

London Life

London Life Limited

Principles and Practices of Financial Management

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PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT

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A. BACKGROUND

- 0.00 None of the contents of this document forms part of, or varies, the terms or conditions of any policy issued or to be issued by *London Life*. In the event of any inconsistency between the contents of this document and any policy, the terms and conditions of the policy prevail.
- 0.01 This document is intended to assist knowledgeable observers to understand the way in which the with-profits business of *London Life* is conducted and the material risks and rewards involved in effecting or maintaining a with-profits policy with *London Life*. It is not a comprehensive explanation either of the management of the with-profits business of *London Life* or of every matter which may affect that 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 with *London Life* should seek independent financial advice.
- 0.02 Statements in this document in relation to the risks and rewards involved in effecting and maintaining a with-profits policy with *London Life* 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.
- 0.03 The contents of this document may change as the circumstances of *London Life* and the business environment changes. The document may also change to reflect changes made by *London Life* to the management of the with-profits business. *London Life* intends to give notice of any such change in accordance with the *FSA rules*.

Historical information

- 0.04 *London Life* is a United Kingdom proprietary company with a registered office at 1 Wythall Green Way, Wythall Green, Birmingham B47 6WG. Phoenix Group Holdings is the ultimate parent of *London Life*.
- 0.05 On 31 December 1997, the business of the London Life sub-fund of the Australian Mutual Provident Society (AMPS) and the UK branch business of the Australian Mutual Provident Society were transferred to London Life Managed Funds Ltd, which was renamed London Life Limited. This transfer was achieved by a scheme, effected under schedule 2C of the 1982 Insurance Companies Act.
- 0.06 The *Scheme* resulted in the with-profits business being 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 that existed prior to the *Scheme*.
- 0.07 On 15 December 2003, the UK business of AMP demerged from the Australasian businesses of AMP and *London Life's* ultimate parent became HHG PLC, a UK company listed on the London Stock Exchange. On 13 April 2005 the ownership changed from HHG PLC to Pearl Group Ltd. On 28 August 2009, the ownership changed from Pearl Group Ltd to Pearl Group. On 15 March 2010, Pearl Group changed its name to Phoenix Group Holdings. Phoenix Group Holdings is the ultimate holding company of the Phoenix Group of companies.

Purpose of this document

- 0.08 The *FSA* (using powers granted to it by the Financial Services and Markets Act 2000) has issued rules regarding the governance of firms conducting with-profits business.

FSA rules state that:

"A firm must establish and maintain the PPFM according to which its with-profits business is conducted"

- 0.09 In addition, *FSA rules* detail a list of requirements that the Principles and Practices of Financial Management is expected to include. These requirements encompass a description and explanation of the features and workings of with-profits policies.
- 0.10 The with-profits principles are intended to:
- be enduring statements of the standards the firm adopts in managing with-profits funds; and
 - describe the business model used by the firm in meeting its duties to with-profits policyholders and in responding to longer term changes in the business and economic environment.
- 0.11 The with-profits practices within the PPFM are intended to:
- describe the firm's approach to managing with-profits 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 with the firm.
- 0.12 This document describes the principles and practices that *London Life* applies when managing its with-profits business. It is intended to enable policyholders of *London Life* to better understand the way its with-profits business is managed.

Format of the document

- 0.13 This document has been set out in the same order as the *FSA rules*. In relation to each of the issues that the *FSA rules* require this document to cover, the document sets out separately the principles, followed by the practices.
- 0.14 A Glossary of defined terms is included in Appendix A. All defined terms are italicised.

London Life with-profits products

0.15 The following table summarises *London Life* with-profits products. The *product group* identifier PGn will be used in this document to identify the products.

<i>participation pool</i>	<i>product group</i>	PG
former-London Life products		
Life Compound Bonus	Endowment assurance	PG01
	Whole-life assurance	PG02
	Deferred annuities	PG03
Life Cash Bonus	Endowment assurances	PG04
	Whole-life assurance	PG05
Pensions Compound Bonus	Old series deferred annuities – without Guaranteed Annuity Option (GAO)	PG06
	Old series deferred annuities – with-GAO	PG07
	New-series endowments	PG08
	Single premium buyouts 'Pension Protector'	PG09
	Annual premium deferred annuities 'PC Contracts'	PG10
	Group pension	PG11
Pensions Simple Bonus	Deferred annuity	PG12
	Immediate annuity	PG13
	Group pensions	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	PG18
	Whole-life	PG19
Pensions Compound Bonus	Regular premium pure endowments	PG20
	Regular premium pure endowments with GAR	PG21

B AMOUNTS PAYABLE

Methods used to determine amount payable

PRINCIPLES

Methods Used

- P100 The overall aim in setting with-profit policy payouts is that payouts should be determined having regard to the experience of each of the with-profit *participation pools*, the *overall financial position of London Life*, and the fair treatment of with-profit policyholders.
- P101 This aim will be achieved by determining payouts with reference to asset shares. A full description of asset shares is set out in section B, paragraph 1.
- P102 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. Smoothing is defined in principles P306 to P310.
- P103 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.
- P104 Asset share will be calculated in accordance with generally accepted actuarial principles.

Changes to Methodology and Assumptions

- P105 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.
- P106 Changes in methods or assumptions that lead to changes in policyholder benefits or expectations would be subject to *London Life* Board approval after receiving advice from the *Actuary* and the *With-Profits Committee*.

Methods used to determine amount payable

PRACTICES

Introduction

- 1.00 This section describes the methods used to determine the overall level of payout from a with-profits policy.
- 1.01 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*.
- 1.02 Payouts on death will generally be determined in accordance with the policy terms and conditions.
- 1.03 The detail of the actual determination of the annual bonus rates, the final bonus rates and smoothing are covered in section B paragraphs 2 and 3. In the following paragraphs, the methods used to calculate the asset share will be described, along with how the data is used and how the assumptions are determined. Details on determination of death benefit values are covered in 3.72.

Asset shares

- 1.04 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).
- 1.05 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*.
- 1.06 For policies belonging to small *product groups* (PG03, PG16 and PG17), asset shares are not calculated but are determined by comparing with the asset shares of other similar *product groups*.
- 1.07 Asset shares are updated annually to reflect the revised assumptions for that calendar year. All updated assumptions will be checked and recorded on file by *London Life*.
- 1.08 The asset shares for *product groups* PG01, PG02, PG06, PG07, PG08, PG12, PG15, PG18, PG19 and PG20 are subject to annual formal review by the *Actuary*.
- 1.09 The methods used to determine asset shares are well established and no changes are anticipated. Any changes to the methods or assumptions will be in accordance with the principles P105 – P106.

Asset Share Data

- 1.10 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.

Asset Share Assumptions

- 1.11 In calculating asset shares current and historic assumptions are required. A full description of how these are derived is set out below:

Asset Mix backing the Asset Shares

- 1.12 The asset mix allocated to each *participation pool* is determined in accordance with the investment strategy, see section C. How this leads to investment return being applied to asset shares is set out below.

Investment Return

- 1.13 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 C.
- 1.14 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*.
- 1.15 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.

Expenses

- 1.16 Expense assumptions are required for all years of a policy's duration.
- 1.17 The asset share model requires parameters for both initial and ongoing expenses.
- 1.18 Expenses charged to the with-profits fund have, since 31 December 1997, been prescribed by the *Scheme*. Further details of the *Scheme* expenses are set out in section E.
- 1.19 For calendar years prior to the *Scheme*, i.e. prior to 1997, expenses were obtained from the results of expense investigations. The aim of these expense investigations was to set per-policy expenses at a level such that the total expenses attributed represented a fair and reasonable allocation of expenses to the with-profits fund. Assumptions for the period that pre-dates the first calculation of asset shares have been obtained using information available from expense investigations and historic *FSA Returns*.

Tax

- 1.20 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.
- 1.21 Investment return rates are reduced to allow for the appropriate rate of tax. Expenses are reduced to allow for tax relief, where appropriate. The rates of tax on unrealised capital gains will be reduced to allow for the period until the expected realisation of the assets. An estimate of the proportion of investments disposed in any one year is also required in order to apportion the amount of capital gains into realised and unrealised capital gains.
- 1.22 The amount of tax deemed to be payable within the asset share calculations is compared to the actual tax paid in order to monitor the accuracy of the calculation. If

there are material differences then the calculations are modified to improve their accuracy.

- 1.23 In accordance with the scheme, tax relating to shareholders' profits is not charged to the with-profits fund.
- 1.24 Assumptions for the period that pre-date the first calculation of asset shares were obtained from historic tax rates applicable to insurance companies.

Mortality Charges

- 1.25 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 *London Life* and industry experience and is reviewed infrequently.

Capital Charge

- 1.26 No charge for the cost of capital is reflected in the asset shares for *product groups* PG01 to PG14 and PG17.
- 1.27 For *product groups* PG18 to PG21, a charge for capital is made for calendar years up to and including 1997.
- 1.28 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.

Other Charges

- 1.29 *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.

Approximations to Methods used to determine amount payable

- 1.30 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.
- 1.31 Approximate methods do not necessarily lead to the same payout as the full method being applied directly. *London Life* 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.

Scope of calculation – *participation pools*

- 1.32 In accordance with the *Scheme*, 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*.
- 1.33 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.

Documentation

- 1.34 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.

- 1.35 All bonus declarations will be approved by the *London Life* Board following reports by the *Actuary* which would formally summarise the methods and assumptions used in deriving those bonus rates.

Approach to setting annual bonus

PRINCIPLES – All participation pools

- P200 Annual bonus rates will be determined separately for different *participation pools*.
- P201 Annual bonuses form one part of *London Life's* overall distribution to policyholders. The remainder will be distributed as a final bonus. *London Life* gives priority to final bonus over annual bonus.

Approach to setting annual bonus

PRACTICES

Timing of calculation

- 2.00 Annual bonuses are reviewed towards the end of a calendar year, for declaration at the annual statutory valuation at 31 December.
- 2.01 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 conventional with-profits policies*, PG01-PG14
 - the following 1 May for all *former-AMP UK conventional with-profits policies*, PG18 – PG21
 - 1 January for all *unitised with-profits policies*, PG15 & PG16
 - 1 July for all *With-Profits Annuity policies*, PG17

Governance

- 2.02 *London Life* implements annual bonus rate changes after the Board has considered a report by the *Actuary* and subsequently approved the changes.

Calculation of annual bonus rates

CONVENTIONAL WITH-PROFITS POLICIES (all products except PG15 - PG17)

- 2.03 For the reasons set out in the following paragraphs, annual bonus rates are zero for all *participation pools* (with the exception PG04, PG05 and PG13 - which are discussed below) with effect from the 1 Jan 2004 declaration.
- 2.04 Declaring annual bonus increases the *guaranteed benefits*. This increases the liabilities and weakens the *overall financial position of London Life*. Paying final bonus also weakens the *overall financial position of London Life*. If no bonuses are paid, all things being equal, the *overall financial position of London Life* tends to improve over time because the *mathematical reserves* contain prudent assumptions about the future.
- 2.05 The current annual improvement in and the current level of the *overall financial position of London Life* is not such as to allow payment of both annual and final bonuses. Priority has been given to the payment of final bonuses.
- 2.06 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.

- 2.07 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.
- 2.08 Conventional annual bonus rates are declared in advance and consequently no interim rates need apply.
- 2.09 There is no limit to the change in the level of annual bonus from one declaration to the next.

UNITISED WITH-PROFITS POLICIES (PG15 and PG16)

- 2.10 For *unitised with-profits* contracts the annual bonus rate declared will reflect the running yield on assets apportioned to these policies. The running yield is the total income from any fixed interest stocks and deposit investments; the dividends from any equity investments; and the rental income from any property investments.
- 2.11 Since annual bonuses for this class of business are declared in arrears, an interim bonus rate will also be declared at the valuation that applies to all policyholders that surrender, transfer or retire early before declaration of the next annual bonus rate. Calculation of the interim rate is made in exactly the same manner as described for the actual annual declaration except that anticipated running yields for the following year are used instead of the actual running yields.
- 2.12 There is no limit to the change in the level of annual bonus from one declaration to the next.

SECURE PENSION PLUS (PG17)

- 2.13 The level of annual bonus rate is currently set equal to the Guaranteed Annual Bonus Rate, and will remain unchanged from this current level.

Approach to setting final Bonus and smoothing

PRINCIPLES – FINAL BONUS

- P300 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. Final bonus rates for death and surrenders are described in P304 and P305 below.
- P301 When setting final bonus rates, payouts will be smoothed and so there will be a difference between actual and target payouts. See the smoothing principles P306 – P310.
- P302 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 *overall financial position of London Life*.
- P303 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 *overall financial position of London Life*.
- P304 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 *overall financial position of London Life* and anticipated rates of surrender in order to protect the level of security for the remaining policyholders.
- P305 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.

PRINCIPLES - SMOOTHING

- P306 The actual payout paid to any particular policy may be different to the target payout because of the fact that with-profit payouts are smoothed.
- P307 The nature of with-profit policies means that actual payouts do not immediately reflect changes in investment returns but are smoothed over time.
- P308 The degree of smoothing and the amounts of smoothing costs are not limited by the financial position of the with-profits fund. Furthermore, there is no specific limit on the amount of smoothing costs that can be incurred by *London Life*. However, the degree of smoothing and the amounts of smoothing costs are limited by the *overall financial position of London Life*.
- P309 Other than the impact on the *overall financial position of London Life*, 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.
- P310 If the Board considers it necessary in the light of the current or expected *overall financial position of London Life*, 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 *overall financial position of London Life*.

Approach to setting final bonus and smoothing

PRACTICES

Frequency of review

- 3.00 Final bonuses can be reviewed at any time but, in general, for *conventional with-profits* business such reviews will be carried out twice yearly. The major review of final bonus rates will be carried out at the end of the calendar year; with implementation of bonus rates early in the second quarter of the following calendar year. A further review of final bonus rates will be undertaken in mid-year.
- 3.01 For *unitised with-profits* business, final bonus rates will normally be reviewed quarterly.
- 3.02 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 *overall financial position of London Life*,
 - if a larger than normal number of surrenders or transfers are anticipated.

Governance

- 3.03 *London Life* implements final bonus rate changes after the Board has considered a report by the *Actuary* and subsequently approved the changes.
- 3.04 Final bonus rates and *MVRFs* for *unitised with-profits* business (PG15 and PG16) are implemented on the advice of the *Actuary*, acting on behalf of the *London Life* Board with delegated authority.

Application of smoothing

- 3.05 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 an average period of three years 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 *London Life* makes any changes in the methodology or historic assumptions used to determine payouts, such changes will be smoothed over time.
- 3.06 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 *overall financial position of London Life*.

Calculation of final bonus rates

- 3.07 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

- 3.08 Products covered in this *participation pool* include:
- Regular premium endowment assurance - PG01
 - Regular premium whole-life assurance - PG02
 - Regular premium deferred annuities - PG03
- 3.09 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

- 3.10 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.

- 3.11 The overall aim is that the final bonus rates should be set so that the payouts equal the target payouts, after allowing for smoothing. In arriving at the appropriate final bonus rates the following factors are taken into account:
- For these policies smoothing is applied to maturity or retirement values and is done by limiting the change in final bonus rates. Normally the change in final bonus rates for a notional 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 15% at each annual review.
 - For these policies smoothing is applied in the surrender value basis review, by limiting the change in immediate surrender value for notional policies. Normally the surrender value for notional policies will not change by more than 20% at each annual 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 Principles P308 and P310, sometimes larger changes are made in final bonus rates and surrender values.
 - If there is 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 notional 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.
 - Where the difference between actual payout and target payouts is small, then payouts may be left unchanged.
- 3.12 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.
- 3.13 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

- 3.14 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.
- 3.15 Final bonus rates will be set according to the same practices as those used for the corresponding endowment assurance policies (PG01) described in paragraphs 3.11 – 3.13 above.

Regular Premium deferred annuities - PG03

- 3.16 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

3.17 Products covered in this *participation pool* are:

- Regular premium endowment assurance - PG04
- Regular premium whole-life assurance - PG05

3.18 Final bonus rates will be set having regard to the annualised yield on premiums on equivalent policies in *product groups* PG01 and PG02.

Pensions Compound Bonus

3.19 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

3.20 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

3.21 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.

3.22 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. In arriving at the appropriate final bonus rates the following factors will be taken into account:

- For these policies smoothing is applied to maturity or retirement values and is done by limiting the change in final bonus rates. Normally the change in final bonus rates for a notional 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 15% at each annual review.
- For these policies smoothing is applied in the surrender value basis review, by limiting the change in immediate surrender value for notional policies. Normally the surrender value for notional policies will not change by more than 20% at each annual 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 Principles P308 and P310, sometimes larger changes are made in final bonus rates and surrender values.
- If there is 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 rates change does occur.
- Calculations may also be carried out for notional 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.

- 3.23 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.
- 3.24 These policies are recurrent single premium and so each premium has its own final bonus.
- 3.25 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

- 3.26 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.
- 3.27 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.
- 3.28 The practice is to base the charge on the proportions that are expected to take cash as opposed to annuity benefit. This charge is checked for reasonableness by comparing with the price of financial options more generally traded in financial markets.

New-series endowments - PG08

- 3.29 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

- 3.30 All policies in this *product group* comprise of the benefits from one single premium paid at a particular date. A simple final bonus scale has been devised that depends solely on the calendar year of the policy's inception.
- 3.31 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

- 3.32 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.
- 3.33 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

- 3.34 This is a very small *product group*.
- 3.35 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

- 3.36 Products covered in this *participation pool* are:
- Deferred annuities - PG12
 - Immediate annuities - PG13
 - Group pensions – PG14
- 3.37 For this *participation pool*, asset shares are calculated for all premium paying regular premium deferred annuities.

Deferred annuities - PG12

- 3.38 Asset shares are compared with payouts for notional maturing policies over a range of different past durations.
- 3.39 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.
- 3.40 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. In arriving at the appropriate final bonus scale the following factors will be taken into account:
- For these policies smoothing is applied to maturity or retirement values and is done by limiting the change in final bonus rates. Normally the change in final bonus rates for a notional 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 15% at each annual review.
 - For these policies smoothing is applied in the surrender value basis review, by limiting the change in immediate surrender value for notional policies. Normally the surrender value for notional policies will not change by more than 20% at each annual 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 Principles P308 and P310, sometimes larger changes are made in final bonus rates and surrender values.
 - If there is 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 notional 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.
- 3.41 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

- 3.42 This class of policies 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

- 3.43 This is a very small *product group* that covers just one remaining 'in-force' group scheme and a few remaining 'paid-up' group schemes.
- 3.44 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

- 3.45 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 a three year period. The smoothed asset share is kept within plus or minus 12.5% of the asset share.
- 3.46 The final bonus amount is defined as the excess of smoothed asset share over the current unit value.
- 3.47 No additional discretion is used for this product, although final bonus rates are rounded to the nearest 5%.
- 3.48 Where the amount of final bonus calculated by the formula above is negative an MVRF may, at the *Actuary's* discretion, be applied. The *MVRF* will in general bring the payout down to smoothed asset share.
- 3.49 Some discretion is applied in the setting of *MVRFs*. *MVRFs* are more likely to be set when:
- the difference between actual payouts and target payouts is large,
 - the *Actuary* considers it necessary in the light of the *overall financial position of London Life*,
 - if a large number of surrenders or transfers are anticipated.
- 3.50 *MVRFs* can be applied at any time, rather than just at the normal quarterly final bonus declaration dates.
- 3.51 *MVRFs* will not be applied on death, at the nominated pension date, or at age 75.

Life unitised with-profits - PG16

- 3.52 This is a very small *product group*. Currently, the final bonus rates and *MVRFs* for this *product group* are set to be the same as the pensions *unitised with-profits* (PG15) *product group*.
- 3.53 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.
- 3.54 The effect of tax is allowed for in the setting of annual bonus rates

- 3.55 This approach to final bonus would have to be revised if the approach to setting annual bonus rates were revised.
- 3.56 *MVRFs* will not be applied on death, at the chosen *MVRF* free date (where applicable) or for certain regular withdrawals in accordance with the terms of the policy.

AMP(UK) - Life Compound Bonus

3.57 Products covered in this *participation pool* include:

- Regular premium endowment assurances - PG18
- Regular premium whole-life assurances - PG19

3.58 For this *participation pool*, asset shares are calculated for all premium paying endowment assurances.

Regular premium endowments – PG18

3.59 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.

3.60 The overall aim is that the final bonus rates should be set so that the payouts equal the target payouts, after allowing for smoothing. In arriving at the appropriate final bonus rates the following factors are taken into account:

- For these policies smoothing is applied to maturity or retirement values and is done by limiting the change in final bonus rates. Normally the change in final bonus rates for a notional 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 15% at each annual review.
- For these policies smoothing is applied in the surrender value basis review, by limiting the change in immediate surrender value for notional policies. Normally the surrender value for notional policies will not change by more than 20% at each annual 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 Principles P308 and P310, sometimes larger changes are made in final bonus rates and surrender values.
- If there is 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 notional 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.
- Where the difference between actual payout and target payouts is small, then payouts may be left unchanged.

3.61 Final bonus rates are set for the notional policies, as above, with grouping in 5 year bands of years of entry.

- 3.62 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

- 3.63 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.
- 3.64 Final bonus rates will be set according to the same practices as those used for the corresponding endowment assurance policies (PG18) described in paragraphs 3.60 – 3.62 above.

AMP(UK) - Pension Compound Bonus

- 3.65 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

- 3.66 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

- 3.67 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.

- 3.68 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.
- 3.69 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.
- 3.70 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 3.73.
- 3.71 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

- 3.72 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

- 3.73 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 150% 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. It is expected that at least 90% of cases would fall within these target ranges and that the higher end of this range will reduce over the next few years.

C INVESTMENT STRATEGY

PRINCIPLES

- P400 The assets of the with-profits 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.
- P401 In almost all situations, the *overall financial position of London Life* limits the freedom with which *London Life* may invest.
- P402 *London Life's* 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 *London Life* Board implements a strategy from this range of potential strategies having regard to the following principles in this section C.
- P403 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,
 - The need to provide liquid assets so as to pay current claims, and
 - The *overall financial position of London Life*.
- P404 Asset shares will not be invested in derivative instruments other than for the purpose of efficient portfolio management and/or risk management.
- P405 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 in P402. 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.
- P406 The with-profits fund holds no investments that are of sufficient importance to *London Life* or any other group undertaking that such investments would not normally be traded.

PRACTICES

- 4.00 Paragraphs 4.01 to 4.04 deal specifically with the *Scheme's* rules for transferring assets between funds.
- 4.01 Prior to submission of its annual return to the *FSA* the *London Life Actuary* determines amounts of assets required by the *Scheme*, (the Required Capital Amount) to be held in each of its sub-funds, Life Non-Profit, Pension Non-Profit, Life With-Profits and Pension With-Profits. If the assets within a with-profits sub-fund do not cover that sub-fund's Required Capital Amount then the *Actuary* instructs *London Life* to transfer assets to that fund ('the supported fund').

- 4.02 The with-profits sub-funds cannot support any other fund.
- 4.03 The amount of support provided to a supported fund accumulates at the 3 month LIBOR rate from the date of transfer of assets to the supported fund. Support is never deemed irretrievable by the supporting fund.
- 4.04 The Required Capital Amount in relation to a sub-fund is taken to mean the greater of:
- the value of UK statutory liabilities allocated to the sub-fund, and
 - the amount determined by the *London Life Actuary* to meet the reasonable expectations of holders of policies in that fund
- plus the expected future value of transfers to shareholders from that fund that result from the payment of annual and final bonuses to with-profits policyholders.
- 4.05 The *London Life* Board formally reviews the investment strategy, allowing for the advice of the *Actuary*. The frequency of formal reviews depends upon the *overall financial position of London Life* 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 formal review will occur no less frequently than once per annum.
- From 1 July 2007, following a review of investment strategy, the *London Life with-profits 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.
- 4.06 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 *London Life* Board.
- 4.07 *London Life* 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)	Alternative Investments	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

- 4.08 *London Life* 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 *MVRFs* to payouts, subject to contractual terms.
- 4.09 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*.
- 4.10 The minimum credit quality of fixed interest securities is A3, as per the Moody's scale. There may from time to time be a small proportion of the with-profits 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.
- 4.11 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*.

D BUSINESS RISK

UK life insurance businesses are 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. *London Life* makes provisions that it considers appropriate for the risks that it identifies in relation to its with-profits business. *London Life* does not offer 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 with-profits businesses are exposed will inevitably change over time.

PRINCIPLES

- P500 *London Life* seeks to avoid taking on new business risks and is managed in such a way as to minimise existing business risks.
- P501 In accordance with the *Scheme*, the cost of smoothing with-profits pay-outs from year to year are met firstly from the surplus assets in the with-profits fund and subsequently from surplus assets in the non-profits fund and assets in the shareholders' funds.
- P502 In accordance with the *Scheme*, 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 with-profits fund and subsequently from assets in the shareholders' fund or surplus assets in the non-profits funds.
- P503 Profits or losses on business written outside the with-profits fund are not charged to the with-profits fund.
- P504 Even though *London Life* with-profits policy proceeds do not directly benefit from nor directly suffer the effects of business risks, *London Life* with-profits investment policy is affected by the *overall financial position of London Life*. Therefore, the with-profits policyholder returns are indirectly affected by business risks.
- P505 Compensation costs might be born by the with-profits fund depending on the circumstances giving rise to compensation.

PRACTICES

- 5.00 Particular material risks exist in relation to the following:
- Investments (see section C) producing lower returns than anticipated,
 - Annuitant longevity in the non-profits funds (see below)
 - The existence of policy options (see below)
 - Fixed administration expenses within a fund closed to new business
- 5.01 Other than the returns on investments (see section C), these risks do not directly affect the returns credited to asset shares but they do affect the *overall financial position of London Life*. The impact of the *overall financial position of London Life* on investment policy is discussed in section C and on amounts payable is discussed in section B.
- 5.02 The Board sets the acceptable level of investment risk per section C. 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*.

- 5.03 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.
- 5.04 The *Actuary* 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 *overall financial position of London Life* will worsen.
- 5.05 The *Actuary* 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 *overall financial position of London Life* will worsen.
- 5.06 Investment management and administration services are provided to *London Life* by a number of companies. There is a risk that one or other of these providers fails to provide adequate services.
- 5.07 As a closed fund the ability to spread fixed costs reduces as the value of the fund declines. There is a risk that *London Life* 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.
- 5.08 *London Life* reassures the With-Profits Annuity (PG17) with Pearl Assurance plc. If Pearl Assurance plc was not able to provide this reassurance then there is a small risk that *London Life* might fail to meet its ongoing *solvency requirements*.

E CHARGES AND EXPENSES

PRINCIPLES

- P600 Subject to P601, expenses allocated to the with-profits fund will be no higher than those set out in the *Scheme*.
- P601 *London Life* may alter the *Scheme* expense allocation arrangements subject to the approval of the *Actuary*. For such approval the *Actuary* will consider, amongst other items, the expenses incurred in the ongoing management of the with-profits business and typical charges made by other similar companies to their with-profits policies.
- P602 *London Life* would seek to alter the *Scheme* if the expenses allocated to the with-profits fund were materially less than the costs incurred in the ongoing management of the with-profits business.
- P603 A reasonable charge will be made to policies in PG07, PG09 and PG10 for the cost of providing guaranteed annuity benefits.
- P604 The with-profits 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

- 6.00 Asset shares bear the full cost of ongoing administration expenses allocated to the with-profits fund:
- Reduced to allow for the expenses in respect of the unit linked part of hybrid policies, and
 - Adjusted to reflect cumulative difference between the rate of inflation charged to the fund and the rate of inflation charged to the asset shares.

The administration expenses are then apportioned to *product groups* in line with the estimated costs of running those groups. Where the actual costs of administration exceed those allocated to the with-profits fund the excess is charged to non-profits funds. If actual costs became less than allocated then the allocation would be reduced to equal the cost.

- 6.01 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.
- 6.02 One-off costs, for example costs arising from changes in legislation, will be charged to the with-profits 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.
- 6.03 Phoenix Group Holdings, the ultimate parent of *London Life*, owns subsidiaries that provide services to *London Life*.
- 6.04 Henderson Global Investors Ltd and Ignis Asset Management provide investment management services to *London Life*. Ignis Asset Management is a subsidiary company of Phoenix Group. Pearl Group 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.

- 6.05 Henderson Global Investors Ltd provides investment management services to *London Life*. The arrangement is effective for 10 years from April 2005. The agreement may be terminated in the event of material breach or the insolvency or winding-up of either party.

F MANAGEMENT OF THE INHERITED ESTATE

PRINCIPLES

- P700 *London Life* has no inherited estate. The assets of the fund are covered by liabilities to either policyholders or shareholders.
- P701 *London Life* manages assets in excess of liabilities to policyholders in accordance with the principles of this section. In this section this amount is referred to as Shareholders' Surplus Assets (SSA).
- P702 The *London Life* Board sets the amount of capital that *London Life* holds to meet the range of financial and non-financial risks associated with its ongoing operation. This capital requirement is partly represented by assets of the shareholders' fund and surplus assets in the non-profits funds. The SSA represents the balance of the Board's prescribed capital requirements.
- P703 The *London Life* Board considers the advice of the *Actuary* in making their assessment of these capital requirements. In particular, the *Scheme* requires that no assets are distributed from *London Life* unless the *Actuary* certifies that following the distribution the company is able to continue to meet its ongoing *solvency requirements* and policyholder expectations in a range of reasonably foreseeable circumstances.
- P704 Amongst other items, in making their assessment of the capital requirements the Board will consider the results of the investigations into investment policy (section C) and the exposure to existing business risks (see section D).
- P705 The *London Life* Board has a duty to ensure that the ongoing *solvency requirements* are met. Consequently they set the capital requirements on a prudent basis. This limits investment freedom, see section C, and reduces the potential policyholder returns. However, it also means that *guaranteed benefits* are more secure than they might otherwise be.
- P706 The purpose of the SSA is to meet unexpected costs arising from the future experience of the business over and above those already provided for in the *realistic policyholder liabilities*. For example, if the cost of meeting *guaranteed benefits* (over and above the amount reasonably recoverable from policyholders) exceeds the expected cost then the SSA will reduce accordingly.
- P707 The SSA is not allocated to any specific *participation pool* but is available generally to meet the unexpected costs, mentioned above, arising from the with-profits business.

PRACTICES

- 7.00 Other than to meet unexpected costs as they arise, the SSA does not bear any specific costs.
- 7.01 The investment strategy for the with-profits fund is described in section C. The SSA will form part of the assets in excess of asset share assets. These assets follow a different strategy compared with the strategy for asset share assets.
- 7.02 The current SSA is small relative to its historic size. *London Life* intends over time to increase the SSA as a proportion of the total with-profits fund assets. If in the future the SSA is significant in size then the *Actuary* may advise the Board, consistent with the requirements of the *Scheme* mentioned above, to distribute part of the SSA to shareholders in either the form of a dividend or contingent loan repayment.
- 7.03 The calculation and payment of bonuses under with-profits policies get priority over any distribution of the SSA.

G NEW BUSINESS

PRINCIPLES

- P800 *London Life* will only accept new business where it is contractually obliged to do so or where there is an established practice of accepting new business from the existing customers.
- P801 Following the *Scheme*, *London Life* does not have an inherited estate to distribute to the remaining policyholders.
- P802 *London Life* would cease to accept non-contractual new business if the *overall financial position of London Life* became such that the Board considers it imprudent to continue doing so.

PRACTICES

- 8.00 *London Life* only writes new business in the circumstances set out in P800.

H EQUITY BETWEEN THE WITH-PROFITS FUND AND SHAREHOLDERS

PRINCIPLES

- P900 Section C sets out the investment policy and the consequences for shareholders and policyholders. Section C also sets out the basis upon which further assets are transferable to the with-profits fund to support the business.
- P901 Section F sets out management of the SSA and the consequences for policyholder returns and benefit security.
- P902 For annual bonuses the cost of bonus is the amount by which the *mathematical reserves* increase as a result of declaring the bonus. For final bonus the cost of bonus is simply the amount of final bonus paid in the previous year. Shareholders are entitled to 1/9th of the total cost of bonus. Payment of 1/9th of the cost of bonus results in the shareholder receiving 10% of the total distributed profits.
- P903 There will be no changes to this profit sharing arrangement.

PRACTICES

- 9.00 The current basis of allocating profit between policyholders and shareholders is as per the above principles.
- 9.01 The division of profit between shareholders and policyholders is unaffected by the choice of assumptions used to calculate the *mathematical reserves*. However, the amount distributed to shareholders' funds increases if more prudent valuation assumptions are used. This is because the cost of annual bonuses rises if more prudent valuation assumptions are used, which leads to an increase in *mathematical reserves*, with a corresponding increase in the amount of shareholder entitlement. However, by far the greater part of policyholder bonus is now paid in the form of final rather than annual bonus.
- 9.02 Items affecting the shareholders' share of the with-profits fund are described in section F.
- 9.03 *London Life* does not have an inherited estate and does not charge asset shares with the shareholders' share of the cost of bonus.

APPENDIX A – GLOSSARY

Actuary	The with-profits Actuary or the person performing the actuarial function (as the case may be).
Actively managed asset shares	Investments will be managed with the intention of achieving returns in excess of benchmark returns.
Alternative Investments	Investments typically made within a series of specialised funds set up with the aim of enhancing returns whilst reducing investment risk and fluctuations in returns. The specialist funds will use a range of investment managers in order to diversify their exposure to both individual managers and to the risks of the underlying portfolios. The investment managers will invest in a wide range of financial instruments (such as shares, fixed interest securities, cash and derivatives) to achieve their investment objectives. Selection and management of the investments will be subject to particularly detailed and continuous assessment in order to minimise adverse investment outcomes.
Asset class	refers to the different types of asset exposure that the London Life with-profits fund can have. Asset classes include equities, property, fixed interest securities, <i>Alternative Investments</i> and cash or short term deposits.
Conventional with-profits	London Life business is all with-profits business, apart from <i>unitised with-profits business</i> described below.
Former-AMP UK products	These are products that formed the UK Branch of the AMP Society prior to the merger with the London Life sub-fund of the statutory number 1 fund of the AMP Society to ultimately form <i>London Life</i> .
Former-London Life products	These are products that were written in the London Life sub-fund of the statutory number 1 fund of the AMP Society prior to the merger with the AMP UK Branch business in 1997 to ultimately form <i>London Life</i> . The London Life sub-fund resulted from merging the London Life Association business with the AMP Society in 1989.
FSA	Financial Services Authority.
FSA Returns	Rules issued by the <i>FSA</i> concerning the operation and governance of financial services firms. These rules are issued using powers granted to the <i>FSA</i> by the Financial Services and Markets Act 2000.
Guaranteed benefits	These are the benefits promised at, usually, maturity or normal retirement increased by annual bonuses added to date. They are usually guaranteed provided that all contractual obligations are met.
Investment Committee	The body which has authority from the <i>Board</i> to implement investment strategy.

London Life	This is the legal entity London Life Ltd, an indirect subsidiary of Phoenix Group Holdings. Its principal business result from the merger in 1997 of the London Life sub-fund of the statutory number 1 fund of AMP Society and the UK Branch business of AMP.
MVRF	This means Market Value Reduction Factor. In the case of <i>unitised with-profits</i> products, <i>product groups</i> PG15 and PG16, <i>London Life</i> is able to reduce the amount paid to the customer on surrender, transfer or early retirement on terms set out in policy conditions. The rate of reduction is the <i>MVRF</i> .
Mathematical reserves.	This means the amount set aside to meet liabilities to policyholders calculated in accordance with the <i>FSA rules</i> .
Overall financial position of London Life.	This refers to the current and ongoing position of <i>London Life</i> relative to its <i>solvency requirements</i> . It takes account of the assets and liabilities of the non-profits funds and with-profits fund and the assets of the shareholders' fund.
Participation pools	These are aggregations of with-profits policies for the purpose of determining bonuses. The <i>participation pools</i> arise from the <i>Scheme's</i> requirement that practices that existed prior to 31 December 1997 should not be altered by the <i>Scheme</i> .
Passively managed asset shares	Investments will be managed so that the timing of proceeds broadly matches the timing of claims plus expenses less premiums. The investments held could themselves be actively managed.
Post 1997 products	These are products that did not exist at the time of the merger of the <i>former London Life</i> and <i>former AMP UK</i> businesses in 1997.
Product group	This is the grouping of products as set out in the table in Paragraph 0.15.
Realistic policyholder liabilities	The expected cost of providing for policyholder benefits, including future discretionary benefits, taking account of a best estimate of future policyholder behaviour and allowing for market consistent valuations of policyholder options.
Scheme	The legal documents giving effect to the transfer of AMP UK Branch and London Life sub-fund business from AMP to London Life Managed Funds (renamed London Life Ltd). The <i>Scheme</i> was approved by the High Court on 23 December 1997
Solvency requirements.	This refers to the requirement for <i>London Life</i> to maintain margins of solvency in excess of the Required Minimum Margins as amended by the <i>FSA</i> from time to time.
Unitised with-profits	For <i>unitised with-profits</i> policies, premiums are used to secure units, known as purchase units. At the policy anniversary, bonus units may be added; and on the policyholder's death, surrender, transfer or maturity, additional bonus units may be added in the form of a final

bonus. For *London Life unitised with-profits* products each unit has a value of £1. A unique feature of *unitised with-profits policies* is that the company has the right (in certain circumstances, as specified in the policy terms and conditions) to impose *MVRFs* to the value of the benefits. The *MVRF* will serve to reduce the benefits below those that would have otherwise have been paid in order that the benefits more closely reflect the underlying market value of the assets backing the policy.

With-Profits Committee

A body appointed by the *Board* to help with all aspects of the management of with-profits business including solvency, investment strategy, bonus declaration, customer communication and supervision of the management of the life fund.