. Assets representing unit-linked liabilities which are not wholly reinsured are invested in the assets used to determine the value of the unit liability. Assets representing RPI-linked liabilities or expense reserves are invested in index-linked securities. Assets representing short-term liabilities are invested in cash or short-term debt. Assets representing capital, whether or not required to enable the fund to meet its objectives or to meet regulatory requirements, are mainly invested in fixed interest securities.

Assets representing the *estate* of the Phoenix With-Profits Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth assets in line with the asset mix for the *asset shares*.

Current Asset Policy

11.9.13 Fixed interest assets will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt. The mix of fixed interest asset types backing asset shares, liabilities for guarantees or capital requirements may be different.

The agreements with the *investment managers* set out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single company.
- The maximum amount that can be invested in any single asset class / industry sector / country.
- The maximum amount to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns. (These include restrictions in terms of credit quality, term / duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moody's).
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco

11.9.14 Investments are also made in sterling interest rate *swaps* to enable closer matching of fixed interest income and outgo requirements. All *swaps* and *swaptions* are regularly *marked to market* to minimise exposure to counterparty default.

11.9.15 Growth investments may consist of equities, property and a small amount of *alternative assets* such as hedge funds. Equities are split between UK equities and overseas equities, and may include emerging markets and *private equities*. With the exception of *private equity*, the equities are predominantly quoted and regularly traded on a recognised stock exchange. Equities may be either actively or passively managed relative to recognised index benchmarks. Individual stock selection is carried out by the *investment managers* based on their expert assessment of the relative prospects of available alternatives.

11.9.16 Property investments may be directly owned properties or held via collective investment vehicles.

11.9.17 Sufficient assets are disposable at short notice without material loss in value to meet foreseeable additional liquidity demands.

11.9.18 The proportion of different assets described in this section will vary from time to time due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*.

Miscellaneous

11.9.19 The fund does not hold any assets which are *not normally traded*.

11.9.20 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

11.9.21 Before investing in new or novel investment instruments, the *Board* will obtain the advice of the *Chief Actuary* and the *investment managers* on the benefits and risks of the proposition. This would include an analysis of the nature and proportion of future outcomes in which the instrument would prove materially disadvantageous relative to other more traditional investments. If the instrument is to be held in material amounts in respect of with-profits policies, the *Board* will also seek the opinion of the *With-Profits Actuary* and the *With-Profits Committee.*

11.9.22 If it is considered by the *Board* to be in the best interests of the policyholders, further hypothecation of the assets in the fund may be introduced. For example this may involve further hypothecation of different equity-backing ratios to further classes or groups of policies.

11.9.23 A fixed charge over some of the fund's assets has been provided to SLIDAC as security under the reassurance arrangement and, whilst these assets are held in separately identifiable accounts, this is not expected to impact the overall investment strategy of the fund.

Principle 11.10 Business Risks

As well as investment performance and counterparty exposure, and amounts transferred to the *Shareholder Fund* (see section 11.12), the fund's future ability to continue to pay all guaranteed benefits when due, and the amounts of *annual* and *final bonus*, will be affected by a number of other factors, 'business risks', that may arise from the existing portfolio of with-profits and non-profit business. These are listed, together with the controls which applied, in paragraph 11.10.1.

In some cases, the effect of future profits or losses (such as the increasing longevity of annuitants) is anticipated and any changes reflected in expected outcome immediately in discretionary payments. This reduces the likelihood that excessive business risk exposures will apply to the longest remaining with-profits policyholders, which is otherwise a particular risk because with-profits policies are expected to run off more quickly than non-profit policies.

Any profits made or losses incurred as a result of a business risk will normally be met by the fund, except where the business and the risk is wholly reinsured to the Non-Profit Fund or another Phoenix Group subsidiary. However, the costs of any compensation payable as a result of policies mis-sold will not affect the reasonably expected benefits payable to policyholders. Costs specified by *regulator* rules as being the responsibility of the shareholder (such as regulatory fines) will be met by the *Shareholder Fund* or the Non-Profit Fund.

It is not currently envisaged that any business risks would be taken on in addition to those to which the fund is already exposed although, if it appears to be potentially beneficial to policyholders to do so, the exposure to risks to which the fund is already exposed (such as by cancelling reinsurance arrangements) may be increased. If business risks were taken on or increased, this would only be done if the reward was expected to be better than that from other investments with broadly equivalent risks (such as investing in shares or property). The *Board* would formally consult and take account of the opinions of the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee* before doing so.

Existing business risk exposures will be annually reviewed as part of the assessment of the formal regulatory capital requirements and appropriate measures will be taken to limit risk to amounts to which it is fair for the with-profits business to remain exposed.

Practices

11.10.1 The main business risks of the fund, and the controls that are applied to those that Phoenix Life Limited can influence, include:

- Expenses of management – controlled mainly by outsourcing all business activities, including policy administration and investment management. Normal activities are outsourced on an agreed pricing basis. The main residual costs not subject to an agreed pricing basis are project activity and certain direct costs and fees.
- Failure of non-group outsourced services provider – part of the administration services provided by PGMS are sub-contracted to Diligenta - controlled by having exit plans. PGMS is liable for any additional cost of providing these services which might arise if Diligenta were to default. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

- Meeting minimum guaranteed policy benefits (where these costs are reasonably attributable to the fund) and the cost of *smoothing* – controlled by having an appropriate rate of *annual bonus*, limiting the extent of *smoothing* and investing primarily to meet the guarantees, all whilst ensuring that customers continue to be treated fairly.
- Fluctuations and long-term trends in death or sickness rates – fluctuations are constrained by the use of reinsurance contracts to limit exposure on any one insurance policy but significant risks remain from improvements in longevity on existing annuities, deferred annuities and from future annuities under guaranteed options.
- Changes in taxation.
- Profits or losses from investments backing non-profit business or other liabilities and from investments which represent additional capital.
- The cost of guaranteed annuity options – risks from varying interest rates are controlled by investing in appropriate hedging assets but significant exposure remains in respect of improving longevity.
- Profits or losses from the early or late termination of policies – a significant increase in the persistency of policies with onerous guarantees could cause a significant reduction to other policy values.
- Provision of compensation for past legal or regulatory infringements, especially due to inadequate sales practices – controlled in part by ensuring that compensation is only paid where a legal entitlement exists.
- The cost of additional capital needed to be held for regulatory purposes or for the optimal management of the business – controlled by regularly reviewing the excess capital being held and by ensuring that only a commercial cost for capital is being paid.
- Failure of reassurers – the reassurance credit risk is monitored.
- There is an arrangement which transfers the unit liability for non-profit unit-linked liabilities to the Non-Profit Fund - the financial position of the Non-Profit Fund is monitored.

11.10.2 In paragraph 11.4.2, how and to what extent business profits and losses are incorporated in the *asset share* calculations for specimen policies are described and so how each, if at all, affects the amounts payable under with-profits policies.

11.10.3 As a result of the approach described in paragraph 11.4.2(s), the effect of other business profits and losses on the amounts payable under with-profits policies will be implicitly smoothed as described in paragraph 11.6.4 and in section 11.7.

Also, as explained in paragraph 11.4.2(s), if a particularly large business profit or loss in any one year is experienced or identified, its incorporation may be spread in *asset share* calculations over a number of future years to avoid excessive impact on policy values in the short-term.

11.10.4 The outcome from all the business risk of the fund is currently mainly pooled across all with-profits policies in the fund, although this has not always been the practice in the past. Any exceptions are highlighted elsewhere in this document.

11.10.5 Since January 2011, in accordance with paragraph 5.2.9, any annuities coming into payment are transferred to the Non-Profit Fund, and the fund pays the Non-Profit Fund a premium in respect of the liability transferred. After such transfer, all the risks in relation to the transferred annuities are borne by the Non-Profit Fund.

11.10.6 Phoenix Group’s current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

Principle 11.11 Expenses and Charges

Costs may be recovered from policies directly, for example by the cancellation of units of *unitised* policies, or indirectly via bonuses and early termination values. Where indirect costs are specific to a class of policy then, taking into account the approximations referred to in section 11.4, such costs will be taken into account in assessing the bonuses added to that policy class and in assessing the early termination value payable.

Where indirect costs are not specific to a single policy class, they will be apportioned across the policy classes to which they are relevant in a reasonable manner, as is explained in the practices.

Implicit charges for mortality, sickness and other benefits will generally reflect the fund's own or insurance industry actual claims experience. Explicit charges for such benefits will be determined in line with policy conditions; where this requires periodic reviews in the light of experience, such reviews will be carried out and charges adjusted accordingly.

In some cases, policy conditions restrict the type and amount of charges that may be levied.

Practices

11.11.1 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

The main expenses that are apportioned to the *asset shares* of specimen with-profits policies relate to the fees paid to PGMS in connection with all business activities. These charges are mainly expressed as an annual amount per policy, irrespective of type (other than for non-profit annuities, for which the fee is lower), increasing each year by RPI + 1%. For group pension plans, the fee is per member rather than per policy. For policies with more than one benefit, including premium increments, the charge is only made once. They are apportioned on this basis.

Additional fees payable for certain other one-off activities and developments are generally apportioned in proportion to the PGMS fees.

11.11.2 Fees are also payable to the *investment managers* in connection with the management of the investments. These amounts are expressed as a percentage of the investments under management. Where investments are via a collective investment vehicle operated by the *investment managers*, the total fees payable to the *investment managers* are not materially different than if those investments were directly held.

Commission is also payable to intermediaries on some contracts and to the ceding office under the *unitised* pension reassurance agreement.

11.11.3 Other than to the extent that costs are apportioned to certain activities the costs of which are not apportioned to *asset shares* or to the extent described in paragraph 11.4.2, the totality of expenses allocated to the fund will be taken into account via the *asset share* calculations for specimen policies. Costs attributable to the fund that are not apportioned to *asset shares* will reduce the excess assets of the fund.

It is not intended to include expenses at other than cost to *asset share* calculation, other than as described in paragraph 11.4.2.

Principle
11.12 *Estate* Management

The aim is to manage the fund so that there is always a small excess of the value of the assets over the amount considered necessary on *market consistent* assumptions to enable the fund to meet the aims described in the guiding principles in section 5.

It is intended to maintain the excess at the targeted level by:
- controlling the addition of *annual bonuses* to policies;
- only paying *final bonus*es or other discretionary benefits in line with the principles set out earlier;
- maintaining an appropriate investment strategy;
- limiting, where possible, the business risks faced;
- exercising discretion in other areas with moderation; and
- drawing on or repaying additional financial support from the shareholder in the form of loans to the fund or otherwise.

Practices

11.12.1 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

11.12.2 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 11.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

11.12.3 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;
(c) meet any costs which are charged directly to the *estate*, rather than to *asset shares*;
(d) meet the costs of any changes which the *Board* believe to be necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and
(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

11.12.4 Any enhancement in benefits on account of the *distributable estate* referred to in 11.12.3(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration needs to be given to making additions to the *asset shares* from the *estate*.

11.12.5 The amount of the *estate*, the *distributable estate*, and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

11.12.6 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to the *asset shares* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

11.12.7 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 11.12.6 be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims in the guiding principles in section 5. In determining benefits under with-profits policies, any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* will be disregarded to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle
11.13 New Business

Apart from as a result of the exercise of options under existing policies, contractual increments and new entrants to stakeholder, occupational and 'group personal' pension plans, new business is no longer accepted. The future business risk from this source is expected to be small.

Practices

11.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts.

Currently there are no plans to reopen the fund to new business.

Principle
11.14 Equity Between the Fund and Shareholders

The transfer of profits in any year from the fund to the *Shareholder Fund* is restricted by the *2023 Scheme* to a maximum of one ninth of the value of bonuses added to policies in that year. Any change to the one ninth limit would require the agreement of the *Board* and would be subject to approval by our *regulator* and the High Court. Payments from the fund are therefore limited to those amounts required to meet obligations under policies and reassurance agreements written in the fund and to transferring to the *Shareholder Fund* the shareholders share of the divisible profits. None of the divisible profits arising in the fund are attributed to the other *with-profits funds*.

If the *Board* were considering making changes to increase this percentage, it would first request and consider the advice of the *Chief Actuary* and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee.* If it was decided to proceed, the *Board* would notify policyholders at least three months in advance. It would also need to seek the agreement of Phoenix Group and the High Court to make such a change.

From time to time, for some classes of business, less than the permitted maximum may be transferred from the fund to the *Shareholder Fund*.

The fund may from time to time receive financial support from the Non-Profit Fund or *Shareholder Fund* or from another member of Phoenix Group, whether in the form of a loan or otherwise, if such support is needed to enable the fund to meet the target excess assets described in section 11.12. The terms on which such support is provided will be on a commercial basis which is fair and reasonable to both parties, taking into account prevailing market conditions and the risks involved. If such support forms part of the fund, then it will be treated as a liability if it would otherwise increase the excess assets.

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arms length commercial basis.

Practices

11.14.1 For *traditional* policies and *PPF policies*, the value of *annual bonus* added to policies, discounted at the risk free yield, is determined. One ninth of that value is transferred to the *Shareholder Fund* together with one ninth of the discounted value of any *interim bonus* and one ninth of any *final bonus*. This means that the transfer to the *Shareholder Fund* is 10% of the distributed surplus.

11.14.2 For other *unitised* business, currently only five ninety-fifths of the value of *annual* or *final bonus* added is attributed. This is broadly equivalent to 5% of distributed surplus.

11.14.3 For *unitised* business where a *market value reduction* is applied on claims, which has the effect of reducing the *annual bonus* previously added, then there is a corresponding reduction in the transfer to the *Shareholder Fund*.

11.14.4 Transfers to shareholders on pensions business are reduced by an amount reflecting the expected additional tax arising on those transfers. Hence the net amounts transferred to shareholders for pensions policies are lower than the 10% and 5% referred to above.

11.14.5 The relative apportionment of value between shareholder and policyholder will not be affected by changes in the discount rate, as shareholder transfers are discounted at market rates.

11.14.6 Additional tax arising from transfers to shareholders is allocated to the fund (but is not charged to *asset shares*). In considering the allocation of tax and any tax impacts that may arise from time to time fairness between the stakeholders is considered.

11.14.7 The *Board* are not aware of any external or internal factors which, if they were to change, would have a material effect on the apportionment of surplus as described above.

11.14.8 There are no classes of business which are significantly and systematically reducing the value of the excess assets of the fund as a result of the shareholder transfer in respect of that class.

12 Principles and Practices – Scottish Mutual With-Profits Fund

The Principles and Practices given in sections 12.4 to 12.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the Scottish Mutual With-Profits Fund. Sections 12.1 to 12.3 give background information specific to the Scottish Mutual With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the Scottish Mutual With-Profits Fund.

12.1 Fund History

The Scottish Mutual With-Profits Fund comprises the business that was transferred to Phoenix Life Limited under the *2009 Scheme* from the With Profits Sub-Fund of Scottish Mutual Assurance Limited.

The Scottish Mutual With-Profits Fund also comprises the Smoothed Investment Fund business that was transferred to the Phoenix Life Limited Non-Profit Fund under the *2009 Scheme* from the Other Business Sub-Fund of Scottish Mutual Assurance Limited, and then subsequently reassured to the Scottish Mutual With-Profits Fund.

12.1.1 The Scottish Mutual Assurance Society demutualised on 1 January 1992 and its business was transferred to Scottish Mutual Assurance plc. Scottish Mutual Assurance plc was subsequently renamed Scottish Mutual Assurance Limited.

From 1991 to 2006, Scottish Mutual Assurance Limited was owned by Abbey National plc. In September 2006, Scottish Mutual Assurance Limited was acquired by Resolution plc.

The Scottish Mutual Assurance Limited With Profits Sub-Fund closed to new business in 2002. The Smoothed Investment Fund business written in the Scottish Mutual Assurance Limited Other Business Sub-Fund remained open to new business until 2008.

12.2 Types of Business

12.2.1 The with-profits business in the fund is split into different classes for the purposes of allocating *annual bonuses*, *final bonus*es and *smoothed returns* as appropriate. The split primarily depends on:

- The type of product and the method by which it participates in profits, that is *traditional* with-profits business and *unitised* with-profits business. In addition certain types of business for which *final bonuses* are not applicable are treated separately.
- The classification for tax purposes, that is life assurance business, general annuity business, pension business and overseas life assurance business.
- Whether the business is regular premium paying or single premium.

12.2.2 The *traditional* with-profits business comprises:

- Life assurance (basic life assurance and general annuity business), primarily endowment assurances and whole of life policies.
- Pension with-profits endowments arising from the Federated Superannuation Scheme for Universities. Some of these contain guaranteed annuity options.
- Individual pension with-profits policies. This group includes the Self-Employed Retirement Annuity contracts (SE contracts) and the Individual Pension Arrangement policies (IPAs) for employed persons and the Master Policy arrangements which are essentially packaged sets of IPA benefits written under one policy for the trustees of the scheme. Some contracts are written as a deferred annuity and may have a guaranteed cash option whilst others provide a cash sum at retirement and may have a guaranteed annuity option.

- With-profits annuities.
- Group deferred annuity with-profits contracts.
- Group cash with-profits contracts.

12.2.3 The *unitised* with-profits business arises from *unitised* policies in the Non-Profit Fund which have chosen this investment option.

Some of the with-profits units from single premium investment bonds of Scottish Mutual International (SMI) based in Dublin, are reassured into the Scottish Mutual With-Profits Fund.

12.2.4 The *smoothed return* business arises from *unitised* policies in the Non-Profit Fund which have chosen the Smoothed Income Fund or Smoothed Growth Fund investment options. The assets attributable to this business are notionally ring-fenced.

12.2.5 The fund includes both business issued in the UK and denominated in sterling and overseas business denominated in Sterling, Euros or US dollars. The overseas business is reassured from SMI.

12.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to the receipt of support are detailed in sections 3.3 and 5.2.

Principle 12.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under with-profits policies is *asset share* calculations which are carried out for certain specimen policies. The amounts payable will allow for a fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es or *smoothed returns*.

The degree of approximation used in the application of these methods aims to be consistent with the overall fair treatment of all with-profits policyholders.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Different bonuses are declared for different classes of with-profits business, reflecting the different tax, type of with-profits business and product features. New bonus classes would be required if a new type of product were developed. An existing class would normally only be split in exceptional circumstances. Within classes, bonuses may be further differentiated by series.

Bonus policy can be affected by a variety of factors including the financial and solvency position of Phoenix Life Limited, the financial strength of the fund, the expected cost of guarantees, actual and expected investment returns and expenses, the likelihood of changes in the level of provisions and the constraints which increases in guaranteed benefits may place on the fund, particularly in relation to investment strategy. These factors, together with the aim to retain flexibility in the operation of the fund, constrain *annual* and *final bonus* declarations, *smoothed return* declarations and the *smoothing* policy. These constraints also apply in changing economic conditions.

Bonuses can only be declared if there is surplus available for distribution or they are guaranteed.

Practices

***Asset Share* Methodology**

12.4.1 The basic method for *asset share* calculations for with-profits business uses actual investment returns net of tax and for expenses, mortality and morbidity benefits, uses the actual underlying experience for *traditional* with-profits business and uses product charges for *unitised* with-profits and s*moothed return* business.

Asset shares are not smoothed. In particular the investment returns and experience elements contributing to *asset shares* are generally not smoothed, other than that inherent in the processes used in the derivation of the assumptions.

12.4.2 The following table describes the elements credited or charged to *asset shares* for *traditional* with-profits, *unitised* with-profits and *smoothed return* business.

Element		***Traditional* With-Profits Business**	***Unitised* With-Profits Business**	***Smoothed Return* Business**
(a)	Premiums	Premiums paid Note (a)	Premiums paid Note (a)	Premiums paid Note (a)
(b)	Investment return	Allocated return Note (b)	Allocated return Note (b)	Allocated return Note (b)
(c)	Investment expenses	Actual allocated Note (c)	Implicit in product charges	Implicit in product charges
(d)	Initial expenses	Actual allocated Note (d)	Implicit in product charges	Implicit in product charges
(e)	Renewal expenses	Actual allocated Note (e)	Product charges Note (e)	Implicit in product charges
(f)	Other expenses	Actual allocated Note (f)	Not charged	Not charged
(g)	Tax on investment return	Actual allocated Note (g)	Actual allocated Note (g)	Actual allocated Note (g)
(h)	Tax relief on expenses	Actual allocated Note (g)	Implicit in product charges	Implicit in product charges
(i)	Mortality & morbidity costs	Experience Note (i)	Note (i)	Note (i)
(j)	Early terminations	Charged Note (j)	Charged Note (j)	Charged Note (j)
(k)	Paid-up policies	Charged Note (k)	Not applicable	Not applicable
(l)	Partial and regular withdrawals	Not applicable	Note(l)	Note(l)
(m)	Surrenders at *protected dates*	Not applicable	Note (m)	Note (m)
(n)	Annuity payments	Sometimes Note (n)	Not applicable	Not applicable
(o)	Charges for the cost of guarantees	Note (o)	Note (o)	Note (o)
(p)	Charges for the cost of capital	Not charged	Not charged	Not charged
(q)	Distributions to shareholders	Sometimes Note (q)	Not applicable	Not applicable
(r)	Tax on distributions to shareholders	Not applicable	Not applicable	Not applicable
(s)	Profit and losses from other business	Not charged	Not charged	Not charged Note (s)
(t)	*Estate* distribution or charge	Note (t)	Note (t)	Not charged Note (t)
(u)	Exceptional items	Not applicable	Not applicable	Not applicable

The way in which the above items are taken into account is described in the notes below, together with how they vary by type of business. Where charged is used in the table above this means both charged and / or credited depending on whether it is a loss or profit.

Notes

(a) Premiums

Premiums paid under the specimen policy. For *unitised* business, it is the premiums used to purchase units which are net of any premium related policy charges. These charges include any reduced, nil or enhanced allocation percentages, additional initial unit charges and a bid/offer spread.

(b) Investment return

The investment returns are based on separate notional ring-fenced assets. The *smoothed return* business is notionally ring-fenced. The remaining assets are split between policies denominated in Sterling, Euros and US dollars. The investment returns allocated to asset shares vary by type of policy as described in section 12.9. Further distinctions may be made for different classes and groups of policies if this was considered fair. In particular, the return from any assets bought specifically to cover guarantees may be reserved to meet the costs of these guarantees.

(c) Investment expenses

For *traditional business* this is based on a best estimate of the actual expense incurred.

(d) Initial expenses

Historically these are based on an estimate of typical costs for the year of entry.

(e) Renewal expenses

For *traditional* business the per policy expenses used are the same as those used to determine the actual charges.

For *unitised* with-profits and *smoothed return* business many of the policy fees charged have a standard provision that they are annually reviewable (in some cases specifically in line with increases in RPI or NAE).

(f) Other expenses

For *traditional* business a proportion of other expenses actually incurred in managing the fund or the business can be charged against the *asset shares*.

(g) Tax on investment return

Allowance for the relevant rate of tax on the respective investment classes is applied. It is based on a best estimate of actual current tax payable.

(h) Tax relief on expenses

Tax relief is available on some expenses.

(i) Mortality and morbidity costs

For *traditional* with-profits business, the charge is based on the underlying experience and is approximated by applying a percentage of a standard published mortality table. The percentage applied is based on the results of mortality investigations carried out from time to time.

For some *unitised* with-profits business and some *smoothed return* business, these costs are charged explicitly in the product charges on a monthly basis, based on the sum at risk, by cancelling units. Any profits or losses from the explicit charges not reflecting the actual underlying experience and costs are not credited to *asset shares*. For other *unitised* with-profits business, the costs are implicit in the product charges and no explicit monthly charge is applied.

For group deferred annuity and group cash *traditional* with-profits business, this includes the cost of amounts used to provide benefits.

(j) Early terminations

Profits or losses arising from surrenders currently accumulate in the *estate*. The surrender profits / losses on with-profits business may be applied to *asset shares* by an addition to or deduction from the rate of investment return applied in the year in which the profit or loss arises or may be accumulated in the *estate* and applied as part of a distribution of the *estate* in a later year.

The surrender profits and losses are pooled within *traditional* with-profits business, *unitised* with-profits business and *smoothed return* business separately and may be pooled at bonus class level.

(k) Paid-up policies

Separate *asset shares* are not worked out for paid-up policies. Any profits or losses arising from policies becoming paid-up are treated as in note (j).

(l) Partial and regular withdrawals

These are reflected in *asset share* calculations only to the extent that part of the policy has been cancelled. The proportion of the policy withdrawn is reflected in both the underlying *asset share* and remaining policy values. Profits and losses arising are treated as in note (j).

(m) Surrenders at *protected dates*

Profits and losses arising are treated as in note (j).

(n) Annuity payments

For *traditional* with-profits annuity business, these reflect the pension payments made under the policy.

(o) Charges for the cost of guarantees

Currently no explicit charge is made for the cost of guarantees and the cost is effectively borne by the *estate*. The cost of rebalancing the hedge asset to match the guarantees may be charged through an adjustment in the net investment return credited to *asset shares* for *traditional* and *unitised* with-profits business. The ring-fenced *smoothed return* business may be charged for any hedge rebalance costs if hedging assets are held for this business.

Any charges would be pooled within *traditional* with-profits business, *unitised* with-profits business and *smoothed return* business separately as applicable and may be pooled at bonus class level. However, where the cost is deemed too high for one class of business, the charge may be made over all classes and types of business except losses on *traditional* business which cannot be charged to *unitised* with-profits business, unless the effect of such charges was only to remove previous enhancements to the *asset shares* from the *estate*.

(q) Distributions to shareholders

For *traditional* with-profits business, for policies issued from 1 January 1992 (that is post demutualisation), the cost of distributions to shareholders resulting from the cost of bonus allocated to policies, is charged to *asset shares*. The cost of bonus is as described in section 12.14, using the basis applicable at the time. For policies issued before 1 January 1992 (that is pre demutualisation), the cost of distributions to shareholders is not charged to *asset shares*.

(s) Other business profit or losses

All profits and losses arising on *smoothed return* business are reflected in the *asset shares* of *smoothed return* policies. However profits and losses arising on other types of with-profits business do not impact on *smoothed return* business, other than in extreme circumstances.

(t) *Estate* distribution or charge

Asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate*. However these distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 12.12.

The value of the demutualisation Special Bonus which was added on 1 January 1992 is included in the *asset shares*.

12.4.3 *Asset shares* are calculated for representative specimen policies when setting bonus rates and *surrender value* bases for *non-protected exits.* Specimen policies are chosen to represent the business and include a range of policy terms and years of entry. The primary emphasis in selecting specimen policies is the size of premium or sum assured. There is however a degree of averaging, particularly for those terms where there are relatively few policies.

12.4.4 *Asset share* models contain some approximations, but these approximations do not prejudice the overall fair treatment of with-profits policyholders. Whilst only minor approximations are employed in *asset share* calculations, no investigations are carried out on the level of approximation built into the resulting *asset shares*.

Policies that have been subject to alterations, including becoming paid-up, do not yield robust *asset share* calculations. For these policies, bonuses are based on those for an equivalent unaltered policy with approximate adjustments to reflect the differing premium and benefit payment histories.

For *traditional* whole life policies, *final bonuses* and *surrender value* bases may be set with reference to those applicable for endowments.

12.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in section 12.12.

12.4.6 *Asset share* practices are documented.

Asset share and bonus policies are documented at a high level in various *Board* (and previously SMA Board) reports and reports on *asset share* investigations that have been undertaken from time to time.

Detailed specifications relating to the *asset share* calculations and the bonus calculations only exist to a varying degree, but the coding within the models used in the processes are viewable and thus document the calculations.

Asset share assumptions are documented and this tends to include references to their source of derivation.

For each bonus review appropriate documentation is produced and provides an audit trail of the process, including sources of data, source and derivation of assumptions, backing calculations, notes and correspondence. This audit trail normally includes retaining electronic copies of the systems and calculations used for the review.

12.4.7 *Asset share* models, processes and documentation are subject to a continual process of development, improvement and refinement. Significant effects are reported to and considered by the *Board*.

12.4.8 *Asset share* practices are not guaranteed and may be changed in future. Historic *asset shares* were agreed at the time of demutualisation in 1992.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

12.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

12.4.10 For *traditional* with-profits business separate *annual bonus* scales are declared for the following classes:

- Life *traditional* with-profits business
- Individual pension *traditional* with-profits cash based policies with an annuity option and individual pension traditional with-profits deferred annuity contracts with a guaranteed cash option
- With-profits annuities
- Group deferred annuity *traditional* with-profits business
- Group cash *traditional* with-profits business

Separate *final bonus* scales are declared for the following *traditional* with-profits classes:

- Life *traditional* with-profits business
- Individual pension *traditional* with-profits cash based policies with an annuity option
- Individual pension *traditional* with-profits deferred annuity contracts with a guaranteed cash option
- Group pension *traditional* with-profits cash based policies with an annuity option (additional voluntary contribution policies).

There is no *final bonus* applicable to with-profits annuity, group deferred annuity and group cash pension business.

For with-profits annuity business, there may be an additional bonus.

For individual pension *traditional* with-profits deferred annuity policies with a guaranteed cash option the policy sets out the guaranteed rate at which the annuity benefits can be commuted for a cash benefit (including any tax free lump sum) or an *open market option*. It is current practice to offer enhanced commutation terms to broadly reflect the fair value of the annuity benefits being given up, having regard to market interest rates and best estimate assumptions of mortality rates and forecast improvements. The enhanced commutation terms will normally be reviewed with the same frequency and at the same time as final bonus rates are reviewed. The continued availability of such enhanced terms is not guaranteed.

12.4.11 For *unitised* with-profits business:

Separate *annual bonus* scales are declared for the following classes of *unitised* with-profits business:

- UK *unitised* with-profits life - rates depend on series
- UK *unitised* with-profits pension - rates depend on series
- Overseas (international) *unitised* with-profits - rates depend on currency

Separate *final bonus* scales are declared for the following classes of *unitised* with-profits business:

- UK *unitised* with-profits life regular premium - scale depends on series
- UK *unitised* with-profits life single premium - scale depends on series
- UK *unitised* with-profits pension regular premium - scale depends on series
- UK *unitised* with-profits pension single premium - scale depends on series
- Overseas (international) *unitised* with-profits - scale depends on currency

12.4.12 For *smoothed return* business, there are separate smoothed unit prices and smoothing adjustments for the Smoothed Income Fund and the Smoothed Growth Fund.

12.4.13 For *traditional* with-profits business where *final bonus* is applicable, *annual bonuses* are reviewed annually and are declared in arrears in March of the following year to which the bonus relates. *Final bonuses* are declared in advance and are reviewed at least twice a year, normally from 1 January and 1 July. For with-profits annuities, the *annual bonus* (and additional bonus) normally applies for policy anniversaries during the period from 6 April to 5 April in the following year and is declared annually shortly before the 6 April. For group deferred annuity and group cash business, *annual bonuses* apply on the policy anniversary in each calendar year and rates are declared early in the calendar year.

For *unitised* with-profits business, *annual bonus* rates are set in advance. The time for which they will apply is not fixed and they may be reviewed at any time. They will be reviewed at least once a year at the time of the *annual bonus* review for *traditional* with-profits business. *Final bonuses* are declared in advance and reviewed at least twice a year, normally from 1 January and 1 July.

For *smoothed return* business, the smoothed unit price is formula based and changes daily and smoothing adjustments may be changed at any time.

12.4.14 The timing of *final bonus* declarations may be varied.

12.4.15 *Final bonus*es and *annual bonuses* declared in advance are expected to, but are not guaranteed to apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. *Unitised* with-profits business *final bonuses* and *market value reductions* are particularly subject to more frequent reviews in response to investment market movements or where there has been, or is expected to be a high volume of surrenders. Otherwise, additional reviews would normally only be in response to more exceptional investment market movements.

12.4.16 *Final bonus* reviews also consider the amount of *final bonus* paid on *non-protected exits* (surrenders).

12.4.17 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared, unless they are guaranteed.

Principle 12.5	***Annual Bonus* Rates** The aim is to set *annual bonuses* at a prudent level, balancing the benefit to policyholders of increased guarantees, the aim for an element of *final bonus*, the flexibility of the operation of the fund and its ability to ensure the guarantees can be met in future. *Annual bonuses* may increase or decrease from declaration to declaration and may also be nil. *Annual bonuses* can be declared only if there is sufficient surplus available or if they are guaranteed. In cases where *final bonus* is not applicable, *smoothing* of the *annual bonus rates* is used as a mechanism to adhere to section 12.4 where applicable.

Practices

12.5.1 For *smoothed return* business, there are no bonuses and section 12.7 describes how benefits are determined for this business. The rest of this section does not apply to this business.

12.5.2 The *Board* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in the following paragraphs.

12.5.3 For each class of business, other than *traditional* with-profits business not eligible for *final bonus* (see 12.5.5), the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, close to nil. However some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

Some classes of *unitised* with-profits business have guaranteed *annual bonuses*:

- UK *unitised* with-profits life Series I and Series II have a guaranteed increase of 3% per annum in unit prices.
- UK *unitised* with-profits pension Series I and Series II have a guaranteed increase of 4% per annum on accumulation units.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

12.5.4 Where the financial position of the fund is weak, the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

12.5.5 For *traditional* with-profits business where *final bonus* is not applicable, that is with-profits annuity, group deferred annuity and group cash business, *annual bonuses* will be set with the aim of achieving the current long-term target *payout* *ratio* of 100% of *asset share* (per paragraph 12.6.2). The general approach for group deferred annuity and group cash business is based on *smoothing* investment returns and the impact of other charges and profits and losses over five years, limiting changes in *annual bonus* rates to maintain a smooth progression, but with an overriding constraint to bring *payout ratios* into line over a period of five years. For with-profits annuity business the annual bonus rate is set by comparing asset shares with the expected value of future annuity payments to determine a level of future bonus that is expected to be supportable in the longer term, should the assumptions made about future investment growth, life expectancy and other factors be realised in practice.

If at any time the fund is targeting payouts at a higher proportion of *asset share* than 100% on account of *distributable estate*, then this will be allowed for in the smoothed investment returns with the aim that the distributable *estate* will therefore be gradually reflected in policy benefits over a five year period.

For with-profits annuity business, an additional bonus may be added to smooth changes in *annual bonuses*. Also additional bonuses may be added to different groups of with-profits annuity business to allow for material differences in experience between different groups. Additional bonuses are not a guaranteed addition and only apply to the annuity income for the relevant year.

12.5.6 The *asset share* comparisons are performed for representative specimen policies grouped according to the level at which different bonus rates are declared.

12.5.7 For *traditional* with-profits business where *final bonus* is applicable, *annual bonus* rates are declared in arrears and are expressed as a percentage of the benefit payable. For *traditional* with-profits business where *final bonus* is not applicable, *annual bonus* rates are declared in advance, apply from the next policy anniversary and are expressed as a percentage of the benefit payable. For *unitised* with-profits business, *annual bonus* rates are declared in advance and apply daily as an increase in the unit price (but subject to any rounding in the unit price).

12.5.8 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

Principle
12.6 *Final Bonus* Rates

The aim is to set *final bonus* rates so that specimen policy *payouts* achieve a target *payout ratio*. These *final bonus* rates are then adjusted for *smoothing* as described in section 12.7. *Final bonus*es for a policy may increase or decrease from declaration to declaration and may also be nil. *Final bonus*es will be reviewed regularly, but can be reviewed at any time.

Practices

12.6.1 *Final bonus* is not applicable to *traditional* with-profits annuity, group deferred annuity and group cash business or to *smoothed return* business. The rest of this section does not apply to these types of business.

12.6.2 The current long-term target *payout ratio* for maturing policies is 100% of *asset share*.

In this context *maturity* includes retirement at selected retirement age for pensions business and surrender or withdrawal at a *protected date* for *unitised* with-profits business. The guaranteed benefit for *traditional* with-profits pension business used in the comparisons is as follows:

- The guaranteed cash benefit for cash based contracts with a guaranteed annuity option.
- The expected cost of providing the guaranteed annuity for deferred annuity contracts with a guaranteed cash option.

12.6.3 The actual *payout ratio* for maturing policies at any one time will not necessarily be equal to the target portion due to:

- the level of accumulated guarantees; or
- the effects of *smoothing*.

12.6.4 *Final bonuses* are determined by comparing projected *asset shares* with the corresponding guaranteed benefits, together with any *interim bonus*, for maturities in the period under consideration. These projected *asset shares* allow for the actual experience to date and expected future experience, including expected future investment return and where relevant, shareholder transfers in respect of the *final bonus* being determined. The *final bonuses* actually declared are based on these figures after adjusting for *smoothing* as described in section 12.7.

12.6.5 The projections supporting *final bonus* investigations are based on actual experience up to five months in advance of the start date of the declaration. The projections generally consider policies maturing during the calendar year in which the *final bonus* rates apply.

12.6.6 *Final bonus* declarations are also informed by comparisons of projected *asset shares* and corresponding projected benefits for maturities in subsequent *final bonus* periods and over the next couple of years.

12.6.7 The *asset share* comparisons are performed for representative specimen policies, grouped according to the level at which different bonus rates are declared. For *traditional* with-profits business, the primary focus is on performing the calculations for specimen policies at the terms which contain a significant volume of policies. For other terms approximations may be used.

12.6.8 For *traditional* with-profits business *final bonus* rates are rounded and expressed as a percentage of sum assured and *annual bonus* and are based on the number of completed years.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

12.6.9 For *unitised* with-profits business, *final bonus* rates are rounded and expressed as a percentage of the value of with-profits units. The *final bonus rates* depend on start year of policy and may also vary within start year of policy if the impact of variations in investment returns is significant.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

12.6.10 *Final bonus* scales are determined by reference to maturing representative specimen policies.

For *traditional* with-profits life assurance business, the *final bonus* payable on a death claim (or terminal illness claim, if applicable) is based on the *final bonus* rate for a policy maturing with the same entry year, for both endowments and whole life policies.

For *unitised* with-profits business, the *final bonus* scale applies to death claim (or terminal or critical illness claim, if applicable) as well.

12.6.11 *Final bonus*es are declared in advance and are made in anticipation of a surplus arising. *Final bonus*es can only be declared if there is an expectation of such surplus arising.

12.6.12 *Final bonus* reviews also consider the amount of *final bonus* for surrenders, including *market value reductions* for *unitised* with-profits business, based on section 12.8.

12.6.13 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on maturities may deviate from the target *payout ratios* during the period between reviews. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the *maturity payout ratios* at the latest *final bonus* review were near the top or bottom of the range described in paragraph 12.7.3, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle 12.7 ***Smoothing***

The aim is to smooth with-profits policy *payouts* at *protected dates* to manage the *volatility* of with-profits policy *payouts*. The effect of *smoothing* may have a positive or negative effect on with-profits policy *payouts*.

Smoothing leads to profits and losses which are anticipated to offset each other over time. In the short-term, if these profits or losses were to become excessive, then the *smoothing* policy would be reviewed.

For all business except *traditional* with-profits business, the *non-protected exit* values may take account of day to day investment market movements and as a result may have a *market value reduction* applied or in the case of *smoothed return* business a smoothing adjustment applied. For *traditional* with-profits business, *non-protected exit* values will have a degree of *smoothing*.

Practices

12.7.1 For *traditional* with-profits business where *final bonus* is not applicable, that is with-profits annuity, group deferred annuity and group cash business, the mechanism for setting *annual bonuses* as described in section 12.5, describes how *smoothing* applies to this business. The rest of this section does not apply to this business.

***Traditional* and *Unitised* With-Profits Business**

12.7.2 *Final* and *interim bonus*es are declared in advance and are expected to, but are not guaranteed to apply until the next planned review date. Additional reviews would normally only occur in response to exceptional adverse investment market movements. Thus with-profits policyholders leaving at *protected dates* are not impacted by day to day investment fluctuations. This forms part of the *smoothing* process.

For *traditional* with-profits business the calculated *final bonuses* may be adjusted to give a reasonably smooth progressive scale. This forms part of the *smoothing* process.

12.7.3 *Final bonus* reviews take into account the current *maturity payout ratios* and the long-term target *payout ratio* per paragraph 12.6.2. The aim is to ultimately bring *maturity payout ratios* for representative specimen policies in line with the long-term target *payout ratio* in a smoothed manner based on the guidelines as described in paragraph 12.7.4. The target range for *payout ratios* is to be between 80% and 120% of *asset share* before the effects of *smoothing*.

In this context *maturity* includes retirement at selected retirement age for pensions business and surrender or withdrawal at a *protected* date for *unitised* with-profits business.

12.7.4 For *traditional* with-profits policies where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* and retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies and *unitised* with-profits policies, *surrender value* bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as term remaining which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values.*

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing.* Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

12.7.5 The *smoothing* of *maturity* values from declaration to declaration primarily focuses on specimen policies. The effect on the aggregate position for maturities, incorporating all relevant business for the class of with-profits business and grouped according to the level at which different bonus rates are declared, is also considered. As *final bonus* rates are rounded, this may result in slight deviations from the target position.

12.7.6 In adverse conditions, where the level of guaranteed benefits exceeds the target proportion of the relevant *asset shares*, no *final bonus*es may be warranted. In this situation, the guaranteed benefits provide a floor for *maturity payouts*. This provides further protection against day to day investment fluctuations and may further limit movements in *maturity payouts* for similar policies, as a result of bonus declarations.

12.7.7 *Smoothing* leads to profits and losses which are anticipated to offset each other over time. Costs may arise under paragraph 12.7.6, but such costs are the cost of guarantees and not the cost of *smoothing*. The *smoothing* policy is not specifically constrained by a limit on the short-term profits and losses of *smoothing*, but should these become excessive, the *smoothing* policy may be revised. The total cost or scale of *smoothing* over the shorter term should be kept small in relation to the size of the fund. The profits and losses from *smoothing* and costs from guarantees feed through to the *estate* and are effectively dealt with by principle 12.12 and its associated practices.

12.7.8 As the *final bonus* payable on life assurance business death claims is based on the *final bonus* scale for maturities, there is a similar element of *smoothing* operating on *payouts* for death claims.

12.7.9 For *unitised* with-profits business, *surrender values* will target a proportion of *asset share*, as described in section 12.8. *Surrender values* on *unitised* policies may be subject to the application of a *market value reduction*. *Market value reductions* are regularly reviewed, normally monthly and may be revised to reflect market movements between normal *final bonus* reviews. Also it is probable that during a period of adverse conditions, *unitised final bonuses* might be changed sooner and possibly also more frequently than might apply to the *traditional* business.

***Smoothed Return* Business**

12.7.10 For the Smoothed Income Fund and the Smoothed Growth Fund, *smoothing* is achieved through a formulaic process. Benefits payable are the number of units multiplied by the smoothed unit price. The smoothed unit price is calculated daily based on the weighted arithmetic average daily unsmoothed unit price over the previous 12 months. The weighting is 75% of the average over the previous six months and 25% of the average over the six months before that.

The unsmoothed unit price is based on the actual underlying assets of the smoothed fund allowing for the actual investment performance and all other profits and losses attributable to that smoothed fund.

12.7.11 The smoothed unit price applies to all unit allocations and unit cancellations. In addition a smoothing adjustment may be applied to unit cancellations. The smoothing adjustment may be positive or negative, although negative smoothing adjustments will not be applied on death or on withdrawals up to 5% of the policyholders smoothed fund each year from the Smoothed Income Fund.

A smoothing adjustment may be applied when there is a significant difference between the unsmoothed unit price and the smoothed unit price. Smoothing adjustments would normally only be applied where there was more than a 10% difference between smoothed and unsmoothed unit prices.

12.7.12 The long-term target *payout ratio* is 100% of *asset share*. The target range is for *payout ratios* to be between 80% of *asset share* and 120% of *asset share* before the effects of *smoothing*.

12.7.13 *Smoothing* leads to profits and losses which are anticipated to offset each other over time. The *smoothing* policy is not specifically constrained by a limit on the short-term profits and losses of *smoothing*, but should these become excessive, the *smoothing* policy may be revised. The profits and losses from *smoothing* and costs from guarantees feed through into the unsmoothed unit price and will ultimately be reflected in the smoothed unit price.

12.7.14 Material changes to methods would be made only following a decision of the *Board*, based on a recommendation by the *With-Profits Committee*.

Principle 12.8 ***Surrender Values*** The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies achieve a target *payout ratio*.

Practices

***Traditional* With-Profits Business**

12.8.1 For life business *non-protected exits* refer to *surrenders* and policies becoming paid-up. For pensions business *non-protected exits* refer to transfers, early and late retirements and policies becoming paid-up.

Surrender values are targeted in the long term at 100% of *asset share*. The target range for surrenders is 80% of *asset share* to 120% of *asset share*.

12.8.2 The basis for the *surrender value* formulae is determined by targeting the target proportion of *asset share* for representative specimen policies.

12.8.3 Actual surrender payments on individual policies will not generally be in line with the target proportion because:

- Individual *asset shares* are not calculated or held on the administration systems for use in *surrender value* calculations. Rather *surrender values* are calculated in a variety of ways for different types of policy. Typically *surrender values* are based on a discounted value of the guaranteed sum at *maturity* or retirement (reduced to allow for non-payment of future premiums in the case of regular premium policies) together with an allowance, where appropriate for *final bonus*.
- Specimen policies are used to determine the parameters in the *surrender value* calculations. The outcome for a particular individual policy may be different from that of the specimen policy.
- There are a limited number of parameters that may be altered in the surrender formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.
- As the value of assets are changing every day but the parameters in the *surrender value* formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate.

12.8.4 In some cases, values in excess of *asset share* may be payable when policies are surrendered close to *maturity* and the *asset share* of the relevant specimen policy is less than the guaranteed benefits at *maturity,* or the *maturity payout* is in excess of the *asset share* due to *smoothing.* This may also occur if the value of the guaranteed benefits is high relative to *asset share*, due to the effective maximum discount rate used in the surrender bases.

12.8.5 Paid-up policy benefits are determined such that the paid-up policy benefits target similar *payout ratios* to surrenders. Paid-up policies continue to participate in profits.

12.8.6 Some policies have surrender and paid-up policy calculations specified in the policy conditions. These represent a minimum basis that is applied.

12.8.7 *Surrender* value and paid-up policy value bases will normally be reviewed once a year. However more frequent reviews might take place, in particular in response to significant investment market movements. *Surrender values* and paid-up policy values may also change more regularly following a review of *final bonus* rates.

12.8.8 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

***Unitised* With-Profits Business**

12.8.9 *Non-protected exits* refer to surrenders and withdrawals, other than those at a guarantee date, transfers, switches, early or late retirements and any excess regular withdrawals.

Surrender values are targeted in the long term at 100% of *asset share*. The target range for surrender or transfers is 80% of *asset share* to 120% of *asset share*.

12.8.10 The resulting *surrender value* may be subject to withdrawal charges to cover unrecovered initial costs or the administration costs of processing the surrender.

12.8.11 *Unitised* with-profits business paid-up policy values are the with-profits units and bonus units added to date and they continue to participate in profits.

12.8.12 *Surrender value* bases will normally be reviewed once a year, although *surrender values* may change more frequently following changes in *final bonuses* and *market value reductions*.

12.8.13 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

***Smoothed Return* Business**

12.8.14 For *smoothed return* business, the *surrender value* is based on the number of units multiplied by the smoothed unit price.

In addition a smoothing adjustment may be applied which may be positive and increase the value or negative and reduce the value (equivalent to a *market value reduction*). A smoothing adjustment may be applied if the smoothed unit price is significantly different from the unsmoothed unit price as described in paragraph 12.7.11.

12.8.15 The long-term target *payout ratio* is 100% of *asset share*. The target range for surrenders is for *payout ratios* to be between 80% of *asset share* and 120% of *asset share*.

12.8.16 The introduction of smoothing adjustments may be *smoothed* and they will not necessarily be based on the long-term target *payout ratio*.

12.8.17 Smoothing adjustments are reviewed on a regular basis, but may be subject to more frequent or significant changes during periods of volatile investment conditions.

Principle 12.9 Investment Strategy

The fund will take investment risk only to the extent that there is a high degree of certainty that the fund is sufficiently strong to absorb adverse experience. Within this constraint the primary objective of the strategy will be to achieve the best long-term investment return. The size and timing of guaranteed benefits and other liabilities determine the investment freedom and risk tolerance.

Investments will be spread over a number of asset classes and within these asset classes the actual holdings will normally be diversified and of an appropriate quality. Derivatives are normally only used for efficient portfolio management or to reduce investment risk.

The fund may hold assets which are *not normally traded*, but will not normally seek to increase its exposure to such type of assets.

The investment strategy will be reviewed regularly to ensure it remains appropriate.

Practices

12.9.1 The fund maintains two ring-fenced sets of assets backing the *smoothed return* business, one in respect of the *Smoothed Income Fund* and one in respect of the *Smoothed Growth Fund* business.

The assets backing the rest of the business are currently split over four asset pools. The main asset pool backs the sterling denominated business. There are two similar assets pools backing other business, one for Euro-denominated business and one for US dollar denominated business. The remaining asset pool covers the hedging arrangements where the return is used to meet guarantee costs and the *estate*. Further splits into different asset pools may be made if the *Board* considers this would be appropriate and it was considered to be in the overall best interests of policyholders.

The ring-fenced assets and asset pools are described in more detail subsequently.

These investments are managed by the *investment managers* in accordance with an investment mandate specified by the *Board*.

12.9.2 The investment assets are spread over a number of different asset classes, which may include:

- Approved fixed interest securities, such as British Government gilts and other government and supranational bonds
- Other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt
- Property
- Approved variable interest securities, such as British Government index-linked gilts
- Other variable interest securities, such as variable rate corporate bonds
- United Kingdom equity shares
- Overseas equity shares, such as European, United States of America, Japanese, Asia Pacific and emerging markets
- Loans secured by mortgage
- Cash, such as short term deposits and money market funds
- *Alternative assets* such as hedge funds
- Assets to hedge mis-match risk
- *Private equity*

- Derivatives.

The investments may be direct or via collective investment schemes such as unit trusts.

With the exception of property, *private equity,* loans secured by mortgages, some *alternative assets* and assets to hedge mis-match risk, investments are predominately listed and traded on a recognised stock exchange. Credit quality is controlled by investment guidelines.

The actual investments held are widely diversified within these asset classes.

The agreements with the *investment managers* set out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single company.
- The maximum amount that can be invested in any single asset class / industry sector / country.
- The maximum amount to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns. (These include restrictions in terms of credit quality, term / duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moody's)
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

12.9.3 Derivatives are currently used. They may also be used to implement policy decisions where this would be efficient portfolio management.

12.9.4 Where there is a significant mis-match between assets and liabilities, assets to hedge those risks may be purchased or a short position in certain investments may be held. This applies both to equity risk and to interest rate risk (for example with respect to the interest rate risk arising from guaranteed annuity options). The hedge assets may not be fully effective at covering the mis-match risk.

12.9.5 The introduction of any new asset or liability instruments into the investment strategy will only occur following approval by the *Board*. Such instruments are only likely to be permitted for efficient portfolio management or to reduce investment risk.

12.9.6 The fund may include assets that are *not normally traded*. There are no material holdings of assets that would not be normally traded and it is not expected that there will be any in future.

Any future assets which would *not normally* be traded will only be acquired following a review by the *With-Profits Committee* and approval by the *Board*. Any acquisition of such assets would be made after considering the run-off position of the fund, the management of the *estate* and the ultimate need at some future time to realise such assets.

12.9.7 The *Board* reviews the investment strategy taking account of a variety of considerations, including our approach to *responsible investment* at least once a year. However more frequent reviews might take place, in particular in response to adverse market movements or significant changes in the operating environment. The *Board* documents the investment strategy, provides investment ranges to the *investment managers* and monitors the position.

Assets backing *Smoothed Return* Business

12.9.8 The strategy underlying the assets backing the Smoothed Income Fund and Smoothed Growth Fund business is that each of these funds does not rely on other assets to maintain the investment strategy. Other than this constraint, the principal objective is to maximise the expected returns.

12.9.9 The guideline asset mix ranges for *asset shares* are:

	Smoothed Growth Fund	Smoothed Income Fund
Fixed interest and cash	35% to 60%	90% to 100%
Equities	35% to 60%	Nil
Property	0% to 10%	0% to 10%

The different asset mix allows for the regular withdrawal guarantees under the Smoothed Income Fund.

Each fund may have small derivative holdings to manage guarantees. Apart from this there is no expectation of using derivatives, other than as short-term methods of implementing investment decisions.

From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*. Fixed interest will be a mixture of approved fixed interest securities such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures and loan notes.

Assets backing other than *Smoothed Return* Business

12.9.10 The investment policy will be set with the objective of maximising the return and managing a smooth distribution of the *estate*, whilst taking account of the management actions and shareholder support available. The strategy will seek to minimise the need for any support from shareholders to cover any Pillar 1 capital requirement.

Any external support to the fund will be provided as described in section 5.2.

12.9.11 The degree of matching between assets and liabilities will depend upon the level of surplus assets within the fund. Where a large surplus exists, a higher level of exposure to equities and property will normally be maintained. If there is no surplus or it is small, matching will be closer with a lower exposure to equities and property.

12.9.12 There are different mixes of assets for Sterling, Euro and US dollar denominated business. The assets backing the sterling denominated business include a high proportion of investments denominated in sterling. Similarly the assets backing Euro and US dollar business include a high proportion of investments denominated in their respective currencies.

12.9.13 The proportion of equities, property and *alternative assets* within *asset shares* varies by type of policy, according to the overall level of guaranteed benefits for that type of policy.

For products with high levels of guarantees relative to *asset shares*, lower proportions of equity, property and *alternative assets* are held, and for products with low levels of guarantees relative to *asset shares*, higher proportions of equity, property and *alternative assets* are held. The target guideline ranges for the proportion to be invested in equities, property and *alternative assets* are shown in the table below.

Type of policy	Guideline range for the proportion to be invested in equities, commercial property and *alternative assets*
Traditional with-profits life endowment or whole of life policies	50% - 60%
Traditional with-profits pension policies (including with-profits annuities and group deferred cash / pension policies)	25% - 35%
Unitised with-profits policies with guaranteed minimum bonus rates	25% - 35%
Unitised with-profits policies with no guaranteed minimum bonus rate	60% - 70%

The equity, property and *alternative assets* proportion may include *private equity* and *alternative assets* such as hedge funds. Fixed interest will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt. The balance of the *asset shares* is invested in fixed interest and cash.

From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*.

12.9.14 Assets representing the *estate* of the Scottish Mutual With-Profits Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth investments in line with the asset mix for the *asset shares*.

12.9.15 If it is considered by the *Board* to be in the best interests of the policyholders, further hypothecation of the assets in the fund may be introduced. For example this may involve matching of non *asset share* liabilities more accurately, hypothecation of different equity-backing ratios to further classes or groups of policies or the hypothecation of fixed interest assets by *term remaining* within *asset shares* to reduce the volatility of policyholder returns near *maturity*.

Principle
12.10 Business Risks

The *Board* aims to manage its business in a prudent manner, having regard to both the risks and rewards of which it is aware. The *Board* will also have regard to the availability of suitable capital and the amount required in light of the risks being undertaken. Some business risks are outside the control of Phoenix Life Limited.

Risks determined by the *Board* to arise in connection with the insurance business of the fund are attributed to the fund. Costs and benefits are attributed in the same manner.

Unless specifically passed through to *asset share* calculations, the impact of business risks is borne by the *estate*. Thus with-profits policyholders are exposed through bonuses or *smoothing*, following from sections 12.4 and 12.12, to the profits and losses of the fund.

Practices

12.10.1 There is no established formal monetary limit to the taking on of business risk by the fund but any such risk is expected to be small in relation to the overall size of the fund. Any costs arising from business risks will be borne by the fund (or part of the fund) which took them on and expects to profit from them if the experience is favourable.

12.10.2 Risks taken on by Scottish Mutual prior to its demutualisation, such as mis-selling will normally be deemed to have transferred to the fund and any associated costs may be charged to the fund. Following demutualisation, mis-selling risks do not fall to the fund and any associated costs will not be charged to the fund. Similarly, other risks taken on after demutualisation, other than normal insurance risks directly associated with the *traditional* with-profits policies, are normally outside the fund.

Risks will be met by the fund where they are properly attributable to the fund in accordance with the principles underlying the *2023 Scheme* or such an attribution is fair and equitable, having regard to policyholders' reasonable expectation.

12.10.3 Infrastructure risks

(a) As the unit charges under the management services agreement are subject to annual increases linked to movements in the Retail Prices Index (RPI), the fund is exposed to the risk of higher than expected inflation.

Costs associated with day to day administrative problems are borne by PGMS.

(b) The PGMS charges are currently VAT exempt. Phoenix Life Limited retains the risk of increase in charges due to changes in VAT rules, including any retrospective changes.

12.10.4 As the fund is running off, there is a risk that the fixed costs will not be reduced in line with the reducing policy volumes. This is substantially mitigated by agreements for the provision of administration services, but this risk has not been entirely eliminated.

The current management services agreement with PGMS is a perpetual agreement.

12.10.5 In the event of failure by PGMS, substantial costs would be incurred in securing an alternative supplier, especially as PGMS and / or its sub-contractors own the infrastructure assets. To monitor this risk the financial viability of PGMS is regularly monitored. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

12.10.6 There are no material reassurance treaties applicable to the fund which would have a material impact in the event of the reassurer failing. Future new reassurance or similar arrangements (where the fund would be exposed to the failure of the reassurer) will only be entered into to reduce the risk within the business and where they are cost or benefit justified.

12.10.7 Mortality and persistency experience may impact *asset shares* or charges directly, but can also have an indirect effect, such as causing the level of expense charges to vary, other than the service level charges from PGMS. Experience is regularly investigated. The potential impact of variations in experience is also considered.

12.10.8 Although the fund is no longer actively seeking new business, there remains some risk in respect of any new business arising and from the exercising of policy options. For some minor classes, the new or additional benefits are on fixed terms which are onerous.

12.10.9 Investment management services are provided to the fund by the *investment managers*. Failures at the *investment managers* might result in losses or costs to the fund, either through losses in the investments being managed or in securing an alternative supplier.

12.10.10 *Smoothed return* business is ring fenced within each smoothed investment fund and is only affected by profits and losses arising in respect of the business in the respective fund.

Unitised with-profits business participates only in the investment and financial experience including the cost of guarantees associated with this business.

Traditional with-profits business shares in all elements of the fund’s insurance experience.

12.10.11 The fund is notionally ring-fenced with the ring-fenced portfolios of business being the Sterling, Euro and US dollar classes of business, and within the sterling fund there are notional divisions between *unitised* and *traditional* and between life and different classes of pensions business. This ring-fencing is long-standing practice, but not legally watertight in the event of insolvency of the fund or Phoenix Life Limited.

12.10.12 Within any notionally segregated portfolio there is pooling across all categories of policy, although to the extent that costs cannot reasonably be borne within the class they may be charged initially to the *estate* and hence, indirectly, to other classes.

12.10.13 Other business risks which potentially impact the fund and the amounts payable under with-profits policies are explicitly or implicitly covered under the other principles and their associated practices, but are summarised here as follows:

- Solvency risks
- Investment risks
- Expense and charges risks
- Mortality and morbidity risks
- Persistency risks
- Taxation risks
- Guarantee risks
- Regulatory risks
- Bonus declaration risks
- Operational risks including failure of third party service providers, including third party administrators and reassurers
- *Estate* management and distribution risks.

12.10.14 Phoenix Group’s current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

12.10.15 Risks undertaken by the fund are approved by the *Board*. They consider the scale of such risks and the cost / benefit justification, having regard to the availability of suitable capital and the amount required in light of the risks being undertaken. They also aim to ensure that risks are undertaken which are, in their opinion, to the advantage of with-profits policyholders.

The *Board* approves to what extent these risks pass to *asset shares*. The balance of these risks feed through to the *estate*. The profits and losses from risks which pass to *asset shares* affect the amounts payable under with-profits policies. The profits and losses from risks that feed through to the *estate* only indirectly affect the amounts payable under with-profits policies, as part of any distribution of or charge to the *estate* as described in section 12.12.

Profits and losses from business risks within the fund will normally be taken as affecting the size of the *estate*. Only very large profits and losses would be treated other than as an addition to or deduction from the *estate*.

12.10.16 Business risks are regularly monitored and they form part of the key insurance risk and operational risk management processes. The risk based capital requirements are assessed with regard to the business risks being undertaken.

Business risks attributed to the fund are reviewed at least once a year by the *With-Profits Committee*.

Principle
12.11 Expenses and Charges

Policies will either be charged product charges or be charged amounts which represent a fair share of the actual costs of the fund.

This approach will be adjusted where necessary in order to continue to treat customers fairly.

Product charges may be either explicit or implicit.

Where actual costs are used and where costs are specific to a policy or policy class, then taking into account the approximations referred to in section 12.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

12.11.1 Expenses and charges applied to *asset shares* are product charges for *unitised* with-profits business and *smoothed return* business and actual costs for *traditional* with-profits business as described in section 12.4. For *unitised* with-profits and *smoothed return* business stated levels of charges were disclosed in the product and marketing literature (although there are provisions that would allow in certain circumstances for these levels to be altered).

12.11.2 For *unitised* with-profits and *smoothed return* business the fund pays the Non-Profit Fund 1% per annum of the value of the units, and the expenses are met by the Non-Profit Fund.

12.11.3 In setting the expense parameters for *traditional with-profits* business the levels are chosen so that if applied across all policies, they give an overall level of expenses close to the actual expenses apportioned to the fund.

12.11.4 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

12.11.5 Were an adverse change to the external fiscal or regulatory environment to occur then action may be taken to reflect this within the charges and expenses.

12.11.6 The costs apportioned to any particular group of policies will only change:

- if the formulaic bases of cost charging are altered to reflect a change in the underlying cost of the activities supporting that group of policies; or
- if the apportioned costs are allocated on a basis which more fairly reflects the costs of the group.

Principle 12.12	***Estate* Management** The *estate* should lie in a target range. If the *estate* falls outside the target range then either the target *payout ratio* (in section 12.6) will be changed or *asset shares* (in section 12.4) will be adjusted, to maintain the *estate* within the target range where possible.

Practices

12.12.1 The *smoothed return* business is ring fenced and all profits and losses arising in respect of these smoothed investment funds are reflected in the unsmoothed unit prices. This *smoothed return* business does not have any interest in the *estate* arising in the fund and the references in this section to potential benefit enhancements from *estate* distribution do not apply to this business.

12.12.2 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

12.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with 12.12.2, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

12.12.4 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;

(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient.

(c) meet any costs which are charged directly to the *estate* rather than to *asset shares*;

(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and

(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

12.12.5 Any enhancement in benefits on account of the *distributable estate* referred to in 12.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

12.12.6 The amount of the *estate*, the *distributable estate*, and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

12.12.7 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to the *asset share* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

12.12.8 In the event of the assets in the fund being insufficient to cover the liabilities, the following management actions will take place:

(a) Any future planned enhancements to *asset shares* will be removed.
(b) If step (a) is insufficient to remove the deficit and restore an *estate* of at least 0.5% of aggregate *asset shares*, any past *asset share* enhancements will be removed.
(c) If steps (a) and (b) are insufficient to remove the deficit and restore an *estate* of at least 0.5% of aggregate *asset shares*, *asset shares* will be reduced or charges will be applied to *asset shares* up to the level of:
- the maximum amount charged to asset shares in one year will be 1.0% of *asset shares;*
- once the cumulative charges reach 5.0% of *asset share*, then the maximum charge thereafter is 0.5% in one year; and
- the cumulative charges made to *asset shares* for any given policy where policyholders have to bear all the costs will be limited to 7.0%.

(d) If steps (a) through to (c) have proved to be insufficient to remove the deficit and restore an *estate* of at least 0.5% of aggregate *asset shares*, an internal loan will be provided by the Non-Profit Fund or the *Shareholder Fund* under the terms of the arrangements described in paragraph 5.2.5.

To the extent that deficits arise in respect of *traditional* with-profits business, no action will be applied in respect of steps (c) through to (d) to *unitised* with-profits business to address such deficits.

In determining the action to be taken, the *Board* will have regard to treating customers fairly, past practices and discussions with the *regulator*.

Realistic surpluses arising in a subsequent period will be applied in the reverse order to these general principles except that there is no cap to future *asset share* enhancements in the event of favourable conditions.

12.12.9 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 12.12.7 and 12.12.8 be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *Board* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle
12.13 New Business

The fund is generally no longer actively seeking new business. Policy options under existing contracts to effect new policies are honoured.

Practices

12.13.1 The fund is generally no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts. Some existing group policies for pension schemes also contain rights to affect increments for existing members and rights to add new members.

12.13.2 Currently there are no plans to generally reopen the fund to new business. The ability of the fund to reopen is constrained by the *2023 Scheme*.

Principle
12.14 Equity Between the Fund and Shareholders

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arms length commercial basis.

Shareholders receive no more than one ninth of the cost of bonuses distributed to policyholders of *traditional* with-profits policies and receive the charges on *unitised* with-profits business and *smoothed return* business, as laid down in the *2023 Scheme*. Any change to the one ninth limit would require the agreement of the *Board* and would be subject to approval by our *regulator* and the High Court.

Practices

12.14.1 The following services are provided to the fund:
- administration services by PGMS; and
- product provision (annuity products) by the Non-Profit Fund.

12.14.2 Shareholders will only provide services to the fund on commercial terms which would require an adequate return for the risks involved in providing the services. The profit margin for shareholders is acceptable to the fund if:
- the cost for the fund is consistent with the terms available from other providers; or
- the profit margin is consistent with the risks borne and there are reasonably foreseeable circumstances in which the shareholder could make a loss.

12.14.3 The allocation of profits between policyholders and shareholders is laid down in the *2023 Scheme* which states that not less than 90% of the surplus being distributed from the fund in respect of *traditional* with-profits policies is allocated to *traditional* with-profits policyholders. Current practice is to distribute exactly 90% of such surplus to policyholders, leaving the remaining 10%, being one ninth of the cost of bonus, to be transferred to shareholders. For *unitised* with-profits business and *smoothed return* business the shareholder does not receive any share of the surplus distributed.

The division of profits between with-profits policyholders and shareholders does not change as a result of changes in the underlying basis used to determine the cost of bonus as described in paragraph 12.14.5. The transfer to shareholders remains one ninth of the cost of bonus for *traditional* with-profits policies as determined in accordance with the underlying basis.

On *unitised* with-profits business and *smoothed return* business, the shareholder receives the product charges.

12.14.4 The shareholder transfer associated with the distribution of profits from the fund can only take place following the published annual actuarial investigation of the long-term business of Phoenix Life Limited carried out in accordance with the requirements of the Financial Services and Markets Act 2000 (or equivalent subsequent legislation). The *Board* is responsible for the distribution of profits and no transfer to shareholders can take place without its authority.

12.14.5 For all *traditional* with-profits business, the cost of bonus is the increase in the liabilities using a risk free discount rate (net of tax as appropriate), as a result of the bonus declaration together with cost of bonus paid on claims since the previous actuarial investigation as follows:

(a) Life assurance *traditional* with-profits business

- The cost of *annual bonus* is the value of any *annual bonus* added, discounted using the above basis.

- The cost of *final bonus* is the value of any *final bonus* paid on death or *maturity* or where applicable terminal or serious illness. The cost of any *interim bonus* paid on such claims is the value of the *interim bonus* added, discounted using the above basis.

- The cost of *interim bonus* on surrender is the value of that bonus discounted using the above basis and the cost of *final bonus* is the value of the *final bonus* element of the *surrender value*.

(b) Pensions *traditional* with-profits business

- The cost of *annual bonus* is the capital value at the selected retirement age using the above basis, of the *annual bonus* added (for deferred annuity policies) or the value (for other policies), discounted using the above basis.

- The cost of any *interim bonus* paid on retirements is the capital value at the retirement date using the above basis (for deferred annuity policies) or the value (for other policies).

- On retirement, the cost of *final bonus* is the excess of the capital value of the annuity, *annual bonus*, *interim bonus* and *final bonus* on the commencement basis, less the capital value of the annuity, *annual bonus* and *interim bonus* on the above basis, subject to a minimum of nil (for deferred annuity policies) or the value (for other policies). The capital value takes into account any element taken as cash.

- The cost of any *interim bonus* on transfer is the capital value, at the selected retirement age using the above basis, of any *interim bonus* added, discounted using the above basis and the cost of any *final bonus* is the capital value, at the selected retirement age using the transfer basis, of the *final bonus* added (for deferred annuity policies) or the value (for other policies).

(c) Group deferred annuity and group cash business

- The cost of bonus is the cash value of the *annual bonus* added.

(d) With-profits annuity

- The cost of bonus is the capital value of the *annual bonus* added and the value of the additional bonus for the next policy year on the published valuation basis, but using a risk free discount rate.

12.14.6 Although the fund is no longer actively seeking new business, new business may arise from the exercising of policy options, including payment of additional premiums. For some minor classes, the new or additional benefits are on fixed terms which are onerous and where future bonuses are added, then any associated shareholder transfer would add to the strain.

12.14.7 Where distributions to policyholders are made in anticipation of a surplus arising, these only contribute to the cost of bonus at the next actuarial investigation and only generate an allocation to shareholders at that time.

12.14.8 The tax charged to the fund is on a standalone mutual company basis and the Non-Profit Fund bears any difference between the tax charged to the fund and any tax Phoenix Life Limited incurs as a result of the fund. In particular any tax associated with the distribution of profits from the fund to the shareholders, is borne by the Non-Profit Fund.

13 Principles and Practices – SPI With-Profits Fund

The Principles and Practices given in sections 13.4 to 13.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the SPI With-Profits Fund. Sections 13.1 to 13.3 give background information specific to the SPI With-Profits Fund. Subsequently in this section the use of the term ‘the fund’ generally means the SPI With-Profits Fund.

13.1 Fund History

The SPI With-Profits Fund comprises the business that was transferred to Phoenix Life Limited under the *2009 Scheme* from the SPI Fund and the Special Fund of Scottish Provident Limited.

Scottish Provident Institution’s origins date back to 1837. In 1995 the long-term business of Scottish Provident Assurance Limited, PFM Assurance Limited and Scottish Provident Managed Pension Funds Limited were transferred to the Scottish Provident Institution by way of a scheme. The Scottish Provident Institution demutualised on 1 August 2001 and transferred part of its business to the SPI Fund of Scottish Provident Limited. Scottish Provident Limited contained an Irish branch which included business sold in Ireland by the Scottish Provident Institution prior to the demutualisation in 2001.

From 2001 until 2006, Scottish Provident Limited was owned by Abbey National. In September 2006 Scottish Provident Limited was acquired by Resolution plc.

The Scottish Provident Limited SPI Fund closed to new business at the end of 2001.

The with-profits policies originally held within the Special Fund within Scottish Provident Limited were converted into non-profit policies with guaranteed benefits and transferred into the SPI With-Profits Fund as part of the *2009 Scheme*.

The key powers attributable to the Scottish Provident Limited SPI Fund Supervisory Committee were handed over to the *With-Profits Committee* under the *2009 Scheme* and remain in force under the *2023 Scheme*. For this fund the *With-Profits Committee* has the additional responsibility for setting the investment and bonus policy.

In 2022 policies sold in Ireland were transferred to PLAE, an Irish company within the Group, and immediately reinsured back into the SPI With-Profits Fund. Subsequently from 1 January 2025 these policies transferred from PLAE to SLIDAC, another company within the Group. They remain reinsured into the SPI With-Profits Fund. SLIDAC is responsible for paying claims under these policies. For as long as the reinsurance remains in force, amounts payable to SLIDAC on these policies under the reinsurance will continue to reflect participation in the SPI With-Profits Fund at the same level as before.

13.2 Types of Business

The with-profits business in the fund is split into different classes for the purposes of allocating *annual bonuses* and *final bonus*es as appropriate. The split primarily depends on:

- The type of product and the method by which it participates in profits, that is *traditional* with-profits business, *unitised* with-profits business and *deposit administration* business.
- The classification for tax purposes, that is life assurance business, general annuity business, pension business or overseas life assurance business.
- Whether the business is regular premium paying or single premium.

Traditional with-profits pension policies are split between Self-Employed Retirement Annuity and Personal Pension contracts (SEDA contracts) where the benefit available at the normal retirement date is in terms of an annuity and Individual and Executive Pension Arrangement policies (E-Type contracts) where the benefit available at the normal retirement date is in terms of a fund, with a guaranteed annuity option.

The *unitised* with-profits business arises from *unitised* policies in the Non-Profit Fund which have chosen this investment option.

The *deposit administration* business comprises Simplified Pension Investment Plan policies.

The fund includes both business issued in the UK and denominated in Sterling, and the reinsured business from SLIDAC which was issued as Irish branch business and is denominated in Euros.

13.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 13.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under with-profits policies is *asset share* calculations. The amounts payable will allow for a fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es.

The degree of approximation used in the application of these methods aims to be consistent with the overall fair treatment of all with-profits policyholders.

Asset share methodology and processes will be regularly reviewed by the *With-Profits Committee* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Policyholders have no entitlement to receive the *asset shares*, if any, used to determine the bonuses for their policies.

Different bonuses are declared for different classes of with-profits business, reflecting the different tax, type of with-profits business and product features. New bonus classes would be required if a new type of product were developed. An existing class would normally only be split in exceptional circumstances. Within classes, bonuses may be further differentiated by series.

Bonus policy can be affected by a variety of factors including the financial and solvency position of Phoenix Life Limited, the financial strength of the fund, the expected cost of guarantees, actual and expected investment returns and expenses, the likelihood of changes in the level of provisions and the constraints which increases in guaranteed benefits may place on the fund, particularly in relation to investment strategy. These factors, together with the aim to retain flexibility in the operation of the fund, constrain *annual* and *final bonus* declarations and the *smoothing* policy. These constraints also apply in changing economic conditions.

Bonuses can only be declared if there is surplus available for distribution or they are guaranteed.

Practices

***Asset Share* Methodology**

13.4.1 The basic method for *asset share* calculations for with-profits business uses actual investment returns net of tax and for expenses, mortality and morbidity benefits, the actual underlying experience for *traditional* with-profits business and *deposit administration* business and generally product charges for *unitised* with-profits business.

Asset shares are not smoothed. In particular the investment returns and experience elements contributing to *asset shares* are generally not smoothed, other than that inherent in the processes used in the derivation of the assumptions.

13.4.2 The following table describes the elements credited or charged to *asset shares* for *traditional* with-profits, *unitised* with-profits and *deposit administration* business.

Element		***Traditional* With-Profits Business**	***Unitised* With-Profits Business**	***Deposit Administration* Business**
(a)	Premiums	Premiums paid Note (a)	Premiums paid Note (a)	Premiums paid Note (a)
(b)	Investment return	Allocated return Note (b)	Allocated return Note (b)	Allocated return Note (b)
(c)	Investment expenses	Actual allocated Note (c)	Implicit in product charges	Actual allocated Note (c)
(d)	Initial expenses	Actual allocated Note (d)	Implicit in product charges	Actual allocated Note (d)
(e)	Renewal expenses	Actual allocated Note (e)	Product charges Note (e)	Actual allocated Note (e)
(f)	Other expenses	Actual allocated Note (f)	Not charged	Actual allocated Note (f)
(g)	Tax on investment return	Actual allocated Note (g)	Actual allocated Note (g)	Actual allocated Note (g)
(h)	Tax relief on expenses	Actual allocated Note (g)	Implicit in product charges	Actual allocated Note (g)
(i)	Mortality & morbidity costs	Experience Note (i)	Note (i)	Experience Note (i)
(j)	Early terminations	Not charged Note (j)	Not charged	Not charged
(k)	Paid-up policies	Not charged Note (k)	Not applicable	Not applicable
(l)	Partial and regular withdrawals	Not applicable	Charged Note (l)	Not applicable
(m)	Surrenders at *protected dates*	Not applicable	Note (m)	Note (m)
(n)	Annuity payments	Not applicable	Not applicable	Not applicable
(o)	Charges for the cost of guarantees	Note (o)	Note (o)	Note (o)
(p)	Charges for the cost of capital	Charged Note(p)	Not charged	Charged Note(p)
(q)	Distributions to shareholders	Not charged	Not applicable	Not applicable
(r)	Tax on distributions to shareholders	Not charged	Not applicable	Not applicable
(s)	Profit and losses from other business	Not charged	Not charged	Not charged
(t)	*Estate* distribution or charge	Note (t)	Note (t)	Note (t)
(u)	Exceptional items	Not applicable	Not applicable	Not applicable

The way in which the above items are taken into account is described in the notes below, together with how they vary by type of business. Where charged is used in the table above this means both charged and / or credited depending on whether it is a loss or profit.

Notes

(a) Premiums

Premiums paid under the policy. For *unitised* business, it is the premiums used to purchase units which are net of any premium related policy charges. These charges include any reduced, nil or enhanced allocation percentages, additional initial unit charges and a bid / offer spread.

(b) Investment return

The investment returns are based on separate notional ring-fenced assets. The split is between UK and Irish business with further splits between *deposit administration* business (Simplified Pension Investment Plan policies) and other business. The investment returns allocated to *asset shares* vary by type of policy as described in section 13.9. Further distinctions may be made for different classes and groups of policies if it were considered fair. In particular, the return from any assets bought specifically to cover guarantees may be reserved to meet the costs of these guarantees.

(c) Investment expenses

For *traditional* and *deposit administration* business, investment expenses are based on best estimate of the actual expense incurred prior to demutualisation, and are fixed subsequently at an effective monthly rate of 0.01166%.

(d) Initial expenses

No new business is written in the fund other than to honour policy options or if new members join a pension scheme insured by the fund.

Historic initial expenses are based on estimates of the typical costs for the year of entry.

Initial expenses for increments affected are detailed in the *2023 Scheme*. Those initial expenses detailed in the *2023 Scheme* include a standard provision that they are annually reviewable (in some cases specifically in line with increases in RPI plus 0.75%) and are limited to be within the range of 85% to 115% of actual expenses incurred.

(e) Renewal expenses

For *traditional* and *deposit administration* business, expenses are based on the actual costs incurred as set out in the *2023 Scheme*.

For *unitised* business the expenses are implicit in the product charges specified in the policy terms and conditions. However the product charges include an annual management charge of 1.0% per annum, but *asset shares* are only charged an annual management charge of 0.6% per annum for life policies and 0.85% per annum for pension policies.

Those renewal expenses detailed in the *2023 Scheme* include a standard provision that they are annually reviewable (in some cases specifically in line with increases in RPI plus 0.75%) and are limited to be within the range of 85% to 115% of actual expenses incurred.

(f) Other expenses

Any additional project costs will only be charged to *asset shares* following approval by the *With-Profits Committee*.

(g) Tax on investment return

Allowance for the relevant rate of tax on the respective investment classes is applied.

(h) Tax relief on expenses

Tax relief is available on some expenses.

(i) Mortality and morbidity costs

For *traditional* with-profits business, the charge is based on the underlying experience and is approximated by applying a percentage of a standard published mortality table. The percentage applied varies by calendar year and is based on the results of mortality investigations carried out from time to time.

For some *unitised* with-profits business, these costs are charged explicitly in the product charges on a monthly basis, based on the sum at risk, by cancelling units. Any profits or losses from the explicit charges not reflecting the actual underlying experience and costs are not credited to *asset shares*. For other *unitised* with-profits business, the costs are implicit in the product charges and no explicit monthly charge is applied.

For *deposit administration* business this includes amounts used to purchase individual pensions.

(j) Early terminations

Currently profits or losses on with-profits business surrendered early are applied to the fund as a whole and thus affect the *estate*. However, in future, the surrender profits or losses on with-profits business may be applied to the *asset share* by an addition to or deduction from the rate of investment return applied in the year in which the profit or loss arises or may be accumulated and applied at a later date.

(k) Paid-up policies

Any profits or losses arising from with-profits policies becoming paid-up are applied to the fund as a whole and follow the practice in note (j).

(l) Partial and regular withdrawals

These are reflected in *asset share* calculations only to the extent that part of the policy has been cancelled. Specifically no profits or losses resulting from partial or regular withdrawals are credited. The proportion of the policy withdrawn is reflected in both the underlying *asset share* and remaining policy values.

(m) Surrenders at *protected date*s

Where a guaranteed minimum surrender value is greater than would otherwise be quoted the resulting cost is treated as a profit or loss to the fund as a whole, and follows the practice in note (j).

(o) Charges for the cost of guarantees

This is the expected cost of meeting guaranteed benefits in excess of *asset share* for all with-profits business in the fund and the cost of meeting guaranteed annuity options on all business in the fund that are not hedged. The cost of guarantees can be charged to the *asset share* as a deduction from the rate of investment return applied in the year in which it arises.

The cost of the rebalancing the hedge asset to match the guarantees may be charged through an adjustment in the net investment return if no positive *estate* exists.

(p) Charges for the cost of capital

This is the charge for holding risk based capital which is currently zero. The cost of capital may be applied to the *asset share* as a deduction from the rate of investment return applied in the year in which it arises or it may be accumulated to be applied at a later date.

(t) *Estate* distribution or charge

Asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate*. However, these *estate* distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 13.12.

13.4.3 *Asset shares* are calculated for representative specimen policies when setting bonus rates and *surrender value* bases for *non-protected exits.* Specimen policies are used to represent the business and include a range of policy terms and years of entry. The primary emphasis in selecting specimen policies is the size of premium or sum assured. There is however a degree of averaging, particularly for those terms where there are relatively few policies.

13.4.4 *Asset share* models contain some approximations, but these approximations do not prejudice the overall fair treatment of with-profits policyholders. Whilst only minor approximations are employed in *asset share* calculations, no investigations are carried out on the level of approximation built into the resulting *asset shares*.

Policies that have been subject to alterations, including becoming paid-up, do not yield robust *asset share* calculations. For these policies, bonuses are based on those for an equivalent unaltered policy.

For *traditional* whole life policies, *final bonuses* and *surrender value* bases may be set with reference to those applicable for endowments.

13.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in section 13.12.

13.4.6 *Asset share* practices are documented.

Asset share and bonus policies are documented at a high level in various *With-Profits Committee* (and previously SPI Fund Supervisory Committee) reports and reports on *asset share* investigations that have been undertaken from time to time.

Detailed specifications relating to the *asset share* calculations and the bonus calculations only exist to a varying degree, but the coding within the models used in the processes are viewable and thus document the calculations.

Asset share assumptions are documented and this tends to include references to their source of derivation.

For each bonus review appropriate documentation is produced and provides an audit trail of the process, including sources of data, source and derivation of assumptions, backing calculations, notes and correspondence. This audit trail normally includes retaining electronic copies of the systems and calculations used for the review.

13.4.7 *Asset share* models, processes and documentation are subject to a continual process of development, improvement and refinement. Significant effects are reported to and considered by the *With-Profits Committee*.

13.4.8 *Asset share* practices are not guaranteed and may be changed in future. Historic *asset shares* were agreed at the time of demutualisation in 2001.

Asset share methodology and processes will be regularly reviewed by the *With-Profits Committee* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited.

Bonus Declarations

13.4.9 Bonus declarations are approved by the *With-Profits Committee* or sub-committee or delegated to senior management and then retrospectively approved.

13.4.10 For *traditional* with-profits business separate *annual bonus* scales are declared for the following classes:

- UK life *traditional* with-profits business
- UK SEDA pension *traditional* with-profits business
- UK E-Type pension *traditional* with-profits business
- Irish life *traditional* with-profits business
- Irish SEDA Pension *traditional* with-profits business
- Irish E-Type Pension *traditional* with-profits business

Separate *final bonus* scales are declared for the following *traditional* with-profits classes:

- UK life *traditional* with-profits
- UK E-Type *traditional* with-profits pension regular premium
- UK E-Type *traditional* with-profits pension single premium
- UK SEDA *traditional* with-profits pension regular premium
- UK SEDA *traditional* with-profits pension single premium
- Irish life *traditional* with-profits business (other than 10 year single premium bond)
- Irish E-Type *traditional* with-profits pension regular premium
- Irish E-Type *traditional* with-profits pension single premium
- Irish SEDA *traditional* with-profits pension regular premium
- Irish SEDA *traditional* with-profits pension single premium

There is also a '*maturity*' bonus on Irish SEDA *traditional* with-profits pension business. This acts as a second layer of *final bonus* and varies by age and sex.

For individual pension self-employed deferred annuity (SEDA) *traditional* with-profits deferred annuity policies the rate at which the annuity benefits can be commuted for a cash benefit (including any tax free lump sum) or an open market option is calculated to broadly reflect the fair value of the annuity benefits being given up, having regard to market interest rates and best estimate assumptions of mortality rates and forecast improvements. The commutation terms will normally be reviewed with the same frequency and at the same time as *final bonus* rates are reviewed.

For group pension E-Type *traditional* with-profits deferred annuity policies the rate at which the annuity benefits can be commuted for a cash benefit (including any tax free lump sum) or an open market option is calculated using the contractual cash factors written in the contract.

13.4.11 For *unitised* with-profits business:

Separate *annual bonus* scales are declared for the following classes of business:

- UK *unitised* with-profits life Series I
- UK *unitised* with-profits life Series II
- UK *unitised* with-profits pension Series I
- UK *unitised* with-profits pension Series II
- Irish *unitised* with-profits pension Series I
- Irish *unitised* with-profits pension Series II and Series III
- Irish *unitised* with-profits life Series.

Separate *final bonus* scales are declared for the following *unitised* with-profits classes:

- UK *unitised* with-profits life Series I
- UK *unitised* with-profits life Series II
- UK *unitised* with-profits pension Series I
- UK *unitised* with-profits pension Series II
- Irish *unitised* with-profits pension Series I
- Irish *unitised* with-profits pension Series II and Series III
- Irish *unitised* with-profits life Series.

13.4.12 For *deposit administration* business, separate *annual bonuses* are declared for each class of business:

- UK business, varying by tranche
- Irish business, varying by tranche

There is no *final bonus* applicable to *deposit administration* business.

13.4.13 For *traditional* with-profits business, *annual bonuses* are reviewed annually and are declared in arrears in January of the following year to which the bonus relates. *Final bonus*es are declared in advance and are reviewed at least twice a year, normally from 1 January and 1 July.

For *unitised* with-profits business, *annual bonus* rates are set in advance. The time for which they will apply is not fixed and they may be reviewed at any time. They will be reviewed at least once a year at the time of the *annual bonus* review for *traditional* with-profits business. *Final bonuses* are declared in advance and are reviewed at least twice a year, normally from 1 January and 1 July.

For *deposit administration* business, the *annual bonus* rates are declared once a year and apply to the policy anniversary following the calendar year just completed.

13.4.14 The timing of *final bonus* declarations may be varied.

13.4.15 *Final bonus*es and *annual bonuses* declared in advance are expected to, but are not guaranteed to apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. *Unitised* with-profits business *final bonuses* and *market value reductions* are particularly subject to more frequent reviews in response to investment market movements or where there has been, or is expected to be a high volume of surrenders. Otherwise, additional reviews would normally only be in response to more exceptional investment market movements.

13.4.16 *Final bonus* reviews also consider the amount of *final bonus* paid on *non-protected exits* (surrenders).

13.4.17 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared except where they are guaranteed.

Principle 13.5 ***Annual Bonus* Rates**

The aim is to set *annual bonuses* at a prudent level, balancing the benefit to policyholders of increased guarantees, the aim for an element of *final bonus*, the flexibility of the operation of the fund and its ability to ensure the guarantees can be met in future. *Annual bonuses* may increase or decrease from declaration to declaration and may also be nil. *Annual bonuses* can only be declared if there is sufficient surplus available or where they are guaranteed.

In cases where *final bonus* is not applicable, *smoothing* of the *annual bonus rates* is used as a mechanism to adhere to section 13.4 where applicable.

Practices

13.5.1 The *With-Profits Committee* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in the following paragraphs.

13.5.2 For each class of *traditional* with-profits and *unitised* with-profits business, other than those not eligible for *final bonus* (see 13.5.3), the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target. Some classes of *unitised* with-profits business have guaranteed *annual bonuses*:

- UK *unitised* with-profits life Series I has a guaranteed increase of 3% per annum in unit prices.
- UK and Irish *unitised* with-profits pension Series I have a guaranteed increase of 4% per annum for ordinary (or accumulation) units while initial (or capital) units are guaranteed to increase at a rate of 4% less their additional annual management charge.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

13.5.3 Where the financial position of the fund is weak the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* being above the 25% target.

13.5.4 For deposit administration business, *annual bonus* will be set at a level which, using realistic assumptions, will bring the projected *asset share* and the value of projected policy benefits broadly in line over a five year period. If at any time the fund is targeting payouts at a higher proportion of *asset share* than 100% on account of *distributable estate*, then this will be allowed for in the projected *asset share* used for this purpose of calculating *annual bonus* rates, and such *distributable estate* will therefore be gradually reflected in *payouts* over a five year period.

Annual bonuses are normally reviewed once a year. Changes in annual bonuses are limited to maintain a smooth progression.

Deposit administration business has guaranteed *annual bonuses*:

Year premiums paid	Guaranteed bonus rate (per annum)
1975 to 1977	6.00%
1978 to 1978	5.50%
1979 to 1982	6.00%
1983 to 1993	5.25%
1994 to May 1999	4.50%
June 1999 to Sep 2005	3.00%
Oct 2005 onwards	0.50%

13.5.5 The *asset share* comparisons are performed for representative specimen policies grouped according to the level at which different bonus rates are declared.

13.5.6 For *traditional* with-profits business, *annual bonus* rates are declared in arrears and are expressed as a percentage of the benefit payable. For *unitised* with-profits business, *annual bonus* rates are declared in advance and are applied daily as an increase in the unit price (but subject to any rounding in the unit price). For *deposit administration* business *annual bonus* rates are declared in arrears and are expressed as a percentage of the notional fund.

13.5.7 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

Principle 13.6	***Final Bonus* Rates**
	The aim is to set *final bonus* rates so that specimen policy *payouts* achieve a target *payout ratio*. These *final bonus* rates are then adjusted for *smoothing* as described in section 13.7. *Final bonus*es for a policy may increase or decrease from declaration to declaration and may also be nil. *Final bonus*es will be reviewed regularly, but can be reviewed at any time.

Practices

13.6.1 *Final bonus* is not applicable to *deposit administration* business and the rest of this section does not apply to this business.

13.6.2 The current long-term target *payout ratio* for maturing policies is 100% of *asset share*.

In this context *maturity* includes retirement at selected retirement age for pensions business and surrender or withdrawal at a *protected date* for *unitised* with-profits business. The guaranteed benefit of *traditional* with-profits pension business used in the comparisons is the capital value of the annuity and *annual bonuses* at retirement for SEDA policies and for E-Type policies it is the cash sum and *annual bonuses*.

13.6.3 The actual *payout ratio* for maturing policies at any one time will not necessarily be equal to the target portion due to:
- the level of accumulated guarantees; or
- the effects of *smoothing*.

13.6.4 *Final bonuses* are determined by comparing projected *asset shares* with the corresponding guaranteed benefits, together with any *interim bonus*, for maturities in the period under consideration. These projected *asset shares* allow for the actual experience to date and expected future experience, including expected future investment return. The *final bonuses* actually declared are based on these figures after adjusting for *smoothing* as described in section 13.7.

13.6.5 The projections supporting *final bonus* investigations are based on actual experience up to five months in advance of the start date of the declaration. The projections consider policies maturing during the calendar year in which the *final bonus* rates apply.

13.6.6 *Final bonus* declarations are also informed by comparisons of projected *asset shares* and corresponding projected benefits for maturities in subsequent *final bonus* periods and over the next couple of years.

13.6.7 The *asset share* comparisons are performed for representative specimen policies, grouped according to the level at which different bonus rates are declared. For *traditional* with-profits business, approximations such as interpolation and extrapolation, may be used to generate comprehensive *final bonus* scales.

13.6.8 For *traditional* with-profits business, *final bonus* rates are rounded and expressed as a percentage of the sum assured (annuity or cash sum) and *annual bonus* and are entry year dependent.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

13.6.9 For *unitised* with-profits business, *final bonus* rates are rounded and expressed as a percentage of the value of with-profits units. The *final bonus rates* depend on year of unit allocation and may also vary within year of unit allocation if investment returns have varied considerably over the year.

Rounding may mean that resulting *payout ratios* deviate slightly from the target.

13.6.10 *Final bonus* scales are determined by reference to maturing representative specimen policies.

For *traditional* with-profits life assurance business, the *final bonus* payable on a death claim (or terminal or critical illness claim, if applicable) is based on the *final bonus* rate for a policy maturing with the same entry year, for both endowments and whole life policies.

For *unitised* with-profits business, the *final bonus* scale applies to death claims (or terminal or critical illness claim, if applicable) as well.

13.6.11 *Final bonus*es are declared in advance and are made in anticipation of a surplus arising. *Final bonus*es can only be declared if there is an expectation of such surplus arising.

13.6.12 *Final bonus* reviews also consider the amount of *final bonus* for surrenders, including *market value reductions* for *unitised* with-profits business, based on section 13.8.

13.6.13 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on maturities may deviate from the target *payout ratios* during the period between reviews. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the *maturity payout ratios* at the latest *final bonus* review were near the top or bottom of the range described in paragraph 13.7.3, a lower level of investment return variance may lead to an additional *final bonus* review.

Principle 13.7	***Smoothing***
	The aim is to smooth with-profits policy *payouts* at *protected dates* to manage the *volatility* of with-profits policy *payouts*. The effect of *smoothing* may have a positive or negative effect on with-profits policy *payouts*. *Smoothing* leads to profits and losses which are anticipated to offset each other over time. In the short-term, if these profits or losses were to become excessive, then the *smoothing* policy would be reviewed. For all business except *traditional* with-profits business, the *non-protected exit* values will take account of day to day investment market movements and as a result may have a *market value reduction* applied. For *traditional* with-profits business, *non-protected exit* values will have a degree of *smoothing*.

Practices

13.7.1 For *deposit administration* business, the mechanism for setting *annual bonuses* rates as described in section 13.5 describes how *smoothing* applies to this business. The rest of this section does not apply to *deposit administration* business.

13.7.2 *Final* and *interim bonus*es are declared in advance and are expected but are not guaranteed to apply until the next planned review date. Additional reviews would normally only occur in response to exceptional adverse investment market movements. Thus with-profits policyholders leaving at *protected dates* are not impacted by day to day investment fluctuations. This forms part of the *smoothing* process.

13.7.3 *Final bonus* reviews take into account the current *maturity payout ratios* and the long-term target *payout ratio* per paragraph 13.6.2. The aim is to ultimately bring *maturity payout ratios* for representative specimen policies in line with the long-term target *payout ratio* in a smoothed manner based on the guidelines as described in paragraph 13.7.4. The target range for *payout ratios* is to be between 80% and 120% of *asset share* before the effects of *smoothing*.

In this context *maturity* includes retirement at selected retirement age for pensions business and surrender or withdrawal at a guarantee date for *unitised* with-profits business.

13.7.4 For *traditional* and *unitised* with-profits policies where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* and retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies with-profits policies, *surrender value* bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as term remaining which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values.*

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their *maturity* date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values and *surrender values*, any change to *payouts* that results from changes in the *distributable estate,* if any, will be additional to the limits described and will not be subject to *smoothing.* Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

13.7.5 The *smoothing* of *maturity* values from declaration to declaration primarily focuses on standard specimen policies. The effect on the aggregate position for maturities, incorporating all relevant business for the class of with-profits business and grouped according to the level at which different bonus rates are declared, is also considered. As *final bonus* rates are rounded, this may result in slight deviations from the target position.

13.7.6 In adverse conditions, where the level of guaranteed benefits exceeds the target proportion of the relevant *asset shares*, no *final bonus*es may be warranted. In this situation, the guaranteed benefits provide a floor for *maturity payouts*. This provides further protection against day to day investment fluctuations and may further limit movements in *maturity payouts* for similar policies, as a result of bonus declarations.

13.7.7 *Smoothing* leads to profits and losses which are anticipated to offset each other over time. Costs may arise under paragraph 13.7.6, but such costs are the cost of guarantees and not the cost of *smoothing*. The *smoothing* policy is not specifically constrained by a limit on the short-term profits and losses of *smoothing*, but should these become excessive, the *smoothing* policy may be revised. The total cost of *smoothing* over the shorter term should be kept small in relation to the size of the fund. The profits and losses from *smoothing* and costs from guarantees feed through to the *estate* and are effectively dealt with by principle 13.12 and its associated practices.

13.7.8 As the *final bonus* payable on life assurance business death claims (or terminal or critical illness claims, if applicable) is based on the *final bonus* scale for maturities, there is a similar element of *smoothing* operating on *payouts* for death claims.

13.7.9 For *unitised* with-profits business, *surrender values* will target a proportion of *asset share*, as described in section 13.8. *Surrender values* on *unitised* policies may be subject to the application of a *market value reduction*. *Market value reductions* are regularly reviewed, normally monthly and may be revised to reflect market movements between normal *final bonus* reviews. Also it is probable that during a period of adverse conditions, *unitised final bonuses* might be changed sooner and possibly also more frequently than might apply to the *traditional* business.

Principle 13.8	***Surrender Values*** The aim in setting *non-protected exit* values will be to minimise any adverse effect on the interests of continuing policyholders and subject to this, the aim is to set *non-protected exit* values so that *payouts* for specimen policies achieve a target *payout ratio*.

Practices

***Traditional* With-Profits Business**

13.8.1 For life business *non-protected exits* refer to *surrenders* and policies becoming paid-up. For pensions business *non-protected exits* refer to transfers, early and late retirements and policies becoming paid-up.

Surrender values are targeted in the long term at 100% of *asset share*. The target range for surrenders or transfers is 80% of *asset share* to 120% of *asset share* before the effects of *smoothing*.

13.8.2 The basis for the *surrender value* formulae is determined by targeting the target proportion of *asset share* for specimen policies.

13.8.3 Actual surrender payments on individual policies will not generally be in line with the target proportion because:

- Individual *asset shares* are not calculated or held on the administration systems for use in *surrender value* calculations. Rather *surrender values* are calculated in a variety of ways for different types of policy. Specimen policies are used to determine the parameters in the *surrender value* calculations. The outcome for a particular individual policy may be different from that of the specimen policy.
- There are a limited number of parameters that may be altered in the surrender formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.
- As the value of assets are changing every day but the parameters in the *surrender value* formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate.

13.8.4 In some cases, values in excess of *asset share* may be payable when policies are surrendered close to *maturity* and the *asset share* of the relevant specimen policy is less than the guaranteed benefits at *maturity,* or the *maturity payout* is in excess of the *asset share* due to *smoothing.* This may also occur if the value of the guaranteed benefits is high relative to *asset share*, due to the effective maximum discount rate used in the surrender bases.

13.8.5 Paid-up policy benefits are determined such that the paid-up policy benefits target similar *payout ratios* to surrenders. Paid-up policies continue to participate in profits.

13.8.6 Some policies have surrender and paid-up policy calculations specified in the policy conditions. These represent a minimum basis that is applied.

13.8.7 *Surrender value* and paid-up policy value bases will normally be reviewed once a year. However more frequent reviews might take place, in particular in response to significant investment market movements. *Surrender values* and paid-up policy values may also change more regularly following a review of *final bonus* rates.

13.8.8 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

***Unitised* With-Profits Business**

13.8.9 *Non-protected exits* refer to surrenders and withdrawals, other than those at a guarantee date, transfers, switches, early or late retirements and any excess regular withdrawals.

Surrender values are targeted in the long term at 100% of *asset share*. The target range for surrenders or transfers is 80% of *asset share* to 120% of *asset share*.

13.8.10 The resulting *surrender value* may be subject to withdrawal charges to cover any unrecovered initial costs or the administration costs of processing the surrender.

13.8.11 *Unitised* with-profits business paid-up policy values, are the with-profits units purchased to date and they continue to participate in profits.

13.8.12 *Surrender value* bases will normally be reviewed once a year, although *surrender values* may change more frequently following changes in *final bonuses* and *market value reductions*.

13.8.13 Due to fluctuations in the underlying assets and hence *asset shares*, the actual *payout ratio* on *surrender values* may deviate from the target *payout ratios* during the period between reviews.

***Deposit Administration* Business**

13.8.14 All *deposit administration* policies have been in force at least five years and the calculation of the *surrender value* is on a prescribed basis specified in the policy documentation.

Principle
13.9 Investment Strategy

The fund will take investment risk only to the extent that there is a high degree of certainty that the fund is sufficiently strong to absorb adverse experience. Within this constraint the primary objective of the strategy will be to achieve the best long-term investment return. The size and timing of guaranteed benefits and other liabilities determine the investment freedom and risk tolerance.

Investments will be spread over a number of asset classes and within these asset classes the actual holdings will normally be diversified and of an appropriate quality. Derivatives are normally only used for efficient portfolio management or to reduce investment risk.

The fund may hold assets which are *not normally traded*, but will not normally seek to increase its exposure to such type of assets.

The investment strategy will be reviewed regularly to ensure it remains appropriate.

Practices

13.9.1 These investments are managed by the *investment managers* in accordance with an investment mandate specified by the *With-Profits Committee*.

13.9.2 The investment assets are spread over a number of different asset classes, which may include:

- Approved fixed interest securities, such as British Government gilts and other government and supranational bonds
- Other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt
- Property
- Approved variable interest securities, such as British Government index-linked gilts
- Other variable interest securities, such as variable rate corporate bonds
- United Kingdom equity shares
- Overseas equity shares, such as European, United States of America, Japanese, Asia Pacific and emerging markets
- Loans secured by mortgage
- Cash, such as short term deposits and money market funds
- *Alternative assets* such as hedge funds
- Assets to hedge mis-match risk
- *Private equity*
- Derivatives.

The investments may be direct or via collective investment schemes such as unit trusts.

With the exception of property, *private equity*, loans secured by mortgages, some *alternative assets* and assets to hedge mis-match risk, investments are predominately listed and traded on a recognised stock exchange. Credit quality is controlled by investment guidelines.

The actual investments held are widely diversified within these asset classes.

The agreements with the *investment managers* set out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single company.
- The maximum amount that can be invested in any single asset class / industry sector / country.
- The maximum amount to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns. (These include restrictions in terms of credit quality, term / duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moody's).
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco

The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

13.9.3 The investment policy will be set with the objective of maximising the return to optimise the level of with-profits benefits, whilst protecting the *estate* and ensuring its smooth and equitable distribution taking account of the management actions and shareholder support available. The strategy will seek to control the risk that support will be required from shareholders to cover any Pillar 1 capital requirement.

Any external support to the fund will be provided as described in section 5.2.

13.9.4 Derivatives are currently used. They may also be used to implement policy decisions where this would be efficient portfolio management.

13.9.5 Where there is a significant mis-match between assets and liabilities, assets to hedge those risks may be purchased. This applies both to equity risk and to interest rate risk (for example with respect to the interest rate risk arising from guaranteed annuity options). The hedge assets may not be fully effective at covering the mis-match risk.

13.9.6 The introduction of any new asset class into the investment strategy will only occur following approval by the *With-Profits Committee*.

13.9.7 The fund may include assets that are *not normally traded*. There are no material holdings of assets that would not be normally traded and it is not expected that there will be any in future.

Any future assets which would *not normally* be traded will only be acquired following a review and approval by the *With-Profits Committee*. Any acquisition of such assets would be made after considering the run-off position of the fund, the management of the *estate* and the ultimate need at some future time to realise such assets.

13.9.8 There are different mixes of assets for UK and Irish business. The assets backing the UK business include a high proportion of investments denominated in Sterling, while those backing the Irish business include a high proportion of investments denominated in Euros.

Assets representing the estate of the SPI With-Profits Fund are mostly invested in fixed interest securities. However, if the estate is large in relation to the potential risks facing the fund, then part of the estate may be invested in growth investments in line with the asset mix for the asset shares.

The assets invested to back the cost of guarantees are mainly invested in hedging arrangements using financial instruments.

13.9.9 The proportion of equities, property and *alternative assets* within *asset shares* varies by type of policy, according to the overall level of guaranteed benefits for that type of policy.

For products with high levels of guarantees relative to *asset shares*, lower proportions of equity, property and *alternative assets* are held, and for products with low levels of guarantees relative to *asset shares*, higher proportions of equity, property and *alternative assets* are held. The target guideline ranges for the proportion to be invested in equities, property and *alternative assets* are shown in the table below.

Type of policy	Guideline range for the proportion to be invested in equities, commercial property and *alternative assets*
Traditional with-profits life endowment or whole of life policies	45% - 55%
Traditional with-profits pension policies	25% - 35%
Unitised with-profits pension policies with guaranteed minimum bonus rates	25% - 35%
Unitised with-profits pension policies with no guaranteed minimum bonus rate	60% - 70%
Unitised with-profits life policies	60% - 70%
Deposit Administration business	25% - 35%

The equity, property and *alternative assets* proportion may include *private equity* and *alternative assets* such as hedge funds. The balance of the asset shares is invested in fixed interest and cash. Fixed interest will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt.

From time to time the actual asset mix will be different from the guideline asset mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*.

13.9.10 If it is considered by the *With-Profits Committee* to be in the best interests of the policyholders, further hypothecation of the assets in the fund may be introduced. For example this may involve matching of non *asset share* liabilities more accurately, hypothecation of different equity-backing ratios to further classes or groups of policies or the hypothecation of fixed interest assets by *term remaining* within *asset shares* to reduce the volatility of policyholder returns near *maturity.*

13.9.11 The *With-Profits Committee* reviews the investment strategy taking account of a variety of considerations, including our approach to *responsible investment* at least once a year. However more frequent reviews might take place, in particular in response to adverse market movements or significant changes in the operating environment. The *With-Profits Committee* documents the investment strategy, provides investment ranges to the *investment managers* and monitors the position.

13.9.12 A fixed charge over some of the fund's assets has been provided to SLIDAC as security under the reassurance arrangement and, whilst these assets are held in separately identifiable accounts, this is not expected to impact the overall investment strategy of the fund.

Principle 13.10 Business Risks

The *Board* aims to manage its business in a prudent manner, having regard to both the risks and rewards of which it is aware. The *Board* will also have regard to the availability of suitable capital and the amount required in light of the risks being undertaken. Some business risks are outside the control of Phoenix Life Limited.

Risks determined by the *Board* to arise in connection with the insurance business of the fund are attributed to the fund. Costs and benefits are attributed in the same manner.

Unless specifically passed through to *asset share* calculations, the impact of business risks is borne by the *estate*. Thus with-profits policyholders are exposed through bonuses, following from sections 13.4 and 13.12, to the profits and losses of the fund.

Practices

13.10.1 There is no established formal monetary limit to the taking on of business risk by the fund but any such risk is expected to be small in relation to the overall size of the fund.

13.10.2 Risks taken on by the Scottish Provident Limited SPI Fund prior to its demutualisation, such as mis-selling will normally be deemed to have transferred to the fund and any associated costs may be charged to the fund. Following demutualisation, mis-selling risks do not fall to the fund and any associated costs will not to be charged to the fund.

Risks will be met by the fund where they are properly attributable to the fund in accordance with the principles underlying the *2023 Scheme* or such an attribution is fair and equitable, having regard to policyholders' reasonable expectation.

13.10.3 Infrastructure risks.

(a) As the unit charges under the management services agreements are subject to annual increases linked to movements in the Retail Prices Index (RPI), the fund is exposed to the risk of higher than expected inflation.

Costs associated with day to day administrative problems are borne by PGMS.

(b) The PGMS charges are currently VAT exempt. Phoenix Life Limited retains the risk of increase in charges due to changes in VAT rules, including any retrospective changes.

13.10.4 As the fund is running off, there is a risk that the fixed costs will not be reduced in line with the reducing policy volumes. This is substantially mitigated by agreements for the provision of administration services, but this risk has not been entirely eliminated.

The current management services agreement with PGMS is a perpetual agreement.

Currently the costs charged to the fund are detailed in the *2023 Scheme* and are based on charges agreed following demutualisation. The Non-Profit Fund bears any difference between the PGMS charges and the expenses charged to the fund.

The renewal and initial expenses charged to the fund will continue to inflate but are limited to a maximum of 115% and a minimum of 85% of actual expenses incurred in the year by Phoenix Life Limited in respect of the fund's business.

13.10.5 In the event of failure by PGMS, substantial costs would be incurred in securing an alternative supplier, especially as PGMS and / or its sub-contractors own the infrastructure assets. To monitor this risk the financial viability of PGMS is regularly monitored. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund, and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

13.10.6 The fund contains non-profit business and the profits or losses arising in respect of this business fall to the fund.

13.10.7 There are no material reassurance treaties applicable to the fund which would have a material impact in the event of the reassurer failing. Future new reassurance or similar arrangements (where the fund would be exposed to the failure of the reassurer) will only be entered into to reduce the risk within the business and where they are cost or benefit justified.

13.10.8 Mortality and persistency experience may impact *asset shares* or charges directly, but can also have an indirect effect, such as causing the level of expense charges to vary, other than the service level charges from PGMS. Experience is regularly investigated. The potential impact of variations in experience is also considered.

13.10.9 Although the fund is no longer actively seeking new business, there remains some risk in respect of any new business arising and from the exercising of policy options. For some minor classes, the new or additional benefits are on fixed terms which are onerous.

13.10.10 Investment management services are provided to the fund by the *investment managers*. Failures at the *investment managers* might result in losses or costs to the fund, either through losses in the investments being managed or in securing an alternative supplier.

13.10.11 Within any notionally segregated portfolio there is pooling across all categories of policy, except that within the *traditional* pensions classes different bonus series may be treated separately. If costs cannot reasonably be borne within the class they may be charged initially to the *estate* and hence, indirectly, to other classes.

13.10.12 Other business risks which potentially impact the fund and the amounts payable under with-profits policies are explicitly or implicitly covered under the other principles and their associated practices, but are summarised here as follows:

- Solvency risks
- Investment risks
- Expense and charges risks
- Mortality and morbidity risks
- Persistency risks
- Taxation risks
- Guarantee risks
- Regulatory risks
- Bonus declaration risks
- Operational risks including failure of third party service providers, including third party administrators and reassurers
- *Estate* management and distribution risks

13.10.13 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

13.10.14 Risks undertaken by the fund are approved by the *Board*. They consider the scale of such risks and the cost / benefit justification, having regard to the availability of suitable capital and the amount required in light of the risks being undertaken. They also aim to ensure that risks are undertaken which are, in their opinion, to the advantage of with-profits policyholders.

The *With-Profits Committee* approves to what extent these risks pass to *asset shares*. The balance of these risks feed through to the *estate*. The profits and losses from risks which pass to *asset shares* affect the amounts payable under with-profits policies. The profits and losses from risks that feed through to the *estate* only indirectly affect the amounts payable under with-profits policies, as part of any distribution of or charge to the *estate* as described in section 13.12.

13.10.15 Business risks are regularly monitored and they form part of the key insurance risk and operational risk management processes. The risk based capital requirements are assessed with regard to the business risks being undertaken.

Business risks attributed to the fund are reviewed at least once a year by the *With-Profits Committee*.

Principle
13.11 Expenses and Charges

Policies will either be charged product charges or be charged amounts which represent a fair share of the actual costs or a sub-set of the actual costs.

This approach will be adjusted where necessary in order to continue to treat customers fairly.

Product charges may be either explicit or implicit.

Where actual costs are used and where costs are specific to a policy or policy class, then taking into account the approximations referred to in section 13.4, such costs will be taken into account in assessing the bonuses added to that policy or class and in assessing the early termination value payable. Where costs are not specific to a policy or class, they will be apportioned across the policies or classes to which they are relevant in a reasonable manner.

Practices

13.11.1 For *traditional* with-profits business and *deposit administration* business the costs charged to the fund are the actual costs incurred, but subject to adjustment in accordance with the provisions of the 2023 Scheme. For *unitised* with-profits business the fund is charged an annual management charge of 1% of the value of the units.

13.11.2 The investment expenses, initial and renewal expenses are detailed in the *2023 Scheme*. Any difference between the PGMS charges in respect of the fund and those specified under the *2023 Scheme* are borne by or credited to the Non-Profit Fund.

13.11.3 For *unitised* with-profits business the fund pays the Non-Profit Fund 1% of the value of the units, after allowing for any applicable final bonus or market value reductions, and the expenses are met by the Non–Profit Fund. However, the implicit annual management charge taken into account in determining *asset shares* is 0.60% in respect of life units and 0.85% in respect of pensions units. To the extent that the explicit charge exceeds the implicit charge, the balance falls to the *estate.*

13.11.4 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

The renewal and initial expenses charged to the fund will continue to inflate but are limited to a maximum of 115% and a minimum of 85% of actual expenses incurred in the year by Phoenix Life Limited in respect of the fund's business.

13.11.5 Were an adverse change to the external fiscal or regulatory environment to occur, then action would be taken to reflect this within the charges and expenses, subject to the provisions of the *2023 Scheme*.

Principle 13.12	***Estate* Management** The *estate* should lie in a target range. If the *estate* falls outside the target range then either the target *payout ratio* (in section 13.6) will be changed or *asset shares* (in section 13.4) will be adjusted, to maintain the *estate* within the target range where possible.

Practices

13.12.1 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

13.12.2 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 13.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

13.12.3 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;

(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;

(c) meet any costs which are charged directly to the *estate* rather than to *asset shares*;

(d) meet the costs of any changes which the *With-Profits Committee* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and

(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* always aiming to retain sufficient *estate* to meet the expected amounts for (a), (b), (c) and (d). The amount considered by the *With-Profits Committee* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

13.12.4 Any enhancement in benefits on account of the *distributable estate* referred to in 13.12.3(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate*.

13.12.5 The amount of the *estate,* the *distributable estate* and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

13.12.6 In the event of a risk of the assets in the fund being insufficient to cover the liabilities, charges may be made to the *asset shares* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

13.12.7 In the event of the assets in the fund being insufficient to cover the liabilities, the following management actions will take place:

(a) Any future planned enhancements to *asset shares* will be removed.

(b) If step (a) is insufficient to remove the deficit and restore an *estate* of at least 0.5% of aggregate *asset shares*, any past *asset share* enhancements will be removed.

(c) If steps (a) and (b) are insufficient to remove the deficit and restore an *estate* of at least 0.5% of aggregate *asset shares*, *asset shares* will be reduced or charges will be applied to *asset shares* up to the level of:

- the maximum amount charged to *asset shares* in one year will be 1.0% of *asset shares;* and
- the cumulative charges made to *asset shares* for any given policy where policyholders have to bear all the costs will be limited to 5.0%.

(d) If steps (a) through to (c) have proved to be insufficient to remove the deficit and restore an *estate* of at least 0.5% of aggregate *asset shares*, an internal loan will be provided by the Non-Profit Fund or the *Shareholder Fund* under the terms of the arrangements described in paragraph 5.2.5.

In determining the action to be taken, the *With-Profits Committee* will have regard to treating customers fairly, past practices and discussions with the *regulator*.

Realistic surpluses arising in a subsequent period will be applied in the reverse order to these general principles except that there is no cap to future *asset share* enhancements in the event of favourable conditions.

13.12.8 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 13.12.6 and 13.12.7 be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the Non-Profit Fund or the *Shareholder Fund* will be made whenever emerging surplus in the fund permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *With-Profits Committee* will disregard any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle
13.13 New Business

The fund is no longer actively seeking new business. Policy options under existing contracts to effect new policies are honoured.

Practices

13.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts. Some existing group policies for pension schemes also contain rights to add increments for existing members and rights to add new members.

Currently there are no plans to reopen the fund to new business. The ability of the fund to reopen is constrained by the *2023 Scheme*.

Principle
13.14 Equity Between the Fund and Shareholders

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arms length commercial basis.

Shareholders receive no more than one ninth of the cost of bonuses distributed to policyholders of *traditional* with-profits policies and receive the charges on *unitised* with-profits business, as laid down in the *2023 Scheme*. Any change to the one ninth limit would require the agreement of the *Board* and would be subject to approval by our *regulator* and the High Court.

Practices

13.14.1 The following services are provided to the fund:
- administration services by PGMS; and
- product provision (annuity products) by the Non-Profit Fund.

13.14.2 Shareholders will only provide services to the fund on commercial terms which would require an adequate return for the risks involved in providing the services. The profit margin for shareholders is acceptable to the fund if:
- the cost for the fund is consistent with the terms available from other providers; or
- the profit margin is consistent with the risks borne and there are reasonably foreseeable circumstances in which the shareholder could make a loss.

13.14.3 The allocation of profits between policyholders and shareholders is laid down in the *2023 Scheme* which states that not less than 90% of the surplus being distributed from the fund in respect of *traditional* with-profits policies is allocated to *traditional* with-profits policyholders. Current practice is to distribute exactly 90% of such surplus to policyholders, leaving the remaining 10%, being one ninth of the cost of bonus, to be transferred to shareholders. For *unitised* with-profits business and *deposit administration* business the shareholder does not receive any share of the surplus distributed.

The division of profits between with-profits policyholders and shareholders does not change as a result of changes in the underlying basis used to determine the cost of bonus as described in paragraph 13.14.5. The transfer to shareholders remains one ninth of the cost of bonus for *traditional* with-profits policies as determined in accordance with the underlying basis.

On *unitised* with-profits business, the shareholder receives the product charges.

13.14.4 The shareholder transfer associated with the distribution of profits from the fund can only take place following the published annual actuarial investigation of the long-term business of Phoenix Life Limited carried out in accordance with the requirements of the Financial Services and Markets Act 2000 (or equivalent subsequent legislation). The *Board* is responsible for the distribution of profits and no transfer to shareholders can take place without its authority.

13.14.5 For all *traditional* with-profits business, the cost of bonus is the increase in the liabilities using a risk free discount rate (net of tax as appropriate), as a result of the bonus declaration together with cost of bonus paid on claims since the previous actuarial investigation as follows:

(a) Life assurance *traditional* with-profits business

- The cost of *annual bonus* is the value of any *annual bonus* added, discounted using the above basis.

- The cost of *final bonus* is the value of any *final bonus* paid on death or *maturity* or where applicable terminal or serious illness. The cost of any *interim bonus* paid on such claims is the value of the *interim bonus* added, discounted using the above basis.

- The cost of *interim bonus* on surrender is the value of that bonus discounted using the above basis and the cost of *final bonus* is the value of the *final bonus* element of the *surrender value*.

(b) Pensions *traditional* with-profits business

- The cost of *annual bonus* is the value of the *annual bonus* added (for E-Type policies) or the capital value of *annual bonus* added at the selected retirement age using the above basis (for SEDA policies), discounted using the above basis.

- The cost of any *interim bonus* paid on retirement is the value of *interim bonus* paid at the retirement date (for E-Type policies) or the capital value of *interim bonus* paid at the retirement date using the above basis (for SEDA policies).

- On retirement the cost of *final bonus* is the value of *final bonus* paid (for E-Type policies) or the excess of the capital value of the annuity, *annual* bonus, *interim bonus* and *final bonus* on the commencement basis compared to the capital value of the annuity, *annual bonus* and *interim bonus* on the above basis, subject to a minimum of nil (for SEDA policies).

- The cost of any *interim bonus* on transfer is the value, at the selected retirement date, of *interim bonus* paid, discounted using the above basis (for E-Type policies) or the capital value, at the selected retirement age, using the above basis, of any *interim bonus* added on transfer, discounted using the above basis (for SEDA policies). The cost of any *final bonus* on transfer is the value of *final bonus* paid on transfer (for E-Type policies) or the capital value of *final bonus* added using the transfer basis (for SEDA policies).

13.14.6 Although the fund is no longer actively seeking new business, new business may arise from the exercising of policy options, including payment of additional premiums. For some minor classes, the new or additional benefits are on fixed terms which are onerous and where future bonuses are added, then any associated shareholder transfer would add to the strain.

13.14.7 Where distributions to policyholders are made in anticipation of a surplus arising, these only contribute to the cost of bonus at the next actuarial investigation and only generate an allocation to shareholders at that time.

13.14.8 The tax charged to the fund is based on the fund being a standalone mutual company and the Non-Profit Fund bears any difference between the tax charged to the fund and any tax Phoenix Life Limited incurs as a result of the fund. In particular any tax associated with the distribution of profits from the fund to the shareholders is borne by the Non-Profit Fund.

14 Principles and Practices – SAL With-Profits Fund

The Principles and Practices given in sections 14.4 to 14.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the SAL With-Profits Fund. Sections 14.1 to 14.3 give background information specific to the SAL With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the SAL With-Profits Fund.

14.1 Fund History

The SAL With-Profits Fund comprises the business that was transferred into Phoenix Life Limited from the long-term business fund of Phoenix & London Assurance Limited (PALAL) under the *2011 Scheme*.

Phoenix & London Assurance Limited was previously named Sun Alliance and London Assurance Company Limited and was part of the Royal & Sun Alliance group of companies.

In September 2004, Resolution Life Group Limited bought the UK life operations of Royal & Sun Alliance and subsequently rebranded policies to Phoenix.

Phoenix & London Assurance Limited closed to new business in 2002, although it has continued to issue policies under options on existing policies, including the acceptance of new members to existing pension arrangements and the issue of immediate annuities in respect of vesting pensions.

On 31 December 2009, a scheme of arrangement under Part 26 of the Companies Act 2006 (the *2009 PALAL Scheme*) became effective. Under its terms, certain with-profits pension policyholders gave up their option to convert their maturity value into an annuity on guaranteed rates in exchange for an immediate increase to the value of their policy and a change to the underlying investment practices for their policy. These polices are referred to as *2009 PALAL Scheme* policies. The same principles and practices apply to these policies as to other policies except where indicated. In some cases, only parts of a policy were subject to the *2009 PALAL Scheme*. Where this is the case, the different principles and practices apply only to those parts.

14.2 Types of Business

The with-profits contracts in the fund mainly fall into the following categories:
- *traditional* endowments and whole life policies
- *traditional* pension policies funding for cash or a pension
- *unitised* with-profits single premium whole life bonds
- *unitised* with-profits regular premium life policies
- *unitised* with-profits pension policies
- final salary *unitised* with-profits group pension policies

The final salary *unitised* with-profits group pension policies arose from:
- final salary pension schemes which had a Growth Fund policy with Phoenix Assurance Limited prior to 1996 and subsequently transferred to Sun Alliance and London Assurance Company Limited; or
- Retirement Plan policies issued by Sun Alliance and London Assurance Company Limited prior to 1996 which were subsequently converted to a Group Unitised With Profits Pension investment.

14.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle
14.4 Amounts Payable Under a With-Profits Policy

The aim of the methods employed in determining the amounts payable under a with-profits policy is the fair treatment of all with-profits policyholders consistent with the guiding principles.

The main guide used for determining the amounts payable under with-profits policies is *asset share* calculations which are carried out for certain specimen policies. The amounts payable will allow for a fair share of any surplus distributed, which may be in the form of *annual* or *final bonus*es.

In putting into practice the aims set out in the guiding principles and in the application of our with-profits principles generally, we apply various degrees of approximation in a number of different areas, the major ones being described in paragraph 14.4.4. The *Board* endeavours to ensure that these approximations:

- are applied consistently;
- have a broadly neutral effect between policyholder and *shareholder* interests;
- where appropriate, have a broadly neutral effect over time (that is between one generation of policyholders and another); and
- for the larger classes of business, are of broadly neutral effect within that class.

This may mean that for some smaller classes of business, a different result would result if less approximate methods were used.

The *Board* controls the changes to the methods we use to determine the amounts payable under a with-profits policy by:

- requesting and considering the advice of the *Chief Actuary*, of the *With-Profits Actuary* and the opinion of the *With-Profits Committee* before making any changes;
- assigning to the *Chief Actuary* the executive responsibility to continue to apply the currently agreed methods until advised differently; and
- following legal or regulatory requirements to obtain independent expert input where necessary.

The *Board* might change any assumptions used in previous years (such as investment returns, charges, allocations of miscellaneous profits and losses) relevant to the methods we use to meet our aims at any time:

- should they be shown to have been incorrect; or
- should legal or regulatory change render it necessary to do so; or
- if their continued application unchanged could put at risk the achievement of our aims as set out in the guiding principles in section 5.

Practices

***Asset Share* Methodology**

14.4.1 The basic method for *asset share* calculations for with-profits business in the fund uses an apportionment of actual investment returns net of tax and the actual underlying experience.

Asset shares are generally not smoothed. In particular the investment returns and experience elements contributing to *asset shares* are generally not smoothed, other than that inherent in the processes used in the derivation of the assumptions or in respect of large profits and losses from other business per paragraph 14.4.2(s).

14.4.2 The following table describes the elements currently credited or charged to *asset shares* for specimen policies.

Element		Description of Allowance
(a)	Premiums	Premiums paid under the policy
(b)	Investment return	Allocated return – note (b)
(c)	Investment expenses	Actual allocated – note (c)
(d)	Initial expenses	Actual allocated – note (d)
(e)	Renewal expenses	Actual allocated – note (e)
(f)	Other expenses	Actual allocated – note (f)
(g)	Tax on investment return	Actual allocated – note (g)
(h)	Tax relief on expenses	Actual allocated – note (h)
(i)	Mortality & morbidity costs	Based on underlying experience – note (i)
(j)	Early terminations	Note (j)
(k)	Paid-up policies	No profits or losses are credited
(l)	Partial and regular withdrawals	No profits or losses are credited other than as described in note (o) below
(m)	Surrenders at *protected dates*	No profits or losses are credited
(n)	Annuity payments	Not applicable
(o)	Charges for the cost of guarantees	Charged – note (o)
(p)	Charges for the cost of capital	See note (p)
(q)	Distributions to shareholders	Actual incurred – note (q)
(r)	Tax on distributions to shareholders	Not charged
(s)	Profit and losses from other business	Profits or losses are credited – note (s)
(t)	*Estate* distribution or charge	Distributions from or charges to the *estate* as determined - note (t)
(u)	Exceptional items	Enhancement for surrender of options or guarantees – note (u)

The way in which the above items are taken into account is described in the notes below.

Not all the above items may necessarily apply or have applied at all times for all types of policy. Different practices, often more approximate, may have been used in the past and the practice is generally to continue to use the results of these practices when determining the effect of those years on the *asset share* of specimen policies.

Notes

(b) Investment return

Each year the total return, income and capital gains / losses, made on the assets of the fund is determined. For equity shares and property (growth investments as described in section 14.9, as appropriate), this is done in aggregate. For fixed interest securities, the returns are sub-divided according to the time to redemption of the security.

The investment strategy currently adopted is described in section 14.9. In accordance with this, generally different proportions of each type of asset are notionally attributed to the specimen with-profits policies depending upon a number of factors, in particular:
- the *term remaining*,
- the anticipated relative size of the guaranteed benefits and the *asset share* at such a date, and
- whether or not the policy was subject to the *2009 PALAL Scheme*.

The return attributed to each specimen policy is then the weighted average return from each asset type using those proportions. Generally, the return on fixed interest securities (that do not form part of the growth investments described in section 14.9, as appropriate) will be that of the subclass of such securities issued by the UK government with a duration which matches most closely the *term remaining* of the specimen policy. For policies subject to the *2009 PALAL Scheme*, the return will be an average of the returns from the subclasses which match the cashflow of the annuity which could be purchased with the maturity value of the specimen policy.

For with-profits bonds and *unitised* with-profits pension policies without guaranteed annuity rates, the *term remaining* is adjusted as described in paragraph 14.9.10.

For *unitised* with-profits life regular premium policies, the same asset mix applies to all specimen policies. Also the same fixed interest return applies to all specimen policies and there is no differentiation by *term remaining*.

For final salary *unitised* with-profits group pension policies, the same asset mix applies to all specimen policies. Also the same fixed interest return applies to all specimen policies and there is no differentiation by *term remaining*.

Any difference in return between UK government fixed interest securities and the other fixed interest securities within the *asset share* is applied as a uniform percentage adjustment across the fixed interest part of the *asset shares* of all policies, irrespective of the *term remaining*.

The return on some types of asset, particularly derivative securities, may be attributed to the class of policy, if any, in respect of which they are deemed to have been purchased.

The ratio of overseas equities to UK equities is generally the same for all specimen policies. The ratio of UK government to other fixed interest securities is generally the same for all specimen policies. The exception is the business which transfers some of its risks to the Phoenix Life Limited Phoenix With-Profits Fund and this may have different ratios.

For some types of business as described in section 14.9.6 which transfer some or all of their risks to the Phoenix With-Profits Fund, the investment return credited to *asset shares* is based on the investment return of the Phoenix With-Profits Fund using the equivalent practices described above.

Different, more approximate, methods have been used in the past to determine the return to attribute for a particular year to specimen policies. Our practice is to continue to use these returns in the calculation of the *asset share* of those specimen policies.

(c) Investment expenses

Actual investment expenses are charged based on those allocated to the fund in accordance with section 14.11.

The investment expenses are expressed as a percentage charge to be applied to the assets.

(d) Initial expenses

Initial expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 14.11. Commission is also payable to intermediaries on some contracts.

In the past, a proportion of sales expenses for some policy classes have been met from the excess assets in the with-profits fund and so that the proportion is not taken into account when calculating the *asset share* of specimen policies of those classes.

(e) Renewal expenses

Renewal expenses are based on PGMS charges and an uplift to cover direct costs. These are all per policy expenses, allocated in accordance with sections 5.2 and 14.11.

For those policy classes where there is an explicit policy fee or other charge collected by cancellation of units or other reduction in benefits, only the expenses not covered by these fees or charges, if any, are apportioned to the *asset shares* of the specimen policies for these classes.

For final salary *unitised* with-profits group pension policies a charge for expenses is made each year which is expressed as a proportion of the bonuses added in that year. To the extent that this charge, plus the explicit policy fees or other charges are different from the actual expenses incurred for this business, the difference will increase or reduce the excess assets in the fund.

(f) Other expenses

The cost of compensation to with-profits policyholders provided with incorrect advice has not been deducted from *asset share* calculations for specimen policies.

Compensation costs in respect of unit-linked policies issued by the company but which fully transferred their risk into another fund within Phoenix Life Limited, have been met by that fund.

Project and other one-off expenses incurred are included in the actual renewal expenses charged to *asset shares*.

The historic costs of establishing policy administration outsource arrangements over the period 2003 to 2005 was spread over a five year period.

Significant future project, additional activity and other one-off costs will only be charged to *asset shares* following approval by the *Board*.

(g) Tax on investment return

The tax charged to classes of policy subject to tax is calculated by applying the current rates applicable to life insurance companies in respect of income attributable to policyholders to the different elements of the investment return. Approximate allowance is made for any deferment in tax payment, particularly in respect of tax on unrealised capital gains (which is charged at a discounted rate to reflect the average expected period until it is payable). If the actual tax incurred differs from the total calculated in this way, the difference will increase or reduce the excess assets in the with-profits fund.

(h) Tax relief on expenses

Tax relief due on the actual expenses charged is allowed for in those classes of business that are subject to tax. Where the tax relief in respect of expenses is deferred this is allowed for in an approximate manner. The rates of tax relief are the average rates applicable.

(i) Mortality and morbidity costs

Amounts to cover the cost of payments in excess of *asset share* on death or illness are deducted.

Where a policy class is designed to pay a benefit on death or illness which exceeds *asset share* at that time, and where no explicit charge for benefit is applicable, an annual charge is made to cover the cost of making those enhanced payments.

Most *unitised* with-profits policies are subject to an explicit charge for such costs. Any differences between the aggregate cost deducted and the total enhancements to payment will increase or reduce the excess assets of the with-profits fund.

For other policies, the estimated annual cost of providing such benefits is determined periodically from an analysis of recent actual mortality and illness rates experienced by policyholders and / or from insurance industry and national statistics. These costs are expressed as rates dependent upon various factors including age.

The charge on each specimen policy in each year is then determined by applying the appropriate rate to the current difference between the benefit payable on death or illness and the *asset share*.

Some pension policies provide either no benefit at all on death or only a return of premiums paid, with or without interest. For the specimen policies representing such classes, a credit to *asset share* is calculated using similar principles.

(j) Early terminations

It is not the current practice to attribute to the *asset share* of specimen policies any differences between the amount paid on the early termination of with-profits policies and their estimated *asset share*.

Prior to 2002, profits from this source were credited to the *asset share* of specimen policies and we continue to take those past profits, expressed each year as an addition to the investment return, into account in the calculation of the *asset share* for specimen policies. However, no such allocations are made to final salary *unitised* with-profits group pension policies.

(o) Charges for the cost of guarantees

The costs of meeting guarantees in the fund are periodically assessed. No charges for guarantees are currently being made.

For policies subject to the 2009 PALAL Scheme, charges to *asset shares* in respect of guarantee costs will not be applied unless in the opinion of the *Board,* the *With-Profits Committee* and the *With-Profits Actuary*, and with the agreement of the *regulator*, it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles and Principle 14.4.

For other policies guarantee charges may be applied. Some charges were applied in the past but these were refunded in 2017. Should the assets of the fund be insufficient to cover the liabilities these past charges will be re-applied to the extent required to enable the liabilities to be covered. Should the re-application of these past charges be insufficient to cover the liabilities then, to the extent this is due to guarantee costs, a further annual charge may be applied. This will normally be limited to 1.5% of asset share per annum.

The exception to the above is incremental premiums on certain Section 226 pension policies not subject to the *2009 PALAL Scheme*. These are the only contracts on which the benefits arising from new incremental premiums have an attaching guaranteed annuity option. For these policies, the *asset share* for the incremental benefit is charged with the full expected cost at the date the increment commenced of providing the guaranteed annuity option on that increment.

(p) Charges for the cost of capital

A reinsurance arrangement was in force between May 2000 and August 2003, the effect of which was to reduce the total capital which the company was required to hold. The premium payable to the reinsurer was, between January 2002 and August 2003, deducted from the *asset shares* of all classes of specimen policy, other than final salary *unitised* with-profits group pension policies. For the earlier part of the period in force, the premium reduced the excess assets of the with-profits fund.

From time to time, one or more loan agreements may be in place in accordance with section 5.2. Further details may be found in section 14.12. Interest at a commercial rate will be payable on such loans. Where part of such a loan is required to eliminate a deficit in the fund, then the interest payable on that part of the loan is not currently charged to *asset shares*. Where part of such a loan is not required to cover a deficit, then a deduction is currently made from *asset shares* to reflect the excess of the interest payable on that part of the loan above the return achieved by the fund from investing that part of the loan. Prior to 2005 the whole of any interest incurred on loans to the with-profits fund was deducted in *asset share* calculations.

No charge is currently made to the fund for the capital that it is necessary to retain in the Non-Profit Fund and *Shareholder Fund* in order that Phoenix Life Limited continues to have adequate capital in accordance with paragraph 5.2.6.

The *asset shares* of specimen policies do not receive any credit for the return earned on excess assets held within the fund.

No charges for cost of capital are applied for final salary *unitised* with-profits group pension policies.

No charge for any cost of capital arising after 31 December 2009 will be deducted from the *asset shares* of specimen policies used to determine the benefits of policies subject to the *2009 PALAL Scheme*. Moreover, in respect of 2010 and subsequent years, the effect of the deduction of cost of capital charges from the specimen policies used to determine the benefits of policies not subject to the *2009 PALAL Scheme* will be no more than had the *2009 PALAL Scheme* not been implemented. This practice may only be changed with the agreement of the *regulator*.

(q) Distributions to shareholders

The cost of distributions to shareholders resulting from the cost of bonus allocated to policies is charged to *asset shares*.

(s) Other business profit or losses

It is the current practice to attribute to the *asset share* of most specimen policies in most classes any other business profits or losses arising in a year, other than the costs of any compensation payable as a result of policies mis-sold or as described in sections 14.4.2(f), 14.4.2(j) and 14.4.2(o), expressed each year as an addition or reduction to the investment return.

Some larger business profits or losses may be spread over a number of future years.

No profits or losses are charged to final salary *unitised* with-profits group pension policies.

These practices may be changed if the *Board* consider it necessary to do so to enable the fund to meet the objectives set out in Principle 14.4.

In respect of 2010 and subsequent years, only those business profits or losses arising from policies subject to the *2009 PALAL Scheme* will be attributed (and only attributed) to the *asset shares* of specimen policies used to determine the benefits of policies subject to the *2009 PALAL Scheme*. Moreover, in respect of those years, the effect of the attribution of business profits and losses to the specimen policies used to determine the benefits of policies not subject to the *2009 PALAL Scheme* will be no more than had the *2009 PALAL Scheme* not been implemented. This practice may only be changed with the agreement of the *regulator*.

(t) *Estate* distribution or charge

Asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate.* In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

No *estate* distribution or charge is made to final salary *unitised* with-profits group pension policies.

(u) Specimens of policies subject to the *2009 PALAL Scheme* receive an uplift to *asset shares*. This is expressed as an additional percentage return in respect of 2009. It differs by policy class, premium mode, inception year and *maturity* year.

14.4.3 For *traditional* with-profits business, the primary focus is on performing the calculations for specimen policies at the terms which contain a significant volume of policies. For other terms approximations may be used.

For *unitised* with-profits business, the specimen policies are for every past year (month, in the case of with-profits bonds, quarter for final salary *unitised* with-profits group pension policies) of commencement.

Separate single premium and regular premium specimen policies are used. Policies generally reflect the average size and policyholder age for the year of issue and term. Where *final bonus* rates or *market value reductions* are shared by policies of different years of issue or different premium types, the specimen policies may be grouped or otherwise averaged.

Separate specimen policies are used for policies subject to and not subject to the *2009 PALAL Scheme*. These may only be changed with the agreement of the *With-Profits Actuary*. Different specimen policies are also used for standard single premiums and National Insurance contribution rebates to policies subject to the *2009 PALAL Scheme*.

For final salary *unitised* with-profits group pension classes, the specimen policies referred to are tranches of units issued within particular quarterly periods to give *final bonus* rates which are applied to units within the policy issued at the appropriate times.

Asset shares are not calculated for specimen whole life, paid-up and altered policies. As a result the target ranges described in sections 14.6 and 14.8 do not apply to policies of these types.

14.4.4 Various approximations are inherent in the *asset share* method described above and in the general applications of the Principles in practice. These include:

- Investment returns are calculated monthly but may be applied uniformly over the period within the model which is usually quarterly or six-monthly.
- The investment return itself is only calculated approximately during the course of a year (by the use of appropriate indices) and is updated after the end of each year to reflect the actual performance earned.
- The asset mixes used to determine investment returns may not be exactly in line with the actual assets held.
- Carrying out the calculations (and hence changing *final bonus* rates) only infrequently (such as monthly, half yearly or annually).
- An inevitable time delay before actual experience is reflected in bonus rates and their application to policies.
- The application of bonus rates determined using a specimen policy of one type to policies of another type (such as the use of *final bonus* rates determined for standard endowment policies for low start endowments and for whole life policies).
- Where the premium rate for a specimen policy changed in the middle of a year of issue, the *final bonus* may be based on either the pre or the post change rate.
- The use of specimen policies will usually mean that small premium policies receive more than *asset share* (as many administration costs are independent of premium size) and large premium policies less.
- The use of specimen policies only for selected terms of policy and the interpolation of *final bonus* rates for intermediate terms will mean that the amounts paid on policies of those intermediate terms will not necessarily equal *asset share*.
- The calculations of *final bonus*es are based on specimen policies with a typical and straightforward premium history and so the bonuses will only be approximate for policies with complex premium histories. Similarly bonuses will only be approximate for policies that have been altered in other ways.
- For policies which been made paid-up, the use of *final bonus* rates applicable to policies which have been premium paying throughout. Or, alternatively, the application to both types of policy of *final bonus* rates calculated using both specimen paid-up policies and specimen premium paying throughout policies.
- Specimen policy calculations generally assume that all policies were subject to standard terms, including sales commission.

Some of these approximations, as well as others not listed, will also be present in the calculations of the excess assets of the fund from time to time.

14.4.5 Items not charged to *asset shares*, the effects of the approximations in the experience assumptions and the effects of other approximations in the methods employed feed through to the *estate* as described in principle 14.4.

14.4.6 The procedures have been documented that set out how the *asset share* calculations described above are to be carried out and how the parameters to be used in the calculation are to be derived each year. A permanent record is kept of the historic parameters used. Some of the instructions for the detailed computations are embedded within a number of computer programs.

14.4.7 Any change to the practices used, including those used to determine the excess assets in the fund, would be subject to the procedure described in section 2.

Any material changes to the historical parameters used would, if a result of the identification of a past inaccuracy, be notified to the *Board* and the *With-Profits Committee* at the time of the next recommended change in bonus rates. If considered appropriate, any changes may be phased in over a period rather than implemented at once.

Any proposed changes to the historical parameters for other reasons would be subject to the same processes as a change in practice.

14.4.8 *Asset share* practices are not guaranteed and may be changed in future.

Asset share methodology and processes will be regularly reviewed by the *Board* and may change. This may include changes to the historical aspects of the calculations as a result of a variety of factors, including changes in regulations, improvements in the degree of approximations, maintaining equity between classes and groups of policyholders and significant changes in the financial condition of Phoenix Life Limited. Any changes will take into account the requirements of the *2009 PALAL Scheme*.

Bonus Declarations

14.4.9 Bonus declarations are approved by the *Board* or committee of the *Board* or delegated to senior management and then retrospectively approved by the *Board*.

14.4.10 The amount payable (or available to convert to a pension) on most *traditional* with-profits policies on *maturity* is the total of:

- the sum assured;
- the *annual bonuses* added whilst the policy has been in force; and
- *final bonus*, if any.

Exceptions are some pension policies, where the sum assured and bonuses are expressed as annual amounts of pension rather than as cash amounts.

The amount payable (or available to convert to a pension) on most *unitised* with-profits policies on *maturity* is the total of:

- the value of the units; and
- *final bonus*, if any.

Exceptions are some pension policies which may be subject to a full or limited *market value reduction* at *maturity*, where either is allowed under the policy conditions.

Amounts payable on the encashment of policies at times other than *maturity* are determined in different ways.

The rate, if any, of *final bonus* which applies to a particular policy class, date of issue and date of *maturity* is currently determined in most cases with reference to the *asset share* of a representative range of specimen policies.

14.4.11 Bonuses are reviewed regularly at least once a year.

The timing of *annual bonus* reviews is described in section 14.5.5.

The timing of *final bonus* reviews is described in section 14.6.4.

14.4.12 The timing of *final bonus* declarations may be varied.

14.4.13 *Final bonus*es are expected to, but are not guaranteed to, apply until the next planned review date. These bonuses may be reviewed at any time between normal planned review dates. Additional reviews would normally only be in response to exceptional investment market movements.

14.4.14 *Final bonus* reviews also consider the amount of *final bonus* paid on *non-protected exits* (surrenders) for policies where the *surrender value* calculation makes explicit use of the current *final bonus* scale.

14.4.15 Bonuses are declared out of surplus arising in the year or in anticipation of surplus arising. If there is no surplus or no expectation of surplus arising, no bonuses can be declared.

Principle
14.5 ***Annual Bonus* Rates**

In circumstances where the value of our assets is fairly close to the minimum amount required to enable us to meet the guiding principles in section 5, low or nil rates of *annual bonus* are likely to be added for most classes of with-profits policy. Conversely, if the value of our assets is more than reasonably sufficient, higher rates of *annual* bonus are likely to be added for many classes.

We apply separate *annual* bonus rates to different policy classes to reflect the different aspects of the products, including tax treatment, country of issue, form of benefit and extent of guaranteed benefit (although we do not differentiate between policies of the same class with and without guaranteed annuity options except in respect of policies subject to the *2009 PALAL Scheme)*. Apart from with-profits bonds, we do not currently differentiate between different dates of issue, although we may do so in the future if it helped us to better satisfy the aims described in the guiding principles in section 5.

Although we no longer accept most classes of new business, other than under options on existing policies, we might at some time introduce alternative products into which existing customers could switch their benefits at their discretion, which might receive different bonus rates.

Practices

14.5.1 The *Board* makes decisions on *annual bonus* declarations taking into account a number of factors. These factors are set out in paragraphs 14.5.2 to 14.5.5.

14.5.2 *Annual bonuses* currently take the form of:

- additions to the sum assured (or equivalent amount) and / or to existing bonuses (*traditional* policies); or
- increases in the price of units (*unitised* policies).

14.5.3 For each class of business, the level of *annual bonus* is set so as to maintain a buffer for *final bonus.* The future claim *payouts* are estimated using realistic assumptions and the *annual bonuses* set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected final bonus broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

There is no maximum change in the *annual bonus* rate; however, in the normal course of events the declared *annual bonus* rates would not be expected to change by more than 2% from one declaration to the next.

14.5.4 Where the financial position of the fund is weak, the Board may decide not to increase the annual bonus, or to keep the annual bonus at nil, or to reduce the annual bonus despite the final bonus being above the 25% target.

14.5.5 Currently *annual bonus* rates are reviewed as follows:

- for *traditional* policies, towards the end of each year, with changes taking effect from 1 January; and
- for *unitised* policies, in time for the new rates to take effect from the 1 March and 1 September.

However, rates may be reviewed at other time should it be considered to be necessary to continue to adhere to the Principles.

14.5.6 Where *annual bonuses* are declared in arrears, *interim bonus* rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may, however, eventually be set at a level that differs from the interim rate.

Principle 14.6 ***Final Bonus* Rates**

Subject to the guiding principles set out in section 5, *final bonus* may be added to policies when they terminate or when benefits are encashed for other purposes, with the aim of ensuring, if they do not already do so, that benefits reflect fairly a share in the profits (and losses) which have been generated within the with-profits fund whilst the policy has been in force.

We apply separate *final bonus* rates to different policy classes to reflect the different aspects of the products, including tax treatment, country of issue, form of benefit and extent of guaranteed benefit (although not the presence or absence of guaranteed annuity options except in respect of policies subject to the *2009 PALAL Scheme*). For most policy classes, we also differentiate between different dates of issue and different periods in force. On death and on early termination, the *final bonus* added may be higher or lower than indicated above, for reasons explained in our Practices.

Practices

14.6.1 For each specimen policy, we determine a proportion of *asset share* that it is appropriate to use to best meet the guiding principles. This proportion will vary from time to time, may be greater or lesser than 100% and may vary by class of policy, date of issue, *term remaining* to a date at which a guarantee or option applies or other relevant factor.

For each specimen policy the following are compared:

(i) the appropriate proportion of each specimen policy's *asset share* (the *asset share* for this purpose being inclusive of any enhancement as described in paragraph 14.4.2); and

(ii) the total of the sum assured and the *annual bonuses* already added to that specimen policy (or the value of units for a *unitised* policy or the value of the annuity benefit for pre 1981 Section 226 retirement annuity policies).

If (i) is the larger, a *final bonus* for the specimen policy is normally set using the methods described below. If (ii) is the larger, no *final bonus* will normally be set for that specimen policy.

The target for the proportion in (i) is 100%. The proportion used for particular specimen policies may be affected by *smoothing* (see section 14.7). The aim is to maintain the proportions in (i) within the range 80% to 120% for most specimen policies before the effects of *smoothing*.

For each specimen policy where a *final bonus* is to be set, the excess of (i) over (ii), after any *smoothing*, is expressed as a percentage of:

- the sum assured only for *traditional* policies not subject to the *2009 PALAL Scheme*
- the sum assured plus *annual bonus* additions for policies subject to the *2009 PALAL Scheme* (such practice not to be changed without the agreement of the PRA);
- the value of units for *unitised* policies; or
- the value of the annuity, including *annual bonus* additions, for pre 1981 Section 226 retirement annuity policies.

This is then the new *final bonus* rate for all policies of the same type and duration in force as the specimen policy.

Where a rate is not derived for every duration, the rates applicable for other durations are determined by interpolation or extrapolation between the rates derived as above.

Exceptions:

(a) For *unitised* with-profits pensions business reinsured into the Phoenix With-Profits Fund the same rate of *final bonus* applies for a given year of entry, irrespective of the *term remaining* to the selected normal retirement age. The investment returns used to calculate *final bonus* rates are based on representative *term remaining* for this business as a whole.

14.6.2 *Final bonus* and *market value reductions* do not apply at the same time to any of the policies.

14.6.3 *Final bonus* is paid on death claims on *traditional* whole life and endowment policies at the rate that applied to endowment policies which commenced at the same time and reached *maturity* at the date of death.

14.6.4 For all classes of policy the *final bonus* rates may be changed at any time. At times when the value of the excess assets in the fund is not changing rapidly, this is likely to mean that changes, if any, are normally made monthly for with-profits bonds, quarterly for final salary *unitised* with-profits group pension policies and one to two times per year (effective from 1 January and 1 July) for most other classes. However, a sudden change in the value of those excess assets (such as because of a significant change in the value of equity share markets) may cause changes to the *final bonus* rates on other occasions.

14.6.5 As the value of assets are changing every day but *final bonus* rates are only recalculated infrequently, there will inevitably often be times when, if the *asset shares* for specimen policies were recalculated, *final bonus* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10% compared to that assumed when the *final bonuses* were last reviewed, would be allowed before there would be an additional *final bonus* review. However, where the proportion of *asset shares* at the latest *final bonus* review was near the top or bottom of the range described in paragraph 14.6.1(i), a lower level of investment return variance may lead to an additional *final bonus* review.

Principle 14.7 ***Smoothing***

Smoothing refers to the practice of limiting the change in *final bonus* rates on any one occasion so that the benefits paid to policyholders differ from those which would otherwise apply and also to the practice of limiting the frequency of such changes. *Smoothing* means that the value on similar policies maturing at different times either vary little (between changes in *final bonus* rates) or change by no more than a specified amount over a given period. We apply *smoothing* to all classes of policy which are eligible for *final bonus* and to all types of claim. However, we make more frequent and generally smaller changes to some classes of *unitised* with-profits policies.

We intend *smoothing* to have a neutral effect over time. In other words, if applying the limitation on the changes in rate of *final bonus* results for a period in different amounts of discretionary benefits than we would otherwise have paid, then in a subsequent period we would adjust discretionary benefits by a broadly equal and opposite amount when circumstances and our practices allow.

Other than on death or early termination, the aim at all times is to pay policy benefits that are close to those described under section 14.6. Accordingly, we do not *smooth* very much and *final bonus* rates and total policy benefits may change by relatively large amounts both on any one occasion and over a 12 month or longer period. The cost of *smoothing* is not expected to be material at any time and so no specific upper limit is imposed on it.

The *smoothing* principles also generally underlie the *market value reductions* which may apply to most *unitised* policies. However, these principles are not necessarily applied when determining the amount payable on *traditional* policies which are terminated significantly early.

Practices

14.7.1 For with-profits bonds, *smoothing* is applied to policy benefits by means of an adjustment to the credited investment return. However, *smoothing* is only applied when *asset shares* are more than 95% of the *asset share* with the *smoothing* adjustment applied to the investment return. When *smoothing* does apply, *final bonus* rates or *market value reductions* are set in relation to an investment return, including business profits and losses smoothed over three years. The smoothed investment return over the first three years of a specimen policy is calculated in part by reference to a deemed return in respect of the period prior to the commencement of the policy or series. This rate is determined by the *Board* from time to time.

For final salary *unitised* with-profits group pension policies, changes in the *final bonus* rate or *market value reductions* are normally limited to 5% per quarter. However, if it is necessary for the fund to continue to meet the objectives set out in the guiding principles in section 5 or to maintain the proportions described in paragraph 14.6.1(i) within the range set out in paragraph 14.6.1 for the majority of specimen policies, larger changes in *final bonus* rates (or *market value reductions*) are sometimes made.

14.7.2 For *traditional* and other *unitised* with-profits policies where *final bonus* changes are normally made twice a year, *smoothing* is applied to *maturity* and retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

For *traditional* policies and *unitised* with-profits policies, *surrender value* bases are normally reviewed twice a year, *smoothing* is applied by limiting the change in immediate *surrender value* for specimen policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend upon factors such as *term remaining* which change over time.

However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values.*

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing *payouts*, then *smoothing* will not be applied, so that the change in *payouts* intended by the premium rate change does occur.

Calculations may also be carried out for specimen policies which are due to reach their maturity date in the following few years. If these calculations show a trend in *payouts* which could not be accommodated by following the normal limits on change described above, the *final bonus* rate or *surrender value* being determined may be adjusted so that the trend may more easily be accommodated.

For both *maturity* and retirement values and *surrender values*, changes to *payouts* resulting from any changes in the *distributable estate*, or from any changes in the level of guarantee charges, will be additional to the limits described and will not be subject to *smoothing.* Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

14.7.3 The period over which *smoothing* will be of neutral effect on a class of policies is indirectly determined by the application of the above practices.

14.7.4 Applying *smoothing* does mean that on occasions, particularly for *traditional* policies, payments are more or less than the proportion of *asset share* which it is considered appropriate to pay. This difference will reduce or increase the excess assets of the fund. There is no particular maximum accumulated cost of or benefit to the fund which is allowed, although no *smoothing* accumulation would be allowed to build up which was inconsistent with the achievements of the objectives set out in the guiding principles in section 5.

14.7.5 Other than in the charge described in 14.4.2(o), for those *unitised* policies which permit small regular withdrawals without a *market value reduction* being applied, the eventual value of the uncashed units takes no account of the extent, if any, to which the withdrawn amounts have exceeded the proportion of *asset share* considered appropriate to pay at the time of each encashment.

Other than in the charge described in 14.4.2(o), for final salary *unitised* with-profits group pension policies which permit units to be encashed to meet *normal scheme claims* without a *market value reduction* being applied, the eventual value of the uncashed units takes no account of the extent, if any, to which the withdrawn amounts have exceeded the proportion of *asset share* considered appropriate to pay at the time of each encashment.

14.7.6 Any cost to the fund of partial payments under *unitised* policies to which a *market value reduction* does not apply does not affect the remaining value of the policies concerned. Rather, it reduces the value of the excess assets in the fund (although the excess assets will be increased for charges levied in respect of such guarantees).

Principle 14.8	***Surrender Values*** Our aims when determining the amounts payable to with-profits policyholders are to pay discretionary benefits only to an extent that would not unreasonably put at risk our future ability to continue to pay all guaranteed benefits when due, whilst taking account of the need to treat customers fairly relative to their reasonable expectations and to other current and past customers.

Practices

14.8.1 *Non-protected exits* refer to surrenders, and transfers for pensions business.

14.8.2 For *traditional* policies that surrender early the aim is to make payments that are, in aggregate and over time, across all specimen policies used in determining surrender bases, a proportion of *asset share*.

14.8.3 For all policies this is currently 100%. In the past it has been the practice to target less than 100% of *asset share* on surrender and this practice may be resumed in the future should the fund have insufficient assets to cover its liabilities. However the proportion targeted in such circumstances will be limited as described below:

- For policies not subject to the 2009 PALAL Scheme, the target proportions of *asset share* on surrender referred to in 14.8.3 above will also normally not be lower than 95% for policies with a term remaining of 10 years or more, increasing gradually to 100% at maturity for policies with less than 10 years remaining.
- For policies subject to the 2009 PALAL Scheme, the target proportions of *asset share* on surrender referred to in 14.8.3 above will also normally not be lower than 97% for policies with a term remaining of 10 years or more, increasing gradually to 100% at maturity for policies with less than 10 years remaining.
- Lower target proportions of *asset share* on surrender will apply if, in the opinion of the *Board,* the *With-Profits Committee* and the *With-Profits Actuary*, and with the agreement of the *regulator*, it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles and Principle 14.4.

14.8.4 Actual surrender payments on individual policies will not generally be in line with the target proportion because:

- Individual *asset shares* are not calculated or held on our administration systems for use in *surrender value* calculations. Rather *surrender values* are calculated in a variety of ways for different types of policy. Typically *surrender values* are based on a discounted value of the guaranteed sum at *maturity* or retirement (reduced to allow for non-payment of future premiums for regular premium policies) together with an allowance, where appropriate, for *final bonus.*
- Specimen policies are used to determine the parameters in the *surrender value* calculations. The outcome for a particular individual policy may be different from that of the specimen policy.
- There are a limited number of parameters that may be altered in the surrender formulae for certain products which means that the parameters are set in aggregate across a range of specimen policies.
- As the value of assets are changing every day but the parameters in the *surrender value* formulae are only reviewed infrequently, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or

smaller percentages of those *asset shares* than the practices would in theory dictate.

14.8.5 For the reasons given above, *surrender values*, when expressed as a proportion of *asset share*, are expected to fall in a wide range around the target proportion. However the parameters in the *surrender value* bases are reviewed periodically with the aim that the majority of *surrender values* for the range of specimen policies analysed, will fall within the range of 80% to 120% of *asset share* before the effects of *smoothing*.

14.8.6 In some cases, values in excess of 120% of *asset share* may be payable when policies are surrendered close to *maturity* and the *asset share* of the relevant specimen policy is less than the guaranteed benefits at *maturity,* or the *maturity* payout is in excess of the *asset share* due to *smoothing.* This may also occur if the value of the guaranteed benefits is high relative to *asset share*, due to the effective maximum discount rate used in the surrender bases.

14.8.7 For *traditional* policies, the method used to derive the *surrender* or transfer value may not involve the explicit application of *final bonus*. Where the value paid is larger than the discounted value of the guaranteed sum assured and *annual bonuses* already added, an element equivalent to *final bonus* will be implicit in the value. For the purposes of determining the shareholder's entitlement to profit in respect of any *surrender* or transfer, an appropriate proportion of the value paid is deemed as representing *final bonus*.

14.8.8 For *unitised* policies, a *market value reduction* will be applied in most circumstances where the calculation described in 14.6.1 results in a shortfall of the determined proportion *of asset share* relative to the value of units. The amount of the *market value reduction* will not exceed the amount of the shortfall. Any reduction in *market values reduction* is not restricted by *smoothing*. Most policies contain a date or range of dates on which no *market value reduction* or a limited *market value reduction* will apply. Some policies also allow small regular encashments to be made without a *market value reduction* applying (but otherwise the same *market value reduction*s apply to partial as to full encashments). The final salary *unitised* with-profits group pension policies allow that a *market value reduction* will not apply to units encashed to meet *normal scheme claims*.

As the value of assets change every day but *market value reductions* are only reviewed periodically, there will inevitably often be times when, if the *asset share* for the specimen policies were recalculated, *surrender values* would, in effect, be based on slightly larger or smaller percentages of those *asset shares* than the practices would in theory dictate. Normally an investment return variation of up to 10% compared to that assumed when *market value reductions* were last reviewed, would be allowed before there would be an additional *market value reduction* review.

Where bulk surrenders of final salary *unitised* with-profits group pension policies are being made at a time when investment values are falling then *market value reductions* may be reviewed more frequently.

14.8.9 For with-profits bonds, the date at which no *market value reduction* applies on encashment is the 10th anniversary of commencement. A period of three months following the 10th anniversary is allowed during which any encashment request received will also benefit from no *market value reduction* or a limited *market value reduction*. The *market value reduction* may also be limited prior to the 10th anniversary so that the encashment value represents the discounted value of the amount which would be available at the 10th anniversary. Most such dates have now passed.

14.8.10 The percentages described above may be changed at any time, as may the methods of calculation. However, before any changes are made, the *Board* will formally consult with and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee*.

Principle 14.9 **Investment Strategy**

Overall, our strategy will be to invest in fixed interest securities, equity shares (shares) and commercial property (property), either directly or through vehicles such as unit trusts, OEICS or derivatives. Shares and property will only be held to the extent to which this is possible without unduly putting at risk our ability to meet guaranteed benefits as they arise. Some cash or equivalent assets may be held for liquidity purposes.

For certain purposes, including determining the bonus rates applicable to policies, we may take account of assets such as future profits. The investment strategy adopted in respect of the reserves held to meet guarantees is described in paragraphs 14.9.11 and 14.9.12 of our Practices.

We may from time to time rely on assets outside the fund to provide some or all of a margin against future adverse change in investment markets. Our investment strategy is, however, based upon the intention that we will meet our aims using only the assets of the with-profits fund after repayment of any loans or other financial support received.

We may use derivatives from time to time to make changes in our investment dispositions more rapidly or cheaply than could be done directly through the markets. We may also use them from time to time to reduce the risk of loss, for example from share price falls, interest rate changes or exchange rate fluctuations.

There is no direct link between individual policies and specific assets. The proportion of shares and property used indirectly to determine the bonuses applicable to different policies may differ between different products, dates of issue or *term remaining* to reflect the different risks to both the specific policyholders and to policyholders and the *shareholder* more generally. For some with-profits policies with relatively high guaranteed benefits, this may mean that few or no shares and property will be deemed to be held.

Non-profit, non-linked policies are backed by fixed interest securities of appropriate duration.

Index-linked and unit-linked liabilities are either backed to the extent possible with close-matching assets or, in the case of unit-linked policies, the risk is transferred to another Phoenix Life Limited fund, which does so.

We aim to restrict the maximum loss which we could suffer from the complete default of any one external counterparty, whether through reinsurance, direct investment or derivatives by dealing with a wide range of counterparties. In some cases, additional precautions such as daily *marking to market* or *deposit back* are used.

Larger, unprotected exposures are permitted to sister companies (regulated UK life insurers) through internal reinsurance arrangements.

From time to time our investments may include a small number of properties which are occupied by the company or by a related company and which we would not expect to trade.

Practices

14.9.1 There are no formal procedures in place for assets to be transferred permanently from the *Shareholder Fund* to the with-profits fund. Formal loan arrangements as described in paragraph 14.4.2(p) and section 14.14 may be in place from time to time but would not normally be considered as permanently irrecoverable at any time.

14.9.2 The investment strategy is regularly reviewed taking account of a variety of considerations, including our approach to *responsible investment*. In particular, reports from the *investment managers*, the *Chief Actuary*, the *With-Profits Actuary* and *the With-Profits Committee*, and recommendations for change are considered and, if appropriate, implemented.

14.9.3 All the guarantees to policyholders and liabilities to other creditors are not completely matched with assets which provide a similar guarantee or payment. In particular, often a proportion of the assets is invested in growth investments because it is considered that, over most longer periods of time, a better return will result. Growth investments will normally consist of equity shares (including *private equity*) and commercial property. Separate investment strategies are followed for assets equal in amount to the estimated aggregate *asset shares* of policies and for assets representing additional provisions for liabilities under non-profit policies, for guarantees on with-profits policies, for other liabilities and for the capital margins and excess capital. Each of these strategies is described in more detail below.

14.9.4 It is not possible to implement the strategies described below with absolute precision and any difference between the actual outcome and the theoretical outcome will be treated as described in paragraph 14.4.2(s).

14.9.5 Investment returns allocated to the *asset shares* of specimen policies will reflect the actual mix of assets held, should this be different from the theoretical mix calculated according to paragraphs 14.9.6 to 14.9.10.

Asset Shares

14.9.6 Firstly, the appropriate asset mix for a large number of specimen policies of different types, *term remaining* and commencement dates is determined.

For final salary *unitised* with-profits group pension policies, the asset mix is approximately 45% in growth investments and 55% in fixed interest securities.

The asset mix for all other classes of policy is determined by the successive application of a number of rules:

(i) For policies not subject to the *2009 PALAL Scheme*, the asset mix is approximately 50% in growth investments and 50% in fixed interest securities with a small balance invested in cash and / or other assets such as future profits.

For policies subject to *2009 PALAL Scheme*, the asset mix is approximately 70% in growth investments and 30% in fixed interest securities with any balance (such balance not to exceed 10%) invested in cash and / or other assets such as future profits. From time to time, on the advice of the *investment managers* for the purposes of increasing the expected return for policyholders and subject to the approval of the *With-Profits Actuary* (such approval not to be given unless it is unlikely to have a materially adverse effect on the interests of holders of policies subject to the *2009 PALAL Scheme*), we might change the asset mix. Otherwise, the asset mix for policies subject to the *2009 PALAL Scheme* may only be changed with the agreement of the *regulator*.

For policies where the risk is transferred to the Phoenix With-Profits Fund (see below), the asset mix is approximately 70% in growth investments and approximately 30% in fixed interest securities with a small balance invested in cash and/or other assets such as future profits. Growth investments will normally consist of equity shares (including *private equity*) and commercial property. However, the *investment managers* may also choose to hold other types of investment within the growth investment category including *alternative assets* such as hedge funds, corporate bonds, cash, total return funds, derivatives, currencies and commodities.

Unless

(ii) There are less than nine years of *term remaining*, when the mixes are changed as the *term remaining* reduces. The mixes change proportionately for polices not subject to the *2009 PALAL Scheme* until they are 17.5% in growth investments and 82.5% in fixed interest securities with one year or less of *term remaining* . For polices subject to the *2009 PALAL Scheme*, the mix changes proportionately until they are 35% in growth investments and 65% in fixed interest securities with one year or less of *term remaining.* For policies where the risk is transferred to the Phoenix With-Profits Fund, the mixes change proportionately until they are 35% in growth investments and 65% in fixed interest securities with one year or less of *term remaining*.

Unless (for policies not subject to the *2009 PALAL Scheme* only)

(iii) The rate of return required from equity shares and commercial property (or growth investments as appropriate) for the *asset share* of that specimen policy to grow over the *term remaining*, after the deduction of retentions and charges, to equal the projected guaranteed benefits at the *maturity date* is more than 5% per annum gross, when the growth investments proportions above are reduced according to the table below (and the proportion in fixed interest securities increased to balance).

Rate of return required*	Reduction applied
5% - 7.5%	33%
7.5% - 10%	67%
10% or more	100%

(* For *terms remaining* of seven years or less, the dividing points of 7.5% and 10% are higher, rising to 11% and 17% respectively for terms remaining of one year or less).

For the purpose of determining the exposure to growth investments, the *term remaining* for a with-profits bond will be taken as:

- for bonds with a future guarantee date upon which no *market value reduction* will apply on surrender, the time to that guarantee date; or
- for bonds which have passed the date upon which such a guarantee applied, 10 years.

For *unitised* with-profits life regular premium policies, the mix in (i) applies to all specimen policies and the rules in (ii) and (iii) above do not apply to these policies.

The investment return credited to *asset shares* of the policies where the risk is transferred to the Phoenix With-Profits Fund is based on the investment return of the Phoenix With-Profits Fund. The following *unitised* with-profits policies have such an inter fund arrangement with the Phoenix With-Profits Fund:

- *unitised* with-profits bonds written after September 1997;
- Executive pension plan;
- Company pension scheme;
- Company additional pension scheme;
- Individual personal pension plan;
- Group personal pension plan; and
- Personal additional pension plan.

14.9.7 The parameters defining the asset mix of policies not subject to the *2009 PALAL Scheme* may be changed from time to time. When doing so, account will be taken of the results of stochastic modelling calculations which demonstrate the range of reasonable parameter sets that satisfy the aims described in principle 14.9. From within this range, one is selected which is considered to best balance the interests of all policyholders.

The parameters defining the asset mix of policies subject to the *2009 PALAL Scheme* may only be changed with the agreement of our *regulator* or changes may be made to the parameters on the advice of *the investment managers* and with the agreement of the *With-Profits Actuary* (as referred to in paragraph 14.9.6(i)).

14.9.8 The actual proportions of different assets held will vary slightly from the specified parameters as asset value change, although the actual mixes will be reviewed at least annually and adjusted if necessary to bring to bring the proportions more closely in line with the target.

14.9.9 Phoenix Life Limited has adopted two undertakings in relation to the asset mix for policies subject to the *2009 PALAL Scheme* as specified in paragraph 14.9.6. The first undertaking is that if:

(i) the proportion of assets invested in growth investments for policies subject to the *2009 PALAL Scheme* referred to in paragraph 14.9.6(i) should fall below a threshold of 65% (and below 65/70ths of the lower percentages applicable for policies subject to the *2009 PALAL Scheme* with less than nine years of *term remaining* as referred to in paragraph 14.9.6(ii)) ("the Threshold"); or

(ii) Phoenix Life Limited intends to take any action which might reasonably be expected to cause the proportion of assets invested in growth investments for policies subject to the *2009 PALAL Scheme* to fall or remain below the Threshold;

then Phoenix Life Limited shall:

(iii) immediately notify our *regulator* of (i) the fall and the cause; or (ii) the intended action and the reason; and

(iv) in the event of a fall, put in place actions to restore the asset mix to above the Threshold as soon as reasonably practicable (and inform our *regulator* of those actions); or

(v) in the event of an intended action, not to take that action until the *Board* has consulted with the *With-Profits Committee* and the *With-Profits Actuary* and has obtained the *regulator's* non objection to the action.

Phoenix Life Limited's second undertaking is that:

Until the proportion of assets invested in growth investments has exceeded the Threshold for the first time, it will keep our *regulator* regularly informed of progress towards that Threshold.

Either of the above High Court undertakings is capable of being amended by agreement between Phoenix Life Limited and our *regulator*. No such agreement will be effective to amend either undertaking unless produced in writing and signed on behalf of Phoenix Life Limited and the *regulator*, but for the avoidance of doubt, no amendment that is in fact produced in writing and signed will require High Court approval.

14.9.10 All policies are grouped according to the specimen policy which most closely represents them and the asset mix for each specimen policy is determined by applying the rules in 14.9.6 to the policies in the group.

For policies not subject to the *2009 PALAL Scheme*, the term of the fixed interest securities reflect the *term remaining*. For policies subject to the *2009 PALAL Scheme*, the term of the fixed interest securities reflects the calendar years over which a pension bought with the proceeds of the specimen policy would be paid and this shall not be determined in any different way unless legislative change makes it appropriate to assume that the majority of the holders of policies subject to the *2009 PALAL Scheme* who retire under their policies will no longer take benefits predominantly in annuity form and such change in assumption is approved by the *With-Profits Actuary* (such approval not to be given unless it was unlikely to have a materially adverse effect on holders of policies subject to the *2009 PALAL Scheme*). Otherwise, the term of the fixed interest securities for policies subject to the *2009 PALAL Scheme* may only be changed with the agreement of the *regulator*.

For the purpose of determining the duration of the fixed interest investments, the *term remaining* for a *unitised* with-profits bond will be taken as:

- for bonds with a future guarantee date upon which no *market value reduction* will apply on surrender, the time to that guarantee date; or
- for bonds which have passed the date upon which such a guarantee applied, five years.

For *unitised* with-profits pension business without guaranteed annuity rates where the risk is transferred to the Phoenix With-Profits Fund, the fixed interest duration is frozen once a policy has reached nine years of *term remaining*.

For *unitised* with-profits business where the risk is transferred to the Phoenix With-Profits Fund, asset mix and the term of any fixed interest securities which form part of the growth investments per paragraph 14.9.6(i) reflect an average *term remaining*.

Returns on emerging market debt do not reflect the *term remaining*, but rather reflect the overall return on such debt.

Guarantee Reserves

14.9.11 Firstly, the *market consistent* cost of the guarantees inherent in the with-profits policies is calculated. How this cost, net of the value of expected future guarantee charges and early termination profits, will change as the prices of the growth investments rise and fall and as *volatility, credit spreads* and interest rates change is then calculated. A mix of assets which will broadly change in line with the change in the net cost of the guarantees is identified. This asset mix may require a *short position* in growth investments to be adopted and a *long position* in fixed interest securities or cash. It may also require the purchase or sale of financial instruments such as equity options or credit derivatives or the holding of fixed interest securities with an average term which is otherwise different.

This calculation may be done in respect of specimen policies in some cases and the results aggregated and in other cases a more approximate method is used.

As the prices of growth investments, interest rates, *credit spreads* and *volatility* change, and in any case periodically, the appropriate asset mix for the guarantee reserve will be reassessed.

14.9.12 The liabilities for guaranteed annuity options are backed by fixed interest assets whose value is expected to change broadly in line with the value of the guaranteed annuity option liabilities when interest rates change. *Swaps* and /or *swaptions* may be used for this purpose.

Irrespective of the fixed interest assets actually held, the *asset share* of specimen policies with guaranteed annuity rates will, to the extent that they are deemed to be invested in fixed interest securities, be credited with the return on securities of duration appropriate to the *maturity* date of the specimen policy.

Non-Profit Policies, Other Liabilities, Capital and Excess Assets

14.9.13 Assets representing the reserves for non-profit policies are invested in fixed interest securities of appropriate duration. Assets representing unit-linked liabilities which do not transfer their risk are invested in the assets used to determine the value of the unit liability. Assets representing RPI-linked liabilities or expense reserves are invested in index-linked securities. Assets representing short-term liabilities are invested in cash or short-term debt. Assets representing capital, whether or not required to enable the fund to meet its objectives or to meet regulatory requirement, are mainly invested in fixed interest securities.

Assets representing the *estate* of the SAL With-Profits Fund are mostly invested in fixed interest securities. However, if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in growth investments in line with the asset mix for the *asset shares*.

Current Asset Policy

14.9.14 Fixed interest assets will be a mixture of approved fixed interest securities, such as British Government gilts and other government and supranational bonds, and other fixed interest securities, such as corporate bonds, debentures, loan notes and emerging market debt. The mix of fixed interest asset types backing asset shares, liabilities for guarantees or capital requirements may be different.

The agreements with the *investment managers* set out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single company.
- The maximum amount that can be invested in any single asset class / industry sector / country.
- The maximum amount to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns. (These include restrictions in terms of credit quality, term / duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor’s and Moody’s).
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco

14.9.15 Investments are also made in sterling interest rate *swaps* to enable closer matching of fixed interest income and outgo requirements. All *swaps* and *swaptions* are regularly *marked to market* to minimise exposure to counterparty default.

14.9.16 Equities are split between UK equities and overseas equities and may include emerging markets. The proportions will vary from time to time due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*. With the exception of *private equity*, the equities are predominantly quoted and regularly traded on a recognised stock exchange. Equities may be either actively or passively managed relative to recognised index benchmarks. Individual stock selection is carried out by the *investment managers* based on their expert assessment of the relative prospects of available alternatives.

14.9.17 Property investments may be directly owned properties or held via collective investment vehicles.

14.9.18 Sufficient assets are disposable at short notice without material loss in value to meet foreseeable additional liquidity demands.

14.9.19 The proportion of different assets described in this section may vary from time to time due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*.

Miscellaneous

14.9.20 The fund does not hold any assets which are *not normally traded*.

14.9.21 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

14.9.22 Before investing in new or novel investment instruments, the *Board* will obtain the advice of the *Chief Actuary* and the *investment managers* on the benefits and risks of the proposition. This would include an analysis of the nature and proportion of future outcomes in which the instrument would prove materially disadvantageous relative to other more traditional investments. If the instrument is to be held in material amounts in respect of with-profits policies, the *Board* will also seek the opinion of the *With-Profits Actuary* and the *With-Profits Committee.*

Principle
14.10 Business Risks

As well as investment performance and counterparty exposure, and amounts transferred to the *Shareholder Fund* (see section 14.12), our future ability to continue to pay all guaranteed benefits when due, and the amounts of *annual* and *final bonus*, will be affected by a number of other factors, ‘business risks’, that may arise from our existing portfolio of with-profits and non-profit business. These are listed, together with the controls which apply, in paragraph 14.10.1.

In some cases, we will anticipate the effect of future profits or losses (such as the increasing longevity of annuitants) and reflect any changes in expected outcome immediately in discretionary payments. This reduces the likelihood that excessive business risk exposures will apply to the longest remaining with-profits policyholders, which is otherwise a particular risk because with-profits policies are expected to run off more quickly than non-profit policies.

Any profits made or losses incurred as a result of a business risk will normally be met by the fund, except where the business and the risk was wholly transferred to another with-profits fund within Phoenix Life Limited. However, the costs of any compensation payable as a result of policies mis-sold by the company or its agents will not affect the reasonably expected benefits payable to policyholders. Costs specified by our *regulator’s* rules as being the responsibility of the *Shareholder Fund* (such as regulatory fines) will be met by that fund.

We do not currently envisage that we would take on any business risks in addition to those to which we are already exposed although we may, if it appears to be potentially beneficial to policyholders to do so, increase our exposure to risks to which we are already exposed (such as by cancelling reinsurance arrangements). If we did take on or increase business risk, we would only do so if the reward was expected to be better than that from other investments with broadly equivalent risks (such as investing in shares or property). We would formally consult and take account of the opinions of the *Chief Actuary*, the *With-Profits Actuary* and the *With-Profits Committee* before doing so.

The *Board* will annually review existing business risk exposures as part of the assessment of the formal regulatory capital requirements and appropriate measures will be taken to limit risk to amounts to which it is fair for the with-profits business to remain exposed.

Practices

14.10.1 The main business risks of the fund, and the controls that are applied to those that Phoenix Life Limited can influence, include:

- Expenses of management – controlled mainly by outsourcing all business activities, including policy administration and investment management. Normal activities are outsourced on an agreed pricing basis. The main residual costs not subject to an agreed pricing basis are project activity and certain direct costs and fees.
- Failure of non-group outsourced services provider – part of the administration services provided by PGMS are sub-contracted to Diligenta, - controlled by having exit plans. PGMS is liable for any additional cost of providing these services which might arise if Diligenta were to default. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the shareholder fund or Non-Profit Fund,

and the fund would only be affected if the shareholder fund or Non-Profit Fund had insufficient excess assets to bear the losses.

- Meeting minimum guaranteed policy benefits (where these costs are reasonably attributable to the fund) and the cost of *smoothing* – controlled by having an appropriate rate of *annual bonus*, limiting the extent of *smoothing* and investing primarily to meet the guarantees, all whilst ensuring that customers continue to be treated fairly.
- Fluctuations and long-term trends in death or sickness rates – fluctuations are constrained by the use of reinsurance contracts to limit exposure on any one insurance policy but significant risks remain from improvements in longevity on existing annuities, deferred annuities and (although significantly reduced by the *2009 PALAL Scheme*) from future annuities under guaranteed options.
- Changes in taxation.
- Profits or losses from investments backing non-profit business or other liabilities and from investments which represent additional capital.
- The cost of guaranteed annuity options – risks from varying interest rates are controlled by investing in appropriate hedging assets but significant exposure remains in respect of improving longevity.
- Profits or losses from the early or late termination of policies – a significant increase in the persistency of policies with onerous guarantees could cause a significant reduction to other policy values.
- Provision of compensation for past legal or regulatory infringements, especially due to inadequate sales practices – controlled in part by ensuring that compensation is only paid where a legal entitlement exists.
- The cost of additional capital needed to be held for regulatory purposes or for the optimal management of the business – controlled by regularly reviewing the excess capital being held and by ensuring that only a commercial cost for capital is being paid.
- Profits or losses may arise from the reassurance of with-profits business.
- Failure of reassurers – the reassurance credit risk is monitored.

14.10.2 In paragraph 14.4.2, how and to what extent business profits and losses are incorporated in the *asset share* calculations for specimen policies are described and so how each, if at all, affects the amounts payable under with-profits policies.

14.10.3 As a result of the approach described in paragraph 14.4.2(s), the effect of other business profits and losses on the amounts payable under with-profits policies will be implicitly smoothed as described in paragraph 14.6.4 and in section 14.7.

Also, as explained in paragraph 14.4.2(s), if a particularly large business profit or loss in any one year is experienced or identified, its incorporation may be spread in *asset share* calculations over a number of future years to avoid excessive impact on policy values in the short-term.

14.10.4 The outcome from all the business risk of the fund is currently mainly pooled across all with-profits policies in the fund, although this has not always been the practice in the past. Any exceptions are highlighted elsewhere in this document.

14.10.5 Since January 2011, in accordance with paragraph 5.2.9, any annuities coming into payment are transferred to the Non-Profit Fund, and the fund pays the Non-Profit Fund a premium in respect of the liability transferred. After such transfer, all the risks in relation to the transferred annuities are borne by the Non-Profit Fund.

14.10.6 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

Principle
14.11 Expenses and Charges

Our overall aim when applying charges and apportioning expenses when determining the bonus rates to apply to different with-profits policies is to reflect the actual costs incurred. Costs include

- sales, marketing and administration costs, including commission to intermediaries in respect of new and existing business;
- investment management costs;
- charges for mortality, sickness and other insurance benefits; and
- charges for guarantees.

Costs may be recovered from policies directly, for example by the cancellation of units of *unitised* policies, or indirectly via bonuses and early termination values.

Where indirect costs are specific to a class of policy then, taking into account the approximations referred to in section 14.4, such costs will be taken into account in assessing the bonuses added to that policy class and in assessing the early termination value payable. Where indirect costs are not specific to a single policy class, they will be apportioned across the policy classes to which they are relevant in a reasonable manner, as is explained in our practices.

Implicit charges for mortality, sickness and other benefits will generally reflect our own or insurance industry actual claims experience. Explicit charges for such benefits will be determined in line with policy conditions; where this requires periodic reviews in the light of experience, such reviews will be carried out and charges adjusted accordingly.

In some cases, policy conditions restrict the type and amount of charges that may be levied.

Some costs relevant to the company are incurred collectively at various levels within the Phoenix Group hierarchy (such as general management, internal audit and IT). A share of these costs is attributed to the company on an appropriate and objective basis (such as time spent, headcount, salary and system usage).

We would change the way in which charges were apportioned between or allocated to policies or classes of policy and between different funds if we considered that this was necessary to enable us to continue to treat customers fairly. The apportionment method may also change if it was possible to do so without ceasing to treat customers fairly and to do so assisted in meeting one of Phoenix Group's other corporate objectives.

Charges for guarantees or *smoothing* may be made annually or by a retention from *maturity* or early termination values (or by a combination of both methods). The basis on which the charges will be determined are described in section 14.4.2 of our practices.

Practices

14.11.1 An agreement exists with PGMS to supply administration services to the fund.

This is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated early for material failure to meet service standards or other non compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are changed separately.

The main expenses that are apportioned to the *asset shares* of specimen with-profits policies relate to the fees paid to PGMS in connection with all business activities. These charges are mainly expressed as an annual amount per policy, irrespective of type (other than for non-profit annuities, for which the fee is lower), increasing each year by RPI + 1%. For group pension plans, the fee is per member rather than per policy. For policies with more than one benefit, including premium increments, the charge is only made once. They are apportioned on this basis.

Additional fees payable for certain other one-off activities and developments are generally apportioned in proportion to the PGMS fees.

14.11.2 Fees are also payable to the investment managers in connection with the management of the investments. These amounts are expressed as a percentage of the investments under management. Where investments are via a collective investment vehicle operated by the investment managers, the total fees payable to the investment managers are not materially different than if those investments were directly held.

Commission is also payable to intermediaries on some contracts.

14.11.3 Other than to the extent that expenses are apportioned to non-profit business or to certain activities the expenses of which are not apportioned to *asset shares* (such as mis-selling compensation) or to the extent described in paragraph 14.4.2, the totality of expenses allocated to the fund will be taken into account via the *asset share* calculations for specimen policies. Costs attributable to the fund that are not apportioned to *asset shares* or non-profit business will reduce the excess assets of the fund.

It is not intended to include expenses at other than cost to *asset share* calculation, other than as described in paragraph 14.4.2.

Principle
14.12 ***Estate* Management**

We aim to manage the size of the excess of the value of the assets over the amount we consider necessary on *market consistent* assumptions to enable us to meet the aims described in the guiding principles in section 5, so that the excess provides at all times an adequate but not excessive margin against an adverse outcome compared with the assumptions. The excess can be made up of assets within the fund, the excess assets within the Non-Profit Fund and the *Shareholder Fund* of Phoenix Life Limited.

We intend to maintain the excess at the targeted level by:

- controlling the addition of *annual bonuses* to policies;
- only paying *final bonus*es or other discretionary benefits in line with the principles set out earlier;
- maintaining an appropriate investment strategy;
- limiting, where possible, the business risks we face;
- exercising discretion in other areas with moderation;
- releasing *Shareholder Fund* assets to the shareholder; or
- as a short-term measure, drawing on additional financial support from the *Shareholder* fund or Non-Profit Fund in the form of loans to the fund or otherwise.

Practices

14.12.1 The *estate* is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.

14.12.2 The fund is currently able to cover its liabilities from its own resources and so does not require support by a loan from the Non-Profit Fund, although it has relied on such loans in the past.

14.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with section 14.4, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate.*

14.12.4 The estate in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly:

(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;

(c) meet any costs which are charged directly to the *estate* rather than to *asset shares;*

(d) meet the costs of any changes which the *Board* believe are necessary to improve fairness between policyholders and / or enhance the run-off of the fund; and

(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

14.12.5 Any enhancement in benefits on account of the *distributable estate* referred to in 14.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and surrender values. However if the *distributable estate* is large then consideration would be given to making additions to the *asset shares* from the *estate.*

14.12.6 The amount of the *estate*, the *distributable estate* and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

14.12.7 In the event of a risk of the assets of the fund being insufficient to cover the liabilities, charges may be made to the *asset share* to restore the *estate* to a target minimum level. However such charges could not be applied to any part of the deficit caused by regulatory penalties (fines) or compensation payments relating to events which occurred before 31 July 2009, see paragraph 5.2.18, except to the extent that such charges are effectively reversing any *estate* previously added into *asset shares*.

14.12.8 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the excess assets using solely the resources of the fund and avoiding the need to draw on any external sources of capital.

In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Arrangements exist for monies to be transferred from the Non-Profit Fund or *Shareholder Fund* to the fund with the aim that the amount of assets in the fund exceeds the liabilities by a small margin, should the charges described in 14.12.7 be insufficient to restore the *estate*. For this purpose, the possibility of distributing any surplus assets to policyholders will not be regarded as a liability.

Transfer of such amounts back to the *Shareholder Fund* will be made whenever emerging surplus in the fund, after the cost of bonuses (including shareholders share), permits.

The exercise of discretion in respect of with-profits policies will be managed with the aim that the amounts transferred to the fund will be repaid to the extent that is possible whilst still meeting the aims described in the guiding principles in section 5. In determining benefits under with-profits policies, any liability to transfer such amounts back to the Non-Profit Fund or *Shareholder Fund* will be disregarded to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle
14.13 New Business

Apart from as a result of the exercise of options under existing policies, contractual increments and new entrants to stakeholder, occupational and 'group personal' pension plans, we no longer accept new business. The future business risk from this source is expected to be small.

Practices

14.13.1 The fund is no longer actively seeking new business, but continues to write a small amount of new business relating to policy options under existing contracts.

Currently there are no plans to reopen the fund to new business.

Principle
14.14 Equity Between the Fund and *Shareholders*

The requirements of the *2023 Scheme* are such that holders of with-profits policies in the fund are entitled to receive at least 90% of the total distributable profits arising from the fund. The shareholder is entitled to receive the balance. None of the divisible profits arising in the fund are attributed to the other *with-profits funds*.

If the *Board* were considering making changes to increase this percentage, the *Board* would first request and consider the advice of the *Chief Actuary* and take into account the opinions of the *With-Profits Actuary* and the *With-Profits Committee.* If the *Board* still decided to proceed, the *Board* would notify policyholders at least three months in advance. The *Board* would also need to seek the agreement of its shareholders and, the High Court to make such a change.

From time to time, for some classes of business, we may transfer less than the permitted maximum from the with-profits fund to the *Shareholder Fund*.

If the fund requires financial support from the Non-Profit Fund or *Shareholder Fund* to enable the fund to meet the target excess assets described in section 14.12, the terms on which such support is provided will be fair and reasonable to all parties, taking into account prevailing market conditions and the risks involved. If such support forms part of the fund, then it will be treated as a liability to the extent that it would otherwise increase the excess assets.

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arms length commercial basis.

Practices

14.14.1 For *traditional* policies, the value of *annual bonus* added to policies, discounted at the risk free yield, is determined. One ninth of that value is transferred to the *Shareholder Fund* together with one ninth of the discounted value of any *interim bonus* and one ninth of any *final bonus*. This means that the transfer to the *Shareholder Fund* is 10% of the distributed surplus.

14.14.2 For *unitised* business, currently only five ninety-fifths of the face value of *annual* or *final bonus* added is attributed. This means that the transfer to the *Shareholder Fund* is broadly equivalent to 5% of distributed surplus.

14.14.3 For *unitised* business where a *market value reduction* is applied on claims, which has the effect of reducing the *annual bonus* previously added, then there is a corresponding reduction in the transfer to the *Shareholder Fund*.

14.14.4 Transfers to the *Shareholder Fund* on pensions business are reduced by an amount reflecting the expected additional tax arising on those transfers. Hence the net amounts transferred to the *Shareholder Fund* for pensions policies are lower than the 10% and 5% referred to above.

14.14.5 The relative apportionment of value between *shareholder* and policyholder will not be affected by changes in the discount rate, as shareholder transfers are discounted at market rates.

14.14.6 Additional tax arising from transfers to shareholders is allocated to the fund (but is not charged to *asset shares*). In considering the allocation of tax and any tax impacts that may arise from time to time fairness between the stakeholders is considered.

14.14.7 The *Board* are not aware of any external or internal factors which, if they were to change, would have a material effect on the apportionment of surplus as described above.

14.14.8 There are no classes of business which are significantly and systematically reducing the value of the excess assets of the fund as a result of the shareholder transfer in respect of that class.

15 Principles and Practices – Pearl With-Profits Fund

The Principles and Practices given in sections 15.4 to 15.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the Pearl With-Profits Fund. Sections 15.1 to 15.3 give background information specific to the Pearl With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the Pearl With-Profits Fund.

15.1 Fund History

The Pearl With-Profits Fund comprises *traditional* and *unitised* with-profits business as well as business transferred in from the NPI With-Profits Fund in Phoenix Life Limited under the *2023 Scheme*. The liability for certain *unitised* with-profits investments known as Portfolio Bonds is also transferred to the fund from the National Provident Life With-Profits Fund.

15.1.1 Pearl ceased issuing new with-profits policies in 2002 (apart from policies arising from options on existing with-profits business).

15.2 Types of Business

15.2.1 The with-profits policies within the Pearl With-Profits Fund are internally separated into five product groups:

- the Industrial Branch (IB) *traditional* business,
- the Ordinary Branch (OB) *traditional* business,
- the Ordinary Branch (OB) *unitised* business,
- the Ordinary Branch (OB) personal pension (PP) and free standing additional contribution (FSAVC) business, and
- *allocated business*.

15.2.2 Industrial Branch (IB) *traditional* business

These are similar to the OB *traditional* whole life and endowment policies, as described in 15.2.3. However, no *annual bonuses* were declared in the first five years of the contract, and guaranteed minimum *surrender* scales apply as required by legislation.

Groups of policies that have similar characteristics and features receive the same *annual bonus* rates and the same *final bonus* rates. These groups are known as bonus series.

Separate *annual bonus* and *final bonus* scales are declared for the following classes:

- endowments
- extended endowments
- whole of life policies

15.2.3 Ordinary Branch (OB) *traditional* business

This product group includes *traditional* whole of life, deferred annuities and endowment contracts. Benefits are payable on *maturity*, early termination or claim event (e.g. death or retirement). On *maturity* or claim event, the *guaranteed benefits* plus *final bonuses* are payable, except where contractual terms provide for alternative benefits. *Annual bonuses* may be declared each year, and once declared cannot be taken away. *Final bonuses* are not guaranteed and can be changed at any time. On early termination, a different approach to determining benefits payable is followed and is described in more detail in 15.8.

Groups of policies that have similar characteristics and features receive the same *annual bonus* rates and the same *final bonus* rates. These groups are known as bonus series.

Separate *annual bonus* scales are declared for the following classes:

- life simple bonus business
- pension and general annuity fund simple bonus business
- life compound bonus business
- pension and general annuity fund compound bonus business

Simple bonuses apply generally to those policies issued before 1 February 1982. The bonus amount is calculated either as a percentage of sum assured or premium. For certain pension policies nominal capital sum or annuity per annum is used instead of sum assured.

Compound bonuses apply generally to those policies issued on or after 1 February 1982. The bonus amount is calculated as a percentage of sum assured and attaching bonuses. For certain pension policies nominal capital sum or annuity per annum is used instead of sum assured.

Separate *final bonus* scales are declared for the following classes:

- life regular premium simple bonus endowment business
- life regular premium simple bonus whole of life business
- life single premium simple bonus business
- pension and general annuity fund regular premium simple bonus business
- pension and general annuity fund single premium simple bonus business
- homebuilder compound bonus business
- life, excluding homebuilder, regular premium compound bonus endowment business
- life, excluding homebuilder, regular premium compound bonus whole of life business
- life single premium compound bonus business
- pension and general annuity fund regular premium compound bonus business
- pensions and general annuity fund single premium compound bonus business

15.2.4 Ordinary Branch (OB) *unitised* with-profits business

Premiums paid by policyholders are allocated *investment units* at the date of the premium payment. Benefits are payable on *maturity*, early termination or claim event (e.g. death and retirement).

The units allocated to the policy increase by the daily addition of bonus units (if the declared bonus rate is greater than zero). One rate of bonus applies to the *investment units* and a different rate to bonus units previously added. Bonus units once added cannot be taken away. The daily bonus rates are declared in advance of the period to which they apply and can be changed at any time.

A *final bonus* may also be added to the policy when a claim is paid. This will be determined for each policy individually. The amount of this bonus will vary and will depend on premiums invested, the dates the investments were made and how much the assets of the fund have grown since those dates compared to the amount of daily bonus units already declared. On early termination, a different approach to determining benefits payable is followed and is described in more detail in 15.8.

Groups of policies that have similar characteristics and features will receive the same daily bonus rates and the same global *final bonus* rate. These groups are known as bonus series.

Separate *annual bonus* and *final bonus* scales are declared for the following classes:

- life policies issued in 1995
- life policies issued after 1995
- pension policies
- ISA policies
- Bonus Account policies

15.2.5 Ordinary Branch (OB) Personal Pension (PP) and Free Standing Additional Voluntary Contributions (FSAVC)

Premiums paid by policyholders are allocated *investment units* at the date of the premium payment. Benefits are payable on *maturity*, early termination or claim event (e.g. death or retirement). The value of the units allocated to the policy is set at the date of purchase and may increase as further units are allocated. Compound *interim* bonus units, if applicable, are added on a daily basis but these are not guaranteed and are superseded by *annual bonus* units when declared. Compound *annual bonus* units may be declared each year and are guaranteed if the policy is kept until retirement.
A *final bonus* may also be added to the policy. This is not guaranteed and may be changed at any time. On early termination, a different approach to determining benefits payable is followed and is described in more detail in 15.8.

Groups of elements of policies that have similar characteristics and features will receive the same *annual bonus* rates. These groups are known as bonus series.

Separate *annual bonus* and *final bonus* scales are declared for the following classes:

- Regular premium (including both premium paying and when premiums cease being paid)
- Single premium (including single premium transfers)
- Protected rights DSS recurring single premium

15.2.6 *Allocated business*

This includes

- the with-profits component of former NPI unitised with-profits policies in the non-profit fund, and
- the *unitised* with-profits investment for Portfolio Bonds passed to the fund under an inter-fund transfer from the National Provident Life With-Profits Fund.

The former NPI With-Profits Fund business in the fund is split into three different classes for the purposes of allocating *annual bonuses* and *final bonus*es as appropriate. The classes are:

- *Unitised* with-profits business.
- Socially Responsible With-Profits business.
- Capital Account business.

Unitised with-profits bond policies (including Portfolio Bonds) are allocated units when premiums attributable to the with-profits component are paid. The value of the units allocated to the policy increases by the daily addition of *annual bonuses* through the unit price. The rate of *annual bonus* is announced annually in advance in the form of an interim rate of *annual bonus*, but it may be changed at any time until formally declared as at 31 December each year.

A *final bonus*, increasing policy proceeds, or *market value reduction*, reducing policy proceeds, may be applied on early termination or claim event. The amount of *final bonus*, or *market value reduction*, will depend on the premium invested, the date the investment was made, and how much the assets of the fund have grown since that date compared to the amount of *annual bonus* already declared. *Market value reduction*s will not be applied to claims as a result of death, or to regular income payments.

The investment component of former NPI *unitised* with-profits pension policies operates in a similar way to the *unitised* with-profits bonds described above. *Market value reduction*s will not be applied to payments on this business on death and on some retirements, depending on contract terms.

Socially Responsible with-profits business is very much like *unitised* with-profits business, but the investment is in assets selected to meet certain socially responsible conditions.

Capital Account Pensions business does not get a *final bonus* and all the return is given through the *annual bonus* rate. *Market value reduction*s may still be declared on this class of business. As for the other pensions business, payments on death and some retirements are guaranteed to be not subject to a *market value reduction*.

Groups of policies that have similar characteristics and features will receive the same daily bonus rates and the same *final bonus* rates. These groups are known as bonus series.

Separate *annual bonus* and *final bonus* scales are declared for the following classes:

- Bonds
- Socially Responsible With-Profits Bond
- Socially Responsible With-Profits Pension
- Individual pensions
- Group pensions
- Capital Account Pensions

15.3 Capital Support to the Fund

The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund. The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle
15.4 **Amounts Payable Under a With-Profits Policy**

The general aim is to pay the *asset share*, plus any augmentation provided by a release of the *estate* of the Pearl With-Profits Fund. Payouts under *with-profits policies* target 100% of unsmoothed *asset shares* over time subject to guarantees and *smoothing*.

Asset shares are intended to be a reasonable approximation to the contribution a policy has made to the total assets of the *with-profits fund*.

The bases used to determine IB policyholders' *asset shares* will not be amended from those incorporated into Pearl's realistic balance sheet dated 30 June 2003, however, the assumptions used to calculate the *asset shares* for IB business may vary after 30 June 2003. The methodology and assumptions used to calculate the asset shares for all other business may be altered.

Where the use of approximations does not materially affect the resulting payouts to policyholders, then they may be used. In addition approximations may be used in circumstances where the information needed to perform more accurate calculations is not available (or is extremely difficult to obtain without significant expenditure). In this case, the approach will be carried out as accurately as possible in the *Board's* opinion.

Changes may be made to past and future methodology and assumptions where they are material and necessary to maintain equity between policyholders, or to maintain the solvency of the fund.

The methodology, parameters and assumptions and all changes thereto are formally documented and approved by the *Board,* having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

Practices

***Asset Share* Methodology**

15.4.1 For each of the *asset share* components described in this section, assumptions and parameters that are used are based on the actual experience of the fund using best data available at the date of investigation.

Where assumptions and parameters are not material or data not available, either industry experience or other data may be used. Assumptions for future periods (where used to project *asset shares*) are also based on the fund's recent experience and the *Board's* expectations of the future.

Prior to 1 January 2008, *asset shares* for personal pension and FSAVC policies were determined as described in 15.4.2 for *traditional* with-profits policies.

The *Board* determined to restate the *asset shares* for these policies at 31 December 2007 by reference to policy transfer values such that in aggregate the *asset shares* for these policies did not change.

From January 2008 the *asset shares* for these policies are determined as the accumulation of the restated 31 December 2007 *asset share* as described for personal pension and FSAVC policies in 15.4.2.

15.4.2 The following table describes the elements currently credited or charged to *asset shares* for specimen policies.

Element		*Traditional* **With-Profits IB and OB**	*Unitised* **With-Profits OB**	**Personal Pension & FSAVC OB**	***Allocated Business***
(a)	Premiums	Premiums paid under the policy	Premiums paid under the policy	Premiums paid under the policy	Note (a)
(b)	Investment return	Note (b)	Note (b)	Note (b)	Note (b)
(c)	Investment expenses	Note (c)	Note (c)	Note (c)	Note (c)
(d)	Initial expenses	Note (d)	Note (d)	Note (d)	Note (d)
(e)	Renewal expenses	Note (d)	Note (d)	Note (d)	Note (d)
(f)	Other expenses	Note (d)	Note (d)	Note (d)	Note (d)
(g)	Tax on investment return	Note (g)	Note (g)	Note (g)	Note (g)
(h)	Tax relief on expenses	Note (g)	Note (g)	Note (g)	Note (g)
(i)	Mortality & morbidity costs	Note (i)	Note (i)	Note (i)	Not charged
(j)	Early terminations	Note (j)	Note (j)	Note (j)	Not charged
(k)	Paid-up policies	Note (j)	Note (j)	Note (j)	Not charged
(l)	Partial and regular withdrawals	Note (j)	Note (l)	Note (j)	Note (l)
(m)	Surrenders at *protected dates*	Note (j)	Note (j)	Note (j)	Not charged
(n)	Annuity payments	Not applicable	Not applicable	Not applicable	Not applicable
(o)	Charges for the cost of guarantees or *smoothing*	Note (o)	Note (o)	Note (o)	Note (d)
(p)	Charges for the cost of capital	Note (p)	Note (p)	Note (p)	Not charged
(q)	Distributions to shareholders	Note (q)	Note (d)	Note (q)	Note (d)
(r)	Tax on distributions to shareholders	Note (r)	Note (r)	Note (r)	Note (r)
(s)	Profit and losses from other business	Note (s)	Note (s)	Note (s)	Note (s)
(t)	*Estate* distribution or charge	Note (t)	Note (t)	Note (t)	Not applicable
(u)	Exceptional items	Not applicable	Not applicable	Not applicable	Not applicable

Notes

(a) Premiums

For *allocated business*, the premiums used in *asset share* calculations are the premiums paid under the specimen policy which are used to purchase units net of any charges. These charges may include reduced, nil or enhanced allocation percentages, additional initial unit charges and a bid/offer spread.

(b) Investment return

The assets of the fund are currently split into a number of groups according to the business they support:

- OB With-Profits business (*unitised* with-profits *allocated business* receives the OB With-Profits business return)
- IB With-Profits business
- Non-Profit business in the With-Profits fund
- Capital Account Pension business
- Socially Responsible With-Profits business
- *Estate*

The investment return used to determine *asset shares* for a particular product group is equal to the investment return achieved on the pool of assets allocated to that product group.

The assets of the *estate* may be further split into a number of additional groups.

(c) Investment expenses

With the exception of *unitised* with-profits and *allocated business*, the fees for investment services are charged to *asset shares* at cost via a reduction to the investment yield credited to the assets in the fund.

For *unitised* with-profits and *allocated business*, an annual management charge is deducted, partly in lieu of a charge for investment services.

(d) Expenses

With the exception of *unitised* with-profits and *allocated business*, expenses representing the actual level of expenses attributed to the policies are deducted from *asset shares*. Current expense deductions are based on the service agreement the fund has with its service company and *investment managers*. The deductions for expenses incurred prior to the service agreement, are based on expense analyses, where available. In certain circumstances, large exceptional expenses may be spread over a number of years.

The service company charges the fund a fixed charge per policy and these costs are charged to individual policies, via a reduction to the investment yield credited to the *asset shares*. These costs increase in line with the service agreement with the service company.

Directly levied fees which cover costs not already covered by service company charges or investment services charges will be spread in a fair manner across all relevant policies at cost either as a flat monetary addition to the per policy charge or via a reduction to the investment yield credited to the *asset shares*. This may include treating some of the expenses as arising in future years.

For *unitised* with-profits and *allocated business*, an annual management charge is deducted, in lieu of the above expenses, *guarantee costs*, the recognition of gains and losses and shareholder profit where applicable.

(g) Tax on investment return

The amount of tax allocated to each individual policy is based on the policyholders' tax liability of that individual policy, ignoring any synergy benefit from being invested along with other policies. As a result, the total policyholder tax charge made against policyholder *asset share* may be different from the tax charge paid by the fund overall. Any difference between the two will be credited / charged to the *estate.*

(i) Mortality and morbidity costs

Charges are made to *asset shares* for meeting the cost of mortality and other risks under individual policies, with the exception of *asset shares* for *allocated business*.

(j) Early terminations

Credits or charges are made to *asset shares* for profits or losses arising from surrenders, with the exception of *asset shares* for *allocated business*.

(l) Partial and regular withdrawals

For *unitised* with-profits policies *asset shares* are charged for the actual payouts made to policyholders for regular income payments and partial surrenders.

For *allocated business* claim payments are charged to *asset shares*. These refer to payments to policies net of any penalties.

(o) Charges for the cost of guarantees or *smoothing*

Smoothing and guarantee adjustments are determined for and shared among the with-profits policies in accordance with the product groups below:
Group 1: Industrial Branch (IB) – *Traditional* Business
Group 2: Ordinary Branch (OB) – *Traditional* Business, Ordinary Branch (OB) – *Unitised* With-Profits (UWP), Ordinary Branch (OB) – Personal Pension (PP) and Free Standing Additional Voluntary Contribution (FSAVC)

The fund is credited / debited with *smoothing*, guarantee and miscellaneous profits / losses. Such profits / losses arise from the differences between claim payments and *asset shares*. The aim is that wherever possible, such payments should be met by the *asset shares* through *smoothing*, guarantee and miscellaneous adjustments.

Guarantee adjustments

For OB business, a charge of 0.10% per annum deducted from the investment return has been made from 1 April 2002 to 30 June 2007 to reflect the cost of guarantees. The level of this charge is determined by the *Board*, given actual cost of guarantees and policyholders' reasonable expectations. On 1 July 2007 this charge was capitalised and deducted from *asset shares*.

For IB business, no charge will be made for the cost of guarantees up to 30 June 2007. Any excess of actual *guarantee costs* over charges is borne by the *estate*. If the *estate* is or may be at risk then the *asset shares* may be adjusted.

From 1 July 2007 there is a periodic charge or credit for the costs of *guaranteed benefits*. This will normally be determined every six months. This charge or credit is determined at the end of each period as the difference in the realistic cost of meeting guarantees and the value of the assets held in respect of the guarantees adjusted for guarantees paid in the period for the relevant product group.

The charge or credit is restricted to a maximum of 1% of the relevant product group policy *asset shares* per annum. To the extent that the limit is exceeded, the excess will be carried forward and charged or credited, as appropriate, in the following period, subject to *Board* discretion. The *estate* may be used to reduce guarantee adjustments to *asset shares* if in the opinion of the *Board* these would lead to an unfair outcome.

The charge or credit is applied as a percentage charge or credit to *asset shares*, with the same percentage applying to all relevant product group policies.

***Smoothing* adjustments**

From 1 July 2007 there is a periodic charge or credit for the costs of *smoothing*. This will normally be determined every six months. This charge or credit is determined at the end of each period as the aggregate cost of *smoothing* on the relevant product group business during that period. The *estate* may be used to reduce *smoothing* adjustments to *asset shares* if in the opinion of the *Board* these would lead to an unfair outcome.

The charge or credit is applied as a percentage charge or credit to *asset shares*, with the same percentage applying to all relevant product group policies.

The *estate* funds *smoothing* adjustments on a temporary basis until they are charged back to *asset shares*.

(p) Charges for the cost of capital

No charge is currently made to the fund for the cost of capital as the fund does not rely on any capital support from the Non-Profit Fund or *Shareholder Fund*. The capital policy is described in section 3.5. The practices relating to receipt of support are detailed in section 5.2

(q) Distributions to shareholders

This is equal to a certain proportion of the cost of policyholders' bonuses. The proportion is subject to a maximum of 1/9th.

(r) Tax on distributions to shareholders

Shareholders' tax in respect of transfers from the fund is charged to the *estate*.

(s) Other business profit or losses

Credits or charges are made to *asset shares* for profits or losses arising from other business, with the exception of *asset shares* for *allocated business*.

The fund contains non-profit business, and this will generate a profit or loss. In addition, profits and losses will emerge from other sources, for example surrenders.

(t) *Estate* distribution or charge

There is a one off increase to *asset shares* to reflect the special bonus, paid as a result of the segregation of funds under Project Pacific.

Asset shares may be increased by distributions from the *estate* or reduced by charges to the *estate*. However these distributions are not guaranteed. In the event of the assets in the fund being insufficient to cover the liabilities then, in the first instance, any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit. See section 15.12. Any removal of past *estate* distributions will be limited to the amount of these past distributions. The enhancement to reflect the special bonus under Project Pacific will not be removed. The *allocated business* does not participate in any *estate* distribution or charge. See section 15.12.1.

15.4.3 All changes to methodology, parameters and assumptions are formally approved by the *Board,* having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

15.4.4 Except where payment of a contractual benefit results in a higher amount, and except where the amount cannot reasonably be compared with a calculated *asset share*, the target for policy claim payments is between 80% and 120% of the unsmoothed *asset share*. Where notional policies are used for this purpose, the policy claim payment will not be compared to its own *asset share* but rather would be adjusted to the size of the notional policy and then compared to the *asset share* of the notional policy. The longer term aim is to make aggregate policy claim payments of 100% of unsmoothed *asset share* though the outcome in any particular year may vary from this longer term aim.

Principle
15.5 ***Annual Bonus* Rates**

The *Board* sets bonus rates by reference to *asset shares*.

Policies are grouped into *bonus series* consisting of broadly similar policies. A new *bonus series* would be introduced if the *Board* felt that it was both compatible with *with-profits* policyholders' reasonable expectations (PRE) and necessary to maintain equity between different groups of policyholders.

For business other than *allocated business*, the *annual bonus* is usually set with a view that a proportion of the final *payout* will be made up of *final bonus*.

If, in the opinion of the *Board*, the regulatory requirements of the fund are, or may be, at risk then bonus rates, *surrender values* and the amount of *smoothing* may change. In these circumstances, significant weight will be given to the current economic conditions when setting bonus rates (which could be reduced to zero).

Practices

15.5.1 In all cases, these practices will be overridden if, in the opinion of the *Board*, the regulatory requirements of the fund are, or may be, at risk (because of for example, significant changes in market values of assets, or business losses). In these circumstances, the build-up of guarantees may be reduced through the declaration of a low or zero *annual bonus*.

15.5.2 The methodology, parameters and assumptions and all changes thereto are formally documented and approved by the *Board,* having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

IB and OB *traditional* with-profits

15.5.3 For *traditional* business, the *annual bonus* rate is normally reviewed at the end of each calendar year. The *annual bonus* may be set to zero. If a non-zero level is set, it is allocated to the policy on 1 January in the following year, providing all premiums due at that time have been paid.

15.5.4 No interim bonuses are declared in respect of IB and OB *traditional* business.

15.5.5 For *compound bonus* policies where the policyholder has stopped paying premiums and conditions for continuing to participate in future bonuses have been met, the rate of *annual bonus* payable is halved.

Where policyholders cease premiums under a simple bonus policy, the policy becomes non-profit for a reduced amount and no further bonuses will be allocated.

15.5.6 The level of *annual bonus* is set so as to maintain a buffer for *final bonus*.

The future claim payments are estimated using realistic assumptions and the *annual bonuses* set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the payout paid in the form of *final bonus* will be in line with the proportion specified.

Under current investment conditions, the overall target is that 25% of the overall value of payouts, calculated before any augmentation provided by the release of the *estate*, will be in the form of *final bonus*.

Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. The overall target is itself subject to review and may be changed.

15.5.7 If the estimated payouts detailed in 6.5.6 indicate that the level of *final bonus* is in the overall value of payouts is less than 25% then the *annual bonus* will be set to zero.

15.5.8 Where the financial position of the fund is weak the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

15.5.9 Normally the declared *annual bonus* rate would not be expected to be more than 2% different to that declared in the previous year.

OB personal pension and free standing additional voluntary contribution business

15.5.10 For personal pension and free standing additional voluntary contribution business, the *annual bonus* rate is normally reviewed at the end of each calendar year. The *annual bonus* rate may be set to zero.

An interim daily bonus for policyholders claiming during the year is declared. The *interim bonus* can be changed at any time and is set by reference to the expected level of *annual bonus*. If the expected level of *annual bonus* changes, the *interim bonus* will be adjusted to reflect this.

15.5.11 The level of *annual bonus* is set so as to maintain a buffer for *final bonus*.

The future claims payouts are estimated using realistic assumptions and the *annual bonuses* set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the payout in the form of *final bonus* will be in line with the proportion specified.

Under current investment conditions, the overall target is that 25% of the overall value of payouts, calculated before any augmentation provided by release of the *estate*, will be in the form of *final bonus*.

Given the aggregate nature of this target, for an individual policy this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed.

15.5.12 If the estimated payouts detailed in 6.5.10 indicate that the level of *final bonus* in the overall value of payouts is less than 25% then the *annual bonus* will be set to zero.

15.5.13 Where the financial position of the fund is weak the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

15.5.14 Normally the declared *annual bonus* rate would not be expected to be more than 2% different to that declared in the previous year.

OB *unitised* with-profits business

15.5.15 Daily bonus rates, as described in 6.2.4 are set with regard to the expected average return in the medium term future on the underlying assets, less

- the expected level of tax and charges, as appropriate;
- a margin to allow for gains and losses; and

- a margin for *final bonus*.

The deductions above may vary in size from time to time. The rates of daily bonus may be changed at any time, although they are normally reviewed quarterly. The periodic review of bonus rates has regard to profits and losses on terminating policies.

Allocated Business

15.5.16 *Annual bonus* rates for the calendar year are normally declared at 31 December and *interim bonus* rates for the following year are set at the same time.

15.5.17 For *allocated business*, other than Capital Account business, *interim bonus* rates are set at a level of the expected average return in the medium term future on the underlying assets, less the expected level of tax and charges as appropriate less a margin to allow for either some *final bonus* to emerge or *market value reductions* to reduce. The margin may vary in size from time to time. The *interim bonus* rates may be changed at any time.

15.5.18 For Capital Account business, it is intended to set the *interim bonus* rate at the start of each year at a level consistent with the expected return on the underlying assets, plus or minus an adjustment designed to bring the business more closely into line with the *asset shares*.

15.5.19 The declared *annual bonus* rates would normally be the same as the *interim bonus* rates or less, if in the opinion of the *Board*, the regulatory requirements of the fund are, or may be, at risk by declaring rates equal to the interim rates.

15.5.20 *Annual bonus* rates on *allocated business* other than Capital Account business would not normally be expected to reduce or increase by more than two percent per annum.

15.5.21 *Annual bonus* rates on Capital Account business would not normally be expected to reduce or increase by more than two percent per annum.

Principle 15.6	***Final Bonus* Rates** The *Board* sets bonus rates by reference to *asset shares*. Policies are grouped into *bonus series* consisting of broadly similar policies. A new *bonus series* would be introduced if the *Board* felt that it was both compatible with *with-profits* policyholders' reasonable expectations (PRE) and necessary to maintain equity between different groups of policyholders. For business other than *allocated business*, the *annual bonus* is usually set with a view that a proportion of the final payout will be made up of *final bonus*.

Practices

15.6.1 The sections below refer to the practices for setting *final bonuses*, before any augmentation to *final bonus* provided by a release of the *estate*, for each of the main lines of business.

In all cases, these practices will be overridden if, in the opinion of the *Board*, the regulatory requirements of the fund are, or may be, at risk (because of, for example, significant changes in market values of assets, or business losses). In these circumstances, the *Board* may target payouts at less than 100% of *asset shares*, subject to paying out a minimum of the *guaranteed benefits*.

15.6.2 The methodology, parameters and assumptions and all changes thereto are formally documented and approved by the *Board,* having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

IB and OB *traditional*, personal pension and FSAVC with-profits business

15.6.3 Final bonuses are normally reviewed and set every six months such that the final payout targets 100% of unsmoothed *asset share* over time subject to guarantees and *smoothing*.

15.6.4 For business other than PP and FSAVC, the *final bonus* rate is determined for each bonus year by reference to the projected *asset shares* of the policies. Where bonus year is the year from which the policy becomes entitled to participate in bonuses.

For PP and FSAVC, up to and including 31 December 2007, a similar approach is adopted but the *final bonus* rate is determined for each year the policy participates in profits (see 6.6.8 for the approach to be adopted thereafter).

For PP and FSAVC, the *asset share* calculations, which underlie the bonus rates, are performed using notional policies with relevant characteristics, such as age and level of benefits, for each *bonus series*. In these calculations, approximations and considerations of materiality may be applied in determining the notional policies used.

For IB and OB *traditional* business, the aggregate *asset share*, which underlies bonus rates, is calculated by summing the individual *asset shares* for notional policies with relevant characteristics such as age and sum assured for each *bonus series*. In each of these calculations, approximations and considerations of materiality may be applied in determining the notional policies used.

15.6.5 In performing this exercise, for business other than IB and OB *traditional* business, any excess of *guaranteed benefits* over *asset shares* are ignored. This is done so that if the guaranteed benefit under a notional policy is greater than *asset share*, this does not result in a reduction of *final bonus* on other notional policies.

In performing this exercise for IB and OB *traditional* business any excess of the aggregate *guaranteed benefits* over the aggregate *asset shares* for a given bonus year are ignored. This is done so that if the aggregate *guaranteed benefits* for a given bonus year is greater than aggregate *asset shares*, then this does not result in a reduction of *final bonus* on other bonus years.

15.6.6 The unsmoothed *final bonus* rates may be further adjusted as described in 6.7 to allow for *smoothing* and consistency between bonus years.

15.6.7 The same *final bonus* rates apply for both death and maturity where the *final bonus* is paid on death.

15.6.8 With effect from 1 January 2008, *final bonuses* for PP and FSAVC are not as described above but are determined for each individual policy element such that the final payout targets 100% of unsmoothed *asset share* over the time subject to guarantees and *smoothing*.

15.6.9 Full weight is given to recent economic experience in determining *asset shares*. As such payouts are similarly impacted, unless the *smoothing* process acts so as to restrict this link between the *asset shares* and payouts.

OB *unitised* with-profits business

15.6.10 *Final bonuses* are determined for each individual policy such that the final payout targets 100% of unsmoothed *asset share* over time subject to guarantees.

15.6.11 A global *final bonus* rate is determined for each *bonus series*. This rate is determined by comparing the aggregate *asset share* with the sum of the *investment units* and the bonus units for the bonus series. The global final bonus rate is normally reviewed and set fortnightly.

15.6.12 An individual policy *final bonus* rate is calculated by comparing the sum of the *investment units* and the bonus units allocated to the policy to the *asset share* for the policy.

15.6.13 The applicable *final bonus* rate is set by reference to the calculated individual rate having regard to the global rate for the *bonus series*.

15.6.14 Full weight is given to recent economic experience in determining *asset shares*. As such payouts are similarly impacted, unless the *smoothing* process acts so as to restrict this link between the *asset shares* and payouts.

Allocated business

15.6.15 *Final bonuses* are determined such that the final payout targets 100% of *asset share* over time subject to guarantees and *smoothing*. The *asset share* calculations, which underlie the bonus rates, are performed using notional policies with relevant characteristics, such as age and level of sum assured, for each *bonus series*. In these calculations, approximations or considerations of materiality may be applied in determining the notional policies used.

15.6.16 *Final bonus* rates are determined for each tranche of business, typically grouped quarterly by date of premium payment. Separate bonus rates are determined for Socially Responsible with-profits business and other reinsured business excluding Capital Account business. No *final bonus* is applicable to Capital Account business.

15.6.17 Rates are normally reviewed monthly and are changed at least quarterly and are subject to *smoothing*.

Principle
15.7 ***Smoothing***

To avoid significant changes in benefits over time for policies within the same *bonus series*, or for certain similar groups of policies within *bonus series*, smoothing is applied. This limits the changes in payouts from one period to the next.

Where *smoothing* is applied it is intended for *smoothing* costs after 1 July 2007 to be neutral over time. This will be achieved by tracking the payouts made to policyholders and debiting / crediting the *smoothing* cost to *asset shares*. The *estate* of the Pearl With-Profits Fund may be used to reduce *smoothing* adjustments to *asset shares* if in the opinion of the *Board* these would lead to an unfair outcome. Given the process there is no total scale or cost of *smoothing* to the fund over the shorter term that should not be exceeded.

Practices

15.7.1 The sections below set out the *smoothing* practices for the main lines of business. In all instances, the *smoothing* approach described for each product group applies equally to different generations of policyholders. There is no overall limit to the cost of *smoothing* for any product, but *smoothing* is subject to the overall solvency of the fund and the existence of sufficient excess assets of the *with-profits fund* to meet regulatory requirements.

15.7.2 *Smoothing* is applied to payouts determined before any augmentation to *final bonus* for release of the *estate*. The augmentation to *final bonus* for any release of the *estate* is unsmoothed.

15.7.3 Profits / losses from this *smoothing* are shared among the with-profits policies in accordance with the product groups below:
Group 1: Industrial Branch (IB) *traditional* business
Group 2: Ordinary Branch (OB) *traditional* business, Ordinary Branch (OB) *unitised* with-profits (UWP), Ordinary Branch (OB) personal pension (PP) and free standing additional voluntary contribution (FSAVC).

Profits and losses arising from *smoothing* Group 1 policies are shared among Group 1 policies.

Profits and losses arising from *smoothing* Ordinary Branch (OB) *traditional* business, Ordinary Branch (OB) personal pension (PP) and free standing additional voluntary contribution (FSAVC) are shared among the Group 2 policies.

15.7.4 The aim is that, wherever possible, such profits and losses should be met by the *asset shares* through *smoothing* adjustments.

15.7.5 The methodology, parameters and assumptions and all changes thereto are formally documented and approved by the *Board*, having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

Industrial Branch (IB) and Ordinary Branch (OB) *traditional* business, personal pension (PP) and free standing additional voluntary contributions (FSAVC)

15.7.6 For *traditional* policies where *final bonus* changes are normally twice a year *smoothing* is applied to *maturity* or retirement values, and is done by limiting the changes in *final bonus* rates. Normally the change in *final bonus* rates for a policy will be limited so that the increase or reduction in total *maturity* or retirement *payout* (excluding any *estate* distribution) compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

15.7.7 For *traditional* policies, *surrender value* bases are normally reviewed twice a year, and *smoothing* is applied by limiting the change in immediate *surrender value* for policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values* may change in between reviews because in many cases the *surrender values* are calculated using formulae that depend on factors such as term remaining which change over time.

15.7.8 However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values*.

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and surrender bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing payouts, then *smoothing* will not be applied, so that the change in payouts intended by the premium rate changes does occur.

For both maturity and retirement values, and *surrender values*, any change to payouts that results from changes in the *distributable estate*, if any, will be additional to the limits described and will not be subject to *smoothing*. Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

For PP and FSAVC policies, the *smoothing* applied to *surrender values* is described in 15.8.11

Ordinary Branch (OB) – *Unitised* With-Profits (UWP)

15.7.9 The payouts under UWP policies are set to target the *asset share* and there is no maximum amount by which the level of payout can change from year to the next. However given the fact that the bonuses do not reflect day to day market movements, there will be a series of over and underpayments relative to the *asset share* which are met from the *estate*.

Allocated business

15.7.10 The targets under *allocated business* are set to target the *asset share* and there is no maximum amount by which the level of payout can change from one year to the next. However, given the bonuses do not reflect the day to day movements, there will be a series of over and underpayments relative to the *asset share*.

15.7.11 There is no automatic method for *smoothing.* However, extreme changes in the investment return may be *smoothed* by setting different final bonuses or *market value reduction*s than would normally be the case. The extent of such *smoothing* is reduced if discontinuances become excessive; for example if this would otherwise impact the financial security of the fund or lead to significant inequity.

Principle 15.8 ***Surrender Values***

Surrender values will be set with reference to the policy's *asset share*, plus any augmentation provided by release of the *estate*. The fund applies *market value reductions,* or changes to surrender bases for *with-profits policies* that are not *unitised,* to reflect changes in underlying *asset shares*. *Surrender values* may be subject to *smoothing*, and may vary considerably in line with movement in *asset shares*. *Surrender values* as determined will be subject to guaranteed minimums, where provided by the contract terms.

Practices

15.8.1 *Non-protected exits* refer to surrenders and transfers for pension business.

15.8.2 The practices applying to the calculation of *surrender values* for with-profits policies vary by product and are described below. Certain policies have *surrender values* guaranteed in the contract or prescribed by regulation. Where the application of these practices produces *surrender values* that are below these levels, the guaranteed or regulatory benefits will be paid.

15.8.3 Except for levels prescribed by regulation and guarantees, these practices will be overridden if in the opinion of the *Board*, the regulatory requirements of the fund are, or may be, at risk. In these circumstances the *Board* may set payouts to target less than 100% of *asset share*.

15.8.4 The *surrender values* of non-profit policies within the *with-profits fund* are not described in these practices.

15.8.5 The methodology, parameters and assumptions and all changes thereto are formally documented and approved by the *Board*, having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

Industrial Branch (IB) and Ordinary Branch (OB) – *Traditional* business, Personal Pension (PP) and Free Standing Additional Voluntary Contribution (FSAVC)

15.8.6 *Surrender values* are based on a formula designed to ensure *surrender values* paid meet the target in 15.4.4. The *asset share* calculations, for this purpose, are performed using notional policies with relevant characteristics, such as age and level of sum assured / benefits. In these calculations, approximations or considerations of materiality may be applied in determining the notional policies used.

15.8.7 While *asset shares* are targeted, the operation of the formula means that some surrender payments will be higher or lower than *asset shares.* For example, the amounts payable to policies surrendering in the first few years of the policy's life may exceed *asset shares,* particularly where the *asset share* is negative (for example as a result of expenses). In addition, in between review dates fluctuations in *asset shares* will also lead to payments varying by *asset shares.*

15.8.8 In the circumstances described, any overpayment relative to *asset share* is funded from the *estate* of the Pearl With-Profits Fund until passed back to the *asset shares*, and any underpayment is credited to the *estate* of the Pearl With-Profits Fund until credited back to the *asset shares*.

15.8.9 *Surrender values* are normally reviewed every six months. However, the fund may review *surrender values* whenever it is deemed necessary.

15.8.10 For the avoidance of doubt, in the approach described above, *surrender values* at particular policy durations are not related or compared to the actual maturity benefits of policies of the same duration.

15.8.11 With effect from 1 January 2008, *surrender values* for PP and FSAVC policies are smoothed for each individual policy element such that the maximum year on year change in payouts, under normal circumstances is 15%, rather than the process described above. Underlying this maximum change in payouts is the scale detailed in 15.7.7. This limit is not subject to regular review. In making this comparison any premiums paid in the previous year are not taken into account.

Ordinary Branch (OB) – *Unitised* With-Profits (UWP)

15.8.12 *Surrender values* are equal to the value of investment units less any fixed penalties applied plus the value of the bonus units added plus any *final bonus* as determined using the same approach as the maturity *final bonus*.

15.8.13 For a small group of policies issued during 1995, *market value reduction*s may be applied. The aim of the *market value reduction* is to broadly equate *surrender* payments to *asset shares*. The *market value reduction*s are implemented as a reduction to the *final bonus* and can lead to negative *final bonus*.

15.8.14 Where no *market value reduction* applies, there is no distinction made between surrendering and maturing policies when determining *final bonus*.

15.8.15 *Market value reduction*s do not apply to UWP policies sold since 1 January 1996.

15.8.16 Any strain on regular withdrawals arising from the exercise of contractual options will be borne by the *estate* of the Pearl With-Profits Fund.

Allocated business

15.8.17 A *final bonus*, increasing policy proceeds, or *market value reduction*, reducing policy proceeds, may be applied on early termination or claim event. The amount of *final bonus*, or *market value reduction*, will depend on the premium invested, the date the investment was made, and how much the assets of the fund have grown since the date compared to the amount of *annual bonus* already declared. *Market value reductions* will not be applied to claims as a result of death, or to regular income payments, or on some retirements depending on contract terms.

15.8.18 *Final bonuses* are determined such that the final payout targets 100% of *asset share* over time subject to guarantees and *smoothing*. The *asset share* calculations, which underlie the bonus rates, are performed using notional policies with relevant characteristics, such as age and level of sum assured for each *bonus series*. In these calculations approximations or considerations of materiality may be applied in determining the notional policies used.

15.8.19 *Final bonus* rates are determined for each tranche of business, typically grouped quarterly by date of premium payment. Separate bonus rates are determined for Socially Responsible With-Profits business and other reinsured business excluding Capital Account business. No *final bonus* is applicable to Capital Account Pensions business.

15.8.20 Rates are normally reviewed monthly and are changed at least quarterly and are subject to *smoothing*.

Principle 15.9 Investment Strategy

The investment strategy for the fund is set to maximise returns having regard to the solvency position of the fund, the nature and extent of guarantees in the portfolio, the expected liquidity requirements to meet cash outflows and with reference to the asset mix for peer group companies. The assets of the fund are invested in a range of *asset classes* with varying degrees of risk.

The fund aims to hold a target percentage of its assets within each *asset class* so as to maintain an asset mix which is consistent with the interests of policyholders (subject to such constraint as may be necessary to meet solvency and regulatory capital requirements. The investment mandate given to the *investment managers* contains detailed requirements as to the type of asset that are acceptable investments and the target percentage of each *asset class* that the fund aims to hold. The mandate gives a range of values within which the actual proportion invested in each *asset class* must lie, which allows the *investment managers* some flexibility in order to try and maximise returns within the risk requirements of the fund. The investment mandate has counterparty limits within it. The objective is to avoid significant aggregate exposure to any individual counterparty limit.

Within each *asset class*, as far as possible, a diversified range of assets subject to counterparty limits will be held. *Shareholder Funds* are not taken into account when setting investment strategy.

The fund may invest in derivative instruments to implement investment decisions where it is deemed efficient to do so. In addition, derivatives may be used to change the *risk profile* of the fund. Any derivative investments will be subject to counterparty limits as well as the approval of the *Investment Committee*.

The target percentage invested in each *asset class* will be altered in circumstances where there is an unacceptably high risk that regulatory capital requirements may be breached, that guarantees may not be met, or that it will not be possible to apply the stated *smoothing* policy. If in the opinion of the *Board*, the regulatory requirements of the fund are or may be at risk, then the investment mix of assets held will be adjusted as deemed necessary. At the same time, if appropriate to enable the fund to pursue an investment strategy in the best interests of policyholders, regard shall be taken of any excess assets over regulatory capital requirements (if any) in the Non-profit Fund and *Shareholder Fund* (but not any other fund) in setting investment policy, if this is considered necessary to ensure that the investment policy is consistent with policyholders' reasonable expectations.

No future material investments will be made on behalf of the fund in non-tradeable assets.

Assets allocated to the fund may be hypothecated providing that, in the opinion of the *Board*, having taken appropriate advice (including appropriate actuarial advice) the hypothecation:
(i) is unlikely to have a material adverse effect on the interests of any group or generation of holders of policies allocated or reassured to the fund;
(ii) is unlikely to have an adverse effect on the interests of holders of policies allocated or reassured to the fund considered as a whole; and
(iii) is unlikely, where applicable, to have a material adverse effect on the interests of any group or generation of policyholders in any other *with-profits fund*.

Practices

15.9.1 The *Board* receives advice on its investment strategy for the fund from its *Investment Committee* taking account of a variety of considerations, including our approach to *responsible investment.* The *Board* will also receive advice from the *With-Profits Committee* and the *With-Profits Actuary* on any material proposals to change investment mix, or invest in new types of asset.

15.9.2 The investment strategy is documented in a series of investment management agreements between the fund and its *investment managers*. The *Investment Committee* oversees the *investment managers* to ensure that the investments held are in accordance with the investment management agreements.

15.9.3 The investment management agreements set out any limits on matters such as:
- The types of investment that may be held.
- The maximum amount that can be invested in any single currency.
- The maximum amount that can be invested in any single *asset class* / investment sector / country.
- The maximum extent to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns (these include restrictions in terms of credit quality, term / duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moodys).
- The maximum amount of gearing within the fund (that is, the maximum amount of borrowing the fund may undertake to invest in new assets)
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

15.9.4 Before investing in new types of investment, the *Board* will obtain the advice of the *investment managers* and the *Investment Committee* on the benefits and risks. The *Board* will also notify the *With-Profits Actuary* and the *With-Profits Committee* of these proposed new types of investment and they may then, at the *Board's* request or on their own initiative, provide the *Board* with their own advice.

15.9.5 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

Asset Mix

15.9.6 The assets within the fund are separated into different asset pools. This separation may be either physical (where the *investment managers* run a separately identifiable asset pool) or notional (where rather than holding separate assets, we internally apportion the returns within the fund as if separate asset pools were held).

15.9.7 Different asset pools, with different asset mixes are currently held in respect of:
(1) *asset shares*
(2) liabilities for options and guarantees
(3) liabilities for *Non-profit* policies and other liabilities
(4) the *estate* of the Pearl With-Profits Fund.

15.9.8 Within *asset shares*, the asset mix is set separately for:
(a) OB With-Profits business (excluding: (c) and (d) below)
(b) IB With-Profits business
(c) Socially Responsible With-Profits business, and
(d) Capital Account Pensions business.

15.9.9 Currently, the same asset mix is adopted for policies of type (a) and (b) above but different asset mixes may be adopted in future.

15.9.10 The overall asset mix of the fund is the result of combining the assets in each of the underlying asset pools.

15.9.11 Regular calculations are carried out to assess whether the size of the estate is adequate taking into account the risks to which the fund is exposed. The asset mix, including the asset mix within *asset shares*, will be altered in circumstances where there is an unacceptably high risk that regulatory capital requirements may be breached, that guarantees may not be met, or that it will not be possible to apply the stated *smoothing* policy.

15.9.12 Assets held outside of the fund may have their own separately determined asset mix.

Asset Shares

15.9.13 The fund aims to maintain an exposure to *growth investments* for OB and IB With-Profits business. *Growth investments* have higher risk than other investments (such as cash and bonds) but are expected to produce a higher long-term return. The value of the *Growth investments* may therefore be more volatile. *Growth investments* will normally consist of equity shares (including private equity), commercial property and hedge funds. However, the *investment managers* may also choose to hold other types of investment within the *growth investment* category. If holdings in other types of investments are to be anything more than a very small proportion of the *growth investments* then this will be subject to the prior agreement of the *Investment Committee*.

15.9.14 The equity shares will be held in a mix of UK and overseas companies, the majority of which are listed and traded on the major stock exchanges. However the equity shares will also include a proportion of private equity investments which are less liquid and may therefore take longer to sell, should the fund wish to. Some of the private equity investments involve commitments to make further investments if called. Some of the private equity investments are structured in such a way as to give a higher risk reward profile making them potentially more volatile.

Within the equity shares there is a very small exposure (less than 1% of *asset share*) to the equity of collateralised debt obligation structures which are also less liquid and potentially more volatile.

15.9.15 The property investments may be in both UK and overseas properties, and may be held directly, or through specialist funds.

A significant proportion of the property investment is through specialist funds. Some of the specialist funds are geared which means they have borrowed against their properties to increase the potential profits or losses. Some of the specialist funds are structured so that the returns from the underlying property are split to offer different investors a different investment profile, such as lower returns with lower risk or higher returns with higher risk. The fund holds various types of such instruments in its *growth investments*. Some of the specialist funds have end dates at which they will be liquidated, with the underlying assets being sold and returned to investors. Where the specialist funds have borrowings that become repayable at a certain date, then they will have to refinance those borrowings, or sell assets to repay the borrowings. Consequently the value of an investment in a specialist fund may be affected by the expected availability and cost of borrowing at the refinance date, as well as by the value of its assets.

15.9.16 The hedge funds are invested in a range of different funds running different specialist strategies, across different territories.

15.9.17 The balance of the *asset shares* that are not invested in *growth investments* are invested in a mixture of cash and fixed interest securities (bonds issued by governments and corporate bonds issued by companies). Although such investments are generally considered to be lower risk than the *growth investments*, the values of such investments can still be significantly affected by market rates of interest, company or government defaults or debt restructures, and the levels of market liquidity. A small amount is held in a fund of leveraged loans.

The majority of the bonds that are not issued by governments will normally be investment grade (i.e. rated BBB- or higher by a recognised rating agency), but the fund may also have an exposure to lower rated or unrated bonds, including emerging market bonds and high yield bonds.

Hypothecation of fixed interest assets by term remaining was introduced from 1 January 2020 for *traditional* policies to reduce the volatility of policyholder returns near maturity. The return on the fixed interest assets attributed to the *traditional* policy asset share will reflect the term remaining of the policy.

15.9.18 Returns on emerging market debt do not reflect the term remaining, but rather reflect the overall return on such debt.

15.9.19 If it is considered by the *Board* to be appropriate, then, subject to actuarial advice, further hypothecation of the assets in the fund may be introduced.

15.9.20 Although the *asset shares* are invested in a number of assets that might be considered higher risk in their own right, by having exposure to a range of different assets and risks, the overall investment mix within the *asset shares* is well diversified and is designed to give an appropriate overall balance between risk and return.

15.9.21 The guideline asset mix ranges for *asset shares* are:

	All business other than Capital Account Pensions business*
Fixed interest and cash	40% to 55%
Equities including private equity and *alternative assets*	40% to 55%
Property	0% to 10%

*For Capital Account Pensions business, the target asset mix is approximately 25% in aggregate investment across equities, property and *alternative assets.*

Although the overall equity range will remain applicable, over time the target percentages for private equity and alterative assets will reduce.

15.9.22 From time to time the actual asset mix will be different from the guideline mix due to market movements and active management decisions taken by the *investment managers* or the *Investment Committee*.

Liabilities for Policy Options and Guarantees

15.9.23 We assess how the expected cost of the guarantees and options inherent in the with-profits policies, net of the value of expected future guarantee charges and early termination profits, will change as the prices of the *growth investments* rise and fall and as market volatilities and interest rates change. A mix of assets which will broadly change in line with the change in the net cost of the guarantees is identified. This asset mix may require a *short position* in *growth investments* to be adopted and a long position in fixed interest securities or cash. It may also require the use of financial instruments such as interest rate *swaps*, interest rate options, equity futures, equity options or other derivatives.

15.9.24 Because the appropriate asset mix to back guarantees and options will change as the prices of *growth investments*, interest rates, *credit spreads* and volatility change, it is not possible in practice for our investments to match exactly these liabilities. However we periodically assess the appropriate asset mix, and may make interim changes if there have been particularly large market movements.

Liabilities for Non-profit policies and other liabilities

15.9.25 Assets backing the liabilities for non-profit policies are invested in fixed interest securities chosen to broadly match the duration and amount of the liabilities. Assets backing unit-linked liabilities which are not wholly reinsured are invested in the assets used to determine the value of the unit liability. Assets backing RPI-linked liabilities or expense reserves are invested in index-linked securities or inflation linked derivatives. Assets backing short-term liabilities are invested in cash or short-term debt. Assets backing additional benefits granted to certain policyholders with mortgage endowment policies, and certain pension policyholders whose policies were missold, are invested using a similar approach to that described in 15.9.23 above.

Estate

15.9.26 Assets representing the *estate* of the Pearl With-Profits Fund are mostly invested in fixed interest securities. However if the *estate* is large in relation to the potential risks facing the fund, then part of the *estate* may be invested in *growth investments* in line with the asset mix of the *asset shares*.

Currency

15.9.27 The currency exposure arising from any investment in overseas equities or emerging markets is not normally hedged, and so the return achieved by the fund depends on both performance of the investments and any movement in currency exchange rates. Currency exposures from any other types of investments denominated in currencies other than sterling are normally hedged, unless the liabilities that the assets are backing are also denominated in another currency.

Derivatives

15.9.28 Derivatives are normally only used for efficient portfolio management or to reduce investment risk. For example derivatives may be used to make changes in investment allocations more rapidly or cheaply than could be done directly through the markets. Similarly, for example, they are also used to improve the matching of the assets and liabilities. Derivatives having the effect of *growth investments* will be treated as such.

Investment Managers

15.9.29 The majority of the investments are currently managed by the *investment managers,* who may outsource the management of some of the assets under arrangements in place with other specialist managers.

15.9.30 The hedge funds are managed by the *investment managers* although they are then invested in a range of other hedge funds run by other managers.

Assets *not normally traded*

15.9.31 The fund does not currently hold any material assets such as properties occupied by Phoenix Life Limited or shareholdings in subsidiary companies, that would *not normally be traded* because of their strategic importance to the fund or the Phoenix Group.

Principle 15.10 Business Risks

Subject to any future hypothecation of assets in the fund, with-profits policyholders are entitled to share in the total profits of the fund, and therefore are exposed to the business risks of the fund including the ongoing maintenance of other existing with-profits policies and non-profit policies in the fund. Existing business risks are monitored on a regular basis.

The fund seeks to avoid taking on new business risks and is managed in such a way as to minimise the existing business risks.

Where a business risk (other than the provision of guaranteed and contractual benefits charged to *asset shares*; *smoothing* risk; and the profits or losses on non-profit business associated with a particular *bonus series* of with-profits business) results in additional cost or reserve requirements and the fund has been deemed liable, the aim will be to charge these additional costs to the Pearl With-Profits Fund *estate*. In doing this, distinction will be made between IB and OB business, where possible. If the *estate* is exhausted then the costs will be met by the Shareholder, either from the Non-Profit Fund or the *Shareholder Fund*.

The profits / losses from the provision of guaranteed and contractual benefits charged to *asset shares*, *smoothing* risk, and the profits or losses on non-profit business associated with a particular *bonus series* of with-profits business are shared among the *with-profits policies* in accordance with the product groups below:
Group 1: Industrial Branch (IB) - *Traditional* Business
Group 2: Ordinary Branch (OB) – *Traditional* Business, Ordinary Branch (OB) *Unitised* With-Profits (UWP), Ordinary Branch (OB) – Personal Pension (PP) and Free Standing Additional Voluntary Contribution (FSAVC)

Should the grouping above have no flexibility to absorb any losses emerging (due to, for example, guarantees), the losses will be treated in the same way as other business risks, as detailed above.

For *allocated business*, no profits or losses arising from non-profit policies are shared with this business.

Practices

15.10.1 Phoenix Group’s current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

15.10.2 The fund is no longer taking on any additional types of business risk. For the current business risks, there are limited opportunities to affect the impact of such risks on the fund.

15.10.3 Current and potential sources of business risk are described below.

Non-profit business

15.10.4 The most material non-profit business in the fund relates to certain policies, which have been made paid-up. In the normal course of events, profits or losses can be expected to arise from miscellaneous sources, such as mortality or surrender. These profits or losses are credited in accordance with principle 6.10 above.

Pensions mis-selling

15.10.5 The fund has agreed to compensate certain policyholders who were incorrectly advised to transfer out of company pension schemes and into *personal pensions* and full reserves have been established. There is still a risk that the reserve may not be sufficient. The cost of this exercise (including compensation costs) is borne by the Pearl With-Profits Fund *estate*.

Other liability issues

15.10.6 There is a risk that other liabilities may arise that have not yet been discovered. If such an issue were to emerge, this could result in a requirement for compensation payments to be made. The aim is that wherever possible, such payments should be met by the Pearl With-Profits Fund *estate*.

***Smoothing* Risk**

15.10.7 The fund is credited / debited with profits/losses arising from the with-profits policies. Such profits / losses arise from the differences between claim payments and *asset shares*. The aim is that wherever possible, such profits / losses should be met by the *asset shares*. Refer to 6.7.

Insurance Risk

15.10.8 These cover the risk that certain contractual benefits become significantly more valuable and as a result reduce *asset shares*. This would only happen if there were an additional cost in excess of current amounts provisioned against them. An example of this risk is guaranteed annuity options.

15.10.9 The fund has provided certain guarantees in relation to shortfalls under mortgage endowment policies and full reserves have been established. There is still a risk that the reserve may not be sufficient. The cost of this residual guarantee, including any additional reserves which may be required if current reserves prove not to be sufficient (including compensation costs) is borne by the Pearl With-Profits Fund *estate*.

Outsourcer Risk

15.10.10 Investment management services have been outsourced to the *investment managers* and administration services have been outsourced to Phoenix Group Management Services Limited (PGMS). There is a risk that the *investment managers* and / or PGMS fail to provide an adequate service or cease to trade.

Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the *Shareholder Fund* or Non-Profit Fund, and the fund would only be affected if the *Shareholder Fund* or Non-Profit Fund had insufficient excess assets to bear the losses.

Principle
15.11 Expenses and Charges

The fund is charged for the costs of managing the Industrial Branch (IB) and Ordinary Branch (OB) – *Traditional* Business, Personal Pension (PP) and Free Standing Additional Voluntary Contribution (FSAVC) with-profits business. A fair and equitable attribution system based on actual incurred costs will be used. The costs may be charged to *asset shares* via an annual management charge. Where services are provided by other related companies within the Group Structure, these will be charged on commercial terms. Any changes to these terms will be subject to the approval of the *Board*.

Ordinary Branch (OB) - *Unitised* With-Profits (UWP) and *allocated business* with-profits business is levied a specified annual management charge which may be varied if the costs of managing the business change materially.

Any charges applied to with-profits policies in the fund by reference to solvency or financial position or prospects shall be determined by reference to the solvency or financial position or prospects of the Pearl With-Profits Fund only.

Practices

15.11.1 Administrative services are currently provided to the fund by the service company. Investment services are provided by a number of investment management companies.

15.11.2 The agreement with the service company is a perpetual agreement and is not expected to be renegotiated, but charges may be amended in respect of major regulatory change. The agreement can however be terminated for material failure to meet service standards or other non-compliance with the agreement. We regularly monitor service standards.

Value added fees for work outside the service level agreements are charged separately.

Investment performance is monitored continuously and the arrangements with the investment management companies may be terminated in accordance with agreed notice periods.

15.11.3 There are three kinds of charges levied on *asset shares* in the fund, excluding UWP and *allocated business*:

(a) The service company charges the fund a fixed charge per policy and these costs are charged to individual policies at cost that may be via a reduction to the investment yield credited to *asset shares*.
(b) The fees for investment services are charged to *asset shares* at cost via a reduction to the investment yield credited to the assets in the fund.
(c) Directly levied fees which cover costs not already covered by (a) or (b) will be spread in a fair manner across all relevant policies at cost either as a flat monetary addition to the per policy charge or via a reduction to the investment yield credited to *asset shares*. This may include treating some of the expenses as arising in future years.

15.11.4 For UWP and *allocated business*, an annual management charge is deducted in lieu of the above expenses and other costs.

15.11.5 The *With-Profits Actuary* will review annually any charges (per 15.11.3 c) levied on the fund for reasonableness relative to the service received.

15.11.6 The total charges levied on *asset shares* will be smaller than the total fund expenses, as these charges do not include any allowance for investment management fees associated with the *estate*, which are borne by the *estate* itself.

Principle 15.12 ***Estate* Management**

The *distributable estate* is part of the *estate* of the Pearl With-Profits Fund.

The intention is that the *estate* of the Pearl With-Profits Fund other than the *distributable estate* will be large enough to support existing policyholders' reasonable expectations by providing:

- For any excess of *guaranteed benefits* over *asset shares*.
- For the temporary cost of *smoothing* payouts.
- Guarantee adjustments and *smoothing* adjustments which in the *Board's* opinion are chargeable to the *estate*.
- Security through protection against adverse experience.
- Support for the financing of new business (should any be written).
- For shareholders' tax in respect of transfers from the fund.
- For any tax paid by the Pearl With-Profits Fund not charged against policyholder *asset shares.*

In addition the *estate* will be used to provide investment freedom for the fund, permitting exposure to volatile assets.

If, in the opinion of the *Board*, the *estate* more than provides for the elements listed above, then the *distributable estate* will be released. The released *distributable estate* would be used to augment the benefits of with-profits policyholders via additions to *final bonus* (and hence shareholders will receive their share) over the lifetime of the fund. That part of the released *estate* not paid out at any time will be retained to augment future policy payouts.

If the *estate* other than the *distributable estate* is insufficient to provide for the elements listed above, then the deficit will, so far as possible, be made good through a reduction in the *distributable estate* previously released but not paid out (and retained to augment future policy payouts) at the relevant time

The *allocated business* has no rights to share in the *estate* of the *Pearl With-Profits Fund*.

Practices

15.12.1 The *allocated business* does not have any interest in the *estate* arising in the fund and references in this section to potential benefit enhancements from *estate* distribution do not apply to this business.

15.12.2 The estate is the estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board.*

15.12.3 To the extent that any profits or losses arising in the fund are not allocated to *asset shares* in accordance with 15.4.2, they will act to increase or reduce the *estate*. To the extent that the amounts charged to *asset shares* are based on estimates or assumptions, then any difference between these and the actual amounts will act to increase or reduce the *estate*.

15.12.4 The *estate* in the fund will be used to:

(a) assist the fund in demonstrating it has access to sufficient capital resources to meet its liabilities and treat customers fairly;
(b) provide a buffer in the fund should adverse experience mean that the reserves held to cover the liabilities prove insufficient;

(c) meet any costs which are charged directly to the estate rather than to *asset shares*;
(d) to meet the costs of any changes to which the *Board* believe are necessary to improve fairness between policyholders and/or enhance the run-off of the fund.
(e) enhance the benefits payable to those with-profits policies which have an interest in the *estate* but always aiming to retain sufficient *estate* to meet the expected amounts required for (a), (b), (c) and (d). The amount considered by the *Board* to be available from time to time for such enhancements will be referred to as the *distributable estate*.

15.12.5 Any enhancement in benefits on account of the *distributable estate* referred to in 15.12.4(e) will generally be achieved by including a temporary uplift to the *asset share* for the purpose of setting *final bonus* rates and *surrender values*. However if the *estate* is large then consideration would be given to making additions to the *asset shares* from the *estate.*

15.12.6 The amount of the *estate*, the *distributable estate*, and the potential for any enhancements to policyholder benefits will be subject to review at least once a year.

15.12.7 In the event of the assets in the fund being insufficient to cover the liabilities, then any past *asset share* enhancements out of the *estate* will be removed to the extent needed to remove the deficit.

Principle
15.13 New Business

The approach to setting the volume of new business written is that new business will be accepted only if it is the opinion of the *Board*, after taking actuarial advice, that the proposed volume and terms are attractive to the fund and fair to incoming and existing policyholders.

Practices

15.13.1 The fund is not open to new business and there are no plans to reopen the fund to new business, although the *Board* reserves the right to do so.

15.13.2 Certain new with-profits policies are issued as a result of policyholders exercising options on existing policies.

Principle

15.14 Equity Between the Fund and Shareholders

At least 90% of surplus distributed in the fund is allocated to with-profits policyholders.

Any changes to the above would require the agreement of the *Board* and would be subject to approval by the High Court.

Practices

15.14.1 Currently 90% of the surplus distributed is allocated to With-Profits policyholders. A higher proportion applies to the *allocated business*.

15.14.2 The division of profits between with-profits policyholders and shareholders will not change as a result of a change in the underlying basis on which the surplus is calculated.

15.14.3 There are no other significant factors that would affect the proportion of surplus allocated to shareholders.

15.14.4 The *estate* subsidises shareholder transfers for some lines of business currently accepting increments. Increments are only accepted when the fund is contractually obliged to do so.

16. Principles and Practices – SERP Fund

The Principles and Practices given in sections 16.4 to 16.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the SERP Fund. Sections 16.1 to 16.3 give background information specific to the SERP Fund. Subsequently in this section the use of the term 'the fund' means the SERP Fund.

16.1 Fund History

16.1.1 The SERP Fund comprises the self employed retirement plan ('SERP') business originally written by National Provident Institution and subsequently managed by National Provident Life Limited, before being transferred to Phoenix Life Assurance Limited, then finally transferred into the SERP Fund in Phoenix Life Limited under the *2023 Scheme*.

16.2 Types of Business

16.2.1 Self employed retirement plans (SERPs) are policies originally approved under Section 620 of the Income and Corporation Taxes Act 1988. The policies are characterised by the promise of an annuity benefit at a future date (or an alternative benefit on death), in return for an agreed series of premium payments. *Annual bonuses* declared are added to the annuity benefit, as is any *final bonus* payable. *Final bonus* rates vary by the date the policy commenced.

16.3 Capital Support for the Fund

16.3.1 The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund.

The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 16.4 Amounts Payable Under a With-Profits Policy

The benefits payable on SERP policies will not be less than the value of the *guaranteed benefits*.

Except where the value of the *guaranteed benefits* are higher, *asset share* techniques are used as a guide to determining *payouts* with the intention that all policyholders are treated fairly and that aggregate *payouts* will target 100% of the *asset share*, plus any augmentation provided by a release of any *estate* that might arise in the SERP Fund.

Asset shares are calculated from the *asset shares* determined as at 1 January 2010, using the methods in use by National Provident Life Limited at 31 December 2009, accumulated by reference to the investment return on the assets underlying the *Asset Share Fund* and the expense and mortality experience of the fund.

Open market option and tax-free cash values will represent a fair value of the annuity benefits given up.

Approximations are only used where it is necessary, for example, due to insufficient data or systems constraints.

Significant changes to the methods and data used to determine payouts require the approval of the *Board*. Changes to historical data are only made if they are found to be incorrect.

Practices

***Asset Share* Methodology**

16.4.1 Payout amounts are determined by reference to *asset share calculations*, subject to the *smoothing* practices described in 16.7, with a minimum *payout* of the value of the *guaranteed benefits*.

16.4.2 The initial *asset shares* used are the *asset shares* as at 1 January 2010. Details of how those *asset shares* were calculated are not included here. Not all the items described in the table in 16.4.3 would necessarily have applied at all times for all types of policy in the past. Different practices, often more approximate, may have been used in the past and the practice is generally to continue to use the results of these practices when determining the effect of those years on the *asset shares* of specimen policies.

16.4.3 The *asset share* is broadly the accumulation of past premiums allowing for investment return, tax, expenses, cost of mortality, (where appropriate) the cost of capital and other charges (see below).

The following table describes the elements credited or charged to *asset shares* for specimen SERP policies.

Element		Description of allowance
(a)	Premiums	Premiums paid under the policy
(b)	Investment return	Allocated return Note (b)
(c)	Investment expenses	Note (c)
(d)	Initial expenses	Not Applicable
(e)	Renewal expenses	Note (e)
(f)	Other expenses	Not charged
(g)	Tax on investment return	Not charged Note (g)
(h)	Tax relief on expenses	Not charged Note (g)
(i)	Mortality & morbidity costs	Experience Note (i)
(j)	Early terminations	Not charged
(k)	Paid-up policies	Not charged
(l)	Partial and regular withdrawals	Not applicable
(m)	Surrenders at *protected dates*	Not applicable
(n)	Annuity payments	Not applicable
(o)	Charges for the cost of guarantees or *smoothing*	*Guarantee costs* not charged, Note (o) *Smoothing* costs Note (b)
(p)	Charges for the cost of capital	Not charged
(q)	Distributions to shareholders	Note (q)
(r)	Tax on distributions to shareholders	Not charged Note (q)
(s)	Profit and losses from other business	Not applicable
(t)	*Estate* distribution or charge	Note (t)
(u)	Exceptional items	Not applicable

The way in which the above items are taken into account is described in the notes below. Where charged is used in the table above this means both charged and / or credited depending on whether it is a loss or profit.

Notes

(b) Investment return

The investment return allocated to *asset shares* is determined from the return on the assets underlying the *Asset Share Fund* as specified in practices 16.7.3 and 16.9.3. The investment return for determining *asset shares* is then increased or decreased as appropriate by the adjustment in respect of past *smoothing* costs in accordance with 16.7.2.

For the purposes of determining payouts, *asset shares* are calculated as at the midpoint of the financial year of claim. Estimates of investment returns are used where the investment return for the year of claim and the previous year are not known at the date of calculation. The actual rates of investment returns (determined as above) are used in any subsequent calculation of *asset shares* once the actual investment returns have been determined.

(c) Investment expenses

The investment management expenses deducted from *asset shares* are based on the expenses set out in Schedule 17 of the *2023 Scheme*, namely, the lower of
- 0.1125% of funds under management; and
- the equivalent charge incurred by the National Provident Life With-Profits Fund for similar services under the terms of the *2023 Scheme*.

(e) Expenses

The expenses deducted from *asset shares* are based on the expenses set out in Schedule 17 of the *2023 Scheme*, for the calendar year ending 31 December 2010, namely:

- £53.97 per annum for each premium paying policy; and
- £21.68 per annum for each non-premium paying policy,

increased each July by the change in the Retail Price Index over the previous 12 months, plus 1%.

The expenses will be subject to a cap such that the total increase (in percentage terms) applying to the above after 31 December 2009 shall not at any time be more than the total increase (in percentage terms) in the same period which applies to charges for similar services incurred by the National Provident Life With-Profits Fund under the *2023 Scheme*.

The amounts deducted from *asset shares* will be adjusted to take account of policies becoming claims.

(g) Tax

No tax is currently brought into the *asset share* calculation since no tax is currently payable on the investment return allocated to *asset shares*, nor is there tax relief on any of the expenses brought into the *asset share* calculations.

(i) Mortality

The mortality rates used for *asset shares* are based on recent experience.

(o) Cost of guarantees

No charge will be made to *asset shares* in respect of *guarantee costs*.

(q) Distribution to shareholders
Shareholders are not entitled to any surplus arising in the SERP Fund

(t) There is no expectation that any *estate* will arise in the future. However, to the extent that an *estate* did arise, this would be used to augment the benefits payable under policies in the fund.

16.4.4 For SERP regular premium business, except where the value of *guaranteed benefits* are higher, payouts are based on *asset shares* calculated for a number of specimen policies commencing in each previous *final bonus* period and becoming payable in the current calendar year. For each *final bonus* period, the specimen policies are chosen to represent a range of premium levels. Payouts on an individual policy are then based on the *final bonus* rate determined for the specimen policy representing the range of premium levels within which the actual premium level for the individual policy falls.

16.4.5 Except where payment of a guaranteed benefit results in a higher amount, and except where the amount cannot be reasonably compared with a calculated *asset share*, the target range for policy payouts is 80% to 120% of *asset share*.

16.4.6 The range applies to both maturity payments and transfer payments. The range has been determined and will be monitored by reference to specimen SERP policies.

16.4.7 The assumptions used to calculate fair values for the *open market option* and tax-free cash are the best estimates of interest, mortality and expenses as follows:
• Interest rates are derived from the SONIA *swaps* curve.
• Future mortality experience follows best estimate assumptions based on recent experience and forecast improvements.
• Expenses reflect the costs of administering the *open market option* net of the expected savings from Phoenix Life Limited not administering the pension.

16.4.8 *Open market option* and tax-free cash values are currently reviewed each month using the then current yields for specimen policies. If the difference compared to the current basis is more than 3%, then the *open market option* and tax-free cash values are normally updated.

16.4.9 The methodology and assumptions used to determine payouts are documented by papers submitted to, and approved by, the *Board*, having received advice from the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate. Investment returns, expenses and charges are documented by internal memoranda.

Principle
16.5 ***Annual Bonus* Rates**

In circumstances where the value of guaranteed benefits is close to or in excess of *asset shares*, no *annual bonus* is likely to be declared. Conversely, if *asset shares* were to exceed the value of the guarantees, consideration would be given to declaring an *annual bonus*.

As the fund is closed to new business it is not anticipated that any new series of bonus rates will be necessary.

Practices

16.5.1 *Annual bonus* rates are normally declared annually at 31 December. The value of the *guaranteed benefits* is currently close to or well in excess of *asset shares* for all SERP policies. This is expected to remain the position and it is therefore expected that no *annual bonus* will be declared for the foreseeable future.

16.5.2 There is currently no maximum amount by which *annual bonuses* would alter were they to be introduced; however, in the normal course of events the declared annual bonus rates would not be expected to change by more than 2% from one declaration to the next.

Principle 16.6 ***Final Bonus* Rates**

SERP policyholders will not receive less than the value of the *guaranteed benefits* under the relevant policy. Subject to this, for maturities and retirements, the aim is to set *final bonuses* so that the total payout is targeted on the *asset share,* subject to *smoothing* (see section 16.7).

Practices

16.6.1 *Final bonus*es are normally reviewed twice each year at 30 June and 31 December, but may be changed without notice at any time. Such an interim change would normally be because economic conditions have changed leading to a larger than expected gap between the levels of payouts and the underlying *asset shares.*

16.6.2 *Final bonuses* are currently set so the payout is targeted at 100% of the *asset share* but the amount payable may differ from this target because of the impact of *smoothing*.

16.6.3 Where the policy provides for a return of fund benefit to be payable on death, the amount payable on death will be determined as if the policyholder could have retired at the date of death, including any *final bonus* then payable.

Principle
16.7 ***Smoothing***

Payouts are usually smoothed so as to avoid excessive differences in payouts on similar policies over short periods of time.

A *smoothing account* is maintained within the *Asset Share Fund* which is credited or debited with the difference between the payouts (excluding any increase due to payment of *guaranteed benefits*) and the *asset shares*. The *smoothing account* is accumulated each year at the rate of return on the *Asset Share Fund*.

The intention is that *smoothing* will be cost neutral over time. If necessary, payouts will be amended to help ensure that the cost of *smoothing* does tend towards zero, and the aim will be to adjust payouts so that any outstanding *smoothing account* balances are small within a limited period of time.

The *Board* may change the way it smooths payouts at any time, or may cease to smooth payouts, if the *Board* deems it necessary to protect the financial position of the fund. In such circumstances, it may also adopt a different approach to *smoothing* by claim type.

The basis for calculating transfer values will be reviewed from time to time so that transfer values remain broadly consistent with the targeted level of payouts.

Practices

16.7.1 The *smoothing account* will be reduced (or increased) by amending the investment return credited to *asset shares*. The resulting change in the *asset shares* will be credited or debited to the *smoothing account*.

16.7.2 The reductions (or increases) in investment return credited to *asset shares* each year are normally determined to cover one half of the then current *smoothing account* balance. However, a higher fraction may be used if the *Board* deems it necessary to protect the financial position of the fund.

16.7.3 Payouts are normally determined using *asset shares* in the year of claim. The investment return credited is only calculated approximately during the course of a year (by the use of appropriate indices) and is updated after the end of each year to reflect the actual performance earned. This applies to all generations of policyholders.

16.7.4 Payouts are also normally determined so that the amount payable is consistent with the *asset share* for a sample policy of similar size, entry date and age attained as the actual policy.

16.7.5 Although we normally smooth so that we avoid excessive changes in payouts, large changes in payouts may be allowed under some circumstances if it is necessary in the interests of fairness or for the fund to meet its objectives.

Principle
16.8 ***Surrender Values***

Asset share techniques are used as a guide to determining *payouts* with the intention that all policyholders are treated fairly and that aggregate payouts will target 100% of the *asset share.*

Practices

16.8.1 Except where payment of a guaranteed benefit results in a higher amount, and except where the amount cannot be reasonably compared with a calculated *asset share*, the target range for policy payouts is 80% to 120% of *asset share*.

16.8.2 The range applies to both maturity payments and transfer payments. The range has been determined and will be monitored by reference to specimen SERP policies.

Principle
16.9 Investment Strategy

The investment strategy will be consistent with the sound financial management of the fund.

The investment strategy will aim to ensure there are sufficient liquid assets to meet claims as they fall due.

The investment strategy for the *estate* may differ from the investment strategy of the *Asset Share Fund*.

Derivatives may be used to implement investment policy ahead of physical sales and purchases of assets. Derivatives are also used to match certain policy liabilities or to provide protection against increases in policy liabilities.

The maximum counterparty risk is that agreed with the *investment managers* from time to time, as authorised by the *Investment Committee*.

The investment policy in respect of the fund is determined by the *Board*. Such investment policy shall take account of (but shall not be bound by) the advice of the *With-Profits Committee* and *With-Profits Actuary,* and shall have regard to the need for the investments to be suitable for the purpose to which they will be put.

The investment return credited to individual *asset shares* may be based on the investment return on a notional portfolio of assets, as opposed to the return on the *Asset Share Fund*.

Practices

16.9.1 The investment strategy for the fund is reviewed formally at least once a year. The *Board* sets the investment strategy for the different parts of the fund, and approves the investment mandate, taking account of a variety of considerations, including our approach to *responsible investment*. The investment mandate specifies what proportion of the fund is to be invested in each of the *asset classes*, within agreed tolerances, and sets out within each *asset class:*

- the restrictions on holdings of any particular asset or group of assets,
- exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco, and
- the acceptable levels of credit risk.

16.9.2 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

16.9.3 The *Board* has to approve any new or novel form of investment, including *alternative assets*.

16.9.4 The investment returns allocated to *asset shares*, before adjusting for investment expenses and *smoothing* costs, are set equal to the returns on the assets backing the *Asset Share Fund* net of the direct costs of investment.

16.9.5 The fund does not hold any assets which are *not normally traded*.

Principle 16.10 Business Risks

The fund is closed to new business and ring-fenced. The business risks it is exposed to are, therefore, expected to be confined to those associated with maintaining the existing policies of the fund.

The fund will not take on new business risks and will be managed in such a way as to minimise the existing business risks.

SERP policyholders will not be directly exposed to the risks associated with the cost of providing guarantees on other SERP policies or any other business risks. No charge will be made to *asset shares* in respect of *guarantee costs* or the costs associated with any other business risks and, to the extent that the *estate* has insufficient assets to meet these costs, the shortfall would be met by support under the capital policy.

Practices

16.10.1 It is not expected that the fund will take on any further business risks. The more significant business risks are outlined below.

16.10.2 Investment management services have been outsourced to the *investment managers* and administration services have been outsourced to Phoenix Group Management Services Limited (PGMS). There is a risk that the *investment managers* and / or PGMS fail to provide an adequate service or cease to trade.

Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the *Shareholder Fund* or Non-Profit Fund, and the fund would only be affected if the *Shareholder Fund* or Non-Profit Fund had insufficient excess assets to bear the losses.

16.10.3 Policyholders are exposed to the risk of changes in future interest rates, the expenses of administering annuities and longevity, causing a reduction in *open market option* and tax-free cash values upon vesting.

16.10.4 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

Principle 16.11 Expenses and Charges

The charges and expenses that can be deducted from the fund are set out in the *2023 Scheme*.

All direct costs of investment are borne by the fund and reduce the investment return on the fund assets.

The *2023 Scheme* requires that the amount that can be deducted from the fund in respect of taxation must not exceed that which the fund would have incurred had it been a separate mutual life assurance company.

Practices

16.11.1 Certain specific expenses set out in the *2023 scheme* and per policy charges are not charged to the fund at cost. The per policy charges charged to the fund exceed the cost which results in a shareholder benefit arising from investments the shareholder has made. Since policyholders have not contributed to this investment the reduced charges are not passed on to them.

Principle
16.12 *Estate* Management

The size of the *estate* will reflect the financial position of the fund.

The fund relies on support provided under the terms of the capital policy. Repayment of that support will have first priority on any assets in excess of liabilities in the fund

Practices

16.12.1 The *estate* will be used to meet any losses incurred by the fund as a result of business risk, to provide a buffer against adverse experience, to meet *guarantee costs* as they arise and to meet any other costs necessary to ensure that payouts meet the reasonable expectations of policyholders.

16.12.2 The size of the *estate* will be monitored to ensure it remains adequate to meet the purposes set out in 16.12.1 and its regulatory liabilities. Capital support, if required, will be provided under the terms of the capital policy.

Principle
16.13 New Business

The fund is closed to new business.

Practices

16.13.1 There are no plans to reopen to new business.

Principle
16.14 Equity between the Fund and Shareholders

The *2023 Scheme* provides that holders of with-profits policies in the fund are entitled to receive the whole of the distributable surplus arising in the fund. Any change to this position would require the agreement of the *Board* and would be subject to approval by the High Court.

SERP policyholders are entitled to receive the higher of their *guaranteed benefits* and benefits targeted on 100% of *asset shares* If the *guaranteed benefits* exceed the relevant *asset share*, the amount of the excess will be met first from the *estate* and second by support under the capital policy

Practices

16.14.1 No interest will be charged on any support provided under the terms of the capital policy. All other charges and expenses to the fund will be made as set out in 16.11

17. Principles and Practices – London Life With-Profits Fund

The Principles and Practices given in sections 17.4 to 17.14 together with the Guiding Principles and Practices form the Principles and Practices of Financial Management for the London Life With-Profits Fund. Sections 17.1 to 17.3 give background information specific to the London Life With-Profits Fund. Subsequently in this section the use of the term 'the fund' generally means the London Life With-Profits Fund.

17.1 Fund History

17.1.1 The London Life With-Profits Fund comprises the business that was transferred into Phoenix Life Limited from the London Life With-Profits Fund of Phoenix Life Assurance Limited under the *2023 Scheme*. This includes both *traditional* and *unitised* with-profits business.

17.1.2 Previously this was business from the Life With-Profits Fund and Pensions With-Profits Fund of London Life Limited, which consisted of business transferred into Phoenix Life Assurance Limited from the London Life sub-fund of Australian Mutual Provident Society (AMP) and the UK branch of the Australian Mutual Provident Society in 1997.

17.1.3 With-profits business within the fund is managed in *participation pools*. These *participation pools* arise from the separate management practices of product groups within the former AMP UK business and the former London Life business.

17.1.4 Under the terms of the *2023 Scheme*, the London Life With-Profits fund within Phoenix Life Limited is managed as a 100:0 with-profits fund.

17.2 Types of Business

17.2.1 The following table summarises London Life with-profits products. The product group identifier PGn will be used in this document to identify the products.

participation pool	product group	PG
Former London Life products		
Life Compound Bonus	Endowment assurance Whole-life assurance Deferred annuities	PG01 PG02 PG03
Life Cash Bonus	Endowment assurances Whole-life assurance	PG04 PG05
Pensions Compound Bonus	Old series deferred annuities – without Guaranteed Annuity Option (*GAO*) Old series deferred annuities – with-*GAO* New-series endowments Single premium buyouts 'Pension Protector' Annual premium deferred annuities 'PC Contracts' Group pension	PG06 PG07 PG08 PG09 PG10 PG11
Pensions Simple Bonus	Deferred annuity Immediate annuity Group pensions	PG12 PG13 PG14
Pensions *Unitised* With-Profits	Endowments	PG15
Life *Unitised* With-Profits policies	Whole-life	PG16
post 1997 products		
With-Profits Annuity	With-Profits Annuity 'Secure Pension Plus'	PG17
Former AMP UK products		
Life Compound Bonus	Endowments Whole-life	PG18 PG19
Pensions Compound Bonus	Regular premium pure endowments Regular premium pure endowments with *GAR*	PG20 PG21

17.3 Capital Support for the Fund

17.3.1 The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund.

The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 17.4 Amounts Payable Under a With-Profits Policy

The overall aim in setting with-profits policy payouts is that payouts should be determined having regard to the experience of each of the with-profits *participation pools*, the financial position of Phoenix Life Limited, and the fair treatment of with-profits policyholders.

This aim will be achieved by determining payouts with reference to *asset shares*.

For all products this means that payouts (with the exception of deaths) are targeted at 100% of *asset share*, on average, after allowing for *smoothing,* plus any augmentations provided by a release of the *estate*. *Smoothing* is described in section 17.7.

On death the policy *payout* is specified in the terms of most contracts and generally carries a *final bonus*. This amount may be more or less than *asset share*.

Asset shares will be calculated in accordance with generally accepted actuarial principles.

Assumptions that relate to the past will only be changed in the event that errors are discovered in them. Other assumptions are reviewed annually in the light of current experience.

Changes in methods or assumptions that lead to changes in policyholder benefits or expectations would be subject to *Board* approval after receiving appropriate actuarial advice and advice from the *With-Profits Committee*.

Practices

***Asset Share* Methodology**

17.4.1 Payout amounts are determined by reference to *asset share* calculations, other than payouts on death which will generally be determined in accordance with the policy terms and conditions.

For surrenders, transfers, early retirements and maturing policies, the target payout is normally the *asset share*. The actual *payout* will depend on *smoothing*. *Guaranteed benefits* can exceed *asset shares*. In this instance, the *payout* will be the *guaranteed benefit*.

17.4.2 Individual *asset shares* are not calculated for every single policy but may be calculated for notional policies with the results used to set *payouts* for a range of similar policies within a particular product group.

17.4.3 The *2023 Scheme* includes restrictions that prevent new types of *asset share* charges being introduced to any *asset share* pool.

17.4.4 For policies belonging to small product groups (PG03 and PG16), *asset shares* are not calculated but are determined by comparing with the *asset shares* of other similar product groups.

17.4.5 Where *asset shares* are calculated, conventional techniques are used, in accordance with generally accepted actuarial practice. The *asset share* is broadly the accumulation of past premiums allowing for investment return, tax, expenses, cost of mortality, (where appropriate) the cost of capital and other charges (see below).

The following table describes the elements credited or charged to *asset shares* for specimen with-profits policies.

Element		**Description of allowance**
(a)	Premiums	Premiums paid under the policy Note (a)
(b)	Investment return	Allocated return Note (b)
(c)	Investment expenses	Note (c)
(d)	Initial expenses	Allocated in accordance with *2023 Scheme* Note (d)
(e)	Renewal expenses	Allocated in accordance with *2023 Scheme* Note (d)
(f)	Other expenses	Actual allocated Note (f)
(g)	Tax on investment return	Actual allocated Note (g)
(h)	Tax relief on expenses	Actual allocated Note (h)
(i)	Mortality & morbidity costs	Experience Note (i)
(j)	Early terminations	Not charged
(k)	Paid-up policies	Not charged
(l)	Partial and regular withdrawals	Not applicable
(m)	Surrenders at *protected dates*	Not applicable
(n)	Annuity payments	Not applicable
(o)	Charges for the cost of guarantees or *smoothing*	Charged Note (o)
(p)	Charges for the cost of capital	Note (p)
(q)	Distributions to shareholders	Not applicable Note (q)
(r)	Tax on distributions to shareholders	Not applicable Note (r)
(s)	Profit and losses from other business	Profits or losses are credited
(t)	*Estate* distribution or charge	Distributions from or charges to the *estate* as determined Note (t)
(u)	Exceptional items	Not applicable

Notes

(a) Premiums

The calculation of *asset shares* requires the accumulation, to date, of all past premiums. For all major product classes, a full premium history is generally known and is used in the calculation of *asset share*; the exceptions being:

- For regular premium products that have been altered, or have been converted to paid-up policies, where the full premium history is not readily available.

These policies are excluded from the *asset share* process and alternative methods are used to set payouts. These methods are set out in the appropriate sections describing how *final bonuses* are calculated.

- For *London Life* old-series deferred annuity products (PG06 and PG07) a full premium history is not readily available for premiums prior to 1987. However, an effective premium history is recreated from the benefits purchased up to that date, and *asset shares* calculated accordingly.

(b) Investment return

The rate of investment return credited to *asset shares* within a *participation pool* is determined at the end of the calendar year from the rates of return on the assets notionally allocated to that pool, see section 17.9.

The rate of investment return credited to the *participation pool* is determined from the investment return on each notionally allocated *asset class* and the proportion of the *participation pool* notionally invested in each *asset class*.

Assumptions for the period that pre-date the first calculation of *asset shares* have been obtained using a combination of historical corporate information and market rates of return.

(c) Investment expenses

Asset share investment returns are net of investment transaction costs and costs incurred through investment in collective investment schemes. Additional investment management expenses incurred in respect of assets backing *asset shares* are expressed as an annual management charge and further reduce the investment return allocated to with-profits policies.

(d) Initial and Renewal Expenses

Expenses charged to the fund had been prescribed since 31 December 1997, under the terms of previous schemes, which applied until 30 September 2017.

From 1 October 2017, expenses representing the actual level of expenses attributed to the policies are deducted from *asset shares*. Current expense deductions are based on the service agreement the fund has with its service company and investment managers.

Further details of the expense provisions are set out in 17.11.

(f) Other expenses

One-off costs, for example costs arising from changes in legislation, will be charged to the fund and to *asset shares* to the extent that the event that gives rise to the cost relates to the fund or the with-profits policies. For example, changes to legislation related to pensions will result in charges to with-profits pension policies only.

(g) Tax on investment return

Tax parameters vary according to the rates of tax applicable for the various components of investment return, for example income and capital gains, in each calendar year.

Investment return rates are reduced to allow for the appropriate rate of tax.
Expenses are reduced to allow for tax relief, where appropriate.
Currently no tax is payable on Pensions business.

(h) Tax relief on expenses

Tax relief on expenses will be determined in accordance with the tax rules applying to the type of policy.

(i) Mortality and morbidity costs

A mortality charge is deducted from *asset shares* based on the expected cost of providing death benefits. The expected cost is calculated by multiplying the cost of deaths, i.e. the amount by which death benefits exceed *asset shares*, by the expected death rate. The expected death rate is based on the experience of the fund and industry experience and is reviewed infrequently.

(o) Charges for the cost of guarantees

Product groups PG07, PG09 and PG10 offer both cash and annuity benefits at retirement. Consequently, these products provide a guaranteed rate for converting cash into annuity. A reasonable charge is deducted for the cost of providing this guaranteed conversion rate. No other deductions are made from *asset shares*.

(p) Charges for the cost of capital

No charge for the cost of capital is reflected in the *asset shares* for product groups PG01 to PG14 and PG17.

For product groups PG18 to PG21, a charge for capital is made for calendar years up to and including 1997.

For *unitised with-profits* business, product groups PG15 and PG16, a cost of capital charge is deducted from the investment return on *asset shares*, currently 0.25% p.a.

(q) Distributions to shareholders

There is no distribution to shareholders.

(r) Tax on distributions to shareholders

There is no distribution to shareholders.

(t) *Estate* distribution or charge

The *2023 Scheme* provides for the possibility of an *estate* arising in the fund although, on implementation of the *2023 Scheme* the value of the *estate* was zero. The basis on which amounts can be credited or debited to the *estate* is described more fully in 17.12. To the extent that an *estate* was to arise, it will be used to augment policyholder benefits. However, it is considered highly unlikely that any *estate* in the London Life With-Profits Fund will arise.

17.4.6 The methods used to determine *asset shares* are well established and no changes are anticipated. All changes to methodology, parameters and assumptions are formally approved by the *Board,* having received advice from the *Chief Actuary*, the *With-Profits Actuary* and from the *With-Profits Committee* as appropriate.

17.4.7 Approximate methods will be used when the methodologies prescribed require the use of information that is not readily available; or for small classes of business, where it is not practical to use the full approach.

Approximate methods do not necessarily lead to the same payout as the full method being applied directly. The fund allows these approximate methods to be used provided that the resultant return to policyholders is comparable with the returns paid to other policyholders, allowing for the differing nature of their policies.

17.4.8 Bonuses are set according to the experience of the 9 different *participation pools*. Accordingly, separate *asset shares* will be determined for products within each of the *participation pools*.

The *participation pools* contain products of a similar nature. However, not all products within the same *participation pool* are exactly the same and hence different products within a particular *participation pool* will not necessarily get the same bonus rates. The specific mechanisms for arriving at bonus rates for each pool are set out below.

17.4.9 The key principles, assumptions and methods used to determine *asset shares*, and the methods used to determine bonus rates are documented in internal company reports.

All bonus declarations will be approved by the *Board* following reports by the *With-Profits Actuary* which would formally summarise the methods and assumptions used in deriving those bonus rates.

Principle **17.5** ***Annual Bonus* Rates** *Annual bonus* rates will be determined separately for different *participation pools*. *Annual bonuses* form one part of the fund's overall distribution to policyholders. The remainder will be distributed as a *final bonus*. The fund gives priority to *final bonus* over *annual bonus*.

Practices

17.5.1 *Annual bonuses* are reviewed towards the end of a calendar year, for declaration at 31 December.

17.5.2 *Annual bonuses* declared at 31 December will apply to policies, on their policy anniversaries with effect from:

- the following 1 July for all former London Life *traditional* with-profits policies, PG01-PG14
- the following 1 May for all former AMP UK *traditional* with-profits policies, PG18 – PG21
- 1 January for all *unitised* with-profits policies, PG15 & PG16
- 1 July for all With-Profits Annuity policies, PG17

17.5.3 *Annual bonus* rate changes are implemented after the *Board* has considered a report by the *With-Profits Actuary* and subsequently approved the changes.

<u>*TRADITIONAL* WITH-PROFITS POLICIES (all products except PG15 - PG17)</u>

17.5.4 For all participation pools (with the exception PG04, PG05 and PG13 - which are discussed below), the level of *annual bonus* is set so as to maintain a buffer for *final bonus*. The future claim payouts are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected *final bonus* broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

17.5.5 Where the financial position of the fund is weak the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

177.5.6 For pension simple bonus immediate annuities (PG13), current practice is that the *annual bonus* will continue to increase at a level of 7% per annum, of the original annuity amount.

17.5.7 Current practice for Life Cash Bonus policies (PG04 and PG05) is that with effect from the 1 Jan 2004 declaration, the level of cash bonuses will increase by a small amount each year.

17.5.8 *Traditional annual bonus* rates are declared in advance and consequently no interim rates need apply.

17.5.9 Normally the declared *annual bonus* rate would not be expected to be more than 2% different to that declared in the previous year.

UNITISED WITH-PROFITS POLICIES (PG15 and PG16)

17.5.10 The level of *annual bonus* is set so as to maintain a buffer for *final bonus*. The future claim payouts are estimated using realistic assumptions and the *annual bonuses* are set at such a level that if experience turns out to be in line with those assumptions, the overall amount of the *payout* paid in the form of *final bonus* will be in line with a target proportion. Under current investment conditions, the overall target is that 25% of the overall value of *payouts*, calculated before any future augmentation provided by a release of the *estate*, will be in the form of *final bonus*. Given the aggregate nature of this target, for an individual policy, this *final bonus* buffer may be more or less than 25%. This overall target is itself subject to review and may be changed. If experience does not turn out to be in line with the assumptions then the 25% target might not be met.

Annual bonus rates will be adjusted to keep the overall level of projected *final bonus* broadly in line with the target. If necessary to remain on target, *annual bonus* rates will be reduced to nil, or close to nil. However, some small *annual bonuses* may be declared even if the *final bonus* buffer is below target.

17.5.11 Where the financial position of the fund is weak the *Board* may decide not to increase the *annual bonus*, or to keep the *annual bonus* at nil, or to reduce the *annual bonus* despite the *final bonus* buffer being above the 25% target.

17.5.12 Since *annual bonuses* for this class of business are declared in arrears, an *interim bonus* rate will also be declared at the end of each calendar year. The *interim annual bonus* applies to all policyholders that surrender, transfer or retire early before declaration of the next *annual bonus* rate.

Interim bonus rates are set with reference to the most recent *annual bonuses* declared and any future anticipated direction of these rates and may be higher or lower than the latest *annual bonus* rates declared. The *annual bonus* rate may however, eventually be set at a level that differs from the *interim* rate.

17.5.13 Normally the declared *annual bonus* rate would not be expected to be more than 2% different to that declared in the previous year.

SECURE PENSION PLUS (PG17)

17.5.14 The level of *annual bonus* rate is currently set equal to the Guaranteed *Annual Bonus* Rate, and will remain unchanged from this current level.

Principle
17.6 ***Final Bonus* Rates**

The aim in setting *final bonus* rates for maturing policies is to set final payouts at the target level of 100% of *asset shares*, subject to *smoothing* as described in section 17.7, plus any augmentation provided by a release of the *estate*.

When setting *final bonus* rates, payouts will be smoothed and so there will be a difference between actual and target payouts.

Final bonuses can be reviewed at any time. The frequency of *final bonus* reviews will depend on the difference between actual and target payouts, current market conditions and the financial position of the fund.

Final bonus rates will be reduced, beyond the normal application of *smoothing* in circumstances where to do otherwise would be imprudent in the view of the *Board* given the financial position of the fund.

A *final bonus* may also be paid in the event of surrender or transfer. The *final bonus* will be based on the *final bonus* rate for a maturing policy of the same term but adjusted to target *asset share*. *Surrender values* may be reduced when the *Board* considers it necessary in the light of the financial position of the fund and anticipated rates of surrender in order to protect the level of security for the remaining policyholders.

On the death of a policyholder the payout is generally prescribed in the policy terms and conditions. Where this includes a discretionary element of *final bonus*, it will be set at the same level as for maturing policies of the same term since inception.

Practices

17.6.1 *Final bonuses* can be reviewed at any time but, in general, for *traditional* with-profits business such reviews will be carried out twice yearly, normally from 1 January and 1 July.

17.6.2 For *unitised* with-profits business, *final bonus* rates will normally be reviewed quarterly.

17.6.3 In certain circumstances, *final bonus* rates may be reviewed more often. These circumstances include:

- following large or sustained changes in the value of the underlying investments,
- if the difference between actual or expected payouts and target payouts is large,
- if the *Board* considers it necessary in the light of the financial position of the fund.

17.6.4 *Final bonus* rate changes are implemented after the *Board* has considered a report by the *With-Profits Actuary* and subsequently approved the changes.

17.6.5 *Final bonus* rates and *market value reductions* for *unitised* with-profits business (PG15 and PG16) are implemented on the advice of the *With-Profits Actuary*, acting on behalf of the *Board* with delegated authority.

17.6.6 Bonus rates are not calculated for individual policies but are calculated for notional policies within the *participation pools*. This has the effect of *smoothing* payouts across different policies within these groups. The calculation of *final bonus* rates is specific to the type of product and so a separate description is required for each *participation pool*.

Life Compound Bonuses

17.6.7 Products covered in this *participation pool* include:

- Regular premium endowment assurance - PG01
- Regular premium whole-life assurance - PG02
- Regular premium deferred annuities - PG03

17.6.8 For this *participation pool*, *asset shares* are calculated for all premium paying endowment assurances. Investment returns used in the calculation of these *asset shares* are unsmoothed.

Regular premium endowment assurance – PG01

17.6.9 *Asset shares* are compared with payouts for notional maturing policies with a range of different commencement dates. This demonstrates the amount by which current payouts will exceed or fall short of the *asset shares*. This will indicate the need to review *final bonus* rates.

17.6.10 The overall aim is that the *final bonus* rates should be set so that the payouts equal the target payouts, after allowing for *smoothing*, see section 17.7.

17.6.11 *Final bonus* rates are set for the notional policies' commencement dates, as above. These rates are used to determine the *final bonus* rates for all other commencement dates.

17.6.12 Policies that are paid-up will receive the same *final bonus* rates as premium paying policies of the same term.

Regular premium whole-life assurance – PG02

17.6.13 *Asset shares* are compared with payouts for notional policies from an appropriate age band with a range of different commencement dates. The age range is determined by considering when claims might be expected to occur.

17.6.14 *Final bonus* rates will be set according to the same practices as those used for the corresponding endowment assurance policies (PG01) described in 17.6.10 and 17.6.11 above.

Regular Premium deferred annuities - PG03

17.6.15 *Final bonus* rates are set to give returns on premiums consistent with those on similar regular premium policies in PG01 and PG06, after allowing for the amount of tax incurred by these old general annuity fund policies.

Life Cash Bonus

17.6.16 Products covered in this *participation pool* are:

- Regular premium endowment assurance - PG04
- Regular premium whole-life assurance - PG05

17.6.17 *Final bonus* rates will be set having regard to the annualised yield on premiums on equivalent policies in product groups PG01.

Pensions Compound Bonus

17.6.18 Products covered in this *participation pool* are as follows:

- Old-series deferred annuity without guaranteed annuity option - PG06

- Old-series deferred annuity with guaranteed annuity option - PG07
- New-series endowments - PG08
- Single premium buyouts (Pension Protector) - PG09
- Annual premium deferred annuities (PC Contracts) - PG10
- Group pensions - PG11

17.6.19 For this *participation pool asset shares* are calculated for all old-series deferred annuities (PG06 and PG07).

Old-series deferred annuity without guaranteed annuity option - PG06

17.6.20 *Asset shares* are compared with payouts for maturing policies over a range of all possible past terms. This comparison is done for policies with an average premium size and for single and regular premium payment patterns.

17.6.21 The overall aim is that the *final bonus* rates should be set so that the actual payout is equal to the target payout, subject to *smoothing*, see section 8.7.

17.6.22 Policies of this type have been written on a number of different premium rate series, and so separate *final bonus* scales will be declared for each different premium rate series.

17.6.23 These policies are recurrent single premium and so each premium has its own *final bonus*.

17.6.24 Early retiring and transferring policyholders will receive the same rate of *final bonus* as policies that have reached their normal retirement date and commenced at the same time.

Old-series deferred annuity with guaranteed annuity option - PG07

17.6.25 The products in this product group are, in general, identical to the products in (PG06) except for the addition of the guaranteed annuity option. These policies are dual-benefit policies with policyholders having the choice of taking either a cash benefit or an alternative annuity benefit, at certain contractual dates.

17.6.26 When setting *final bonuses*, the same approach is used as for old-series deferred annuity without guaranteed annuity option (PG06), described above, but taking account of a reasonable charge for the guaranteed annuity option.

17.6.27 The practice is to base the charge on the proportions that are expected to take cash as opposed to annuity benefit.

New-series endowments - PG08

17.6.28 The same method is used for this product group as is used for old-series deferred annuity without guaranteed annuity option (PG06).

Single premium buyouts (Pension Protector) - PG09

17.6.29 All policies in this product group comprise of the benefits from one single premium paid at a particular date. A *final bonus* scale has been devised that depends solely on the calendar year of the policy's inception.

17.6.30 *Final bonus* rates are set to give maturing policies the same investment return as equivalent PG07 single premiums.

Annual premium deferred annuities (PC Contracts) – PG10

17.6.31 *Final bonus* rates are set such that the yields from these policies are the same as would be obtained from a policy with the same premium payment pattern in PG07.

17.6.32 Policies that are paid-up will receive the same *final bonus* rates as premium paying policies of the same term. Since *final bonus* is a percentage of sum assured and existing bonus, the *final bonus* amount will be reduced accordingly.

Group pensions – PG11

17.6.33 This is a very small product group.

17.6.34 *Final bonus* rates are set for maturing policies so that returns on premiums are broadly equal to the equivalent returns on old-series deferred annuities without *GAO* (PG06) policies reduced to allow for the additional expenses associated with the running of these group final-salary schemes.

Pension Simple Bonus

17.6.35 Products covered in this *participation pool* are:

- Deferred annuities - PG12
- Immediate annuities - PG13
- Group pensions – PG14

17.6.36 For this *participation pool*, *asset shares* are calculated for all premium paying regular premium deferred annuities.

Deferred annuities - PG12

17.6.37 *Asset shares* are compared with payouts for notional maturing policies over a range of different past durations.

17.6.38 When performing such a comparison, the value of annuity benefits is converted to cash using yields on fixed-interest securities and current rates of simple bonus in payment.

17.6.39 The overall aim is that the *final bonus* scale should be set so that the actual payout is equal to the target payout, subject to *smoothing* see section 17.7.

17.6.40 *Final bonus* rates are set for the notional policies' commencement dates, as above. These rates are used to determine the final bonus rates for all other commencement dates.

Immediate annuities - PG13

17.6.41 This class of polices comprise annuities in payment resulting from maturing deferred annuity policies (product PG12). A *final bonus* for these policies would have been paid on maturity, as described in the PG12 section above. No additional entitlement of *final bonus* will be applicable.

Group pensions – PG14

17.6.42 This is a very small product group that covers just one remaining 'in-force' group scheme and a few remaining 'paid-up' group schemes.

17.6.43 *Final bonus* rates for maturing policies are set by reference to the yields on equivalent deferred annuities (PG12) policies.

***Unitised* With-Profits**

Pensions *unitised* with-profits - PG15

17.6.44 *Asset shares* are calculated for all policies in this *participation pool* split by year of premium payment. Smoothed *asset shares* are calculated in a similar manner but allow for *smoothing* of underlying investment returns over the average outstanding term of the business. The smoothed *asset share* is kept within plus or minus 12.5% of the *asset share*.

17.6.45 The *final bonus* amount is defined as the excess of smoothed *asset share* over the current unit value.

17.6.46 No additional discretion is used for this product, although *final bonus* rates are rounded to the nearest 1%.

17.6.47 Where the amount of *final bonus* calculated by the formula above is negative, a *market value reduction* may be applied. The *market value reductions* will in general bring the payout down to smoothed *asset share*.

17.6.48 Some discretion is applied in the setting of *market value reductions*. *Market value reduction*s are more likely to be set when:

- the difference between actual payouts and target payouts is large,
- it is considered necessary (subject to the *Board* having obtained appropriate actuarial advice) in the light of the financial position of the fund, or
- if a large number of surrenders or transfers are anticipated.

17.6.49 *Market value reduction*s can be applied at any time, rather than just at the normal quarterly *final bonus* declaration dates.

17.6.50 *Market value reduction*s will not be applied on death, at the nominated pension date, or at age 75.

Life *unitised* with-profits - PG16

17.6.51 This is a very small product group. Currently, the *final bonus* rates and *market value reduction*s for this product group are set to be the same as the pensions *unitised* with-profits (PG15) product group.

17.6.52 The benefits from this product group are similar to those in the equivalent pensions *unitised* with-profits (PG15) product group; the only major difference being the effect of tax.

17.6.53 The effect of tax is allowed for in the setting of *annual bonus* rates

17.6.54 This approach to final bonus would have to be revised if the approach to setting *annual bonus* rates were revised.

17.6.55 *Market value reductions* will not be applied on death, at the chosen *market value reduction* free date (where applicable) or for certain regular withdrawals in accordance with the terms of the policy.

AMP(UK) - Life Compound Bonus

17.6.56 Products covered in this *participation pool* include:

- Regular premium endowment assurances - PG18
- Regular premium whole-life assurances - PG19

17.6.57 For this *participation pool, asset shares* are calculated for all premium paying endowment assurances.

Regular premium endowments – PG18

17.6.58 *Asset shares* are compared with payouts for notional maturing policies with a range of different commencement dates. This demonstrates the amount by which current payouts will exceed or fall short of the *asset share* if bonus rates are unchanged.

17.6.59 The overall aim is that the final bonus rates should be set so that the payouts equal the target payouts, after allowing for smoothing see section 17.7.

17.6.60 *Final bonus* rates are set for the notional policies, as above, with grouping in 5 year bands of years of entry.

17.6.61 Policies that are paid-up will receive the same *final bonus* rates as premium paying policies of the same term.

Regular premium whole-life assurances – PG19

17.6.62 *Asset shares* are compared with payouts for notional policies from an appropriate age band with a range of different commencement dates. The age range is determined by considering when claims might be expected to occur.

17.6.63 *Final bonus* rates will be set according to the same practices as those used for the corresponding endowment assurance policies (PG18) described in 17.6.59 and 17.6.60 above.

AMP(UK) - Pension Compound Bonus

17.6.64 Products covered in this *participation pool* include:

- Regular premium pure endowments - PG20
- Regular premium pure endowments with *GAR* - PG21

For this *participation pool*, *asset shares* are calculated for all premium paying endowment assurances.

Regular premium pure endowments - PG20

17.6.65 *Final bonus* rates are set using exactly the same methods as for Life Compound Bonus AMP(UK) Endowments (PG18).

Regular premium pure endowments with *GAR* - PG21

17.6.66 These policies have an annuity rate guarantee (GAR). The cash benefits are targeted to *asset share*. The *GAR* is applied to the cash proceeds on the terms set out in the policy conditions to arrive at the amount of guaranteed annuity.

Benefits paid on surrender to products in all product groups except PG15 and PG16.

17.6.67 These paragraphs do not deal with *unitised with-profits* product groups (PG15 and PG16). The benefits paid on surrender, transfer and early retirement for these product groups have been set out above.

17.6.68 The target payout for surrenders, transfers and early retirements is normally the *asset share*. Claim values are calculated using a formula designed to meet this target.

17.6.69 The formula used to achieve the objective above will be based on notional policies. Approximation or considerations of materiality may be applied in determining the notional policies used. The operation of this approach means that some payments will be higher or lower than *asset shares*. However, the formula will ensure that payouts meet the target ranges in 17.6.72.

17.6.70 A *final bonus* may be payable on surrender or transfer. The *final bonus* will be based on the *final bonus* rate for a maturing policy of the same term but adjusted to target *asset share*.

Benefits paid on death

17.6.71 On the death of a policyholder, the policy terms and conditions will generally prescribe the payout. Where this includes a discretionary element of *final bonus, final bonus* is set at the same level as for maturing policies of the same term from inception.

Target ranges

17.6.72 Except where payment of a contractual benefit results in a higher amount, and except where the value cannot reasonably be compared with a calculated *asset share*, the target range for policy payments is 80% to 120% of the unsmoothed *asset share*. The range applies to both maturity payments and surrender payments. This range has been determined and will be monitored by reference to notional with-profits policies of the appropriate classes of business.

Principle 17.7 ***Smoothing***

The actual payout paid to any particular policy may be different to the target payout because of the fact that with-profits payouts are smoothed.

The nature of with-profits policies means that actual payouts do not immediately reflect changes in investment returns but are smoothed over time.

The degree of *smoothing* and the amounts of *smoothing* costs are not limited by the financial position of the fund. Furthermore, there is no specific limit on the amount of *smoothing* costs that can be incurred by the fund. However, the degree of *smoothing* and the amounts of *smoothing* costs are limited by the financial position of Phoenix Life Limited.

Other than the impact on the financial position of the fund, past *smoothing* costs do not directly affect the *smoothing* of current payouts. Although there is no requirement that *smoothing* be neutral, it is expected, over time, that payouts (with the exception of deaths) will average 100% of *asset shares*.

If the *Board* considers it necessary in the light of the current or expected financial position of the fund, the normal operation of *smoothing* may be suspended. In this situation benefits will be determined in accordance with these principles but only to the extent that doing so does not further weaken the financial position of the fund.

Practices

17.7.1 There are a number of types of *smoothing* that are used that will be referred to below when describing different product groups.

- Final payout *smoothing* is achieved by limiting the change in final pay-outs caused by a change in *final bonus* rates.
- Bonus rates are not calculated for individual policies but are calculated for notional policies within the *participation pools*. This has the effect of *smoothing* payouts across different policies within these groups.
- Investment returns applied to *unitised* with-profits products (PG15 and PG16) are smoothed over the average outstanding term of the business subject to the constraint that the smoothed *asset share* does not deviate more than 12.5% from the unsmoothed *asset share*.
- In the event that the fund makes any changes in the methodology or historic assumptions used to determine payouts, such changes will be smoothed over time

17.7.2 In arriving at appropriate *final bonus* rates for regular premium endowment assurances (PG01), old series deferred annuity without guaranteed annuity option (PG06), deferred annuities (PG12), and AMP (UK) regular premium endowments (PG18), the following factors are taken into account:

- Changes to *final bonus* rates will be limited, such that the resulting change in payout for any maturing policy is no more than 7.5% at each six monthly review,
- Where more than one *final bonus* change takes place in any one calendar year, the cumulative effect of such changes may be more than 15%. However, this is only expected to happen when the difference between actual payouts and target payouts is large, and/or the *Board* considers it necessary in the light of the financial position of the fund,
- Where the difference between actual payout and target payouts is small at the mid-year review, then payouts may be left unchanged.

17.7.3 Except for PG15 and PG16, a formal *smoothing account* is not recorded and there is no requirement that total cumulative *smoothing* costs be neutral over time. However, it is expected that the normal operation of *smoothing* will result in payouts (with the exception of deaths) that average 100% of *asset shares*. The degree of *smoothing* will only be limited by the financial position of the fund.

Principle
17.8 ***Surrender Values***

Surrender values may be reduced when the *Board* considers it necessary in the light of the financial position of the fund and anticipated rates of surrender in order to protect the level of security for the remaining policyholders.

Practices

17.8.1 *Non-protected exits* refer to surrenders, and transfers for pension business.

17.8.2 For surrenders and transfers, the target payout is normally the *asset share*. The actual payout will depend on *smoothing*. *Guaranteed benefits* can exceed *asset shares*, in this instance, the payout will be the *guaranteed benefit.*

Principle 17.9 Investment Strategy

The assets of the fund serve two purposes: to provide *asset shares* with investment return and to meet the cost of providing *guaranteed benefits* and other liabilities as they fall due.

The *Board* determines the acceptable level of investment risk taking account of the need to continue to meet the ongoing *solvency requirements*. A range of possible investment strategies are determined that meet this level of risk. The *Board* implements a strategy from this range of potential strategies having regard to the following principles in this section 17.9.

The exposure of each *participation pool's* notional allocation of assets to a particular *asset class* is set with regard to the following:

- the general levels of exposure to this *asset class* experienced by policyholders of other similar with-profits life insurance offices,
- the nature and maturity of the with-profits liabilities within the *participation pool*,
- the exclusion of certain *asset classes* listed below,
- The need to diversify the investments so as to limit exposure to any one *asset class*, market sector, currency, interest rate market or counterparty, and
- the need to provide liquid assets so as to pay current claims.

Asset shares will not be invested in derivative instruments other than for the purpose of efficient portfolio management and/or risk management.

For the balance of total assets in excess of assets notionally allocated to *asset shares* the exposure to a particular *asset class* is set so as to bring the overall investment risk of the with-profits fund to the acceptable level set by the *Board.* Investing these excess assets in this way may enable more investment risk to be taken by the *asset share* assets than would otherwise be the case. These excess assets will be diverse and may be derivatives or non-conventional assets provided that a market value is readily obtainable. These excess assets will be liquid to the extent that they are required to meet current claims.

The fund holds no investments that are of sufficient importance to it or any other group undertaking that such investments would *not normally be traded*.

The mix of assets of the fund will not be changed with the purpose of reducing any support provided to the fund, although it may be changed to ensure that Phoenix Life Limited as a whole can continue to meet regulatory capital requirements.

The mix of assets within the fund backing any policy allocated to the Life With-Profits Fund prior to 31 March 2012 (the date of implementation of the previous *PLAL 2012 Scheme* that has been replaced with the *2023 Scheme*) will not be changed for the purpose of meeting the cost of any guarantees contained within policies allocated to the Pensions With-Profits Fund prior to the *PLAL 2012 Scheme*.

Practices

17.9.1 The *Board* reviews the investment strategy, taking account of a variety of considerations, including our approach to *responsible investment* and allowing for appropriate actuarial advice. The frequency of reviews depends upon the financial position of the fund and the risk of failing to meet the *solvency requirements* allowing for the current mix of assets and liabilities. Where the risk is high, reviews will be more frequent but in any case a review will occur no less frequently than once per annum.

17.9.2 From 1 July 2007, following a review of investment strategy, the fund can also invest in a series of specialist funds to give exposure to different *asset classes*. The aim of this is to enhance returns whilst reducing the investment risk within the fund through a reduction in *volatility* of returns. These specialist funds could themselves use a range of *investment managers* to achieve their investment objectives.

Investment in fixed interest and cash assets may include exposure to *swaps* to reduce the risk from interest rate movements.

17.9.3 The management of the assets is undertaken by a number of investment management companies. The investments are managed in accordance with mandates that are approved through the *Board.* The investment management agreements set out any limits on matters such as, exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

17.9.4 The fund invests *asset shares* of policies differently according to the *participation pool*. The major potential *asset classes* are as shown in the following table.

Participation pool	Shares (*UK* Or International)	Property	Fixed interest (Government Or Corporate Bonds)	Alternative assets	Cash or short term deposits	Private Equity
former-London Life products						
Life Compound Bonus	Yes	Yes	Yes	Yes	Yes	Yes
Life Cash Bonus	No	No	Yes	Yes	Yes	No
Life *Unitised* With-Profits policies	Yes	Yes	Yes	Yes	Yes	Yes
Pensions Compound Bonus	No	No	Yes	Yes	Yes	No
Pensions Simple Bonus	No	No	Yes	Yes	Yes	No
Pensions *Unitised* With-Profits	Yes	Yes	Yes	Yes	Yes	Yes
post 1997 products						
With-Profits Annuity	No	No	Yes	Yes	Yes	No
former-AMP UK products						
Life Compound Bonus	No	Yes	Yes	Yes	Yes	No
Pensions Compound Bonus	No	No	Yes	Yes	Yes	No

17.9.5 The fund is able to invest the *asset shares* of *unitised* with-profits business in a range of *asset classes* because these *participation pools* are small and it is able to apply *market value reductions* to payouts, subject to contractual terms.

17.9.6 Furthermore, for the foreseeable future *participation pools* will either have *actively managed asset shares* or *passively managed asset shares. Participation pools* that will have *actively managed asset shares* are: Life *Unitised* With-Profits, Pension *Unitised* With-Profits, Life Compound Bonus and former AMP UK Life Compound Bonus. All other *participation pools* will have *passively managed asset shares*.

17.9.7 The minimum credit quality of fixed interest securities, other than emerging market debt, is A3, as per the Moody's scale. There may from time to time be a small proportion of the fund invested in lower grade stock. This results from downgrading by the ratings agencies. These lower grade stocks may either be liquidated or continued to be held depending on investment conditions at the time and also based on the investment advice of our *investment managers*.

17.9.8 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

17.9.9 Should the management wish to invest in new types of investment, this new asset will be subject to a risk assessment along with an analysis of the suitability of the asset relative to the liabilities, to be approved by the *Investment Committee* and the *Board*.

17.9.10 The guideline asset mix ranges for *asset shares* are:

Participation pool	**Fixed interest and cash**	**Equities** including *private equity* and *alternative assets*	**Property**
former-London Life products			
Life Compound Bonus	52% to 80%	20% to 40%	0% to 8%
Life Cash Bonus	100%	0%	0%
Life Unitised With-Profits policies	40% to 60%	40% to 50%	0% to 10%
Pensions Compound Bonus	100%	0%	0%
Pensions Simple Bonus	100%	0%	0%
Pensions Unitised With-Profits	40% to 60%	40% to 50%	0% to 10%
post 1997 products			
With-Profits Annuity	100%	0%	0%
former-AMP UK products			
Life Compound Bonus	100%	0%	0%
Pensions Compound Bonus	100%	0%	0%

For policies with an exposure to equity and property, and former AMP traditional life business, the fixed interest assets may include some corporate bonds. The fixed interest assets backing other policies do not currently contain any corporate bonds.

Principle
17.10 Business Risks

The fund seeks to avoid taking on new business risks and is managed in such a way as to minimise existing business risks.

The costs of *smoothing* with-profits pay-outs from year to year are met firstly from the surplus assets in the fund and subsequently from assets in the Non-Profit Fund and *Shareholder Fund* made available in accordance with the capital policy.

The costs of meeting *guaranteed benefits* in excess of those reasonably recoverable from the group of policies that give rise to them are met firstly by the surplus assets of the fund and subsequently from assets in the Non-Profit Fund and *Shareholder Fund* made available in accordance with the capital policy.

Profits or losses on business written outside the fund are not charged to the fund.

Even though the fund's with-profits policy proceeds do not directly benefit from nor directly suffer the effects of business risks, the fund's with-profits investment policy is affected by the financial position of Phoenix Life Limited. Therefore, the with-profits policyholder returns are indirectly affected by business risks.

Practices

17.10.1 Particular material risks exist in relation to the following:

- Investments (see section 17.9) producing lower returns than anticipated.
- Annuitant longevity in the fund (see 17.10.5)
- The existence of policy options (see 17.10.6)
- Fixed administration expenses within a fund closed to new business (see 17.10.8)

17.10.2 Other than the returns on investments (see section 17.9), these risks do not directly affect the returns credited to *asset shares* but they do affect the overall financial position of Phoenix Life Limited. The impact of the overall financial position of Phoenix Life Limited on investment policy is discussed in section 17.9 and on amounts payable is discussed in section 17.4.

17.10.3 The *Board* sets the acceptable level of investment risk per section 17.9. However, there is a significant risk that the investments do not perform as expected. This might result in lower payouts than expected or failure to meet the ongoing *solvency requirements*.

17.10.4 Particular investment risks arise from the general levels of interest rates, defaults on corporate bonds, defaults by other counter-parties for example in relation to derivatives, property prices and to a much lesser degree the movements in share prices.

17.10.5 The *Actuarial Function Holder* makes a prudent assessment of annuitant life expectancy and advises the *Board* of appropriate margins to set aside to meet the cost of payments. If annuitants live longer than expected then these margins may not be sufficient and the financial position of the fund will worsen.

17.10.6 The *Actuarial Function Holder* makes a prudent assessment of the proportions of policyholders that will exercise options within their policies and advises the *Board* of appropriate margins to set aside to meet the additional cost of these options. If policyholder behaviour changes such that more options are exercised than expected then the financial position of the fund will worsen.

17.10.7 Investment management services have been outsourced to the *investment managers* and administration services have been outsourced to Phoenix Group Management Services Limited (PGMS). There is a risk that the *investment managers* and / or PGMS fail to provide an adequate service or cease to trade.

Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the *Shareholder Fund* or Non-Profit Fund, and the fund would only be affected if the *Shareholder Fund* or Non-Profit Fund had insufficient excess assets to bear the losses.

17.10.8 As a closed fund the ability to spread fixed costs reduces as the value of the fund declines. There is a risk that the fund is unable to reduce its fixed costs in line with the decrease in fund over time. This could result in reduced payouts to policyholders through increased charges to *asset shares*.

17.10.9 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

Principle
17.11 Expenses and Charges

Under the terms of the *2023 Scheme* expenses representing the actual level of expenses attributed to the policies are deducted from *asset shares*.

A reasonable charge will be made to policies in PG07, PG09 and PG10 for the cost of providing guaranteed annuity benefits.

The fund is treated as a notional mutual life assurance business for the purpose of determining the tax to be charged to it. In particular, neither *asset shares* nor the fund bear the cost of shareholder taxes.

Practices

17.11.1 Phoenix Group Holdings, the ultimate parent of Phoenix Life Limited, owns subsidiaries that provide services to the fund.

17.11.2 Henderson Global Investors Ltd and Standard Life provide investment management services to the fund. Phoenix Group Management Services Limited provides administration services directly and with the assistance of its third party suppliers. Such arrangements are subject to periodic review by the *Board.*

17.11.3 Under the *2023 Scheme* the basis for charging administration expenses reflects the actual charges made by the service company for administration of the policies in the fund.

Principle 17.12 ***Estate* Management**

On implementation of the *2023 Scheme* the value of the fund's *estate* was zero.

The *estate* may:

(a) be used to smooth short term investment returns and shall accordingly be credited or debited with the difference between payouts (excluding any increase due to payment of *guaranteed benefits*) and *asset shares*;

(b) be debited with the cost of providing guarantees; and

(c) be debited or credited with the difference between amounts allocated or charged to *asset share* and the amounts allocated or charged to the fund in accordance with 17.4 (excluding amounts allocated or charged to any capital support provided for the fund).

The fund relies on support provided under the terms of the capital policy. Any capital support provided by Phoenix Life Limited to the fund shall be repayable to the Shareholders' Fund or the Non-Profit Fund (as the case may be) before any amount is credited to the *estate*

Practices

17.12.1 Providing that it is possible to do so whilst still treating policyholders fairly, it is intended to manage the fund so that it covers its own liabilities and capital requirements using solely the resources of the fund and minimises the need for support under the capital policy.

17.12.2 Subject to 17.9, the exercise of discretion in respect of with-profits policies will be managed with the aim that the support provided to the fund will be repaid to the extent that is possible whilst still meeting the aims described in section 5. In determining benefits under with-profits policies, the *With-Profits Committee* will disregard any liability to repay such support back to the Non-Profit Fund or *Shareholder Fund* to the extent that this is necessary to treat customers fairly (that is in accordance with these Principles and Practices).

Principle 17.13	**New Business**
	The fund will only accept new business where: (a) it is contractually obliged to do so, or where there is an established practice of accepting new business from the existing customers; (b) it is agreed by the *Board* and the *With-Profits Committee* that the policy is more conveniently written in the fund than in any other sub-fund in Phoenix Life Limited; and (c) it is agreed by the *Board*, having taken appropriate actuarial advice and having regard to policyholder reasonable expectations, to accept inwards reassurance. The fund would cease to accept non-contractual new business if the financial position of the fund became such that the *Board* considers it imprudent to continue doing so.

Practices

17.13.1 The fund only writes new business in the circumstances set out in 17.13.

Principle
17.14 Equity Between the Fund and Shareholders

Services may be provided by the shareholders to the fund but terms for such services will be on commercial terms which are considered to be consistent with the risks of providing those services, or considered to be consistent with terms which would be available for such services on an arm's length commercial basis.

As laid down in the *2023 Scheme,* shareholders do not receive any share of the cost of bonuses distributed to policyholders. Any change would require the agreement of the *Board* and would be subject to approval by the High Court.

Practices

17.14.1 The following services are provided to the fund:
- product provision (annuity products by the Non-Profit Fund); and
- administration services by PGMS.

17.14.2 Shareholders will only provide services to the fund on commercial terms, if there is an adequate return for the risks involved in providing the services. The profit margin for shareholders is acceptable to the fund if:
- the cost for the fund is consistent with the terms available from other providers; or
- the profit margin is consistent with the risks borne and there are reasonably foreseeable circumstances in which the shareholder could make a loss.

17.14.3 The allocation of profits between policyholders and shareholders is laid down in the *2023 Scheme* which states that 100% of the surplus being distributed from the fund is allocated to policyholders.

18. Principles and Practices – National Provident Life With-Profits Fund

The Principles and Practices given in sections 18.4 to 18.13, together with the Guiding Principles and Practices; form the Principles and Practices of Financial Management for the National Provident Life With-Profits Fund. Sections 18.1 to 18.3 give background information specific to the National Provident Life With-Profits Fund. Subsequently in this section the use of the term ‘the fund’ generally means the National Provident Life With-Profits Fund.

18.1 Fund History

18.1.1 The National Provident Life With-Profits Fund comprises all of the business that transferred to Phoenix Life Limited under the *2023 Scheme* from the National Provident Life With-Profits Fund of Phoenix Life Assurance Limited.

18.1.2 Originally this business was written by the National Provident Institution (NPI) before being transferred into National Provident Life Limited on 1 January 2000 when NPI was demutualised. NPI Limited was established at the same time to write new business.

18.1.3 National Provident Life Limited did not write new business other than increments, the exercise of options under in-force policies and new members to existing group schemes. Prior to 31 March 2012 most of these were reassured to NPI Limited, together with all unit-linked business (other than Unilink policies). With effect from 31 March 2012, all business in NPI Limited and these reassurance arrangements transferred to Phoenix Life Limited. Under the *2023 Scheme* the reassurance arrangements continue with the Phoenix Life Limited Non-Profit Fund.

18.1.4 From 2007 to 2019 charges were taken from *asset shares* of traditional life, UWP and PSA business to meet guarantee costs. The charges were 2% each year until 2015 and 0.5% each year between 2016 and 2019.

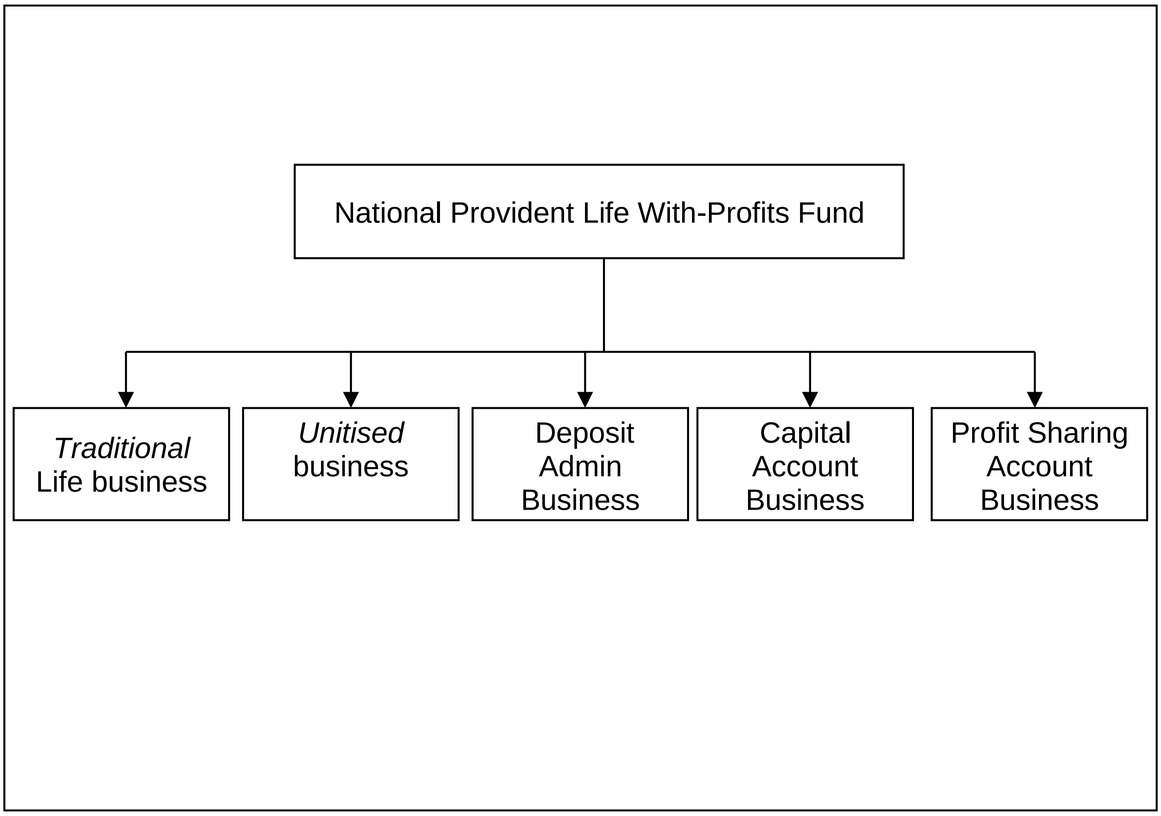
18.2 Types of Business

18.2.1 The fund comprises *traditional* and *unitised* with-profits business and non-profit business mainly in the form of unit-linked pensions. The unit-linked liabilities for policies in the fund are reassured to the Non-Profit Fund in Phoenix Life Limited.

18.2.2 The with-profits business in the fund is split into 5 different classes for the purposes of allocating *annual bonuses* and *final bonuses* as appropriate. The classes are:

- *Traditional* Life with-profits business
- *Unitised* with-profits business (UWP)
- Deposit Administration business (DA)
- Profit Sharing Account business (PSA)
- Capital Account business (CA)

Portfolio Bonds are not covered by these classes, and the approach for them is dealt with in 18.2.3.



18.2.3 Portfolio Bonds

Portfolio Bonds are single premium bonds written in the second half of 1999. There are options for unit linked and *unitised with-profits* investment under the bond and policyholders may switch between the two. The *unitised with-profits* investment is reinsured, on *original terms* to the Pearl With-Profits Fund. Chapter 15 'Principles and Practices – Pearl With-Profits Fund' gives most of the appropriate information in respect of Portfolio Bond business where it is classed as reinsured business. In addition, please note particular issues in respect of business risks (18.10), expenses and charges (18.11) and the *estate* (18.12) affect these policies.

18.2.4 *Traditional* Life with-profits business

This product group includes *traditional* whole of life and endowment contracts. It also includes Flexible Mortgage Plans and Low Cost Mortgage Plans which are a combination of With-Profits Endowment Assurance and Non-Profit Term Assurance.

Benefits are payable on *maturity*, early termination or claim event (e.g. death or retirement). On *maturity* or claim event, the *guaranteed benefits* plus *final bonuses* are payable, except where contractual terms provide for alternative benefits. *Annual bonuses* may be declared each year, and once declared cannot be taken away. *Final bonuses* are not guaranteed and can be changed at any time. On early termination, a different approach to determining benefits payable is followed and is described in more detail in 18.8.

Groups of policies that have similar characteristics and features receive the same *annual bonus* rates and the same *final bonus* rates. These groups are known as bonus series.

Simple bonuses apply to those policies issued before 1 January 1976. The bonus amount is calculated as a percentage of sum assured.

Compound bonuses apply to those policies issued on or after 1 January 1976. The bonus amount is calculated as a percentage of sum assured and attaching bonuses.

Separate *annual bonus* and *final bonus* scales are declared for Whole of Life and Endowment Business.

18.2.5 *Unitised* with-profits business (UWP)

Premiums paid by policyholders are allocated *investment units* at the date of the premium payment. There is no guarantee what those units may be worth at a future date, other than where the policy conditions guarantee a benefit level for certain claim types. Benefits are payable on *maturity*, early termination or claim event (e.g. death and retirement).

The contracts under which UWP is available include:

- With-Profits Bond
- Personal Pension Plan (both individual and group)
- Flexible Income Plan
- Group Money Purchase
- Group Investment Account
- Free-Standing Additional Voluntary Contribution
- Phased Retirement Account

Annual bonuses are declared in the form of additional units or by an increase in the unit price, or a combination of both.

A *final bonus* may also be added to the policy when a claim is paid. This will be determined for each policy individually. The amount of this bonus will vary and will depend on premiums invested, the dates the investments were made and how much the assets of the fund have grown by since those dates compared to the amount of bonus units already declared. On early termination, a different approach to determining benefits payable is followed and is described in more detail in 18.8.

Separate *annual bonus* and *final bonus* scales are declared for the following classes:

- Life single premium business
- Pensions single premium business
- Pensions regular premium business

Note

- Life Series 1 has a minimum guaranteed future *annual bonus rate* of 3.00% p.a.
- Life Series 2 to 7 are classed as 0GB (zero guaranteed *annual bonus*) business, a subset of the UWP business for which the minimum guaranteed future *annual bonus rate* is zero.
- Pension Series 1 ordinary (or accumulation) units have a minimum guaranteed future *annual bonus* rate of 4.00% p.a.
- Pensions Series 2 and 3 are classed as 0GB business.

18.2.6 Deposit Admin Business (DA)

This type of business is a form of with-profits pensions where all the return is given through the *annual bonus* rate. There are no *final bonuses* or *MVRs* on DA business.

DA contracts include:

- Capital Pension Plan
- Visible Growth Fund and
- Cash Accumulation Plans

18.2.7 Capital Account Business (CA)

This is similar to DA business but each investment into the Account purchases units, to which *annual bonuses* are added either through additional units or by an increase in unit price. The underlying investment strategy is the same though, and CA and DA business normally share the same bonus rates. However on transfers, switches or early retirements, an *MVR* may apply to CA business, with the rates of *MVR* varying by date of investment into CA (please see 18.8). There is no *final bonus.*

CA contracts include:

- Personal Pension Plan (both individual and group)
- Flexible Income Plan
- Group Money Purchase
- Group Investment Account
- Free Standing Additional Voluntary Contribution
- Phased Retirement Account
- Executive Pension Plan
- Pension Transfer Plan

18.2.8 Profit Sharing Account (PSA)

This is a form of with-profits business under Executive Pension Plan and Pension Transfer Plan that is a hybrid between *traditional* and *unitised* with-profits business. The contracts are priced and look like a unit linked investment. Each investment buys either units in a unit linked fund or units in CA or, under PSA, a fixed benefit payable from normal retirement date. Bonuses are added to the fixed benefit(s), thus making it similar to *traditional* with-profits business.

18.3 Capital Support to the National Provident Life With-Profits Fund

18.3.1 The cost of the policy guarantees for which the fund is liable has become significant over the years since National Provident Life Limited was established. As a result the financial position of the fund is such that it is expected that the *estate* will not be sufficient to meet this cost and the fund must rely on capital support and also has made charges to *asset shares*.

18.3.2 The capital policy is described in section 3.2.

In certain circumstances, the shareholders will loan money to this fund.

The practices relating to receipt of support are detailed in sections 3.3 and 5.2.

Principle 18.4 Amounts Payable Under a With-Profits Policy

In accordance with the *2023 Scheme*, the total *payout* on with-profits policies is based on *asset shares*, subject to *smoothing* (see section 18.7), plus for eligible with-profits policyholders, a share of any distributable free *estate* of the fund. The total *payout* on with-profits policies is, however, not less than the value of the *guaranteed benefits*.

Payouts are set with the intention that all policyholders will be treated fairly and of distributing equitably all the assets of the fund including all future surpluses, to the extent these are not needed to meet the future cost of guarantees, but excluding any capital support provided to the fund in accordance with the *2023 Scheme*.

Asset share techniques are used as a guide to determining *payouts* on all significant lines of business. For *traditional* Life, PSA and UWP business, the *asset share* techniques provide a guide to the levels of *final bonus* and, for UWP business, the level of *Market Value Reduction (MVR)* that may apply.

Asset share techniques are also used as a guide to determining *payouts* on DA and CA business, primarily to determine the *annual bonus* rate, but also as a guide to the level of *MVR* that may apply to CA business.

The *Board* may decide that the investment return for any identified group of policies may be determined from the returns on assets notionally hypothecated to that group of policies (whether or not the fund holds those hypothecated assets), rather than the return on the actual assets backing the with-profits business as a whole. Any hypothecation will be subject to the principle that it will only be considered if it preserves the fair treatment of policyholders overall.

Approximations are only used where it is made necessary by, for example, insufficient data or systems constraints.

Significant changes to the methods and data used to determine payouts require the approval of the *With-Profits Committee*. Changes to historical data are only likely to be made if they are found to be incorrect.

Practices

Asset Share Methodology

18.4.1 *Payouts* are determined using the results of the *asset share* calculations, subject to *smoothing* practices in respect of the fund, which have regard to the *smoothing* practices operated by National Provident Life Limited, with a minimum *payout* of the value of the *guaranteed benefits*.

18.4.2 The *asset share* is broadly the accumulation of past premiums allowing for investment return, tax, expenses, cost of mortality, (where appropriate) the cost of capital and other charges (see below).

The following table describes the elements credited or charged to *asset shares* for specimen policies.

Element		*Traditional Life* **With-Profits**	***Unitised* With-Profits**	**Deposit Administrat ion(DA)**	**Capital Account (CA)**	**Profit Sharing Account (PSA)**
(a)	Premiums	Premiums paid under the policy	Note(a)	Note(a)	Note(a)	Note(a)
(b)	Investment return	Note (b)	Note (b)	Note (b)	Note (b)	Note (b)
(c)	Investment expenses	Note (c)	Note (c)	Note (c)	Note (c)	Note (c)
(d)	Initial expenses	Note (d)	Note(a)	Not Charged	Note(a)	Note(a)
(e)	Renewal expenses	Note (d)	Note (d)	Note (d)	Note (d)	Note (d)
(f)	Other expenses	Note (f)	Note (f)	Note (f)	Note (f)	Note(f)
(g)	Tax on investment return	Note (g)	Note (g)	Not Charged	Not Charged	Not charged
(h)	Tax relief on expenses	Note (g)	Note (g)	Not Charged	Not Charged	Not Charged
(i)	Mortality & morbidity costs	Note (i)	Not charged	Not charged	Not charged	Not charged
(j)	Early terminations	Not charged	Not charged	Not charged	Not charged	Not charged
(k)	Paid-up policies	Not charged	Not charged	Not charged	Not charged	Not charged
(l)	Partial and regular withdrawals	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable
(m)	Surrenders at *protected dates*	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable
(n)	Annuity payments	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
(o)	Charges for the cost of guarantees or *smoothing*	Note(o)	Note(o)	Note(o)	Note(o)	Note(o)
(p)	Charges for the cost of capital	Not charged	Not charged	Not charged	Not charged	Not charged
(q)	Distributions to shareholders	Not charged Note (q)	Not charged Note (q)	Not charged Note (q)	Not charged Note (q)	Not charged Note (q)
(r)	Tax on distributions to shareholders	Not charged Note (q)	Not charged Note (q)	Not charged Note (q)	Not charged Note (q)	Not charged Note (q)
(s)	Profit and losses from other business	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
(t)	*Estate* distribution or charge	Note (t)	Note (t)	Note (t)	Note(t)	Note(t)
(u)	Exceptional items	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable

Notes

(a) Premiums

For DA business the premiums used in *asset share* calculations are premiums paid less expenses charged to the policy.

For PSA, UWP and CA, the premiums used in *asset share* calculations is the amount invested after initial charges.

(b) Investment return

The investment return allocated to *asset shares* is determined from the return on the assets notionally backing that business as described in 18.9.9. The investment return for determining *asset shares* is then increased or decreased as appropriate by the adjustment in respect of past *smoothing* costs in accordance with note (o) below and 18.7.2.

(c) Investment expenses

The investment management expenses used in *asset share* calculations for *traditional* life business are based since 1 January 2000 on the charges payable under the service agreement with its *investment managers*. For years prior to 2000, investment management expenses are based on the results of internal expense apportionment investigations

For UWP, PSA, DA and CA business an annual management charge is deducted partly in lieu of a charge for investment services.

(d) Expenses

Traditional life business expenses include initial commission payable under National Provident Life With-Profits Fund's normal terms.

For UWP, PSA, DA and CA business the initial charges are deducted to cover initial expenses.

The maintenance expenses used in *asset share* calculations for *traditional* life business are based since 1 January 2000 on the charges payable under the service agreement with Phoenix Group Management Services Limited but, since 14 December 2006, the then current level of expenses are inflated at the fixed rate of 4.07% per annum. For years prior to 2000, maintenance expenses are based on the results of internal expense apportionment investigations

For UWP, PSA, DA and CA business, expenses are not directly attributable to *asset shares* and charges in the form of an annual management charge are taken instead.

(f) Other Expenses

For all business, a charge to cover some or all of *the non-policy costs* is made.

(g) Tax on investment return

For Life business, an appropriate allowance for tax on the investment returns and tax relief on expenses is made.

For Pensions business, no tax is currently brought into the *asset share* calculation since no tax is currently payable on the investment return allocated to *asset shares*, nor is there any tax relief on any of the expenses brought into the *asset share* calculations.

The amount of tax chargeable to life policies in the *asset share* calculations is intended to be a reasonable approximation to that actually payable by the company in respect of its with-profits business. A notional amount of tax is determined as if the fund had constituted the whole long-term fund of a separate mutual life assurance company. Any difference between this notional amount of tax and that taken into account in the calculation of *asset shares* is treated as *non-policy costs*. Any difference between the tax actually payable and the notional amount is payable by or to the shareholder.

(i) Mortality and morbidity costs

For *traditional* life business, charges are made to *asset shares* for meeting the cost of mortality and other risks under individual policies.

The mortality rates used for *traditional* life *asset shares* are based on the fund's most recent experience.

(o) Charges for the cost of guarantees or *smoothing*

Smoothing adjustments are determined for, and shared among, *traditional life*, UWP and CA business. *Smoothing* adjustments are described in 18.7.1.

A charge to *asset shares* to cover *guarantee costs* was made in each year from 2007 to 2019 inclusive, with a total charge of 20% taken over that period. No charge was taken in 2020 and no future charges will be taken.

(q) Distributions to shareholders

Shareholders are not entitled to any surplus arising in the fund.

(t) *Estate* distribution or charge

If a distributable *estate* did arise, this would be used to augment the benefits payable under policies in the fund.

18.4.3 For *traditional* life policies, *payouts* are based on *asset shares* calculated for a sample policy commencing in each previous *final bonus period* and becoming payable in the current calendar year. For PSA, UWP, and CA business, *payouts* are based on a sample investment in each previous *final bonus period* and becoming payable in the current year. Consequently, for UWP, PSA or CA business, a regular premium policy may have numerous rates of *final bonus* and/or *MVR* applicable in the calculation of the amount payable reflecting the investments made in different *final bonus periods*, and a single premium policy will have a separate rate of *final bonus* or *MVR* in respect of each single premium paid.

18.4.4 *Asset shares* are calculated as at the mid-point of the period over which they apply. Estimates of investment returns are used where the actual investment return is not known at the date of calculation. The actual rates of investment returns (determined in accordance with 18.4.2(b)) are used in any subsequent calculation of *asset shares* once the actual investment returns have been determined.

18.4.5 The methodology used to determine *payouts* is documented by papers submitted to, and approved by, the *With-Profits Committee* Investment returns, expenses and charges are documented by internal memoranda.

18.4.6 The investment return for any class of business is determined from the return on assets notionally backing that business as described in 18.9.9 below. The investment return for *traditional* life, PSA, UWP and CA business, less an appropriate allowance for tax in respect of life business, is then increased / reduced by the charge in respect of past *smoothing* costs in accordance with 18.7.2 below.

18.4.7 For certain mortgage endowment policies, the NPI Promise applies which will mean an extra amount is payable at maturity if the *payout* falls below the amount of mortgage the policy was originally targeted to repay, subject to certain conditions being met. The cost of this Promise forms part of the *non-policy costs*.

18.4.8 Except where payment of a contractual benefit results in a higher amount, and except where the amount cannot be reasonably compared with a calculated *asset share*, the target ranges for policy claim *payouts* are 80% to 120% of unsmoothed *asset share* in respect of UWP, *traditional* life, PSA and CA business.

These ranges apply to both maturity payments and surrender payments for these classes of business.

18.4.9 These ranges have been determined and will be monitored by reference to specimen with-profits policies of the appropriate classes of business.

18.4.10 For some minor lines of business, the results of the major line of business most similar to the minor line may be used as a guide to setting *payouts*.

Principle
18.5 ***Annual Bonus* Rates**

Annual bonus rates are set by the *With-Profits Committee* and in doing so they disregard the existence of any capital support provided to the fund under the terms of the capital policy.

Due to the financial position of the fund, the strategy is to keep any increase in *guaranteed benefits* to a minimum by declaring as little *annual bonus* as possible. For *traditional* life business, it is therefore expected that there will be no *annual bonus* declared for the foreseeable future. For UWP business, it is similarly expected that there will be no *annual bonus* declared for the foreseeable future, except where the policy terms and conditions provide for a minimum rate.

For DA and CA business the *annual bonus* rate reflects the current investment return on the assets notionally backing this business plus or minus a *smoothing* adjustment.

To protect the financial position of the fund it may be deemed necessary to change the interim *annual bonus* rate for DA and CA business at any time, and to reduce the interim *annual bonus* rate, possibly to zero, and to declare at the year-end a rate different from the interim rate.

As the fund is closed to new business, it is not expected that any new series of bonus rates will be necessary.

Practices

18.5.1 *Annual bonus rates* and *interim annual bonus rates* for the following year are normally declared annually at 31 December, but *interim annual bonus rates* may be changed at any time.

18.5.2 *Annual bonus rates* on DA and CA business would not normally be expected to change by more than 1.5% per annum, but may change by more, in particular if the *With-Profits Committee* deems it necessary to protect the financial position of the fund.

18.5.3 For DA and CA business the interim *annual bonus* rate is set at the start of each calendar year at a level consistent with the expected return on the underlying assets minus the annual management charge, plus or minus an adjustment designed to bring the nominal value of the business more closely into line with the *asset shares*. In normal circumstances, the rate of *annual bonus* declared at the year-end would be the same as this interim rate.

Principle
18.6 ***Final Bonus* Rates**

The *With-Profits Committee* sets *final bonus* rates with the intention of distributing equitably all the assets of the fund including all future surplus arising in the fund, to the extent this is not needed to meet the cost of guarantees, but excluding any capital support provided to the fund

For maturities and retirements under *traditional* life, PSA and UWP business, and deaths and transfers under PSA and UWP business, *final bonuses* are normally set so that the total *payout* is targeted on *asset share*, subject to smoothing (see section 18.7 below), plus any distribution of the *estate*. The policyholder will receive not less than the value of the *guaranteed benefits* under the relevant policy.

No *final bonus* is normally payable on DA and CA business.

Practices

18.6.1 *Final bonuses* are normally reviewed and set every six months such that the final *payout* targets 100% of unsmoothed *asset share* over time subject to guarantees, *smoothing* and the requirement to protect the financial position of the fund. However, *final bonuses* may be changed without notice at any time that the company determines. Such an interim change would normally either be because economic conditions have changed leading to a larger than expected gap between the levels of *payouts* and the underlying *asset shares*, or if deemed necessary to protect the financial position of the fund.

18.6.2 For each class of policy, *final bonus* rates and *MVR*s, if applicable, would normally be the same for each *final bonus period* whatever the cause of claim (e.g. retirement, death, transfer, switch), except where the policy conditions guarantee a benefit higher than that based on *asset share* for certain claim types. For UWP and CA business, *MVR*s do not apply on some claims (e.g. deaths, some retirements) as specified in the policy conditions.

18.6.3 For UWP business, for each *final bonus period*, either an *MVR* or a *final bonus* will apply. There will not be both at the same time.

Principle
18.7 ***Smoothing***

Payouts are usually smoothed so as to avoid excessive differences in *payouts* on similar policies over short periods of time.

It is intended that *smoothing* will be cost neutral over time. If necessary, *payouts* will be amended to help ensure that the cost of *smoothing* does tend towards zero, and any outstanding *smoothing account* balances can reasonably be expected to be reduced to zero within a limited period.

Phoenix Life Limited may change the way payouts are smoothed at any time or may cease to smooth *payouts* if the *With-Profits Committee* deems it necessary to protect the financial position of the fund. In such circumstances, it may also adopt a different approach to *smoothing* by claim type.

Practices

18.7.1 For business where *final bonus* changes are normally made twice a year, *smoothing* is applied to maturity or retirement values by limiting the change in *final bonus* rates. Normally the change in *final bonus* rates for a specimen policy will be limited so that the increase or reduction in total maturity or retirement *payout* compared to a position where bonus rates are not changed is not more than 7.5% at each six monthly review.

18.7.2 For *traditional* business, *surrender value* bases are normally reviewed twice a year, and *smoothing* is applied by limiting the change in immediate *surrender value* for policies. Normally the *surrender value* for specimen model policies will not change by more than 10% at each six monthly review. *Surrender values may* change in between reviews because in many cases the s*urrender values* are calculated using formulae that depend on factors such as term remaining which change over time.

18.7.3 However, if it is necessary to enable the fund to continue to meet the objectives set out in the guiding principles in section 5 sometimes larger changes are made in *final bonus* rates and *surrender values*.

If there has been a significant change in premium rates then larger changes than those described above may be made so that *final bonus* rates and *surrender* bases remain consistent with the premium rates on which the business was generally written. Where premium rates were revised with the intention of changing payouts, then *smoothing* will not be applied, so that the change in payouts intended by the premium rate changes does occur.

Also where there have been significant changes in methodologies and practices, the impact may not be managed within the normal *smoothing* rules.

18.7.4 For *traditional* life, PSA and UWP business, *payouts* are normally determined using *asset shares* under which the investment return credited is only calculated approximately during the course of the year (by use of the appropriate indices) and is updated after the end of each year to reflect the actual performance earned. This applies to all generations of policyholders.

Principle 18.8 ***Surrender Values***

Surrender values will be set with reference to the policy's *asset share*, they may be subject to *smoothing*, and may vary considerably in line with movement in *asset shares*. *Surrender values* as determined will be subject to guaranteed minimums, where provided by the contract terms.

*MVR*s for UWP and CA business are based on *asset shares* (and, for UWP, result from the same calculation methods as *final bonuses*), and thus reflect changes in underlying asset values.

The basis for *surrender values* of *traditional* life business is reviewed from time to time so that *surrender values* remain broadly consistent with the targeted level of *payouts*.

Practices

18.8.1 Except where payment of a contractual benefit results in a higher amount, and except where the amount cannot be reasonably compared with a calculated *asset share*, the target ranges for policy claim *payouts* are 80% to 120% of unsmoothed *asset share* in respect of UWP, *traditional* life, PSA and CA business.

18.8.2 The range applies to both maturity payments and surrender payments for these classes of business.

18.8.3 For *traditional* life business, the surrender basis approximates on average to *asset share*, so the amount payable on any particular policy may be more or less than the amount targeted.

18.8.4 For With-Profits Endowment Assurance and With-Profits Whole Life Assurance policies, there is no separate scale of *final bonus* for surrenders, but the *surrender value* includes a proportion of the *final bonus* that would be payable were the policy then maturing.

18.8.5 *MVR*s for UWP are calculated in the same way as rates of *final bonus* and rounded similarly. This is generally to the nearest 0.1%. *MVRs* for CA business are calculated using *asset shares* determined as described above for UWP business.

18.8.6 *MVR*s do not apply to payments by way of *regular income payments* under policies such as With-Profits Bonds and Flexible Income Plans. Any resulting costs in excess of *asset shares* form part of the *guarantee costs.*

18.8.7 For With-Profits Endowment Assurance and With-Profits Whole Life Assurance policies, the surrender basis is intended to pay on average the same percentage of *asset shares* as for maturity claims. The same scale of *final bonus* applies to surrender as to maturity claims, but only a proportion depending on sex, age attained and outstanding term is included in the *surrender value*.

Principle
18.9 Investment Strategy

The investment strategy for all the assets in the fund takes into account the liabilities of the fund under its policies and other liabilities. The primary requirement is to maintain the financial position of the fund at a level agreed by the *Board* and protect existing *guaranteed benefits*. The need to meet, as far as possible, policyholders' reasonable expectations on levels of *payouts* in excess of *guaranteed benefits* is secondary to this.

Derivatives may be used to implement investment policy ahead of physical sales and purchases of assets. Derivatives are also used to match certain policy liabilities or to provide protection against increases in policy liabilities.

The maximum counterparty risk is that agreed with the *investment manager* from time to time, as authorised by the *Investment Committee*.

The investment policy in respect of any assets provided as capital support to the fund in accordance with the capital policy is determined by the *Board*.

The investment policy for assets in the fund shall be set on the basis that no support will be provided to the fund other than such support as is provided in accordance with the capital policy.

Practices

18.9.1 The investment strategy for the fund is reviewed formally at least once a year taking account of a variety of considerations, including our approach to *responsible investment*. The *With-Profits Committee* sets the investment strategy for the fund, excluding those assets provided as capital support under the capital policy, and approves the investment mandate. The *Board* sets the investment strategy for the assets provided as capital support under the capital policy.

18.9.2 The investment mandate sets out any limits on matters such as:

- The types of investment that may be held.
- The maximum amount that can be invested in any single currency.
- The maximum amount that can be invested in any single *asset class* / investment sector / country.
- The maximum extent to which the manager might hold assets which are different to the benchmark (guideline) portfolio in order to enhance returns (these include restrictions in terms of credit quality, term / duration and amounts of individual holdings).
- The minimum credit rating quality of assets (as specified by the main rating agencies such as Standard & Poor's and Moody's).
- The maximum amount of gearing within the fund (that is, the maximum amount of borrowing the fund may undertake to invest in new assets).
- Exposure to sectors or companies that do not align with our approach to *responsible investment*, for example Tobacco.

18.9.3 The investments are selected to provide a reasonably close match to the liabilities on a realistic basis, but also having regard to the financial position of the fund.

18.9.4 For non-governmental fixed interest investments (other than bonds held as part of the property portfolio), the minimum acceptable credit rating at the date of purchase is A-. If the credit rating subsequently falls below this level, the holding would, subject to the *investment managers'* advice, normally be sold.

18.9.5 The fund may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its *investment managers* and its lending agents. The *Investment Committee* advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

Asset Mix

18.9.6 The assets within the fund are separated into different asset pools. This separation may be either physical (where the investment managers run a separately identifiable asset pool) or notional (where rather than holding separate assets, we internally apportion the returns within the fund as if separate asset pools were held).

Asset Shares

18.9.7 One set of assets is held backing all *asset shares*, but there is some hypothecation of returns to:

- DA and CA business
- 0GB business
- Other with-profits business

The overall asset mix of the fund is the result of combining the assets in each of the underlying asset pools.

18.9.8 The guideline asset mix range for *asset shares* is:

	DA and CA Business	0GB Business	Other With-Profits Business
Fixed Interest and Cash	70 - 80%	45 - 55%	100%
Equities including *private equity* and *alternative assets*, and Property	20 - 30%	45 - 55%	0%

18.9.9 From time to time the actual asset mix will be different from the above percentages due, for example, to market movements, and active management decisions taken by the *investment managers* or the *Investment Committee*. The asset mix may also be altered in circumstances where there is an unacceptably high risk that regulatory capital requirements may be breached, that guarantees may not be met, or that it will not be possible to apply the stated *smoothing* policy.

18.9.10 The equity shares will be held in a mix of UK and overseas companies, the majority of which are listed and traded on the major stock exchanges. The equity shares may also include a proportion of private equity investments which are less liquid and may take longer to sell, should the fund wish to

18.9.11 Any property investments may be in both UK and overseas properties, and may be held directly, or through specialist funds.

18.9.12 The fixed interest assets backing *asset shares* may include derivative contracts aimed to alter the effective term of some of the physical assets.

18.9.13 The investments may be direct or via collective investment schemes such as unit trusts or derivatives.

Liabilities for Policy Options and Guarantees

18.9.14 The assets comprising the *estate* are mostly required to cover reserves that are necessary over and above the *asset share* to ensure that *guaranteed benefits* can be met, and are invested to match those liabilities. They are invested in fixed interest securities, short term deposits and *alternative assets*. They may also be invested in derivatives, and take a *short position* if this will result in the value of the assets changing more in line with changes in the cost of guarantees. Selection and management of the *alternative assets* will be subject to particularly detailed and continuous assessment in order to minimise adverse investment effects.

Liabilities for Non-profit policies and other liabilities

18.9.15 Assets backing the liabilities for non-profit policies are invested in fixed interest securities chosen to broadly match the duration and amount of the liabilities.

18.9.16 The *With-Profits Committee* and *Board* has to approve any new or novel form of investment in the fund, that does not form part of the capital support provided in accordance with the capital policy. The *Board* has to approve any new or novel form of investment for the capital support provided in accordance with the capital policy.

Not normally traded assets

18.9.17 The fund does not hold any assets which are *not normally traded*

Principle 18.10 Business Risks

The fund is closed to new business other than increments or new members to group schemes or policies coming into force as a result of options contained in existing policies. Most increments to existing policies or new members to group schemes written on or after 1 January 2000 are reassured to Phoenix Life Limited on terms which prevent strain arising in the fund. There is therefore very limited risk to the fund from acquiring new business.

Annuities in payment arising as a result of policies vesting, including those policies with Guaranteed Annuity Options, are set up in the Non-Profit Fund.

The fund has a number of reassurance arrangements in force with companies both inside and outside the Phoenix group of companies. There is a business risk that any of the reassurers could fail and the reassurance become worth less than expected, resulting in the fund having to meet more policy payments than expected.

The fund actively seeks to avoid taking on new risks and is managed in such a way as to minimise the existing risks. The Phoenix group of companies has comprehensive processes at managerial and *Board* level for identifying, reporting, monitoring and managing risks.

The costs of servicing any financing arrangements that the fund has in force could form part of the *non-policy costs*.

Any compensation costs arising from mis-selling of policies allocated to the fund shall be met by the Non-Profit Fund or the *Shareholders' Fund.*

Practices

18.10.1 It is not expected that the fund will take on any further business risks. The more significant business risks are outlined below.

18.10.2 Any profit or loss of any amount arising from business risk would form part of the *non-policy costs.*

18.10.3 Investment management services have been outsourced to the *investment managers* and administration services have been outsourced to Phoenix Group Management Services Limited (PGMS). There is a risk that the *investment managers* and / or PGMS fail to provide an adequate service or cease to trade. Should PGMS be unable to meet any of its obligations to provide services then Phoenix Life Limited would request that Phoenix Group, as owners of PGMS step in to restore the position. Should Phoenix Group not do this, then Phoenix Life Limited would attribute any losses to the *Shareholder Fund* or Non-Profit Fund, and the fund would only be affected if the *Shareholder Fund* or Non-Profit Fund had insufficient excess assets to bear the losses.

18.10.4 There is a risk that the charges for investment management fees and administration fees could vary. This could result in reduced payouts to policyholders.

18.10.5 Many of the in-force policies contain options for new policies, options over the date when benefits are payable, and the format of the benefits. There is therefore a risk that the options could be exercised in a way that increases *guarantee costs*. There is also a risk that many policies will surrender or transfer away, reducing the expected value of future profits on those policies to the *estate* and potentially reducing the fund at a rate that may give rise to liquidity issues. There is also a risk that policies with valuable guarantees lapse at a lower rate than expected, thus increasing *guarantee costs.* These risks are monitored so that action may be taken, where appropriate and practical, to minimise the risk to the fund.

18.10.6 There is a risk that the level of outgoings from the fund exceeded the income at a time when the sale of assets was not practical. This could mean that the fund would be unable to meet its payments to policyholders as they fall due.

18.10.7 The investment in fixed interest securities carries a risk of default by the issuers of those assets.

18.10.8 There is a risk that mortality of assured lives increases substantially resulting in more payments of death benefits than expected.

18.10.9 There are currently no financing arrangements giving rise to *non-policy costs*.

In addition for the Portfolio Bond:

18.10.10 The Portfolio Bond business is exposed to certain business risks of the Pearl With-Profits Fund. However, as Portfolio Bond business is not normally exposed to the profits or losses arising from the Pearl With-Profits Fund's direct written business, it is mainly the investment-related business risks (and the risks to the Pearl With-Profits Fund's solvency position) that are relevant for Portfolio bonds.

18.10.11 In the event that the fund were to become insolvent, Portfolio Bond policyholders would share in any reduction in policy *payouts* along with other policyholders of the fund – the reassurance to the Pearl With-Profits fund is an asset of the fund, and is not directly attributable to the Portfolio Bond policyholders.

18.10.12 Phoenix Group's current strategy includes acquiring closed books of insurance business. Any arrangements impacting on Phoenix Life Limited will be discussed with our *regulator* and will be approved by the *Board*.

Principle 18.11	**Expenses and Charges**
	Portfolio Bonds Portfolio Bond per policy expenses charged by PGMS for policy administration were agreed with PGMS at the date of introduction of Portfolio Bonds and were subsequently increased each year. Portfolio Bond expenses are not directly applied to policies – policies are subject to charges as set out in product terms, and the equivalent of an annual management charge is deducted from *asset shares.* Those charges are expected to at least cover the total costs, including commission, of all aspects of administering the business. The equivalent annual management charges are inclusive of the investment management fees. It is not expected that the equivalent annual management charge would change unless: (a) The policy administration expenses and/or investment management fees increased to the extent that they were greater than the amount of income generated by the policy charges, including the annual management charges, less the normal commission payable. (b) The policies became unprofitable for any other reason. Any such change would not be applied retrospectively. All direct costs of investment are borne by the Pearl With-Profits Fund and act to reduce the investment return. All other business Under the terms of the *2023 Scheme,* subject to applicable laws and regulations from time to time (including any regulations made by the *regulators* regarding the allocation of costs and charges to with-profits funds)*:* *(a)* the per policy administration expenses attributable to the fund were determined from the level set out in that Scheme increased each year by RPI plus 1%. The *Board* may (and shall, where so requested by the *With-Profits Committee*) review and amend the amount and application of the per policy expenses subject to the approval of the *With-Profits Committee*, having obtained appropriate actuarial advice. Increases to the per policy expenses and charges for investment management are determined by the *Board*, subject to the approval of the *With-Profits Committee*. (b) investment management fees attributable to the fund are determined by the *Board* subject to the approval of the *With-Profits Committee*. The charges and expenses attributable to the fund, other than the per policy administration and investment expenses, form part of the *non-policy costs.* For *traditional* life business, *asset shares* allow for the expenses of administration, plus the commission payable under the fund's normal terms. The investment return credited to *traditional* life business is reduced by the investment management fee. For DA, UWP, PSA and CA business, *asset shares* are debited with charges in the form of an annual management charge which includes the investment management fee. It is not expected that the levels of annual management charge made for DA, UWP, PSA and CA business will change unless: • The policy administration expenses and / or investment management fees increased significantly, particularly if they increased to the extent that they were greater than the amount of income generated by the annual management charges; or

- The *estate* was exhausted.

  Any such change would only be prospective.

All direct costs of investment are borne by the fund and act to reduce the investment return.

Practices

18.11.1 Any apportionment of charges and expenses between with-profits and other business is normally only in respect of policies which are invested partially in with-profits and partially in non-profit and/or unit linked investments. Any such apportionment will normally be made on the basis of the value of the policy held in those investments or the amounts of premium to be invested in the various funds.

18.11.2 The outsourcing agreements with Phoenix Group Management Services Limited currently apply a charging arrangement whereby per policy expenses rise each year by RPI plus 1%. The agreements may be terminated at any time by them subject to one year's notice or by Phoenix Life Limited, subject to three months' notice. The agreements may also be terminated in the event of either party becoming insolvent or wound up. Similar arrangements apply to agreements with the *investment managers*, although the time periods may vary.

18.11.3 The current level of annual management charge applicable to *asset shares* for DA, UWP, and CA business is generally 1.0% per annum, but charges applicable to some policies are different. For PSA business, the annual management charge is currently 0.85% per annum. Higher charges apply to *initial units*. The difference between the charges made to *asset shares* for DA, UWP, PSA and CA business and the expenses charged to the company by its *investment managers* and Phoenix Group Management Services Limited are dealt with as *non-policy costs.*

18.11.4 For *Portfolio Bond*s, the per policy expenses charged by PGMS for policy administration are increased each year at RPI plus 1%. Investment management fees are agreed by the *Board* with its *investment managers* from time to time.

18.11.5 *For Portfolio Bonds,* any apportionment of charges and expenses between with-profits and other business is normally only in respect of policies which are invested partially in with-profits and partially in unit linked investments. Any such apportionment will normally be made on the basis of funds held.

Principle 18.12 ***Estate* Management**

As a consequence of *NPI*'s demutualisation, the *distributable estate* is to be applied solely and exclusively in the provision of benefits to the *eligible with-profits policyholders*. The *distributable estate* is to be distributed to the *eligible with-profits policyholders* in an equitable manner, subject to the distribution being prudent and with the intention that all of the *distributable estate* will be distributed. It is unlikely there will be any *distributable estate* for the foreseeable future.

The *estate* may be used to meet any losses incurred by the company as a result of business risk, to provide a buffer against adverse experience, to pay for the *NPI Promise*, to meet *guarantee costs* as they arise and to meet any other costs necessary to ensure that payouts meet the reasonable expectations of policyholders.

Portfolio Bond policyholders have no rights to share in the *distributable estate* of either the fund or the Pearl With-Profits Fund.

Practices

18.12.1 There is no distribution of the *estate* at present nor is there likely to be for the foreseeable future since it is likely that all of it will be needed to meet future *guarantee costs* and other costs for which it is liable.

Principle
18.13 New Business

The fund only accepts new business in the form of increments to existing policies, new policies arising out of rights under existing policies, and new members to existing group schemes. Most *incremental business* is reassured to the Pearl With-Profits Fund on terms which prevent strain arising in the fund*.*

Practices

18.13.1 The amount of new business being accepted is minimal. The only *incremental business* accepted which is not reassured to Pearl With-Profits Fund is investments in PSA under Executive Pension Plans.

Principle 18.14	**Equity Between the Fund and Shareholders** The terms of the *2023 Scheme* are such that the fund continues to operate as if it were a mutual company and the *eligible with-profits policyholders* remain entitled to 100% of the profits and losses arising on the business in the fund. Any changes to these terms of the *2023 Scheme* would require the approval of the High Court.

Practices

18.14.1 The terms of the reassurance of *incremental business* provide for all profits or losses arising on that business to emerge in the Pearl With-Profits Fund, and not in this fund. There are no shareholder profit transfers from the fund.

18.14.2 Subject to certain minimum requirements being satisfied regarding the financial position of the fund, the capital support provided under the capital policy is repayable to the Non-Profit Fund and the *Shareholder Fund* as appropriate.

19 With-Profits Governance Arrangements

19.1 The *Board* is the governing body of Phoenix Life Limited with the final authority in decision making, subject to certain responsibilities in respect of the SPI With-Profits Fund and the National Provident Life With-Profits fund being the responsibility of the *With-Profits Committee*.

The *Board* may consist of executive and non-executive directors. The various funds of Phoenix Life Limited are the direct responsibility of the *Board*, subject to certain responsibilities in respect of the SPI With-Profits Fund and the National Provident Life With-Profits fund being the responsibility of the *With-Profits Committee*.

The *Board* is responsible for managing the with-profits business, including investment and bonus policy for the *with-profits funds,* other than the SPI With-Profits Fund and National Provident Life With-Profits Fund. The *With-Profits Committee* is responsible for setting investment and bonus policy for the SPI With-Profits Fund and National Provident Life With-Profits Fund.

19.2 Phoenix Life Limited has established a *With-Profits Committee* which has a majority of non-executive members. The committee normally meets around six times a year. The committee's role includes:

- reviewing bonus recommendations;
- reviewing ongoing compliance with the Principles and Practices of Financial Management; and
- considering issues that may have an impact on treating customers fairly.

The key powers attributable to the former Scottish Provident Limited SPI Fund Supervisory Committee were assumed by the *With-Profits Committee* under the *2009 Scheme* and remain under the *2023 Scheme*.

The *With-Profits Committee* shall consist of a majority of non-executive members, at least one of whom shall be an Independent Member as detailed in the *2023 Scheme*. The Independent Member must be a non-executive member, who is not a director of any member or prospective member of the Phoenix Group and is an actuary. The committee will be chaired by a non-executive member.

19.3 The *Board* produces a report (or separate reports for each of the *with-profits funds*) addressed to with-profits policyholders each year within six months of the financial year end. This report covers compliance with the Principles and Practices of Financial Management and significant issues where discretion has been exercised, in particular where such issues relate to the competing or conflicting interests of policyholders and shareholders. Policyholders will normally be advised of the report as part of their regular bonus mailing. The report is available on the www.phoenixlife.co.uk internet site and is available to policyholders on request.

19.4 Phoenix Life Limited has appointed a *With-Profits Actuary* for each of its with-profits funds. The *With-Profits Actuary* provides advice to Phoenix Life Limited on the implications of certain matters for with-profits policyholders. The *With-Profits Actuary* for each fund produces a report each year for the *Board* on key aspects of the discretion exercised in respect of that fund (including the application of the Principles and Practices of Financial Management). The *With-Profits Actuary* of the SAL Fund has additional responsibilities relating to the *2009 PALAL Scheme*.

19.5 Standard Life International dac (SLIDAC) Board is entitled to make representation to the Phoenix Life Limited With-Profits Actuary, the Phoenix Life Limited With-Profits Committee, the Phoenix Life Limited Board and the CEO of Phoenix Life Limited on matters affecting the reinsured policies and to receive an explanation of the basis for decisions which affect holders of such reinsured policies, and Phoenix Life Limited shall have regard to all such representations when making its decisions.

Appendix 1 Glossary

Glossary of Terms

2005 Scheme	The Scheme in 2005 under which policies formerly written in the long-term business funds of Phoenix Assurance Limited, Bradford Insurance Limited and Swiss Life (UK) PLC were transferred to Phoenix Life Limited on 31 December 2005. See appendix 2.
2006 Scheme	The Scheme in 2006 under which policies formerly written in the long-term business funds of Alba Life Limited, Britannic Assurance plc, Britannic Retirement Solutions Limited, Britannic Unit Linked Assurance Limited, Century Life plc and Phoenix Life & Pensions Limited were transferred to Phoenix Life Limited on 31 December 2006. See appendix 2.
2009 PALAL Scheme	The Scheme of arrangement under Part 26 of the Companies Act 2006 for Phoenix & London Assurance Limited which became effective on 31 December 2009. Under its terms, certain with-profits pension policies gave up their option to convert their maturity value into an annuity on guaranteed rates in exchange for an immediate increase to their value and a change to the underlying investment practices. See section 14.1
2009 Scheme	The Scheme under which policies formerly written in the long-term business funds of Scottish Provident Limited and Scottish Mutual Assurance Limited were transferred to Phoenix Life Limited on 6 February 2009. See appendix 2.
2011 Scheme	The Scheme under which policies formerly written in the long-term business fund of Phoenix & London Assurance Limited were transferred to Phoenix Life Limited on 14 February 2011. See appendix 2.
2012 Scheme	The Scheme under which policies formerly written in the long-term business fund of NPI Limited were transferred to Phoenix Life Limited on 31 March 2012. See appendix 2.
2022 Scheme	The Scheme under which Irish business formerly written within the 90% With-Profits Fund, the Alba With-Profits Fund, the Phoenix With-Profits Fund and the SPI With-Profits Fund was transferred from Phoenix Life Limited to Phoenix Life Assurance Europe dac on 1 January 2023. See appendix 2.
2023 Scheme	The Scheme under which policies formerly written in the long term business funds of Phoenix Life Assurance Limited, Standard Life Assurance Limited and Standard Life Pension Fund Limited were transferred to Phoenix Life Limited on 27 October 2023. See section 3.2
Allocated Business	With-profits business in the Pearl With-Profits Fund which was allocated from the NPI With-Profits Fund under the *2023 Scheme* and the liability for certain *unitised* with-profits investments known as Portfolio Bonds transferred by an interfund agreement from the National Provident Life With-Profits Fund.
Alternative Assets	Investments that are typically made with the aim of enhancing returns whilst reducing overall investment risk and fluctuations in overall returns. Before investing in new types of investment the *Board* will obtain the advice of the *Chief Actuary* and the *investment managers* on the benefits and risks of the proposition. This would include an analysis of the nature and proportion of future outcomes in which the instrument would prove materially disadvantageous relative to more traditional

	investments. If the instrument is to be held in material amounts in respect of with-profits policies, the *Board* will also seek the opinion of the *With-Profits Actuary* and the *With-Profits Committee*.
Annual Bonus	A bonus which may be added to a with-profits policy which increases the guaranteed benefits. Once added, *annual bonuses* cannot be taken away. Sometimes referred to as a regular or a reversionary bonus and interest additions.
Asset Share	Retrospective accumulation of premiums paid at the rates of investment return earned, after allowing for charges, such as expenses, mortality costs, guarantee costs, tax and other charges. It is described more fully in section 4.3.
Board	The governing body of Phoenix Life Limited with the final authority in decision making. It may consist of executive and non-executive directors. The various funds of Phoenix Life Limited are the direct responsibility of the *Board*. In practice the *Board* (or *With-Profits Committee* where it acts as the *Board* for SPI With-Profits Fund and National Provident Life With-Profits Fund) may delegate some of its day to day decision making capabilities to nominated individuals, although the *Board* will still remain responsible for those decisions.
Bonds Not Eligible for Final Bonus	With-profits bonds in the Phoenix With-Profits Fund under which it has never been the intention or practice to add a *final bonus*. They were issued mainly between 1991 and 1996. This class does not include other with-profits bonds for which, although no *final bonus* is presently payable, may be eligible for it in the future.
Buffer Reserve	An amount of assets in the Britannic Industrial Branch Fund and the Britannic With-Profits Fund that may be used to support their liabilities in accordance with the *2023 Scheme* . See appendix A2.7.
Capital Event	Phoenix Life Limited being unduly exposed to a risk of being unable to meet its SCR, or its capital needs (as determined in accordance with regulatory requirements to be adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due).
Capital Support Arrangements	Specifically for the Alba With-Profits Fund, this refers to the way the fund is to be managed in line with its Capital Support Agreement as described in section 8.3.
Chief Actuary	The actuary who provides guidance to the *Board* on actuarial matters.
Controlled Funding Arrangements	With-profits business held under a grouped basis where the funding of benefits is controlled by periodic actuarial review and is the responsibility of the trustees to the arrangement.
Credit Spread	The excess of the yield on a fixed-interest security not issued by the UK government over the yield on a fixed-interest security of the same term issued by the UK Government (may be negative).
Deposit Administration Business	With-profits business under which policy benefits are determined by holding premiums paid in a monetary account to which interest additions are made based on a declared rate of return subject to the act of *smoothing*.

Deposit Back	Where the company makes a large payment to a counterparty to provide it with future benefits (such as under a reinsurance policy), some of the premium is returned to the company to hold on behalf of the counterparty, releasing it only as the benefits are delivered.
Distributable Estate	The amount of *Estate* if any, considered by the *Board* to be available from time to time to enhance the benefits payable to with-profits policies which have an interest in the *estate*.
Estate	The estimated realistic value of the assets less the estimated realistic value of the liabilities. It is calculated using realistic assumptions and generally accepted methodologies on a basis determined by the *Board*.
Final Bonus	A bonus which may be payable when a with-profits policy becomes a claim such as on death or *maturity*, and paid in addition to the guaranteed benefits and any *interim bonus*.
Final Uplift	A form of bonus which provides an uplift to *payouts* for *fully participating deposit administration* policies to allow for any *distributable estate* from the fund.
Fully Participating Business	With-profits business in the Alba With-Profits Fund where bonuses are determined with respect to both the application on investment return, *smoothing* and all the profits and losses arising in the Alba With-Profits Fund. See also *Investment Smoothing business*.
Interim Bonus	A bonus which may be payable when a with-profits policy becomes a claim. It is paid in addition to the guaranteed benefits, allowing for the accrual of *annual bonus* since the previous *annual bonus* declaration.
Investment Committee	A sub-committee of the *Board* set up to review and consider investment related matters.
Investment Managers	The firm or persons appointed from time to time to manage the investments of a fund.
Investment Smoothing Business	With-profits business in the Alba With-Profits Fund where bonuses are determined with respect to the application of investment returns and *smoothing* only. Policies within this group do not share in the profits and losses of the Alba With-Profits Fund apart from those arising on investments. See also *Fully Participating business*.
Long Position	Where an investor purchases investments in excess of those which it strictly needs; often using the proceeds of a *short position* in a different type of investment to give a combined effect which may be suitable for matching liabilities for policy guarantees.
Long-Term Business Fund	In the context of Phoenix Life Limited, this consists of the Non-Profit Fund, the 90% With-Profits Fund, the 100% With-Profits Fund, the Alba With-Profits Fund, the Britannic With-Profits Fund, the Britannic Industrial Branch Fund, the Phoenix With-Profits Fund, the Scottish Mutual With-Profits Fund, the SPI With-Profits Fund, the SAL With-Profits Fund, the Pearl With-Profits Fund, the SERP Fund, the London Life With-Profits Fund, the National Provident Life With-Profits Fund, the Heritage With-Profits Fund, the UK Smoothed Managed With-Profits Fund, the German With-Profits Fund and the German Smoothed Managed With-Profits Fund.

Marked to Market / Marking to Market	Where the value of an exposure to a counterparty (such as a derivative contract) increases, this is a mechanism whereby the counterparty deposits with the company an amount to cover the increase in value. The opposite is also true, where the value of an exposure to a counterparty (such as a derivative contract) falls, this is a mechanism whereby the counterparty withdraws an amount to cover the decrease. If the value falls negative, the funds would have to deposit collateral in the counterparties collateral account.
Market Consistent	A value placed on a guarantee or policyholder option on a with-profits policy by identifying an asset (such as a financial option) for which a price is available from financial markets and which exactly or closely resembles the guarantee or policyholder option. The price of the asset is then used as a proxy for the value of the guarantee or policyholder option.
Market Value Reduction (MVR)	A percentage reduction to the value of units on a *unitised* policy which applies on encashment except in certain circumstances specified in the policy document. Sometimes referred to as a market valueadjustment. Also applies to *smoothed return* and *deposit administration* business.
Matching Adjustment Fund	The fund of that name maintained in the Phoenix Non-Profit Fund for the purpose of calculating the matching adjustment in accordance with Regulation 42 of the Solvency 2 Regulations 2015.
Mathematical Reserves	The value of guaranteed sums assured and existing *annual bonus*, less the value of future annual premiums, calculated in accordance with the rules of section 1.2 of the PRA Prudential Sourcebook for Insurers.
Maturity (Date)	• for a *traditional* endowment policy, the date on which the sum assured and bonuses will be paid; • for a *traditional* pensions policy, the selected retirement age; • for a *unitised pension* policy, the period around the selected retirement age during which the value of units may be used to provide retirement benefits without the application of a *market value reduction* or with the application of a restricted *market value reduction;* or • for a *unitised* endowment or bond, the date on which the value of units will or can be taken in full without the application of a *market value reduction* or with the application of a restricted *market value reduction.*
Non-Protected Exits	Claims occurring at other than a *protected date*. Policy benefits to be paid are not generally guaranteed. These are typically surrenders or withdrawals, other than at a guarantee date, transfers for pensions business and early retirements. Also refers to policies becoming paid-up.
Not Normally Traded (Assets)	Strategic assets that would not normally be traded because of their strategic importance to the fund / company (per Section 20.3 of the Conduct of Business Sourcebook which forms part of the Handbook issued by the Financial Conduct Authority (FCA)). Examples of such assets might include properties occupied by the company, or investments in subsidiary companies.

Own Funds	Own funds comprise of basic own funds and ancillary own funds. Basic own funds comprise of excess assets over liabilities and subordinated liabilities. Ancillary own funds consist of items other than basic own funds which can be called up to avoid losses.
Payer Swaptions	*Swaptions* in which the underlying *swap* is to pay a fixed rate and receive a variable rate.
Payout	The total amount paid in the event of a claim including bonuses, both *annual bonuses* and *final bonuses* and any *market value reduction* (where applied).
Payout Ratio	The amount paid in the event of a claim (policy *payout*) as a percentage of the *asset share*.
PLAL 2012 Scheme	The Scheme in 2012 under which policies formerly written in the long-term business funds of London Life Limited were transferred to Phoenix Life Assurance Limited on 30 September 2012. See appendix 2.
PLAL 2015 Scheme	The Scheme in 2015 under which policies formerly written in the long term business fund of National Provident Life Limited were transferred to Phoenix Life Assurance Limited on 30 March 2015. See appendix 2.
PPF (Policies)	Unit-linked pensions policies in the Phoenix With-Profits Fund which may invest in full or in part in the with-profits 'Profit Plus Fund'. Any references to these policies in this document are relevant only to the extent that they are invested in that fund.
Private Equity	These are equity securities in operating companies that are not publicly traded on a stock exchange, commonly involving the investment of capital in a company or fund by institutional investors where the investment strategy includes leveraged buyouts, venture capital, growth capital, distressed investments, balance sheet restructures, acquisitions finance, carve-outs and mezzanine capital.
Protected Date	A date (sometimes called a guarantee date) on which policy benefits are either guaranteed to be paid without any reductions, or some other minimum amount applies. Such dates are described in the terms and conditions of each policy, and may include death, *maturity*, surrender or withdrawal at a guarantee date or retirement at selected retirement age. For *traditional* with-profits business, the claim value paid at a *protected date* will normally be the sum assured together with any *annual*, *interim* and *final bonus*.
Receiver Swaptions	An option to enter into an interest rate *swap* of a specified term, at a specified date, in which the underlying *swap* is to receive a fixed rate and pay a variable rate.
Responsible investment	Our practice of incorporating Environmental, Social and Governance (ESG) factors into investment decisions.
Regulator	From April 2013 we are regulated by both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Prior to this we were regulated by the Financial Services Authority (FSA). References in this document to our *regulator*, and the rules set by our *regulator*, refer to the PRA or FCA as appropriate.

Scheme Capital Policy	The company's capital policy (under which the company intends to hold amounts of capital in excess of liabilities) as set out in Schedule 1 of the 2023 Scheme (as amended or adjusted from time to time in accordance with the terms of the 2023 Scheme).
Shareholder Fund	This fund is not part of the *long-term business fund* of Phoenix Life Limited and consists of assets owned by the shareholders of Phoenix Life Limited. Phoenix Life Limited is ultimately owned by Phoenix Group Holdings.
Short Position	Where shares or other assets are sold which the investor does not own (but has, for example, borrowed).
Smoothed Return (Business)	With-profits business in the Britannic With-Profits Fund where bonuses are determined with respect to the application of a smoothed investment return. Smoothed Growth Fund and Smoothed Income Fund business in the Scottish Mutual With-Profits Fund which are collectively known as the smoothed investment funds.
Smoothing	Process applied to reduce the *volatility* of *payouts* for with-profits business. Typically, but not restricted to, the *smoothing* of the effects of volatile investment returns.
Smoothing Account	An account which is credited (debited) with the difference between the *payouts* (excluding any increase due to the payment of guaranteed benefits) and the *asset shares*.
Solvency Capital Requirement	A *Solvency Capital Requirement* is the amount of funds that European Union insurance companies are required to hold.
Surrender Values	This includes all *non-protected exits* where premiums cease or the policy is surrendered except on *protected dates*.
Swaps	Contracts to exchange fixed interest rates for variable interest rates for specified periods or vice versa.
Swaptions	Contracts giving the holder the option but not the obligation to enter into *swaps* at future dates.
Term Remaining	The term remaining on a policy to its *maturity date*. Also refers to term remaining on fixed interest investments to their redemption date.
Threshold Amount	The amount of with-profits assets necessary to meet a *with-profits* fund's regulatory and capital policy.
Traditional (With-Profits) Policy	A with-profits policy under which guaranteed policy benefits are fixed when the policies are taken out in return for payment of either a single premium or annual premiums over the term of the policies. The guaranteed policy benefits are typically expressed as a sum assured or an annuity. Bonuses may be added. Sometimes referred to as a conventional (with-profits) policy. See section 4.2.
Unitised (With-Profits) Policy	A with-profits policy under which each premium purchases a number of 'units' and either: • the price of the units increases daily at the daily equivalent of the current *annual bonus* rate (but subject to any rounding in the unit prices); or • the price remains constant and *annual bonuses* purchase additional units.

On encashment, the value of the units at the then price is paid (possibly subject to a *market value reduction* or, in the case of *PPF policies*, to a surrender charge). See section 4.2.

Volatility

A measure of the past or expected future rate of change in asset prices. It is an important parameter in the pricing of financial options and in the *market-consistent* valuation of liabilities.

With-Profits Actuary

An actuary who is appointed by the *Board* and who under PRA rules is required to provide advice to Phoenix Life Limited on the implications of certain matters for with-profits policyholders. There may be more than one such actuary, each of whom advises on one or more of the *with-profits funds*. References to *With-Profits Actuary* in a particular section refer to the actuary who performs the function for that particular fund.

With-Profits Asset Value

The value of the assets held in a *with-profits* fund (including support) and valued in accordance with the *with-profits* regulatory requirements.

With-Profits Committee

Phoenix Life Limited has established a *With-Profits Committee* which comprises a majority of non-executive members. The chairman of the committee is a non-executive member. The Chief Executive of Phoenix Life Limited also attends. The committee normally meets around six times a year. The committee's role includes:

- reviewing bonus recommendations;
- reviewing ongoing compliance with the Principles and Practices of Financial Management; and
- considering issues that may have an impact on treating customers fairly.

For the SPI With-Profits Fund and National Provident Life With-Profits Fund the *With-Profits Committee* has the additional responsibility to set bonus and investment policy. In practice the *With-Profits Committee* may delegate some of its day to day decision making capabilities to nominated individuals.
At least one member must be totally independent and they must be an actuary as detailed in the *2023 Scheme*.

With-Profits Funds

In the context of this PPFM for Phoenix Life Limited, these consist of the 90% With-Profits Fund, the 100% With-Profits Fund, the Alba With-Profits Fund, the Britannic With-Profits Fund, the Britannic Industrial Branch Fund, the Phoenix With-Profits Fund, the Scottish Mutual With-Profits Fund, the SPI With-Profits Fund, the SAL With-Profits Fund, the Pearl With-Profits Fund, the SERP Fund, the London Life With-Profits Fund and the National Provident Life With-Profits Fund.

Separate documents are maintained for the Principles and Practices of Financial Management for the with-profits funds that were previously part of Standard Life Assurance Limited.

With-profits Policy Liabilities	Liabilities calculated in accordance with 3.2 of the Surplus Funds section of the PRA Rulebook but including future policy-related liabilities in Paragraphs 1 to 6 of the definition of future policy-related liabilities in the Glossary of the PRA Rulebook. The future policy-related liabilities cover planned and future deductions for cost of contractual guarantees, financial options and smoothing, planned deductions for life and other benefits, and future liabilities to repay financing costs.

Abbreviations Used

ACI	Allianz Cornhill Insurance plc
Alba	Alba Life Limited
AVC	Additional Voluntary Contribution
BA	Britannic Assurance plc
BLA	Britannia Life Assurance
BLL	Britannia Life Limited
Bradford	Bradford Insurance Company Limited
Britannic	Britannic Assurance (where used in sections 9 and 10)
BRV	Bonus Reserve Valuation
BULA	Britannic Unit Linked Assurance Limited
Century	Century Life plc
CPI	Consumer Price Inflation
FS	FS Assurance
FCA	Financial Conduct Authority
GAO	Guaranteed annuity option
GAR	Guaranteed annuity rate
IB	Industrial Branch
LAS	Life Association of Scotland Limited
LTICR	Long-Term Insurance Capital Requirement
MVR	Market Value Reduction
NAE	National Average Earnings
NEL	National Employers Life Assurance Company and associated companies
OB	Ordinary Branch
OEICS	Open ended investment companies
PAL	Phoenix Assurance Limited
PALAL	Phoenix & London Assurance Limited
PGMS	Phoenix Group Management Services Limited
PLAE	Phoenix Life Assurance Europe dac
PLAL	Phoenix Life Assurance Limited
PLL	Phoenix Life Limited
PLP	Phoenix Life & Pensions Limited
PPFM	Principles and Practices of Financial Management
PPL	Phoenix Pensions Limited
PRA	Prudential Regulation Authority
Prosperity	Prosperity Life Assurance
RHL	Royal Heritage Life Assurance Limited
RLI	Royal Life Insurance Limited
RPI	Retail Prices Index
RPIX	Retail Prices Index excluding Mortgage Interest Payments
RSALI	Royal & Sun Alliance Linked Insurances Limited
RSALP	Royal & Sun Alliance Life and Pensions Limited
SCR	Solvency Capital Requirement
Sentinel	Sentinel Life
SLIDAC	Standard Life International dac
SMI	Scottish Mutual International
SMA	Scottish Mutual Assurance Limited
SONIA	Sterling Overnight Index Average
SPL	Scottish Provident Limited
Swiss Life	Swiss Life (UK) PLC
WPBR	With-Profits Benefit Reserve

Appendix 2 Historic Information

Phoenix Life Limited traces its history back to Lloyds Life Assurance Limited, which was founded in 1971 and was purchased by Royal Insurance in 1985. It was subsequently renamed Royal Heritage Life Assurance Limited (RHL).

The Royal Insurance Group merged with the Sun Alliance and London Insurance Group in 1996, and in 1998 the business of the following companies was transferred into Royal Heritage Life Assurance Limited:

- Royal Life (Unit Linked Assurances) Limited
- Royal Life (Unit Linked Pension Funds) Limited
- Sun Alliance Linked Insurance Limited
- Sun Alliance Pensions Limited
- Property Growth Assurance Company Limited

At the same time Royal Heritage Life Assurance Limited was renamed Royal & Sun Alliance Linked Insurances Limited (RSALI). As part of the transfers in 1998, the with-profits policies, which existed in Royal Heritage Life Assurance Limited at the time, were converted to non-profit policies and became entitled to the addition of specified additional benefits at specified dates.

Royal & Sun Alliance Linked Insurances Limited closed to new business in 2002, although it has continued to issue policies under options on existing policies, including the acceptance of new members to existing pension arrangements and the issue of immediate annuities in respect of vesting pensions.

On 29 December 2005, Royal & Sun Alliance Limited Insurances Limited was renamed Phoenix Life Limited.

Phoenix Life Limited is now part of Phoenix Group.

2005 Scheme

A2.1 Under the *2005 Scheme*, business from the following companies was transferred into Phoenix Life Limited on 31 December 2005:

- Phoenix Assurance Limited (PAL)
- Bradford Insurance Company Limited (Bradford)
- Swiss Life (UK) PLC (Swiss Life)

A2.2 Two new funds were established within Phoenix Life Limited alongside the then existing Non-Profit Fund, namely the 90% Fund and the 100% Fund.

A2.3 All of the with-profits policies from the Swiss Life OB Fund (apart from the with-profits element of Libra Personal Pension Plans and similar policies) and from the Swiss Life IB fund were transferred to the 90% Fund. Former with-profits policies which became non-profit on becoming paid-up in the Swiss Life OB Fund and the Swiss Life IB Fund were also transferred to the 90% Fund. All of the with-profits policies from PAL, Bradford and the Swiss Life With Profit Fund were transferred into the 100% Fund. Swiss Life Libra Personal Pension Plans and similar policies were transferred to the Non-Profit Fund but any investment in Pension With-Profits Fund units was then internally reassured to the 100% Fund.

2006 Scheme

A2.4 Under the *2006 Scheme*, business from the following companies was transferred into Phoenix Life Limited on 31 December 2006:

- Alba Life Limited (Alba)
- Britannic Assurance plc (BA)
- Britannic Retirement Solutions Limited
- Britannic Unit Linked Assurance Limited (BULA)
- Century Life plc (Century)
- Phoenix Life & Pensions Limited (PLP)

A2.5 Four new *with-profits funds* were created and the 90% Fund was re-named the 90% With-Profits Fund and the 100% Fund was re-named the 100% With-Profits Fund. This resulted in the following seven funds in Phoenix Life Limited:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic With-Profits Fund;
- the Britannic Industrial Branch Fund;
- the Phoenix With-Profits Fund; and
- the Non-Profit Fund.

A2.6 All of the policies from the Ordinary Long Term Fund of Alba Life were transferred to the Alba With-Profits Fund. All of the policies from the Industrial Branch Fund of Britannic Assurance were transferred to the Britannic Industrial Branch Fund. All of the policies from the Ordinary Branch With Profits Fund of Britannic Assurance and the with-profits policies from Century were transferred to the Britannic With-Profits Fund. All of the policies from the With Profits Fund of Britannic Unit Linked Assurance were transferred to the 90% With-Profits Fund. All of the policies from the Phoenix Life & Pensions long-term fund were transferred to the Phoenix With-Profits Fund. Other long-term business from the companies listed in 1 above was transferred to the Non-Profit Fund.

A2.7 Under the *2006 Scheme*, memorandum accounts were set up in the Britannic With-Profits Fund and Britannic Industrial Branch Fund, called the WP Buffer Reserve Account and the IB Buffer Reserve Account, collectively known as the *Buffer Reserve*. The *Buffer Reserve* will be available to support the Britannic With-Profits Fund and Britannic Industrial Branch Fund. This replicates the mechanics that existed in Britannic Assurance prior to the *2006 Scheme*. More details of how the *Buffer Reserve* works are given in sections 9 and 10.

2009 Scheme

A2.8 Under the *2009 Scheme*, business from the following companies was transferred into Phoenix Life Limited on 6 February 2009:

- Scottish Mutual Assurance Limited (SMA)
- Scottish Provident Limited (SPL)

A2.9 Two new funds were established within Phoenix Life Limited alongside the then existing six *with-profits funds* giving:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic With-Profits Fund;
- the Britannic Industrial Branch Fund;
- the Phoenix With-Profits Fund;
- the Scottish Mutual With-Profits Fund;
- the SPI With-Profits Fund; and
- the Non-Profit Fund.

A2.10 Policies in the Scottish Mutual Assurance Limited With Profits Sub-Fund were transferred into the Scottish Mutual With-Profits Fund. The other long-term business remaining in Scottish Mutual Assurance Limited following the transfer of the Pegasus and Self Assurance protection business to the Royal London Mutual Insurance Society Limited was transferred into the Non-Profit Fund. Under the powers of the *2009 Scheme* the Non-Profit Fund reassured the former Scottish Mutual Assurance Limited Smoothed Investment Fund business to the Scottish Mutual With-Profits Fund.

Policies in the Scottish Provident Limited SPI Fund were transferred into the SPI With-Profits Fund. The with-profits policies originally held within the Special Fund within Scottish Provident Limited were converted into non-profit policies and transferred into the SPI With-Profits Fund as part of the *2009 Scheme*. The other long-term business remaining in Scottish Provident Limited following the transfer of the Self Assured protection business to the Royal London Mutual Insurance Society Limited was transferred into the Non-Profit Fund.

The key powers attributable to the SPI Fund Supervisory Committee were assumed by the *With-Profits Committee* under the *2009 Scheme*. For the SPI With-Profits Fund only, the *With-Profits Committee* has the additional responsibility for setting the investment and bonus policy. The *With-Profits Committee* shall consist of a majority of Independent *With-Profits Committee* Members, at least one of whom shall be an Independent Member as detailed in the *2009 Scheme*.

A2.11 Any investments in Pension With-Profits Fund units for former Swiss Life Libra Personal Pensions Plans were internally reassured to the 90% With-Profits Fund. These policies are part of the Non-Profit Fund and previously any investment in Pension With-Profits Fund units was internally reassured to the 100% With-Profits Fund, as described in paragraph A2.3.

A2.12 As part of the *2009 Scheme*, the £200m of subordinated loan notes (debt) that was previously issued by Scottish Mutual Assurance Limited was transferred to the *Shareholder Fund*.

2011 Scheme

A2.13 Under the *2011 Scheme*, business from Phoenix & London Assurance Limited was transferred into Phoenix Life Limited on 14 February 2011.

A2.14 A new fund was established within Phoenix Life Limited alongside the then existing eight *with-profits funds* giving:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic With-Profits Fund;
- the Britannic Industrial Branch Fund;
- the Phoenix With-Profits Fund;
- the Scottish Mutual With-Profits Fund;
- the SPI With-Profits Fund
- the SAL With-Profits Fund; and
- the Non-Profit Fund.

A2.15 Policies in the Phoenix & London Assurance Limited long-term fund were transferred into the SAL With-Profits Fund.

2012 Scheme

A2.16 Under the *2012 Scheme*, business from NPI Limited was transferred into Phoenix Life Limited on 31 March 2012.

A2.17 A new fund was established within Phoenix Life Limited alongside the then existing nine *with-profits funds* giving:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic With-Profits Fund;
- the Britannic Industrial Branch Fund;
- the Phoenix With-Profits Fund;
- the Scottish Mutual With-Profits Fund;
- the SPI With-Profits Fund
- the SAL With-Profits Fund;
- the NPI With-Profits Fund; and
- the Non-Profit Fund.

A2.18 With-profits benefits in respect of policies in the NPI Limited long-term fund were transferred into the NPI With-Profits Fund.

Scheme 2022

A2.19 The *2022 Scheme* transferred the Irish business in the following funds to Phoenix Life Assurance Europe dac (PLAE):

- the 90% With-Profits Fund;
- the Phoenix With-Profits Fund;
- the Alba With-Profits Fund; and
- the SPI With-Profits Fund.

This business was reinsured back to Phoenix Life Limited and associated security given. Benefits for these policies are linked to participation in the relevant with-profits funds within Phoenix Life Limited. The Phoenix Life Limited Principles and Practices of Financial Management continue to apply for the transferred policyholders as the funds are reassured back to Phoenix Life Limited in order to ensure continuity of treatment.

Scheme 2023

A2.20 Under the *2023 Scheme* business from the following companies was transferred into Phoenix Life Limited on 27 October 2023:

- Phoenix Life Assurance Limited (PLAL)
- Standard Life Assurance Limited (SLAL)
- Standard Life Pension Fund Limited (SLPF)

A2.21 Also as part of the *2023 Scheme* the business in the NPI With-Profits Fund which was previously reassured into the PLAL Pearl With-Profits Fund was transferred into the PLL Pearl With-Profits Fund.

A2.22 Eight new funds were established within Phoenix Life Limited alongside the then existing nine *with-profits funds* giving:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic With-Profits Fund;

- the Britannic Industrial Branch Fund;
- the Phoenix With-Profits Fund;
- the Scottish Mutual With-Profits Fund;
- the SPI With-Profits Fund
- the SAL With-Profits Fund;
- the Pearl With-Profits Fund;
- the SERP Fund;
- the London Life With-Profits Fund;
- the National Provident Life With-Profits Fund;
- the Heritage With-Profits Fund;
- the UK Smoothed Managed With-Profits Fund;
- the German With-Profits Fund;
- the German Smoothed Managed With-Profits Fund; and
- the Non-Profit Fund.

A2.23 Policies in the Phoenix Life Assurance Limited Pearl With-Profits Fund and the with-profits benefits in the Phoenix Life Limited NPI With-Profits Fund transferred into the Pearl With-Profits Fund. Policies in the Phoenix Life Assurance SERP Fund transferred into the SERP Fund. Policies in the Phoenix Life Assurance Limited London Life Fund transferred into the London Life With-Profits Fund and policies in the Phoenix Life Assurance Limited National Provident Life With-Profits Fund transferred into the National Provident Life With-Profits Fund.

A2.24 Policies in the Standard Life Assurance Limited Heritage With-Profits Fund transferred into the Heritage With-Profits Fund. Policies in the Standard Life Assurance Limited UK Smoothed With-Profits Fund transferred into the UK Smoothed With-Profits Fund. Policies in the Standard Life Assurance Limited German With-Profits Fund transferred into the German With-Profits Fund and policies from the Standard Life Assurance Limited German Smoothed With-Profits Fund transferred into the German Smoothed With-Profits Fund.

Separate documents are maintained for the Principles and Practices of Financial Management for the with-profits funds that were previously part of Standard Life Assurance Limited. These are the:

- the Heritage With-Profits Fund;
- the UK Smoothed With-Profits Fund;
- the German With-Profits Fund; and
- the German Smoothed With-Profits Fund.

This also applies to participating European business which transferred to Standard Life International (SLIDAC) and was reinsured back to Standard Life Assurance Limited.

PLAL 2012 Scheme

A2.25 Under the *PLAL 2012 Scheme*, business from London Life Limited was transferred into Phoenix Life Assurance Limited on 30 September 2012.

A2.26 A new *with-profits fund* was established within Phoenix Life Assurance Limited alongside the then existing two *with-profits fund*s to receive the former London Life with-profits business and the two non-profit funds were merged to form the Non-Profit Fund. In addition, the 90:10 Fund was renamed the Pearl With-Profits Fund. This meant that the long-term fund of Phoenix Life Assurance Limited comprised of:

- the Pearl With-Profits Fund;
- the SERP Fund;
- the London Life With-Profits Fund and
- the Non-Profit Fund

A2.27 All of the policies from the Pearl 90:10 Fund remained in that fund which was then renamed the Pearl With-Profits Fund. All of the policies from the Pearl SERP Fund remained in that fund which was then renamed the SERP Fund. All of the policies from the London Life with-profits sub-funds (Life With-Profits Fund and Pension With-Profits Fund) transferred to the London Life With-Profits Fund.

PLAL 2015 Scheme

A2.28 Under the *PLAL 2015 Scheme*, business from National Provident Life Limited was transferred into Phoenix Life Assurance Limited. All policies, other than annuities in payment, were transferred into a new with-profits fund, the National Provident Life With-Profits Fund. As a result, the long-term fund of Phoenix Life Assurance Limited comprises of

- the Pearl With-Profits Fund;
- the SERP Fund;
- the London Life With-Profits Fund;
- the National Provident Life With-Profits Fund and
- the Non-Profit Fund

Other events

A2.29 In 2007, Phoenix Life Limited set up Phoenix Pensions Limited (PPL) as a wholly owned subsidiary. PPL is an asset of the *Shareholder Fund* of Phoenix Life Limited. Risks under immediate annuity policies were transferred to PPL. The risks in PPL were subsequently recaptured in 2011.

A2.30 In 2008, the Phoenix Life Limited Non-Profit Fund acquired Scottish Mutual International (SMI) but subsequently sold SMI in 2015

A2.31 At the end of 2008, Phoenix & London Assurance Limited (PALAL) recaptured the group *unitised* with-profits pensions business which it had previously reassured to the 100% With-Profits Fund.

A2.32 In 2010, the Phoenix Life Limited *Shareholder Fund* acquired NPI Limited (NPIL). All the business in NPIL was subsequently transferred into PLL under the *2012 Scheme*.

A2.33 Under the *2012 Scheme* the immediate annuity business reassured from National Provident Life Limited to NPIL was transferred into the Phoenix Life Limited Non-Profit Fund.

Appendix 3 History of Principles and Practices of Financial Management for Phoenix Life Limited since 1 January 2007

The first version of the Principles and Practices of Financial Management for Phoenix Life Limited following the funds merger under the *2006 Scheme* was applicable from 1 January 2007.

For historical information before 1 January 2007 refer to the Principles and Practices of Financial Management of the previous companies.

A3. The Principles and Practices of Financial Management have been republished to reflect changes in Phoenix Life Limited's circumstances and the business environment.

A3.1 The Principles and Practices of Financial Management was republished in May 2007. The main changes to the practices were due to:

- The capital policy in the background section was revised following the FSA PS06/14 rule changes.
- The Alba With-Profits Fund former Crusader With-Profits Performance Fund and With-Profits Pension Fund business being accepted under an inter-fund arrangement with the Non-Profit Fund.
- The clarification of the Alba With-Profits *traditional* business surrender practices.
- Other minor amendments.

A3.2 The Principles and Practices of Financial Management was republished in October 2007. The main changes to the practices were due to:

- The capital policy in the background section was revised to reflect the changes due to Phoenix Pensions Limited which is wholly owned by the *Shareholder Fund*.
- The *asset share* practices were updated to reflect the latest *estate* distributions for the former Swiss Life, former Britannic Unit Linked Assurance, former Phoenix Assurance Limited and former Britannic Assurance Industrial Branch business.
- Update the Phoenix With-Profits Fund equity-backing ratio.
- Other minor amendments.

A3.3 The Principles and Practices of Financial Management was republished in January 2008. The main changes to the practices were due to:

- Revision of *estate* distribution practices and latest *estate* distributions.
- Revised *smoothing* practices.
- Revised *traditional* business *surrender value* targets.
- *Final bonus* reviews normally being twice a year generally 1 January and 1 July.
- Revised cost of bonus for determining shareholder transfers.
- Revised parameters in the Phoenix With-Profits investment strategy.
- Revised Britannic With-Profits Fund and Britannic Industrial Branch Fund initial expenses charged to *traditional* business *asset shares*.
- Britannic With-Profits Fund and Britannic Industrial Branch Fund pension scheme longevity costs to be charged to the *Buffer Reserve*.
- Update for 2008 values and asset mixes.
- Other minor amendments.

A3.4 The Principles and Practices of Financial Management was republished in July 2008. The main changes to the practices were due to:

- Pearl Group Limited acquired Resolution plc.
- Updated asset mixes.
- Updated estate distributions.
- Clarified retainer charges in the Britannic With-Profits and Britannic Industrial Branch Fund.
- Clarified treatment of former Bradford policies in the 100% With-Profits Fund.
- Updated priorities for using the *estate* in the Britannic With-Profits and Britannic Industrial Branch Fund.
- Revised *traditional* with-profits *surrender value* target proportion of *asset share* for Alba With-Profits Fund.
- Clarified the *asset share* treatment of former Crusader With-Profits Performance Fund and With-Profits Pension Fund in the Alba With-Profits Fund.
- Other minor amendments.

A3.5 The Principles and Practices of Financial Management was republished in February 2009.

The main changes were:
- To incorporate the *2009 Scheme*.
- The addition of the Scottish Mutual With-Profits Fund and the SPI With-Profits Fund and the associated transfer of business from Scottish Mutual Assurance Limited and Scottish Provident Limited.
- To reflect the transfer of the former Swiss Life Pension With-Profits Fund business from the 100% With-Profits Fund to the 90% With-Profits Fund.
- To reflect the recapture by Phoenix & London Assurance Limited of the *unitised* with-profits group pension business which it had previously reassured to the 100% With-Profits Fund.

The other main changes to the practices were due to:
- Updated asset mixes, *estate* distributions and year end values
- Update for Resolution Asset Management becoming Ignis Asset Management.
- Update for how *smoothing* had applied for the January 2009 *final bonus* review and to provide further clarification.
- Update on the investment return variances that would lead to an additional bonus review.
- Update on the target proportion range for *final bonuses* for the Phoenix With-Profits Fund.
- The change in structure of the Pearl Group Management Services charges for *unitised* business in the Britannic With-Profits Fund.
- Other minor amendments.

A3.6 The Principles and Practices of Financial Management was republished in July 2009. The main changes to the practices were due to:

- Updated asset mixes and *estate* distributions.
- Updates for how *smoothing* has applied for the July 2009 *final bonus* review.
- Clarification of the surrender value practices for *traditional* with-profits pension policies in the Scottish Mutual With-Profits Fund.
- Revision of the surrender practices for the Scottish Mutual With-Profits Fund *traditional* with-profits life policies so that the *surrender value* target proportion of *asset share* over the last 10 years to run trends into 100% at maturity.
- Revision of the surrender practices for the SPI With-Profits Fund *traditional* with-profits policies so that the *surrender value* target proportion of *asset share* over the last 10 years to run trends into 100% at maturity.

- Revised *traditional* with-profits *surrender value* target proportion of *asset share* for Alba With-Profits Fund.
- Final 2008 year end capital / loan support positions for the Alba With-Profits Fund.
- Revisions to the structure of the PGMS charges for *unitised* business in the Britannic With-Profits Fund.
- Clarification of *final bonus* calculations with respect to the use of an assumed year of retirement for some *unitised* with-profits pensions business in the Phoenix With-Profits Fund.
- Clarified the *asset share* treatment of former Crusader *controlled funding arrangements* in the Alba With-Profits Fund.
- Other minor amendments.

A3.7 The Principles and Practices of Financial Management was republished in January 2010. The main changes to the practices were due to:

- Updated asset mixes and *estate* distributions.
- Updates for the interim October 2009 *final bonus review* and how *smoothing* was applied at that review.
- Updates for how *smoothing* has applied for the January 2010 *final bonus* review.
- Investment strategy changes, including:
  - Hedge for guarantee costs and equity backing ratio in the 90% With-Profits Fund;
  - Hedge for guarantee costs in the Alba With-Profits Fund;
  - Hedge for guarantee costs in the Britannic With-Profits Fund;
  - The estates of the Scottish Mutual With-Profits Fund and the SPI With-Profits Fund are now invested in gilts rather than in line with the same asset mix as asset shares; and
  - Differential equity backing ratio in the Scottish Mutual With-Profits Fund and SPI With-Profits Fund planned for 2010.
- 2009 half year capital / loan support positions for the Alba With-Profits Fund
- The Phoenix With-Profits Fund Profit Plus Fund final bonus structure changes
- Other minor amendments.

A3.8 The Principles and Practices of Financial Management was republished in July 2010. The main changes to the practices were due to:

- Updated asset mixes and *estate* distributions.
- Updates for how *smoothing* has applied for the July 2010 *final bonus* review.
- Investment strategy changes, including:
  - Progress on the implementation of the differential equity backing ratio and associated changes in the Scottish Mutual With-Profits Fund and the SPI With-Profits Fund;
  - Relaxation of the corporate bond criteria;
- Final 2009 year end capital / loan support positions for the Alba With-Profits Fund.
- The Britannic With-Profits Fund and Britannic Industrial Branch Fund estate distribution from the *Buffer Reserve*.
- Clarification of Scottish Mutual With-Profits Fund and SPI With-Profits Fund *traditional* with-profits *surrender value* calculations with respect to the use of an underpin based on discounting the guaranteed benefits.
- Clarification of the use of smoothing in calculation SPI With-Profits Fund *traditional* with-profits *final bonuses* for single premium business.
- Removal of references to Hansard business in the Britannic With-Profits Fund as this has all now run-off.
- Other minor amendments.

A3.9 The Principles and Practices of Financial Management was republished in February 2011. The main changes were:

- To incorporate the *2011 Scheme*.
- The addition of the SAL With-Profits Fund and the associated transfer of business from Phoenix & London Assurance Limited.

The other main changes to the practices were due to:

- Investment strategy and asset mix changes:
  - Progress on the implementation of the differential equity backing ratio and associated changes in the Scottish Mutual With-Profits Fund and the SPI With-Profits Fund.
  - Progress on the *2009 PALAL Scheme* policies' equity backing ratio.
- Latest *estate* distributions, guarantee charges, expenses and 2010 / 2011 asset mixes.
- Finalisation of the *2009 PALAL Scheme*.
- Vesting annuities to be transferred to Phoenix Life Limited Non-Profit Fund from 2011 for Alba With-Profits Fund, Phoenix With-Profits Fund and SAL With-Profits Fund.
- 2010 year end capital / loan support positions.

A3.10 The Principles and Practices of Financial Management was republished in July 2011. The main changes to the practices were due to:

- Revised *estate* distribution strategy.
- Removing some of the variable data relating to asset mixes, guarantee charges and *estate* distributions.
- Vesting annuities are now transferred to the Phoenix Life Limited Non-Profit Fund for Alba With-profits Fund, Phoenix With-Profits Fund and SAL With-Profits Fund.
- The recapture of Phoenix Pensions Limited (PPL) business into the Phoenix Life Limited Non-Profit Fund.
- Other minor amendments.

A3.11 The Principles and Practices of Financial Management was republished in March 2012. The main changes were:

- To incorporate the *2012 Scheme*.
- The addition of the NPI With-Profits Fund and the associated transfer of business from NPI Limited.

The other main changes to the practices were due to:

- Harmonising practices across the funds for *annual bonus* rates, *smoothing* and surrender deductions.
- Clarifying that, for some funds, the range of assets that may be held include emerging market equity and debt, private equity and alternative assets such as hedge funds.
- Other minor amendments.

A3.12 The Principles and Practices of Financial Management was republished in July 2012. The main changes were:

- Introducing the new relationship with HSBC for investment administration services.

The main changes to practices were:

- Clarifying that appropriate profits may be made by shareholders from the intra group arrangements and services provided by group companies.
- Clarification of the business backed by the asset pools in the Alba With-Profits Fund.
- To allow for the sale of 1 Wythall Green Way from the Britannic With-Profits Fund and the associated loan from the Britannic With-Profits Fund to PGMS.
- The *asset share* practices were updated for the 90% With-Profits Fund to reflect that expected profits from the proportion of ex Swiss IB policies not expected to claim are recycled into the *asset shares* of ex Swiss IB and ex Swiss OB life policies as miscellaneous surplus.
- Updates for how *smoothing* has applied for the ex Swiss IB and ex Swiss OB life policies in the 90% With-Profits Fund for the July 2012 *final bonus* review.
- Revised wording for the special bonus for Scottish Mutual With-Profits Fund.
- Clarification of the long-term corporate bond proportion used to determine profits or losses arising from fixed interest investments backing the non-profit business in the SAL With-Profits Fund.
- Other minor amendments.

A3.13 The Principles and Practices of Financial Management was republished in January 2013. The main changes were:

- Renaming Pearl Assurance Limited as Phoenix Life Assurance Limited.

The main changes to practices were:

- Harmonising practices across the funds for target *payout* ranges.
- *Smoothing* practice update for SAL With-Profits Fund to reflect that changes in *payouts* resulting from changes in guarantee charges are not smoothed.
- Updates for the *asset share* and charges and expenses practices for the 90% With-Profits Fund to better reflect the charges applied to ex-Swiss *unitised* pension with-profits policies.
- Updates to the investment practices for Scottish Mutual With-Profits Fund and SPI With-Profits Fund to better reflect the wider forms of investment.
- Other minor amendments.

A3.14 The Principles and Practices of Financial Management was republished in July 2013. The main changes were:

- Updating references to the Financial Services Authority (FSA) to reflect that the FSA has become two regulatory authorities, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

The main changes to practices were:

- Updating the investment strategy practices for the 90% With-Profits Fund and the 100% With-Profits Fund to reflect the allocations to emerging market debt, private equity, property and hedge funds.
- Updating the *surrender value* practices for the Britannic With-Profits Fund and the Britannic Industrial Branch Fund to clarify the calculations for whole life business.
- Updating the investment strategy practices for the Britannic With-Profits Fund and the Britannic Industrial Branch Fund to be consistent with other funds.

- Updating the *estate* management practices for the Britannic With-Profits Fund and the Britannic Industrial Branch Fund to reflect the revised methodology regarding treatment of the Buffer Reserve.
- Updating the *final bonus* practices for the Britannic With-Profits Fund, Britannic Industrial Branch Fund and the Scottish Mutual With-Profits Fund to reflect the standardised approach to *final bonuses*.
- Other minor amendments.

A3.15 The Principles and Practices of Financial Management was republished in September 2013. The main changes were:

- Updating the capital policy.

The main changes to practices were:

- Clarifying that charging of project costs and one off costs to *asset shares* for the Alba With-Profits Fund will only occur following approval by the *Board*.

A3.16 The Principles and Practices of Financial Management was republished in January 2014. The main changes were:

- Updating the significant arrangement section 3.12 to reflect the latest outsourced service provider arrangements.

The main changes to practices were:

- Updating the *asset share* practices for the 90% With-Profits Fund, 100% With-Profits Fund, Phoenix With-Profits Fund and the SAL With-Profits Fund to reflect the standardised approach to *final bonuses*.
- Updating the *final bonus* practices for the Alba With-Profits Fund and the Scottish Mutual With-Profits Fund to reflect the standardised approach to *final bonuses*.
- Updating the *smoothing* practices for the Britannic With-Profits Fund and Britannic Industrial Branch Fund to reflect the standardised approach to *final bonuses.*
- Updating the investment practices for the SAL With-Profits Fund to reflect the allocations to emerging market debt, private equity, property and hedge funds.
- Updating the expenses and charges practices for Alba With-Profits Fund to reflect the expectation of changes to the services agreement for corporate pensions business.
- Updating the *surrender value* practices for Alba With-Profits Fund as we now target 100% of *asset share* for traditional with-profits surrenders.
- Updating the business risks practices for all funds to reflect the outsourced service provider risks.
- The *asset share* practices were updated for the 90% With-Profits Fund to reflect that expected losses as well as profits from the proportion of ex Swiss IB policies not expected to claim are recycled into the *asset shares* of ex Swiss IB and ex Swiss OB life policies.

A3.17 The Principles and Practices of Financial Management was republished in July 2014. The main changes were:

- Updating the main intra group arrangement section 3.11 to reflect the latest investment manager arrangements.
- Updating the other significant arrangement section 3.12 to reflect the latest outsourced service provider arrangements.
- Updating the Glossary of terms to reflect the latest composition of the With-Profits Committee.

The main changes to practices were:

- Updating the investment strategy practices to reflect the role of the Investment Committee.
- Updating the investment strategy practices for the Alba With-Profits Fund to reflect the latest property asset mixes.
- Clarifying in the *asset share* practices for the 90% With-Profits Fund that the former Britannic Unit Linked Assurance policies' investments include overseas equities.
- Other minor amendments

A3.18 The Principles and Practices of Financial Management was republished in January 2015. The main changes were:

- Updating the main intra group arrangements section 3.11 and section 3.12 other significant arrangements to reflect the sale of Ignis to Standard Life.
- Updating the company background section to reflect the Britannic With-Profits Fund and the Britannic Industrial Branch Fund no longer having exposure to the Britannic Pension Fund.

The main changes to practices were:

- Updating the business risks practices for the Alba With-Profits Fund, Britannic With-Profits Fund and Britannic Industrial Branch Fund, and the estate practices for the Britannic With-Profits Fund and the Britannic Industrial Branch Fund to reflect the funds no longer having exposure to the Britannic Pension Fund.
- Updating the capital support to the fund section, the amounts payable under a with-profits policy practices, annual bonus practices, final bonus practices and business risks practices for the Alba With-Profits Fund to reflect the simplification of the operation of the Alba With-Profits Fund
- Updating the other significant arrangements section and the expenses and charges practices for the Alba With-Profits Fund to reflect the replacement management services agreement with Diligenta from Capita Employee Benefits
- Updating the references to Ignis in the investment strategy practices, business risks practices, expenses and charges practices and the equity between the fund and shareholders practices. Also the company background section and the fair treatment guiding principles.
- Updates in expenses and charges practices for 90% With-Profits Fund, Alba With-Profits Fund, Britannic With-Profits Fund and Britannic Industrial Branch Fund for administration agreement with PGMS with an end 2014 expiry.
- Updating the investment strategy practices for the Britannic Industrial Branch Fund (matched Fund) to make them consistent with the Britannic With-Profits Fund
- Updating the final bonus practices for the SAL With-Profits Fund unitised with-profits pensions business reinsured into the Phoenix With-Profits Fund.
- Updating the amounts payable under a with-profits policy and surrender value practices for the SAL With-Profits Fund, including some reordering of paragraphs.
- Including in the investment strategy practices for all funds an explanation of stock lending.
- Other minor amendments

A3.19 The Principles and Practices of Financial Management was republished in July 2015. The main changes were:

- Updating the background to the principles and practices section 2 to reflect that a single With-Profits Actuary report is prepared for all of the with-profits funds in the company.

The main changes to practices were:

- Updating practices for the Scottish Mutual With-Profits Fund, SPI With-Profits Fund and SAL With-Profits Fund to replace references to 'FCA' with 'the *regulator*'.
- Removing obsolete information from the investment strategy practices for the 90% With-Profits Fund, 100% With-Profits Fund, Britannic With-Profits Fund, Britannic Industrial Branch Fund and the SAL With-Profits Fund.
- Updating the amounts payable under a with-profits policy practices for the
    - Britannic With-Profits Fund and Britannic Industrial Branch Fund to reflect that *surrender* profits and losses accumulate in the *estate*.
    - Scottish Mutual With-Profits Fund as no traditional pension endowment policies remain in the fund.
    - Phoenix With-Profits Fund to explain the return on fixed interest securities for unitised with-profits pension solution policies.
    - Phoenix With-Profits Fund and the SAL With-Profits Fund to explain the timing approximations for investment returns in asset shares.
    - SPI With-Profits Fund to reflect the declaration dates for annual bonuses for traditional with-profits business.
- Updating the annual bonus practices for the Phoenix With-Profits Fund to reflect when annual bonuses change.
- Updating the investment strategy practices for:
    - Britannic With-Profits Fund and Britannic Industrial Branch Fund as policyholders no longer receive asset mix information in their annual statement.
    - SPI With-Profits Fund to explain the hedging arrangements.
- Updating the smoothing practices for the Phoenix With-Profits Fund as no allowance is made for withdrawals in the standard bonus model.
- Updating the SAL With-Profits Fund estate management practices as the fund no longer relies on a loan from the Non-Profit Fund.
- Updating the annual bonus rates for the Scottish Mutual With-Profits Fund to distinguish between group deferred annuity and group cash business, and with-profits annuity business.

A3.20 The Principles and Practices of Financial Management was republished in January 2016. The main changes were:

- Updating the Group Structure section 3.1 to allow for the sale of Scottish Mutual International (SMI).
- Updating the Capital Policy section 3.8 as a result of Solvency II. The section has been split into Capital Policy section 3.8 and a new Capital Support section 3.9. And also updating the Capital Support to the Fund sections for all funds.

As a result of Solvency II changes to the principles and practices wording were required in the following practices:

- the legal requirement practices section 5.1 and basic fund concepts practices section 5.2 in the guiding principles.
- the business risk practices for the 90% With-Profits Fund, 100% With-Profits Fund, Phoenix With-Profits Fund and the SAL With-Profits Fund.

- the investment strategy practices for the Scottish Mutual With-Profits Fund and SPI With-Profits Fund.
- Updating the amounts payable under a with-profits policy practices for the 90% With-Profits Fund, 100% With-Profits Fund and Phoenix With-Profits Fund.
- Updating the amounts payable under a with-profits policy principle, the annual bonus practices and the estate management practices for the Alba With-Profits Fund.
- Updating the equity between the fund and the shareholder principle for the 100% With-Profits Fund.

To reflect the impact of Solvency II on the cost of bonuses there were changes required to the equity between the fund and the shareholders practices for the 90% With-Profits Fund, Alba With-Profits Fund, Britannic with-Profits Fund, Britannic Industrial Branch Fund, Phoenix With-Profits Fund, Scottish Mutual With-Profits Fund, SPI With-Profits Fund and the SAL With-Profits Fund.

To reflect the investment changes made in anticipation of Solvency II there were changes to the amounts payable under a with-profits policy practices in the SAL With-Profits Fund and the investment strategy practices in the Alba With-Profits Fund and the Scottish Mutual With-Profits Fund.

There were also the following changes to practices:

- Updating the amounts payable under a with-profits policy practices for the Phoenix With-Profits Fund and SAL With-Profits Fund as part of the cost of guarantees calculation is now redundant.
- Updating the final bonus practices for the Britannic With-Profits Fund, Britannic Industrial Branch Fund, Scottish Mutual With-Profits Fund and the SPI With-Profits Fund to allow for the longer lead time in advance of declarations.
- Updating the investment strategy practices for the Britannic With-Profits Fund, Britannic Industrial Branch Fund, Scottish Mutual With-Profits Fund and the SPI With-Profits Fund as there is no longer an annual review of assets by the With-Profits Committee.
- Updating the annual bonus practices for all funds except the NPI With-Profits Fund which is wholly reassured to the PLAL Pearl With-Profits Fund) to reflect the position for weak funds.
- Updating the investment strategy practices for the Britannic With-Profits Fund and Britannic Industrial Branch Fund to more accurately reflect the investment strategy in the matched fund.
- Other minor amendments.

A3.21 The Principles and Practices of Financial Management was republished in July 2016. The main changes were:

- Updating the Capital Policy section 3.8 to reflect the new regulatory terminology post Solvency II.
- Updating the Basic Fund Concepts Principle section 5.2 to make explicit the protections for the *with-profits funds* in relation to the default or termination of the agreement with PGMS to provide management services to the *with-profits funds.*

As a result of the new management services agreement with PGMS and to introduce standard wording across all the funds there are updates to the expenses and charges practices for several funds, and also to the business risks practices for the Britannic With-Profits Fund and the Britannic Industrial Branch Fund.

As a result of introducing a separate final bonus scale for whole of life policies in the Britannic With-Profits Fund and also in the Britannic Industrial Branch Fund there were changes to the amounts payable under a with-profits policy practices and the final bonus practices for these funds.

There were also the following changes to practices:

- Updating the amounts payable under a with-profits policy practices for the 90% With-Profits Fund, 100% With-Profits Fund, Phoenix With-Profits Fund and the SAL With-Profits Fund to clarify the approximations in investment return used in asset share calculations.
- Updating the annual bonus practices for all funds, except NPI With-Profits Fund, to clarify the maximum expected change in annual bonus.
- Updating the final bonus practices for former BULA policies in the 90% With-Profits Fund.
- Updating the final bonus practices for former Swiss Life policies in the 100% With-Profits Fund.
- Updating the investment strategy practices for the Alba With-Profits Fund, Phoenix With-Profits Fund and SAL With-Profits Fund to include the strategy for investments backing the estate.
- Updating the smoothing practices for smoothed return business in the Britannic With-Profits Fund.
- Updating the surrender value practices for the treatment of surrender profits or losses in asset shares for the Britannic With-Profits Fund and Britannic Industrial Branch Fund.
- Updating the amounts payable under a with-profits policy for the Scottish Mutual With-Profits Fund.
- Updating the final bonus practices for the Scottish Mutual With-Profits Fund to allow for the different guaranteed benefits for different pension types.
- Updating the surrender value practices for the Scottish Mutual With-Profits Fund to reflect that traditional life and pension policies are treated similarly.
- Updating the amounts payable under a with-profits policy practices for the SPI With-Profits Fund.
- Removing out of date information from the amounts payable under a with-profits policy practices for the Phoenix With-Profits Fund and the SAL With-Profits Fund and the surrender value practices for the SPI With-Profits Fund.
- Simplifying the guarantee charges section in the amounts payable under a with-profits policy practices for the SAL With-Profits Fund.

A3.22 The Principles and Practices of Financial Management was republished in January 2017. The main changes were:

- Updating the Capital Support section 3.9 following feedback from our regulators.

There were also the following changes to practices:

- Updating the investment strategy practices for the Alba With-Profits Fund as a result of introducing equities into the fund.
- Updating the amounts payable under a with-profits policy practices for the 90% With-Profits Fund and the Phoenix With-Profits Fund as the part of the cost of guarantees calculation is now redundant.
- Updating the amounts payable under a with-profits policy practices for the SAL With-Profits Fund as a result of distributing estate from the fund.
- Updating the investment strategy practices for the Phoenix With-Profits Fund and the SAL With-Profits fund.

A3.23 The Principles and Practices of Financial Management was republished in July 2017. The main changes were:

- Improving clarity and presentation in the Alba With-Profits Fund Annual bonus rates and Estate management principles.

There were also the following changes to practices:

- Updating the Smoothing and Investment strategy practices for the Britannic With-Profits Fund.
- Updating the Estate management practices for the Scottish Mutual With-Profits Fund and the SAL With-Profits Fund.
- Updating the Amounts payable under a with-profits policy practices for the SPI With-Profits fund.

A3.24 The Principles and Practices of Financial Management was republished in January 2018. There were the following changes:

- The capital policy section has been updated to reflect the latest solvency capital requirement percentages and additional liquidity amount.

There were also the following changes to practices:

- A minor clarification to the practices for the Basic Fund Concept guiding principle.
- Updating the SAL With-Profits Fund Amounts payable under a with-profits policy practices as past guarantee charges are being refunded.
- An update to the Final bonus rates practices for Alba With-Profits Fund and to the Amounts payable under a with-profits policy practices for SPI With-Profits Fund for with-profits deferred annuities.

A3.25 The Principles and Practices of Financial Management was republished in July 2018. There were the following changes to practices:

- Updating the Investment strategy practices for 90% With-Profits Fund, 100% With-Profits Fund, Alba With-Profits Fund, Britannic Industrial Branch Fund, Britannic With-Profits Fund and SPI With-Profits Fund.
- Updating the Amounts payable under a with-profits policy practices for Scottish Mutual With-Profits Fund to clarify the position for the clawback of conditional estate.

A3.26 The Principles and Practices of Financial Management was republished in January 2019. There were the following changes:

- The capital policy section has been updated to reflect the latest solvency capital requirement percentages and additional liquidity amount.

There were also the following changes to practices:

- Removing out of date smoothing practices for 90% With-Profits Fund.
- Updating the investment strategy practices for Phoenix With-Profits Fund and SAL With-Profits Fund to reflect that asset mixes for specimen policies are calculated by reference to the average mix for the underlying policies that the specimen represents and simplify the wording for the investments backing guaranteed annuity options.

A3.27 The Principles and Practices of Financial Management was republished in July 2019. There were the following changes:

- The Main inter fund agreements – risk transfer arrangements section 3.10 was updated as the Alba With-Profits Fund no longer transfers risk to the Britannic With-Profits Fund.
- The glossary definition of *Board* was updated.

There were also the following changes to practices:

- Updating the expenses and charges practices for SPI With-Profits Fund to clarify that the expenses charged are subject to the 2009 Scheme rules.
- Updating the expenses and charges practices for Scottish Mutual With-Profits Fund and SPI With-Profits Fund for *unitised* with-profits policies.
- Updating the Phoenix With-Profits Fund investment strategy practices
- Updating the SAL With-Profits Fund expenses and charges practices
- Updating the Alba With-Profits Fund smoothing, investment strategy and estate management practices as the position of the fund has improved.

A3.28 The Principles and Practices of Financial Management was republished in January 2020. There were the following changes:

- The capital policy section 3.8 has been updated to reflect the latest solvency capital requirement percentages and additional liquidity amount.
- The asset share methodology section 4.3 was updated to clarify mortality charges.

There were also the following changes to practices:

- Updating the investment practices for Britannic With-Profits Fund and Alba With-Profits Fund.
- Updating the Amounts payable under a with-profits policy and the Estate management practices for the 90%, 100%, Alba, Britannic, Britannic Industrial Branch, Phoenix and SAL with-profits funds to better reflect management actions.
- Also the Phoenix, Scottish Mutual and SPI with-profits funds' amounts payable under a with-profits policy practices to better reflect management actions.
- Updating the amounts payable under a with-profits policy practices for the Britannic, Britannic Industrial Branch, Scottish Mutual, SPI and SAL with-profits funds for mortality charges.
- For Phoenix With-Profits Fund amounts payable under a with-profits policy and the final bonus practices were updates as most of the remaining policies are now whole of life.

There was also a change to the Capital support to the fund section for Alba With-Profits Fund again to better reflect management actions.

A3.29 The Principles and Practices of Financial Management was republished in January 2021. There were the following changes:

- The capital policy section 3.8 has been updated to reflect the latest solvency capital requirement percentages.
- The other significant arrangements section 3.12 has been updated to reflect the use of collective investment structures.

There were also the following changes to practices:

- Updating the investment strategy practices for all of the with-profits funds distributing estate to better reflect how the assets backing the estate are invested.

- Also updating the investment strategy practices for Britannic With-Profits Fund and Britannic Industrial Branch Fund to remove out of date wording.
- Updating the final bonus practices for Britannic Industrial Branch Fund, Scottish Mutual With-Profits Fund and SPI With-Profits Fund to better reflect the final bonus projection calculations.

A3.30 The Principles and Practices of Financial Management was republished in January 2022. There were the following changes:

- The capital policy section 3.8 has been updated to reflect the latest solvency capital requirement percentages.
- Replacing references to LIBOR with SONIA as a result of the discontinuance of LIBOR at the end of 2021.
- Simplifying references to outsource service providers.

There were also the following changes to practices:

- Updating the investment strategy practices for all the with-profits funds to reflect our commitment to responsible investment.
- Updating the investment strategy practices for 90% With-Profits Fund, 100% With-Profits Fund, Phoenix With-Profits Fund and SAL With-Profits Fund to explain how the emerging market debt returns are allocated.
- Updating practices for the Alba With-Profits Fund to reflect that eligible deposit administration business is now receiving a 'final uplift' due to estate distribution.
- Updating the annual bonus practices for PLL Britannic With-Profits Fund to reflect the increases to annual bonuses for ex Prosperity policies.

A3.31 The Principles and Practices of Financial Management was republished in January 2023. There were the following changes:

- To incorporate the *2022 Scheme*.
- The introduction of the reassurance arrangement with Phoenix Life Assurance Europe dac (PLAE) after the Irish business in the funds was transferred to PLAE.

There were also the following changes:

- The capital policy section 3.8 has been updated to reflect the latest solvency capital requirement percentages.
- A new guiding practice has been introduced in section 5.2 to reflect that the Board may choose to limit the expenses allocated to asset shares where this is appropriate.

There were also the following changes to practices:

- Updating the amounts payable under a with-profits policy practices for the Alba With-Profits Fund to reflect that the Board may choose to limit the expenses allocated to asset shares where this is appropriate.
- Updating the investment strategy practices for Alba With-Profits Fund as the property proportion has been reduced whilst maintaining the overall growth ….
- Updating the amounts payable under a with-profits policy practices for the Britannic With-Profits Fund and the Britannic Industrial Branch Fund to clarify that there are separate final bonus scales for fully paid whole of life policies.
- For the PLL Scottish Mutual With-Profits Fund there is an update to the amounts payable under a with-profits policy practices to reflect a new process developed for setting bonus rates on particular group pensions.

A3.32 The Principles and Practices of Financial Management was republished in October 2023. The main changes were:

- To incorporate the *2023 Scheme*.

A3.33 The Principles and Practices of Financial Management was republished in January 2024. The main changes were:

To update references to the management services company throughout the PPFM to Phoenix Group Management Services Limited.

In line with notifications we made to policyholders in 2023 there were also the following changes to Principles:

- For the Alba With-Profits Fund, the Amounts payable under a with-profits policy and the Investment strategy Principles, were updated as the fund no longer relies on support from the shareholders.
- For the Phoenix With-Profits Fund, the Estate management Principle was updated to remove references to non-profit annuities that have transferred out of the fund; and
- For the SAL With-Profits Fund, the Estate management Principle was updated to remove references to non-profit annuities that have transferred out of the fund.

There were also the following changes to practices:

- Removing inaccurate wording from the Business risks practices for the 90% With-Profits Fund, the 100% With-Profits Fund, the Phoenix With-Profits Fund, the SAL With-Profits Fund and the SERP Fund;
- Updating the Amounts payable under a with-profits policy practices, Smoothing practices and the Surrender value practices to better explain how surrender values are calculated for the Alba With-Profits Fund;
- Updating the Surrender value practices for the Alba With-Profits Fund to reflect that market value reductions are not automatically taken for some classes of business.
- Updating the Investment Strategy practices for the 90% With-Profits Fund, 100% With-Profits Fund, SERP Fund and National Provident Life With-Profits Fund to improve the wording about not normally traded assets.

A3.34 The Principles and Practices of Financial Management was republished in January 2025. The main changes were:

To reflect the transfer of Irish business from PLAE to SLIDAC.

There were also the following changes to practices:

- Updating the Investment Strategy practice with the latest asset allocation for the 90% With-Profits Fund, 100% With-Profits Fund, Alba With-Profits Fund, Britannic With-Profits Fund, Britannic Industrial Branch Fund, Scottish Mutual Wth-Profits Fund, SPI With-Profits Fund and the Pearl With-Profits Fund.
- Updating the Expenses and charges practices for the 90% With-Profits Fund with the latest expenses.
- Updating the SERP Fund Amounts payable under a with-profits policy practices to reflect monthly monitoring.
- Removing Smoothing practices for the National Provident Life With-Profits Fund as a smoothing account is no longer maintained.
- Updating the Amounts payable under a with-profits policy practices and Surrender Value practices for the Pearl With-Profits Fund, SERP Fund,

London Life With-Profits Fund, National Provident Life With-Profits Fund to better reflect the operation of the funds as they get smaller.

- Making the Business Risks practices reflecting the Phoenix Group strategy consistent for all funds.
- Updating the Investment strategy practices for the SPI With-Profits Fund and the Pearl With-Profits Fund to better reflect the operation of the fund.

There were also changes to improve the readability of the PPFM, including removing out of date wording.

Phoenix Life Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Phoenix Life Limited is registered in England No. 1016269 and have their registered office at: 1 Wythall Green Way, Wythall, Birmingham, B47 6WG.