

# Principles and Practices of Financial Management (PPFM)

for Aviva Life & Pensions UK Limited  
Old With-Profits Sub-Fund and New With-Profits Sub-Fund  
(Aviva Life & Pensions UK Limited Old WPSF and New WPSF)

Version 16



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# Aviva Life & Pensions UK Limited Old With-Profits Sub-Fund (Old WPSF) New With-Profits Sub-Fund (New WPSF)

## Section 1: Introduction

**The Introduction and any statements at the start of subsequent sections of this document, together with the appendices, are provided by way of background information and do not form part of the Principles or Practices.**

### 1.1 Company information

Aviva Life & Pensions UK Limited ('the Company') (previously known as Norwich Union Life & Pensions Limited) is owned by Aviva Life Holdings UK Limited, whose ultimate holding company, Aviva plc, is incorporated in England.

Further information on the company names and background is provided in Appendix B.

Products are sold throughout the United Kingdom under the Aviva brand.

### 1.2 What business is covered by this document?

As a result of past Court transfers of insurance business, Aviva Life & Pensions UK Limited contains policies originally issued by a number of other insurance companies. The structure chart in Appendix C shows the composition of funds under Aviva Life & Pensions UK Limited.

This document covers with-profits business in the Old With-Profits Sub-Fund ('the Old WPSF') and the New With-Profits Sub-Fund ('the New WPSF') of Aviva Life & Pensions UK Limited. On the whole the Old WPSF and the New WPSF are managed as if they constitute a single sub-fund. As such references to Sub-Fund in this document will be to both the Old WPSF and the New WPSF unless otherwise specified. The document also applies to those policies reinsured in from Aviva Life & Pensions Ireland Designated Activity Company.

The most common names that exist on what are now policies of the Old and New With-Profits Sub-Funds are Aviva Life & Pensions UK Limited, General Accident Life Assurance Limited, Yorkshire-General Life Assurance Company Limited, The General Life Assurance Company, Yorkshire Insurance Company Limited, Scottish Insurance Corporation Limited, N&P Life Assurance Limited, Commercial Union Life Assurance Company, North British and Mercantile Insurance Company Limited, London and Scottish Corporation Limited, CGU Life Assurance Limited, CGNU Life Assurance Limited and Norwich Union Life (RBS) Ltd.

Other names will be relevant to policies in our other with-profits sub-funds. Appendix D contains a full list of all the original issuing companies, which will enable policyholders to identify whether this document applies to their policy or whether they should refer to the document for one of the other sub-funds.

### 1.3 Purpose of PPFM

#### What is a PPFM?

A PPFM is a document that sets out the Principles and Practices that a company follows when managing its **with-profits business**. The PPFM for these Sub-Funds has been approved by the Board of Directors of Aviva Life & Pensions UK Limited ('the Board'). The Board will report each year on whether each **with-profits sub-fund** has been managed in accordance with the PPFM.

#### What are Principles?

The with-profits Principles are enduring statements of overarching standards followed by a company when managing a with-profits sub-fund bearing in mind its duties to with-profits policyholders in both the current and future economic environments, its need to be fair to all policyholders, and comply with any relevant legislation and policy terms and conditions.

#### What are Practices?

The with-profits Practices provide more detail on the current approach taken by a company when managing a **with-profits sub-fund**.

#### Changes to Principles and Practices

If we propose to make a material change to any Principle in this PPFM we will inform policyholders with a with-profits policy in the Sub-Funds in writing at least three months in advance, unless we consider that advanced notice is not necessary and the **FCA** (one of our regulators) has agreed. Any proposed change to a Principle would be decided by the Board, having considered the views of the **With-Profits Committee** and having taken **appropriate actuarial advice**, including from the **With-Profits Actuary**.

Any proposed change to a Practice would be decided by the Board, having considered the views of the **With-Profits Committee** and having taken **appropriate actuarial advice**, including from the **With-Profits Actuary**.

Details of all changes to Principles and Practices will be displayed on the Company's website [aviva.co.uk/ppfm](https://www.aviva.co.uk/ppfm) as soon as possible after they are implemented. A link to the website page will also be included in annual statements.

Regardless of any such changes we will review this document at least yearly to ensure that it continues to accurately reflect the Principles and Practices we apply.

We would only change a Principle or a Practice when we consider the change to be justified by the need to:

- respond to changes in the business or economic environment;
- protect the interests of policyholders, for example to improve the fairness of a Principle;
- change a Practice to better achieve a Principle;
- correct an error or omission in the PPFM; or
- improve the clarity or presentation of the PPFM.

Whenever the PPFM is changed we will:

- document the changes and keep the previous versions of the document for at least five years; and
- ensure that any amendments to the Principles and Practices are compliant with all legal and regulatory requirements.

## 1.4 Governance arrangements surrounding the PPFM

It is the responsibility of the Board to ensure that the Company manages the Sub-Funds in line with the Principles and Practices set out in this document.

In line with regulatory requirements, the Company has put in place the following governance arrangements to offer assurance that PPFM have been adhered to:

- The Board will produce a 'With-Profits Policyholder Report' annually that includes information on compliance with the PPFM and the way the firm has exercised discretion and addressed any competing or conflicting rights and expectations. This will be made available to policyholders on the website [aviva.co.uk/ppfm](https://www.aviva.co.uk/ppfm) and on request.
- A **With-Profits Actuary** has been appointed to advise the Board on how it applies its discretion in managing with-profits policies. The **With-Profits Actuary** will report annually to the Board, and a summary will be available for with-profits policyholders as an Annex to the above annual report.

A **With-Profits Committee**, with a majority of independent members, has been formed to provide independent oversight and challenge to the Company to ensure that fairness and with-profits customers' interests are appropriately considered in the Company's governance structures and decision making processes. The committee has been formed under the **FCA Conduct of Business Sourcebook** requirements, and more details including its membership and terms of reference can be found on our website at [aviva.co.uk/wpcommittee](https://www.aviva.co.uk/wpcommittee). The **With-Profits Committee** may also report annually to with-profits policyholders if it considers it appropriate. This would be made available to policyholders as an Annex to the With-Profits Policyholder Report mentioned above.

## 1.5 Court Scheme

The management of Aviva Life & Pensions UK Limited is also governed by a Scheme approved by the High Court of England in 2017, known as 'the **Scheme**'. In the event of any conflict between the terms of the Scheme and this document, the terms of the Scheme will take precedence. If we wish to change a Principle or Practice in this document, and it is directly related to a provision in the Scheme, then the Scheme would first need to be changed, which would normally require court approval.

The PPFM and the Scheme are not intended to alter the rights and obligations we have under any policy documents issued to policyholders.

## 1.6 Glossary

Appendix A defines the key words and phrases used within this report. The following section also gives some background information on types of with-profits policies, and types of bonus.

## 1.7 Background information on with-profits policies

With-profits policies typically provide benefits at certain contractual dates specified in the policy. The contractual date is typically the end of the policy term, called the 'maturity date' for endowment policies or the 'retirement date' for pensions policies. For other policies such as with-profits bonds, the policy may specify particular contractual dates, for example the 10th policy anniversary. The benefits are also, typically, guaranteed on the death of the policyholder. Benefits may be taken at other times, but the payout received in this case is not usually guaranteed in any way.

Bonuses may be added to increase the value of the benefits of the policy. There are typically two forms of bonus:

- **regular bonuses**, which are added throughout the policy term, although at certain times the regular bonus may be zero; and
- **final bonuses**, which may be added whenever the policy benefits are taken. Again, the final bonus may be zero.

There are two types of with-profits policies:

- 'Conventional' with-profits ('CWP') policies typically provide a guaranteed amount of money on a set date or dates ('the contractual date(s)') and/or on death, provided that all the premiums are paid when due. The regular bonuses added from time to time increase the value of the initial guarantee set out in the policy. A final bonus may be added on the contractual date. Policies may be ended early, but the proceeds are then not usually guaranteed.
- 'Unitised' with-profits ('UWP') policies are different. Typically, each premium paid buys a number of units. Regular bonus may be added either by increasing the price of the units held and/or by adding extra units to the policy. Units may be cashed in at any time and a final bonus may be added. However, if the units are cashed in at any time that is not one of the contractual dates, a deduction called a '**Market Value Reduction**' ('MVR') may be made from their value.

Not all policies receive the same bonus rates. For the purposes of setting bonuses, policies are grouped, mainly by type of policy. All policies in the group, known as a 'bonus series', will receive the same rate of regular bonus. The final bonus rates that apply to the group will typically depend on the year the benefits were purchased.

## Section 2: The amount payable under a with-profits policy

### Amount Payable

#### 2.1 Principles

- 2.1.1 The Board will adopt consistent policies for the management of the **with-profits business** of the Old WPSF and the New WPSF, as if they constituted a single Sub-Fund ('the Sub-Fund') so as to ensure that for equivalent policies in the Old WPSF and the New WPSF the same bonus rates are declared (other than the **Additional Benefit** declaration under the **Scheme** in respect of certain **elected policies** or any bonuses that represent a distribution of the **inherited estate** of the Old WPSF).
- 2.1.2 The amount paid on maturity or death for a policy in the Sub-Fund will be the **initial guaranteed benefits**, plus bonuses constituting an equitable share of the surplus available for distribution earned by the Sub-Fund over the period of investment, plus for the New WPSF any **Additional Benefit**, subject to the terms of the policy conditions which take precedence.
- 2.1.3 Where a policy is eligible for a **surrender** value, the amount paid on **surrender** will have regard to the **initial guaranteed benefits** and bonuses, and the desire to avoid **surrenders** causing a strain on the Sub-Fund remaining for continuing policyholders.
- 2.1.4 For the With-Profits Annuity, the amount of each annuity payment may include bonuses in addition to the guaranteed benefits. Where payable, these bonuses constitute an equitable share of the surplus available for distribution earned by the Sub-Fund over the period of investment plus for the New WPSF any **Additional Benefit**. Annuity payments will be paid in accordance with the policy conditions.
- 2.1.5 Common bonus rates are used for appropriate groupings of policies reflecting an element of cross subsidy and **pooling** of risks for policies with similar characteristics. A single group may contain policies of different type, age, year of entry, size and premium history.
- 2.1.6 In order to provide an element of stability in the returns to policyholders, **smoothing** is applied by spreading profits and losses from one year to the next. It is intended that the long-term cost of **smoothing** is broadly neutral across generations of policyholders. No such year-on-year **smoothing** is applied when reviewing **surrender** values and, in the case of **unitised with-profits** policies, other non-contractual cancellation of units. In between such reviews **smoothing** applies as described in the practices.
- 2.1.7 As decided by the Board, having regard to the advice of the **With-Profits Actuary** and review by the **With-Profits Committee**:
- Different systems and different methodologies may be used for the purposes of determining bonuses or payouts for different types of business. The systems and methods used to determine bonuses or payouts may be changed from time to time, as a result of changes in circumstances including systems upgrades or to improve the management of the bonus process. Approximate methods may be used where necessary, or if deemed appropriate:
    - where approximations are not expected to significantly affect the resulting bonuses or payouts, or
    - where the historical data required to perform precise calculations is no longer available or is difficult or costly to access. In this case the calculations will be carried out as accurately as is reasonably possible in the **With-Profits Actuary's** opinion.
  - Assumptions and parameters used post 1 October 2009 will be the same for equivalent policies in the New WPSF and the Old WPSF.

#### 2.2 Practices

- 2.2.1 Where practicable, **asset share** calculations for specimen policies are used as a guide to determine bonus rates and the amounts payable to with-profits policyholders. The **asset share** methodology is described in sections 2.3 and 2.4. The Board determines the appropriate level and timing of distributions to policyholders. The bonus methodology has been established and refined over many years and will be further refined as appropriate. For some small blocks of business where **asset shares** are not available or are inappropriate as a measure, we may use a comparable policy as a proxy to determine payouts or take account of past practice.
- 2.2.2 The aim over the long term in determining **final bonus** is to return to maturing with-profits policies, as a group, on average 100% of **asset shares**. The amounts payable on maturity in any year, or to any particular policyholder may be more or less than 100%, due to the effects of **smoothing**, guarantees, and grouping of policies.
- 2.2.3 Current practice in determining bonus rates is to target an average payment on maturity for each **group of policies** equal to **asset share**, subject to the **smoothing** process. Maturity and **surrender** payouts for a **group of policies** should normally fall in the range 80% to 120% of **asset shares**.
- 2.2.4 Bonus rates are smoothed so that the full extent of changes in the market value of assets in the Sub-Fund is not always immediately reflected in claim payments. The aim is that in normal circumstances the cost of **smoothing** will be broadly neutral over the long term. There is no specific overall limit to the accumulated cost of **smoothing** beyond the principle of maintaining **regulatory solvency** at an acceptable level.

Our current practice is to limit the change in payout to be less than, or equal to, the **smoothing** limit percentage when **final bonus** rates change.

The **smoothing** limit percentage used for a maturing policy depends on the value assuming that the current **final bonus** rates do not change.

- If the payout using the current **final bonus** rate lies within the target payout range (see 2.2.3 above) then the **smoothing** limit is 5%.
- If the payout using the current **final bonus** rate lies outside the target payout range (see 2.2.3 above) then the **smoothing** limit is 7.5%.

In normal circumstances, the maximum amount of **smoothing** in one year will be 15%. If circumstances change so that there is a significant risk that the assets of the funds will not cover the liabilities, then a larger **smoothing** limit percentage may be used, or **smoothing** may be suspended. The bonus philosophy practices provide more detail on the **smoothing** approach, see section 2.6.18.

- 2.2.5 For **unitised with-profits** policies, **smoothing** is managed principally on a single premium basis (i.e. claim values are considered separately for each year of unit purchase). The claim value of regular premium policies is the total of claim values for premiums invested in each calendar year.
- 2.2.6 For **conventional with-profits** policies, over the long term the approach for non-guaranteed **surrender** values is to target an average payout of 100% of **asset shares** less any deductions required at **surrender** to protect the interests of remaining policyholders, subject to policy conditions. At present we do not make any deductions but may do so in future to the extent permitted within the **Conduct of Business Sourcebook** rules, and by the **Scheme**. For some policies, e.g. whole life, standard actuarial formulae may be applied as the use of **asset share** may not be appropriate. Where available, the directly calculated **asset share** for specimen policies will be used as a basis for calculating the amounts payable on **surrender**. Alternatively, a formulaic basis for **surrender** values may be used and factors may be applied to these values in order to achieve the **asset share** payout target on average. Individual policies may receive more or less than the average payout percentage of the group. The bases are reviewed when there is a 5% movement in underlying market indicators from when the bases were last changed and some sign of stability at that new level. In addition there would be a review when **final bonus** rates are changed. At any one time we may pay more or less than target due to changes in investment conditions.
- 2.2.7 Except for defined benefit pension schemes, a **glide path** approach is used to ensure that **surrender** values approach maturity values. The **surrender** basis and factors will be modified so that the **surrender** payout blends into the expected maturity payout, over a period of up to five years.
- 2.2.8 The return in the early years has regard to the actual premiums paid rather than being based solely on **asset shares**. Payouts may be blended in to bring them into line with the **surrender** values described above.
- 2.2.9 Whilst there are no formal **smoothing** practices on **surrender** equivalent to the **smoothing** applied to maturities, we may choose to limit the maximum change in **surrender** values on a policy as a result of a review.
- 2.2.10 For **unitised with-profits** policies, the **final bonus** rate used for **non-contractual unit cancellations** is the same as that used for maturity and death claims of the same duration. Such claim values may, however, be reduced by the application of a **Market Value Reduction (MVR)** as described in sections 2.7 and 2.8 and, in the case of **surrenders**, by the application of any early redemption charge specified in the policy. Subject to policy conditions, we may also allow for any deductions required to protect the interests of remaining policyholders. At present we do not make any deductions but may do so in future to the extent permitted by the **Conduct of Business Sourcebook** rules and the **Scheme**.
- 2.2.11 Supporting documentation of systems, methods, assumptions and parameters is maintained and is subject to formal change control procedures.
- 2.2.12 Any changes to systems, methods, assumptions or parameters are documented and are subject to formal change control procedures with appropriate levels of authorisation. In particular, minor changes in assumptions would normally be authorised by the **With-Profits Actuary**. More significant changes in assumptions and changes in methodology and parameters would be agreed with the **With-Profits Actuary** and would be subject to the formal decision of the Board following review by the **With-Profits Committee**.
- 2.2.13 The same assumptions and parameters are applied across different types of policies and across different generations of policies where in the opinion of the Board the experience of the different groups is felt to be reasonably homogeneous or where the experience of different groups is not separately available. Where appropriate, current practice is to apply a common scale of **final bonus** rates to all life **unitised with-profits** contracts within the same series (other than the **unitised with-profits** Income Fund where no **final bonus** is payable) and a common scale of **final bonus** rates to all pensions **unitised with-profits** contracts within the same series (other than Sterling Group Plan pension contracts where **final bonus** is currently expressed as a percentage of unit growth). For this purpose policies transferred from CGNU Life and CULAC constitute different bonus series. Different rates apply where management charges are taken explicitly, by unit deduction, to when management charges are taken implicitly before determining the rates. Current practice is also to apply the same **final bonus** rates to conventional whole life policies as would apply to endowment contracts effected the same year. A separate bonus rate is declared for the With-Profits Annuity.
- 2.2.14 In the case of certain mortgage endowment policies subject to the **Mortgage Endowment Promise**, payouts may exceed the target percentages of **asset shares** described above. For such policies, a top up payment in the form of an additional **final bonus** (extra to that described in sections 2.5 and 2.6) may be payable up to the maximum amount specified in policyholder mailings.

2.2.15 The **Mortgage Endowment Promise** applies to certain mortgage endowment policies of CGNU Life and CULAC maturing since 1 January 2000 where we have written to policyholders advising them of their maximum promise amount subject to certain conditions. These were:

- future investment returns on the **inherited estate** should be sufficient to meet the top-up costs
- the policy should not be sold to a third party
- policyholders should continue to pay premiums and not alter their policies in any material way.

The promise does not ensure that the mortgage amount will be paid if these conditions are met. The maximum top up amount payable under the Promise is based on projections made in 1999. If the Company gets into a position where it doesn't think it can keep paying the full promise the Company will give at least three years' advance warning that it cannot support all or part of these payments any more.

As part of the terms of the **Reattribution Scheme**, we have agreed to waive our rights to withdraw or reduce the promise on the grounds of the first condition not being met.

## Asset share Methodology

### 2.3 Principles

- 2.3.1 Where **asset shares** are used as a guide to determine the amounts payable under a policy they will reflect the relevant sources of profit or loss to the Sub-Fund applicable to with-profits policies. Equivalent policies in the Old WPSF and the New WPSF will be treated the same. Major sources of profit or loss are described in section 2.4. The same investment return will be credited to the **asset shares** of equivalent policies, irrespective of the proportions in which they are allocated or reassured to the Old WPSF and the New WPSF, which will be based on the investment return of assets backing the **asset shares** of policies (or the relevant **group of policies**) in the Old WPSF and the New WPSF. The same expenses and charges will be charged to the **asset shares** of equivalent policies in the Old WPSF and the New WPSF.
- 2.3.2 Where a policy being proposed for adoption in the management of the **with-profits business** would result in a material benefit to shareholders (excluding any policy the adoption of which the Board considers necessary in order to treat customers fairly) which shareholder benefit, in the reasonable opinion of the Board, would not have resulted from the adoption of the action had the **Reattribution Scheme** not been implemented, the consent of the **With-Profits Committee** will be required to adopt the policy.
- 2.3.3 The Board, on the advice of the **With-Profits Committee** and the **With-Profits Actuary**, may change the approach to the determination of **asset shares** (including allocation of investment returns and charges for expenses and guarantees) as it considers appropriate but this may not be done for **Transferred Policies** except with the approval of the **With-Profits Committee**.

### 2.4 Practices

- 2.4.1 Where **asset shares** are calculated, similar types of product may be grouped together. They are calculated for specimen policies or **groups of policies** from assumptions derived from the actual experience of the Sub-Fund. The experience may be measured across different generations or types of policies if it is considered appropriate by the Board, having regard to the advice of the **With-Profits Actuary** and review by the **With-Profits Committee**. Where a policy being proposed for adoption in the management of the **with-profits business** would result in a material benefit to shareholders (excluding any policy the adoption of which the Board considers necessary in order to treat customers fairly) which shareholder benefit, in the reasonable opinion of the Board, would not have resulted from the adoption of the action had the **Reattribution Scheme** not been implemented, the consent of the **With-Profits Committee** will be required to adopt the policy.
- 2.4.2 The approach is not used for altered policies; for these the bonus rates will follow those of similar unaltered policies.
- 2.4.3 The parameters and assumptions used from 1 October 2009 are reviewed each year and may be changed where appropriate. Any changes are documented and are subject to formal change control procedures with approval of the **With-Profits Actuary** and the review of the **With-Profits Committee**. The historic assumptions used to determine **asset shares** as at 1 October 2009 will not be changed except that adjustments may be made to the **asset shares** if there have been any factual errors or errors in calculation which have resulted in material misstatement of the **Aggregate Asset Shares** on 1 October 2009 as follows:
- where the error has resulted in a material understatement of **asset shares** the error will be corrected. Any such correction in the New WPSF will be funded by the **RIEESA**, and in the Old WPSF, by the **inherited estate** in that Sub-Fund
  - where the error has resulted in a material overstatement of **asset shares** for policies allocated to the New WPSF any correction will be limited to the aggregate amount of any corrections of understatements in the New WPSF
  - where the error resulted in a material overstatement of **asset shares** for policies allocated to the Old WPSF, the **asset shares** will be corrected to the extent that overstatements on equivalent policies in the New WPSF have been corrected.
- 2.4.4 For policies transferred to the Old WPSF, any future distribution of the **inherited estate** allocated to the Old WPSF would normally give rise to an augmentation to **asset share**.

## (A) For conventional with-profits policies (CWP)

**Asset shares** for **conventional with-profits** policies are in general, the accumulation of:

premiums paid

- + an allocation of investment return
- + an allocation of miscellaneous profits/losses from the **Sub-Fund** where appropriate
- + an amount in respect of each tranche of Special Bonus for qualifying policies
- the costs of selling and administering the business
- the cost of death or other risk benefits
- an adjustment for taxation appropriate for the class of business
- the shareholders' share of surplus distributed
- any contribution for the use of capital, provision of guarantees, **glide path** costs or **smoothing**.

This approach is described in more detail below.

For With-Profits Annuities, gross annuity instalments are deducted from the **asset shares** as part of the accumulation.

The Board, on the advice of the **With-Profits Committee** and the **With-Profits Actuary**, may apply additional charges to **asset share** as it considers appropriate but this may not be done for **Transferred Policies** except as permitted under the **Scheme** and with the approval of the **With-Profits Committee**.

### Investment return

The investment return used in the **asset share** calculations is based on the performance of the relevant investment pool. Separate investment pools are maintained for business denominated in different currencies. The majority of business is denominated in sterling, but separate pools exist for business denominated in euros and US dollars. The investment strategy for non-sterling denominated business follows that of the sterling denominated business. These investment pools (referred to as the **Return Assets**) are separately managed. The investment return for a block of business is based on the performance of its respective investment pool, as described above. No further **hypothecation** or notional **hypothecation** of the assets for particular classes of business or **groups of policies** is currently used though this may change if the Board considers that it would be in the interests of with-profits policyholders to use different asset mixes to back the **asset shares** of different **groups of policies**, subject to **With-Profits Committee** approval.

Actual asset mixes have been used for each year since 1968 for CGNU Life **legacy** companies, and since 1985 for CULAC **legacy** companies. For CULAC **legacy** companies, prior to 1985 and for CGNU Life **legacy** companies prior to 1968, assumed asset mixes are used. Between October 1998 and 1 October 2009, the asset mix of the relevant pool of the combined CGNU Life **legacy** and CULAC **legacy** With-Profits Funds has been used. Since 1 October 2009, the asset mix of the relevant **Return Assets** investment pool is used. For dates prior to 1983 (CGNU Life **legacy** companies) or 1990 (CULAC), sector proportions and **index performances** were used to determine the investment return used in **asset share** calculations. Since these dates, actual annual returns, net of dealing costs have been used.

### Allocation of miscellaneous profits/losses

Certain with-profits **Transferred Policies** have participated in the past in profits arising from certain non-profit business of CGNU Life or CULAC. There will be no further allocation in respect of non-profit business written prior to 1 October 2009, as all potential value has been allocated.

Profits or losses on **surrender** are allocated to the **conventional smoothing account** as described in section 2.6.18.

Profits or losses resulting from conventional policies, e.g. whole life, that do not have an **asset share** are included in the **asset share** accumulation for endowment with-profits policies.

**Asset shares** for policies may be adjusted by an additional allocation (or deduction) reflecting any other miscellaneous profits (or losses) arising within the Sub-Fund, as described in section 4. No such profits or losses are currently taken into account (see section 6.2).

### 2008/2009/2010 Special Bonus

For qualifying policies, the **asset share** was enhanced with effect 1 January 2008, 1 January 2009 and 1 January 2010 in respect of the three tranches of the Special Bonus

### Cost of selling and administering the business

For **conventional with-profits** policies the expenses of selling and administering the policies are allowed for in the **asset share** calculations. The expenses and charges are those of a type which were being deducted immediately prior to 1 October 2009.

Development expenses charged to the Sub-Fund are normally not charged to **asset shares**. However where a development is identified as clearly providing expected benefits to policyholders then a proportion of the cost may, subject to the agreement of the **With-Profits Committee**, be charged to **asset shares**.

Since 1 October 1998, these expenses are based on the charges under various management agreements with other companies. The current management service agreement is described in section 5.

Investment expenses charged to **asset shares** are based on the fee rates charged to the Sub-Fund under an investment management agreement (see section 3), or an approximation to the cost when no formal agreement was in place.

Actual commission is used for each policy, where available. If not available then average commission levels for each class of business over the relevant time period are assumed to apply for all policies issued during the period.

Regulatory fees, audit fees and mis-selling costs are not charged to **asset share**. Such costs are borne by the **inherited estate** of the Old WPSF or that part of the **Reattributed Inherited Estate** held in the New WPSF as appropriate.

Industry levies are not currently charged to **asset shares**. The Board will however review this practice from time to time in the light of the size and/or frequency of such levies and it will consider whether it is appropriate to change that practice so as to charge some or all of those levies to **asset shares**. In considering whether or not to make such charges the Board will have regard to **appropriate actuarial advice** and the views of the **With-Profits Committee**.

Other types of expenses or charges can only be deducted from the **asset share** calculation if the Board, having obtained **appropriate actuarial advice** and the approval of the **With-Profits Committee**, considers it is consistent with the policyholders' interests.

#### **Cost of death or other risk benefits**

For **conventional with-profits business** other than With-Profits Annuities, **mortality costs** are charged to **asset shares** based on experience. For With-Profits Annuities, the annuity instalments deducted from the accumulation are based on the **mortality rates** assumed in the premium rate with the difference between actual and expected amounts paid being charged to the Sub-Fund but not **asset shares**. The mortality or other risk cost may be charged by way of a specific premium loading which would be excluded from the premium roll up within **asset shares**.

A charge is made at outset to **asset shares** for With-Profits Annuities in respect of the minimum floor guarantee.

#### **Adjustment for taxation**

Within the **Asset Share** calculations, tax rates are applied to investment income, capital gains and expenses in each year to reflect the rates of taxation that apply to each type of business.

No deduction is made from **Asset Shares** in respect of taxation payable on shareholder transfers. Additional tax associated with shareholder transfers is met from the **inherited estate** of the **Old WPSF** or the assets in excess of **Aggregate Asset Shares** for the **New WPSF**. This practice is well established but subject to annual review by the Board having regard to the advice of the **With-Profits Actuary** and review by the **With-Profits Committee**.

#### **Cost of shareholder transfer**

Shareholders receive a share (currently 10%) of the surplus distributed. This is charged to **asset shares**, based on the cost of new regular and **final bonus** each year, determined (where relevant) using the prevailing valuation basis.

#### **Use of Capital**

An additional charge to **asset share** may only be applied to policies issued since 1 October 2009 or to policies issued before that date to which a charge was already being applied at 1 October 2009, such as With-Profits Annuities at vesting. Such a charge will be to reflect the provision of capital, guarantees, and **smoothing** in the Sub-Fund, or to maintain the **inherited estate** or **regulatory solvency** of the current Sub-Fund at appropriate levels.

Currently, no charges are made.

## **(B) For unitised with-profits policies (UWP)**

**Asset shares** for **unitised with-profits** policies and deposit administration business issued prior to 1 October 2001 (other than former CGNU Life contracts written on a coinsurance basis with Norwich Union Linked Life Assurance Limited (NULLA) prior to 1993 and individual pension business migrated to an explicit charge structure) are based on the accumulations described for **conventional with-profits**. In the case of policies transferred to Aviva Life & Pensions UK Limited on 1 October 2009, which are **Additional Benefit** Policies (as defined in the **Reattribution Scheme**) allocated to the New WPSF, an allocation in respect of the proportion of the reattribution of the **inherited estates** of CGNU Life and CULAC allocated to the RIEESA on the 1 October 2009 is included as part of the accumulation (the **cash equivalent amount** of the incentive payment, determined in accordance with the **Reattribution Scheme**). The deduction for administering the Bonds and Savings business is a restricted MSA charge from 1 January 2009 to 1 January 2014. In the case of group and individual personal pension contracts issued prior to 1 December 2000, the charge to **asset shares** in respect of selling and administering the business and the shareholders' share of declared profits is restricted to 1% per annum with effect from 6 April 2001. This restriction is permanent and will not be reviewed.

For UWP business written since October 2001 by CGNU Life and for coinsurance business with NULLA prior to 1993 and individual pension business issued prior to October 2001 migrated to an explicit charge structure, and for new UWP business written since 1 October 2009 and allocated to the New WPSF the total **asset share** for a policy is the sum of the **asset shares** for all units allocated to that policy. The **asset share** for units allocated at a given time is:

initial investment (less any initial charge)

- + an allocation of investment return
- + an allocation of miscellaneous profits/losses from the Sub-Fund where appropriate
- + **cash equivalent amount** in respect of **Transferred Policies** with **Additional Benefit**
- + an amount in respect of each tranche of Special Bonus for qualifying policies
- some or all of the shareholders' share of declared profits
- an adjustment for taxation appropriate for the class of business
- the **annual management charge** (where this is not taken by way of unit cancellation)
- any deduction which may be made for industry levies
- any contribution which may be levied for the use of capital, provision of guarantees, **glide path** costs or **smoothing**.

In the case of policies transferred to Aviva Life & Pensions UK Limited and allocated to the New WPSF on 1 October 2009, the **cash equivalent amount** (determined in accordance with the **Reattribution Scheme**) corresponding to any additional units allocated to the policy as an **Additional Benefit** in respect of the reattribution of a portion of the **inherited estates** of CGNU Life and CULAC are included as part of the accumulation.

Where expenses and charges for risk or guarantees are taken by way of explicit charges, these are deducted by way of unit cancellation, and so no further deduction needs to be made to the **asset share** of units. There will be no other types of charges applied to for business written before 1 October 2009, except where agreed with the **With-Profits Committee**. For Inflation Protected Guarantee Bonds issued from 12 February 2007, an additional annual charge of 0.7% of the units applies for the first 10 years of the contract.

This approach is described in more detail below.

Units are allocated when premiums are paid and may be cancelled to cover contractual management and expense charges, partial **surrenders** and explicit charges for risk benefits or guarantees. In the case of contracts that were written on a coinsurance basis with NULLA, investment expenses and the shareholders' share of surplus distributed are deducted as part of the accumulation. For group and individual personal pension contracts, however, the charge to **asset shares** in respect of selling and administering the business and the shareholders' share of surplus distributed is restricted to 1% per annum with effect from 6 April 2001. This is achieved by limiting the deduction in respect of the **annual management charge** where necessary. This restriction is permanent and will not be reviewed.

#### **Investment return**

Where we invest in assets managed by external investment managers, additional investment management costs may be incurred. Such costs are expected to be more than offset by additional investment returns.

See also **conventional with-profits**.

#### **Allocation of miscellaneous profits/losses**

See **conventional with-profits**.

Profits or losses on surrender and mortality are allocated to the **unitised life and unitised pensions smoothing** accounts as described in section 2.6.18.

#### **Cash Equivalent Amount**

For the purpose of determining **asset share**, the cash equivalent corresponding to any additional units allocated to the policy as an **Additional Benefit** (as defined in the **Reattribution Scheme**) for **Transferred Policies** allocated to the New WPSF shall be considered as an additional single premium invested and will be subject to the same investment and charging considerations as the basic premiums, (other than in respect of initial commission and expenses).

#### **2008/2009/2010 Special Bonus**

For qualifying policies, the **asset share** was enhanced with effect 1 January 2008, 1 January 2009 and 1 January 2010 in respect of the three tranches of the Special Bonus.

#### **Cost of shareholder transfer**

Shareholders receive a share (currently 10%) of the surplus distributed. For **unitised with-profits business** written prior to 1 October 2001, this is generally charged to **asset shares**, based on the cost of new regular and **final bonus** each year determined (where relevant) using the prevalent valuation basis.

In the case of former CULAC **unitised with-profits** pension and deposit administration policies written between 5 June 1995 and 30 September 1998, the shareholders' share of profits charged to **asset shares** is restricted. For the purpose of assessing the charge to **asset shares**, part of the **regular bonus** declared after 1998 is deemed to consist of an interest element (which would not give rise to a shareholder transfer) in line with the assumptions made in product disclosure. The balance of the actual shareholder transfer is met by the **inherited estate** of the Old WPSF or assets in excess of **Aggregate Asset Shares** for the New WPSF as appropriate. This restriction is permanent and will not be reviewed.

For **unitised with-profits business** written by CGNU Life between 1 October 2000 and 30 September 2001, shareholders continue to receive 10% of the profits declared, but the charge to **asset shares** is restricted, with the balance being met by the **inherited estate** of the Old WPSF or assets in excess of **Aggregate Asset Shares** for the New WPSF as appropriate. This restriction is permanent and will not be reviewed. For **unitised with-profits business** written from 1 October 2001, the shareholder transfer is within the **annual management charge**.

#### **Adjustment for taxation**

See **conventional with-profits**.

#### **Annual management charge**

Where an **Annual Management Charge** (AMC) is taken into account as part of the accumulation as opposed to an explicit charge by way of unit cancellation, the **asset share** for UWP policies will be reduced by the AMC after crediting after tax investment earnings. The AMC is expressed as a percentage of the **asset share** and is set at a similar level to the AMC for policies investing in unit-linked funds. Any change in AMC must

- be reasonable in relation to changes in the Company's expenses
- be the same as the corresponding change in AMC for investments in the internally managed unit-linked funds of Aviva Life & Pensions UK Limited (excluding for this purpose those funds which provide investment guarantees).
- be subject to any further restrictions contained in the policy in relation to changes in the AMC.

#### **Industry levies**

Subject to policy conditions the **asset shares** may reflect a deduction for industry levies in the circumstances described in 2.4.4 (A) above for **conventional with-profits** policies.

#### **Use of capital**

See **conventional with-profits**.

For the Inflation Protected Guarantee Fund, policies issued from 12 February 2007 have an additional management charge of 0.7% each year of units attaching for the first 10 years to assist in meeting the cost of the guarantee.

## **Bonus Philosophy**

### **2.5 Principles**

- 2.5.1 **Regular bonus** rates are set with the aim of providing a progressive build up of guaranteed benefits over the lifetime of the contract with an overarching aim of retaining sufficient profits to provide an appropriate margin for **final bonus**. **Regular bonus** rates may be changed to reflect circumstances including past investment performance, changes in expected long-term investment returns, and any guarantees in the contracts to which they apply. **Regular bonus** rates will be smoothed, to limit the changes in these rates from year to year. The **regular bonus** rate could be zero (subject to policy conditions) if required.
- 2.5.2 Different bonus rates may apply to different types of policy, for example to reflect significant differences in investment mix, guarantees and charges, premium rates, policy types and issue series. New bonus series may be created in a variety of circumstances, including in order to maintain equity between different policy classes, policies written under different premium rates, and different generations of policyholders. The same bonus rates will apply to equivalent policies in the New WPSF and the Old WPSF, except for additional bonuses in respect of the **Additional Benefit** applying to certain policies allocated to the New WPSF, and any distribution of the **inherited estate** for policies allocated to the Old WPSF.
- 2.5.3 In the case of former CGNU Life policies, the relationship between **regular bonus** rates under the various series of life policies issued prior to 1982 is subject to the provisions of the **Scheme** of Transfer sanctioned on 19 October 1970 in the High Court of Justice in England.
- 2.5.4 **Final bonus** rates are set with the aim of distributing the balance of the surplus available for distribution earned over the lifetime of the policy, to the extent that such surplus has not previously been distributed by way of regular or other bonus additions. **Additional Benefit** allocations were not a distribution of surplus, but were funded by shareholders. Accordingly, those allocations will not reduce the rates of **final bonus** payable on relevant policies. The additional **regular bonus** rate of 0.5% per annum applying to the former CGNU Life UWP Loyalty Funds (which are now the Aviva Life & Pensions UK Limited UWP Loyalty Funds) does not reduce the rates of **final bonus** payable on relevant policies. **Final bonus** rates are smoothed as described in sections 2.1 and 2.2

- 2.5.5 The Board may alter conditions for payment of **final bonuses** or cease paying **final bonuses** at any time without notice. Factors which might lead to a change include changes in the financial circumstances of the Sub-Fund and anticipated future experience of an exceptional nature.
- 2.5.6 In addition, each year the Board will, in accordance with the **Scheme**, carry out investigations for the Old WPSF to determine whether any part of the **inherited estate** of the Old WPSF should be distributed or otherwise applied to enhance policyholder benefits as described in section 6.2.

## 2.6 Practices

- 2.6.1 In determining an equitable distribution of surplus for the purposes of section 2.1 we will consider:
- the need to ensure that the Sub-Fund is able to meet its regulatory liabilities after allowing for the capital support available from the **RIEESA**
  - the current and projected capital needs of the Sub-Fund after allowing for the capital support available from the **RIEESA**
  - the investment strategy of the Sub-Fund
  - the bonus philosophy of the Sub-Fund
  - the need for an appropriate level of security for policyholders' benefits
  - the **Risk Appetite Framework** of the Sub-Fund
  - the need to ensure that policyholders' reasonable benefit expectations are maintained and to treat policyholders fairly.

The Sub-Fund will not be managed solely to avoid the need for or the repayment of any capital support.

- 2.6.2 The paragraphs below describe how bonus rates are currently determined and smoothed in normal financial circumstances. The Company may change these arrangements when circumstances are not considered normal. Examples of circumstances which would not be considered normal include a prolonged period of depressed asset values, a heavy incidence of **surrenders**, substantial business losses in the Sub-Fund, or **regulatory solvency** issues.

- 2.6.3 The amount of **regular bonus** may depend on:

- the relevant profits earned in the Sub-Fund over recent years
- the investment return we expect in the long term
- the prospective **final bonus** margin
- the expected cost of guarantees on all existing with-profits policies in the Sub-Fund
- projected **regulatory solvency** levels, now and in the future.

- 2.6.4 **Regular bonus** declarations take into account the rates which the Company expects to be able to maintain over the terms of both existing and, where appropriate, new policies within a bonus series based on best estimates. This is achieved by projecting current **asset shares** for specimen policies each year for a range of future investment returns on the Sub-Fund, and choosing a target **regular bonus** rate which aims for an adequate margin for **final bonus**. The projections allow for potential variations in the future investment returns. Suitable allowance will be made to finance **final bonus**, to reduce the risk of **asset shares** falling below **initial guaranteed benefits** plus previously declared bonuses. Parts of the profits are shared out as **regular bonus**. The aim is to pay between half and two thirds of surplus available for distribution through **regular bonus** over the term of the contract, taking account of the overall strength of the Sub-Fund. At any time we may pay more or less depending upon actual experience.

- 2.6.5 No undue weighting is given to recent economic experience.

- 2.6.6 **Interim bonus** rates, where appropriate, are determined having regard to the estimates of the level of **regular bonus** rates expected to be declared at the next declaration.

- 2.6.7 In normal conditions, **regular bonus** rates will be reviewed twice a year. Although changes are smoothed, there is no maximum amount by which **regular bonus** rates may alter.

- 2.6.8 **Final bonus** rates are set to achieve the overall aim of returning to maturing with-profits policyholders, as a group, on average 100% of **asset shares** in the long term, given the **regular bonus** rates determined as described in section 2.5 and 2.6. They are set so as to achieve the **smoothing** objectives described in section 2.2. Representative specimen policies are used, rather than the underlying policy **asset share** itself. **Final bonus** rates are influenced by the total return on investments and so are reviewed in the light of prevailing financial conditions.

- 2.6.9 In normal conditions, **final bonus** rates will be reviewed at least twice a year. However, we may change **final bonus** at any time during the year, particularly in changing financial conditions. We would expect to change **final bonus** rates when there is a sustained movement in **asset shares** of 15% or more since **final bonus** rates had last been set. **Final bonus** rates are currently based on calendar year of entry (or year of unit purchase for **unitised with-profits** policies), unless there are large discontinuities in which case we may use a time period shorter than one year.

- 2.6.10 **Final bonus** where applicable, is payable on all claims arising on death, maturity, retirement and **surrender** under the terms of the contract for **conventional with-profits** policies. **Final bonus** where applicable is payable on all cancellations of units in the **unitised with-profits** funds and depends on the date of unit purchase. For the **unitised with-profits** Income Fund, any such bonus supplements the income paid in a particular year. The **final bonus** rate could be zero.
- 2.6.11 **Final bonus** for With-Profits Annuity payments is known as 'Top up bonus'. Top up bonus, if declared, applies to all With-Profits Annuity payments during the period for which it is declared, and does not form a permanent addition to the annuity payments.
- 2.6.12 From time to time, special bonuses have been declared on certain **conventional with-profits** life assurance and pensions policies. These bonuses represent a consolidation of part of the **final bonus** otherwise payable on death and maturity claims. Special bonuses are less likely to be a feature of the bonuses in the future as the level of asset growth is expected to be lower. A specific special bonus, being a distribution from the **inherited estate** of CGNU and CULAC was awarded in 2008, with a further award in 2009 and a final third award in 2010 for all with-profits policies in force at defined dates.
- 2.6.13 Each year investigations will be undertaken to determine whether any part of the **inherited estate** of the Old WPSF should be distributed. The Practices adopted for this purpose are described in section 6.3.
- 2.6.14 Where distributions are made from the **inherited estate** of the Old WPSF, these take the form of increases to the **final bonus** rates determined as described in sections 2.6.8 to 2.6.11 above. **Surrender** values are also amended to reflect such distributions. Where policies have monetary guarantees in addition to the with-profits benefits described in this section 2 (such as the Inflation Protected Guaranteed Bonds or pension products with a Guaranteed Minimum Pension), the minimum policy value payable due to such a guarantee is unchanged by the distribution and continues to apply if it exceeds the with-profits benefits.
- 2.6.15 We normally recalculate the appropriate uplifts to with-profits payouts once each year.
- 2.6.16 The latest published uplift as a percentage of with-profits payouts is available from the With-Profits Summary on our website at [aviva.co.uk/ppfm](http://aviva.co.uk/ppfm).
- 2.6.17 The bonuses described in this section also apply to investments that have been altered in some way and/or stopped payment of premiums.
- 2.6.18 Ensuring that the cost of **smoothing** is neutral over time is achieved by the operation of a **smoothing account**. The excess/deficit of smoothed payouts over **asset shares** for most categories of **with-profits business** for each time period is charged/credited to the **smoothing account**. At the end of each calendar year, the balance on the **smoothing account** will be recycled to **asset share** through an addition/deduction to the credited investment return. The maximum deduction is currently 2.5% of **asset shares**. Any balance on the **smoothing account** after applying the maximum deduction will be carried forward for recycling in future years.
- 2.6.19 The Company reviews the returns provided to policyholders by their with-profits policies and, where considered appropriate, may increase the benefit of **smoothing** for some groups of policies by increasing the **final bonus** paid. Such instances are limited, and would be subject to Board approval, having regard to the advice of the **With-Profits Actuary** and review by the **With-Profits Committee**. Where this practice is applied, it is done so it has no material adverse effect on other with-profits policyholders.

## Market value reduction

### Introduction

It is the responsibility of the Board to ensure any current activity does not adversely affect ongoing policyholders and their rights. The use of a **Market Value Reduction (MVR)** is one of the key aspects in the protection of payouts for policyholders still invested in the Sub-Fund.

### 2.7 Principles

For **unitised with-profits** policies, an MVR may be used whenever it is necessary to protect the Sub-Fund or other with-profits investors in the Sub-Fund from losses arising from unit cancellations. An MVR may be used whenever unit cancellations (arising in respect of **surrenders**, transfers or otherwise) are expected to give rise to a strain on the Sub-Fund. The decision as to whether it is appropriate to apply an MVR is based on a comparison of the **asset share** and the credited return indicated from the application of regular and **final bonuses**.

### 2.8 Practices

- 2.8.1 An MVR may be applied where the **asset share** is less than that credited by way of bonuses to policyholders, subject to policy conditions. The same MVR will be applied to equivalent policies in the New WPSF and the Old WPSF.
- 2.8.2 The MVR is an adjustment to the value of units, including any **final bonus**, and is intended to ensure the Sub-Fund doesn't incur a loss on unit cancellation. The decision to apply MVRs and the application and review process is actively managed. Policyholders applying for a settlement value will be informed if an MVR will be applied. This gives them the option to defer the cancellation of the units.
- 2.8.3 The effect of an MVR is to reduce the **final bonus** which is payable on the cancellation of units. If the MVR exceeds the **final bonus**, then the effect is to reduce the amount payable to a level which is below the face value of the units cancelled. An MVR will never apply on payment of a death benefit and certain other times as specified in the policy conditions. MVRs may be used to target payouts (after MVR) that represent 100% of the **asset share** less any required deductions to protect the interests of remaining policyholders

on average. At present we do not make any deductions but may do so in future to the extent permitted within the rules of our regulator and by the **Scheme**. Payouts for individual policies may fall within the range 90% to 110% of **asset share** mainly as a result of accommodating short term market fluctuation. We will look to rebalance MVR rates back to target payouts (after MVR) that represent 100% of **asset share** when there is a 5% movement in underlying market indicators and some sign of stability at that new level. However, payouts may lie outside these ranges on certain policies or in changing investment conditions. MVRs are currently determined by calendar year of unit purchase for pensions and month of unit purchase for life products. The **surrender** value is the sum of the value (after allowance for **final bonus** and MVR) of the units encashed. A **surrender** value may thereby include units to which an MVR has been applied and units to which no MVR has been applied.

- 2.8.4 For defined benefit pension scheme policies, the effect of an MVR is to increase the number of units which are cancelled to provide a given amount payable. Where practical, policyholders applying for a settlement value will be informed if an MVR will be applied. However, this may not always be practical, for example where member pensions are paid from a Pension Fund. Settlements to which an MVR may apply are covered in detail in the product's policy document.
- 2.8.5 It is most likely that an MVR will be needed following a large or sustained fall in stock markets or after a period where investment returns are regularly below the levels we had expected in setting bonus rates. We will look to reduce the MVR as markets improve or increase it if the market worsens. In the case of policies with premiums invested in the **unitised with-profits** Income Fund, an MVR may need to be applied on a more frequent basis than under the main **unitised with-profits** fund.

## Section 3: Investment strategy

### Introduction

The investment strategy covers the Old WPSF and the New WPSF, and also takes into account the capital support that may be required to be made available to the Sub-Fund from the **RIEESA** under the **Scheme**. This support represents that part of the former **inherited estates** of CGNU Life and CULAC which was transferred to the **Non-Profit Sub-Fund** under the **Reattribution Scheme** and has not subsequently been released to shareholders or transferred into the New WPSF, (or in extremis the Old WPSF). It is increased by the net of tax investment return on the assets in which it is invested and by any amounts which are retransferred from the New WPSF or Old WPSF after 1 October 2009. The **Scheme** requires that the **Equity Backing Ratio** (EBR) for assets that will be used to determine the investment return to be credited to the **asset shares** of policies allocated to the New WPSF and the Old WPSF (**Return Assets**) must fall within limits that are set out in the PPFM or as otherwise approved by the **With-Profits Committee**. The **Scheme** requires that the investment policy for the assets of the Old WPSF other than the **Return Assets** (the **Remaining Assets** of the Old WPSF) should be appropriate to the expected and potential liabilities to be met from such assets including new business. The **Scheme** also requires that the investment policy for the assets of the New WPSF, including the **RIEESA**, other than the **Return Assets** (the **Remaining Assets** of the New WPSF) should have regard to the expected and potential liabilities to be met from such assets including new business. The investment policy for the New WPSF will if necessary be constrained so as to ensure that the market value of investments that do not consist of investments in non-profit business, **strategic investments** and investments in Aviva group companies (**Core Eligible Assets**) is not less than the **Aggregate Asset Shares**.

Information (which has previously been made publicly available) on the mix of assets and investment returns in recent years is given in the With-Profits Summary for the Old With-Profits Sub-Fund and New With-Profits Sub-Fund which is available on our website at [aviva.co.uk/ppfm](http://aviva.co.uk/ppfm).

### 3.1 Principles

- 3.1.1 The investment strategy aims to provide the highest long-term returns (allowing for the effect of taxation) commensurate with acceptable levels of solvency risk, having regard to:
- the nature and term of the with-profits liabilities and the management of cash-flows
  - the current and expected level of guarantees
  - current and projected **regulatory solvency** requirements and appropriate capital requirements
  - the aggregate size of the **inherited estates**
  - advice from our Fund Managers
  - short-term and long-term anticipated returns in different asset classes
  - volatility of different asset classes.
- 3.1.2 The monies of the Sub-Fund will be invested in a range of assets which are considered appropriate bearing in mind the **Risk Appetite Framework**. Investment returns are **benchmarked** against appropriate indices, taking into consideration the levels of risk inherent in each asset class and stock. Maximum and minimum exposures to, and performance **benchmarks** for, different investment classes and/or individual investments will be set from time to time in accordance with Sub-Fund objectives. Maximum exposures to investments in any one counter-party are specified. Intended holding ranges in various asset classes may be changed in order to improve long-term performance or to improve the likelihood that the Sub-Fund can meet its guarantees. The aim will be to seek to maintain a high EBR whilst maintaining financial strength. The EBR for the **Return Assets** will depend on the financial strength of the Sub-Fund.
- 3.1.3 In normal circumstances, the investment strategy for the Sub-Fund will be determined according to the overall composition of the New WPSF, the Old WPSF, the Stakeholder WPSF and the **RIEESA**. The Sub-Fund may have recourse to other assets in the **Non-Profit Sub-Fund** or the **Shareholder Fund**, should this be necessary in order to meet guarantees or to give more freedom to the Sub-Fund though this is entirely at the discretion of the Board.
- 3.1.4 Investments may be made in derivatives or similar instruments if they are appropriate to the objectives of the Sub-Fund. Such investments are subject to the appropriate internal governance procedures of the Company.
- 3.1.5 The investment strategy of the Sub-Fund takes into account the nature and term of the liabilities, by considering appropriate assets for different classes of with-profits policy and different generations of with-profits policyholders. No other investment constraints are placed on parts of the Sub-Fund, other than those detailed in the rest of this section which apply to the entire Sub-Fund.
- 3.1.6 The investment policy for the **Return Assets** will be set so as to ensure the same returns are credited to the **asset shares** of equivalent policies in the New WPSF and the Old WPSF. A different investment strategy may be applied to different classes or **groups of policies**. As far as is practicable, the **Return Assets** for the New WPSF will be held in the New WPSF rather than the **RIEESA**.
- 3.1.7 Different investment strategies may be applied for the **Remaining Assets** of the Old WPSF and the **Remaining Assets** of the New WPSF (including the **RIEESA**). In particular the Board may invest the **Remaining Assets** of the New WPSF in non-profit new business, **strategic investments** and investments in Aviva group companies, without doing so for the **Remaining Assets** of the Old WPSF subject to the prior approval of the **With-Profits Committee**.

## 3.2 Practices

- 3.2.1 Aviva Investors Global Services Limited is currently the main Discretionary Fund Manager (the 'Fund Manager') for the Sub-Fund, excluding Commercial Mortgage assets managed by Aviva Commercial Finance Ltd. In addition, some assets are managed externally. An investment management agreement exists between the companies, which sets out investment strategy and guidelines. The Board appoints committees to manage the relationship with the Fund Managers, set the strategic direction and review performance against **benchmarks**. Their activities include agreeing the appointment of Fund Managers, investment management agreements, credit and counter-party limits and approving major, special or **strategic investment** decisions. These committees are responsible for determining the **benchmark** asset allocation strategy, setting the appetite for investment risk and reviewing both competitor activity and economic outlook alongside expected returns on different asset classes (short-term and long-term).
- 3.2.2 The assets of the Sub-Fund are predominantly invested in equities, property, fixed-interest securities and cash. The Board sets investment performance targets for the Fund Manager:
- For asset category allocation (e.g. UK equities, property, fixed-interest securities), the following are set:
    - performance targets relative to **benchmark** indices
    - **benchmarks** and asset allocation ranges for all classes of assets.
  - For stock selection within asset categories:
    - performance targets have been set for all sector funds. For Life and Pensions business, outperformance target ranges have been set against appropriate **benchmark** indices
    - to control the risk profile of the equity sector funds, a tracking error is set at a multiple of the performance objective recognising the expected skill levels of the Fund Manager
    - to control the risk profile of the bond funds, the duration and tracking error ranges are set using the same approach as for equity sector funds.
- 3.2.3 Performance targets are based on the total return (income plus capital gain) before tax.
- 3.2.4 Currently, there is no recourse to assets in the **Non-Profit Sub-Fund** (other than the **RIEESA**) or the **Shareholder Fund** in order to support the investment strategy of the Sub-Fund, as described in section 3.1.
- 3.2.5 For the purpose of managing the assets of the Sub-Fund, a number of separate investment pools are maintained as follows:
- separate pools for business denominated in euros and US dollars;
  - a pool for the remainder of the **Return Assets** of the New WPSF, the Old WPSF and the Stakeholder WPSF. This pool (along with additional Commercial Mortgage and property assets) is used for the purpose of determining the investment return that is credited to the **asset shares** of the business denominated in sterling;
  - a pool for the remaining investments of the New WPSF (apart from Commercial Mortgages and some group loans). This pool includes investments made in respect of guarantees on with-profits policies that are allocated to the New WPSF and those used to back non-profit policies that are allocated to the New WPSF;
  - a pool for any **strategic investments** that are pooled between the **inherited estate** of the Old WPSF and the **RIEESA**;
  - a pool for the remaining investments of the Old WPSF (apart from Commercial Mortgages). This pool includes investments made in respect of guarantees on with-profits policies that are allocated to the Old WPSF and those used to back non-profit policies that are allocated to the Old WPSF as well as any **inherited estate** assets over and above this;
  - a pool for the remaining investments of the **RIEESA**, which would include assets backing non-profit policies written by the **RIEESA**.
- 3.2.6 The first and second investment pools described above (along with some Commercial Mortgages and property assets outside the second pool) constitute the **Return Assets** and the remaining investment pools (along with some Commercial Mortgages and some group loans) constitute the **Remaining Assets**.
- 3.2.7 The target asset allocation is regularly reviewed, usually every three years or following a significant change to market conditions or the financial position of the Sub-Fund. The need for a review is assessed annually. Short term tactical decisions may also be made, having taken account of **appropriate actuarial advice** and having regard to fairness towards policyholders. Allocations between asset categories can be varied by the Fund Manager within tight constraints and the result of this activity is reviewed monthly by the relevant committee.
- 3.2.8 For with-profits business, a suitable proportion of equity type assets, known as the **equity backing ratio (EBR)** is maintained for the **Return Assets**, the Stakeholder With-Profits Sub-Fund, and other UK and Channel Island business of the New and Old WPSF. This is calculated to allow for the cost of guarantees on policies within the Sub-Fund and takes into account the strength of the Sub-Fund and the size of the **inherited estate**. Currently, the same EBR is used across all classes of UK and Channel Islands with-profits policy in the Sub-Fund.
- 3.2.9 The method used to determine the EBR for the **Return Assets** of UK and Channel Islands business is as follows:
- A Theoretical EBR is determined for **Aggregate Asset Shares**. This is taken as an assessment of the maximum exposure to equity or property assets (including hedge funds, convertible bonds and private equity type investments) that can currently be supported given the guarantee costs of the Sub-Fund.

- The appropriateness of the **benchmark** EBR is reviewed by reference to the Theoretical EBR and is usually subject to a tolerance of 5%, although the difference between the **benchmark** EBR and the Theoretical EBR may be permitted to increase to up to 10% where, given investment conditions and the outlook at the time, this is considered likely to be beneficial for the Sub-Fund. The **benchmark** EBR is subject to an upper limit of 75%.
  - The **benchmark** EBR floats over short periods according to the performance of the underlying assets or indices; however, it is regularly reset to the **benchmark** EBR until a revised **benchmark** EBR is approved by the Board.
  - The Board decides changes to the **benchmark** EBR for **asset shares** and has discretion to depart from the Theoretical EBR. For instance it may take into account:
    - the asset distributions of other with-profits funds or companies
    - its view of the outlook for different categories of investment
    - the projected trend of the Theoretical EBR
    - the **benchmark** EBR upper limit of 75%
    - the desire to avoid frequent changes in the EBR, so that small changes in the Theoretical EBR are ignored.
  - The resulting EBR is used to calculate the overall **benchmark** EBR that is specified to the Fund Manager for the **Return assets** of UK and Channel Islands business (the second in the list of investment pools described above). In this connection the **benchmark** EBR represents the Theoretical EBR (after any discretionary adjustments made by the relevant committee).
  - Periodically the split of **benchmarks** for more specific equity and non-equity type asset class benchmarks are reviewed to reflect the strategic view of investment experts, subject to approval by the relevant committee.
  - Asset allocation ranges (tactical limits) around the **benchmark** EBR are specified to the Fund Manager. These tactical limits are determined by the relevant committee.
- 3.2.10 The investment strategy for the **Return Assets** of the business denominated in euros and US dollars currently follows that of the business denominated in sterling.
- 3.2.11 The overall **benchmark** EBR for the **Return Assets** of the New WPSF, the Old WPSF and the Stakeholder WPSF is subject to constraints that are specified in the Report of the Actuarial Function Holder on the **Reattribution Scheme**. These constraints have been introduced so as to limit the potential for conflicts between the interests of policyholders and those of shareholders as a consequence of the implementation of the **Reattribution Scheme**. They have been determined so as to ensure that in normal circumstances a relatively high EBR will be maintained for the **Return Assets**, whilst permitting a move to a lower EBR should this be necessary in order to maintain the financial strength of the Sub-Fund at an adequate level.
- 3.2.12 When establishing the EBR for the purpose of assessing compliance with the constraints, assets are classified according to the underlying economic exposure allowing for the effects of any derivative holdings that are held within the **Return Assets**. Appropriate allowance will be therefore be made for the economic exposure resulting from the investment of the **Return Assets** in derivative contracts.
- 3.2.13 In positioning the **benchmark** EBRs for the **Return Assets** within the constraints imposed by the **Scheme**, the Board will have regard to internal guidelines which have been developed taking into account the views of the **With-Profits Actuary** and the **With-Profits Committee**. Any changes to the approach would need to be approved by the **With-Profits Committee**.
- 3.2.14 Assets backing the liabilities for guarantee costs on with-profits policies are invested so as to hedge the guarantees, most significantly on Inflation Protected Bonds, and aim to largely remove the risk to the **inherited estate** from investing the assets backing **asset shares** in, for example, equities, property and corporate bonds. The mix of assets backing guarantee costs is regularly reviewed to ensure that it remains appropriate for the evolving guarantee costs.
- 3.2.15 Whilst we either seek or accept some market risks, including credit, within the **inherited estate** we aim to limit exposures to interest rate, inflation and currency risk.
- 3.2.16 The use of derivatives in the Sub-Fund is set out in the investment management agreement and is otherwise subject to approval through the appropriate internal governance procedures regarding the use of derivatives. These governance procedures seek to control the risks in using such contracts, and therefore consider amongst other things:
- the types of exchange-traded and over-the-counter derivative contracts which may be used.
  - maximum gross exposures which may be held in each derivative type.
- 3.2.17 The total exposure to an asset class within a sub-fund allowing for derivatives must be within the **benchmark** asset allocation ranges specified for that sub-fund in the investment management agreement, unless otherwise agreed by the relevant committee.
- 3.2.18 Derivatives are used to hedge financial exposures of policyholders and shareholders. The uses of derivatives that are permitted are:
- efficient portfolio management
  - reduction in investment risk
  - as an integral part of a product design.

- 3.2.19 Appropriate credit quality of the investments of the Sub-Fund is maintained by prescribing **benchmarks** for the **credit ratings** in the investment management agreements.
- 3.2.20 The Sub-Fund invests predominantly in **quoted investments** in order to maintain the liquidity quality of the investments at a high level. The investment management agreements specify limits on the level of investment in unquoted securities. Cash and deposit-type investments are also used to back current liabilities to provide a greater level of liquidity within the Sub-Fund than would be achieved by investing solely in longer-term assets.
- 3.2.21 The flexibility to use new investment instruments will be balanced with the need to identify the risk inherent in them and to ensure that they will be subject to adequate controls before their acquisition. No investments will be made in new types of investment instruments unless a proposal has first been made and approved by the Board or the committee responsible for investment strategy. In addition, the prior approval of the **With-Profits Committee** will be required where any new classes of investment are to be allocated to the Sub-Fund.
- 3.2.22 The Sub-Fund may invest in properties used by the Company to administer the New WPSF and the Old WPSF business. Any such investments are on a commercial basis which allows for trading the assets if appropriate.
- 3.2.23 Under certain conditions the Sub-Fund may make a loan to or an investment in any other Aviva group company. This is described further in sections 4.1 and 4.2.
- 3.2.24 Under certain conditions the Sub-Fund may give financial assistance or support to other sub-funds within the Company. This is described further in section 4.1.
- 3.2.25 As part of the investment management activities we may lend some assets of the Sub-Fund to selected financial institutions to generate additional fee income from the Sub-Fund. All revenue derived from this process is passed directly to the Sub-Fund less any associated cost incurred. In certain circumstances, for example, if the institution encountered financial difficulties and was unable to return lent assets, the Sub-Fund could suffer a loss. We have, however, in place a number of controls, such as always obtaining security from each borrower as well as monitoring their **credit ratings**, in order to reduce the risk to the Sub-Fund.
- 3.2.26 The Sub-Fund and the **RIEESA** may make **strategic investments** in the equity or debt of companies in which Aviva plc or the Company has a strategic connection or interest, subject to the prior approval of the **With-Profits Committee**. These investments will be made for strategic reasons considered to be to the long-term benefit of shareholders and policyholders.
- 3.2.27 A **strategic investment** policy sets out the controls and management process for **strategic investments** held by the Company. All **strategic investments** will be made in accordance with this policy. Any change to this policy must be approved by the investment committee appointed by the Board. Any changes to the policy which may affect the Sub-Fund or the **RIEESA** will be subject to the prior approval of the **With-Profits Committee**. Treating the Customer Fairly and **Conduct of Business Sourcebook** requirements will also be adhered to in the consideration of **strategic investments**.
- 3.2.28 The committee regularly reviews the appropriateness and amount of strategic holdings. The Company's **Strategic Investment** Policy outlines the investment guidelines and Sub-Fund implications for the holding of strategic assets. Constraints are specified which have been set to limit the exposure of the Sub-Fund (including for this purpose the **RIEESA**) to strategic assets as follows:
- individual strategic holdings are normally subject to a limit of 1% of invested funds. Stock concentrations would be allowed beyond the normal limits if this is due to good performance within the underlying stock. It is likely that concentrations up to 1.1% would be allowed and if this limit is breached for more than 6 months then the holding would be reduced to the 1% limit.
  - total strategic holdings are subject to a limit of the lower of 2.5% of invested funds or 20% of the **inherited estates** after making realistic allowance for liabilities.
- 3.2.29 The above limitations have been set to reflect the general considerations in the Principles and to limit credit/**counterparty** risk. In addition, appropriate liquidity requirements for these assets are maintained by limiting unquoted **strategic investments** to 10% of the limits of aggregate **strategic investments** by market value in the Sub-Fund.
- 3.2.30 The **Strategic Investment** Policy is applied separately to the New WPSF (including the **RIEESA**) and the Old WPSF as if they were standalone **with-profits sub-funds**.
- 3.2.31 Strategic assets are not normally traded. They include quoted and unquoted equities of external companies. If a strategically held asset is also held in the Sub-Fund to back the liabilities, then there is a constraint on the Sub-Fund to the extent that the asset is also not actively traded. The Sub-Fund will be assumed to have a holding equal to a **benchmark** weight in the stock. The performance of the actual holding will be disregarded for the purposes of measuring the performance of the Fund Manager.
- 3.2.32 Any **strategic investment** will have regard to:
- the financial strength of the Sub-Fund
  - **regulatory solvency**
  - the admissibility of the asset in statutory solvency assessments
  - the need to maintain a suitable degree of liquidity in order to pay claims as they arise and dividends

- the marketability of the investment holdings
- correlation of the holding with other investments of the Sub-Fund
- appropriate limits on counter-party exposure
- limiting exposure to large asset holdings.

3.2.33 Strategic holdings will be allocated to the **inherited estate** of the Old WPSF or the **Reattributed Inherited Estate**. The allocation of strategic assets to Old WPSF will not exceed the **Old WPSF proportion** of such assets allocated to the combined Old WPSF, New WPSF and **RIEESA**. In normal circumstances however, it is envisaged that no new investment in strategic assets will be allocated to the Old WPSF.

3.2.34 The investment of the New WPSF in **strategic investments** and investments in Aviva group companies will be constrained if necessary so as to ensure that the market value of the **Core Eligible Assets** is not less than the balance on the **Aggregate Asset Shares**. This will be achieved by selling assets in the New WPSF and buying **Core Eligible Assets**, by transferring **Core Eligible Assets** from the RIEESA or by a mixture of the two.

3.2.35 The **Remaining Assets** of the Old WPSF and the **Remaining Assets** of the New WPSF (including the **RIEESA**) are managed in a consistent manner, except that the **Remaining Assets** of the New WPSF (through the **RIEESA**) may be used to write non-profit business and to invest in new strategic assets and Aviva group companies without the need to do so for **Remaining Assets** of the Old WPSF. The investment policy for non-profit business and assets backing the liabilities for guarantee costs on with-profits policies are described above. The investment policy for the **inherited estate** is described in section 6 below.

## Section 4: Business risk

### Introduction

The with-profits policyholders are entitled to a share of the surplus available for distribution from the Sub-Fund, as determined by the Board, and are exposed to general business risk of miscellaneous profits and losses that may arise from various sources within the Sub-Fund.

#### 4.1 Principles

- 4.1.1 The Sub-Fund may write new with-profits and new non-profit business either directly, through reinsurance accepted from other Aviva group companies, or through internal arrangements with other sub-funds within the Company. New non-profit business will only be written on terms which, in the opinion of the Board having regard to the advice of the **With-Profits Actuary** and following review by the **With-Profits Committee**, provide an acceptable return to the Sub-Fund taking into account the risks associated with such business. The Principles relating to the volumes of new **with-profits business** which may be accepted are described in section 7.1. In carrying out the calculations described in that section the business risks of both new and existing business will be taken into account.
- 4.1.2 New non-profit business may be written for the benefit of the New WPSF or the **RIEESA** and the **inherited estate** of the Old WPSF as described in section 6.2 below. New non-profit business may also be written after 1 October 2009 for the benefit of **asset shares** subject to the prior approval of the **With-Profits Committee**. In this latter event the non-profit new business would be allocated between the New WPSF and the Old WPSF in proportion to the respective **asset shares** of those Sub-Funds from time to time.
- 4.1.3 The Sub-Fund makes investments in accordance with applicable legal and regulatory requirements.
- 4.1.4 The Sub-Fund may provide financial support to other sub-funds of the Company subject to the approval of the Board having regard to the advice of the **With-Profits Actuary** and the review of the **With-Profits Committee** provided that in the opinion of the Board the provision of such support will not have a material adverse effect on the holders of policies allocated to the sub-funds giving and receiving support. The Sub-Fund may be required to provide financial support to the Stakeholder With-Profits Sub-Fund if a deficit were to arise in that Sub-Fund. Any support would not be charged to **asset shares**. Any support that is provided to the Stakeholder With-Profits Sub-Fund in these circumstances would be by way of a contingent loan. The loan can be repaid, together with the return achieved on the assets loaned, so long as it was only required to provide capital support. No repayment would be payable in the event that such repayment would amount to a deduction from scheme members' rights in any way or contravene the Stakeholder Regulations.
- 4.1.5 In the event of capital support being required by the Old WPSF or the New WPSF to cover their **minimum asset requirements**, this will be provided by the **RIEESA**. However the amount of support which must be provided by the **RIEESA** to either Sub-Fund is limited to the extent the **RIEESA** has assets to do so. The **RIEESA** may only be used to provide capital support to the Old WPSF and the New WPSF or through the Old WPSF and the New WPSF to the Stakeholder WPSF.
- 4.1.6 Control of existing business risk is exercised through the Company's governance arrangements which include regular monitoring of all significant business risks. Processes are established to determine the impact of the various business risks, for example insurance, market, credit, liquidity, and operational risk, on the financial position of the Sub-Fund and where necessary to identify and implement appropriate mitigating actions.
- 4.1.7 Where compensation costs from a business risk will be borne depends on the nature of the compensation and the aim of ensuring fairness of treatment between policyholders and shareholders. Compensation costs not met by Aviva Life Services UK Limited or other parties in respect of with-profits **Transferred Policies** may, to the extent that they can be borne by the Sub-Funds in accordance with the rules of our regulator, be apportioned pro rata to the Old WPSF and the New WPSF as determined by the Board, having obtained **appropriate actuarial advice**. Compensation costs in respect of business written in or reinsured into the Old WPSF or the New WPSF after 1 October 2009 shall be allocated as determined by the Board, having obtained **appropriate actuarial advice**. However, to the extent possible, mis-selling costs will be charged to the Sub-Fund to which the policy is written or reinsured.

#### 4.2 Practices

- 4.2.1 In general, when considering whether to undertake a business risk the Company will consider:
- existing business risks
  - potential rewards to policyholders and shareholders
  - potential rewards to policyholders and shareholders of alternatives including risk free investments
  - possible impact on different generations/classes of policyholders
  - size of, and possible impact on, the Sub-Fund and **inherited estates**.
- 4.2.2 The Company's procedures for deciding on what terms to undertake business risks in relation to new policies are as follows:
- The profitability of a range of policies written on the proposed terms is projected on a standard set of assumptions regarding future experience. Profitability measures are compared against approved hurdles to test acceptability. Sensitivities are also calculated by recalculating the profitability of the policies on alternative sets of assumptions designed to establish the impact of adverse experience in each of the most significant areas of business risk. If these are acceptable the Board decides the terms having regard to the advice of the **With-Profits Actuary** and subject to review by the **With-Profits Committee**.

- In deciding whether such business may be written in the Sub-Fund or reinsured into the Sub-Fund, the Board, after taking the advice of the **With-Profits Actuary** and subject to the review of the **With-Profits Committee**, may impose restrictions on the amount of such business which may be written in order to avoid the build up of excessive concentrations of risk when existing business is taken into account. Reinsurance accepted by the Sub-Fund from other Aviva group companies will be on commercial terms decided by the Board, having regard to the advice of the **With-Profits Actuary** and review by the **With-Profits Committee**.
- 4.2.3 The Sub-Fund's arrangements for reviewing and setting a limit on the scale of business risks in relation to new policies including reinsurance are described in section 7.2.
- 4.2.4 A broad description of the extent to which new **with-profits business** is currently written or reinsured by the Sub-Funds is provided in section 7. Between 2 October 2000 and 1 October 2009 non-profit and unit-linked new business, other than annuity business, has mainly been written by, or reinsured to, the **Non-Profit Sub-Fund**. From 1 October 2009 such business has been written by the **Non-Profit Sub-Fund** (as an investment of the **RIEESA** or otherwise) either directly or through internal arrangements with other sub-funds within the Company. From 1 October 2009 non-profit new business has not been written for the benefit of **asset shares**.
- 4.2.5 Non-profit annuities arising under the terms of certain with-profits pension policies which are allocated to the Sub-Funds are insured by the New WPSF and the Old WPSF in the **New WPSF proportion** and the **Old WPSF proportion** respectively. The policies concerned are those where the annuity benefit is purchased under a guaranteed annuity option or where the benefit is expressed in the contract in annuity form.
- 4.2.6 In considering whether the Sub-Fund or RIEESA may make a loan to, or investment in, any other Aviva group company the Board having regard to the advice of the **With-Profits Actuary** and subject to the approval of the **With-Profits Committee** will need to be satisfied that:
- the extent and terms of the loan or investment are no less favourable to the Sub-Fund than would be the case if the other company were not an Aviva group company
  - the loan or investment is appropriate for the Sub-Fund
  - the loan will, in the reasonable opinion of senior management, be beneficial to with-profits policyholders
  - the loan will not, in the reasonable opinion of senior management, expose those policyholders, to undue credit or group risk
- 4.2.7 Currently the Sub-Funds have provided loans to other Aviva group companies on commercial terms. There are no specific limits covering investments or loans to Aviva group companies, but admissibility limits on investments of this type will be borne in mind by the Company and the investment of the **RIEESA** in loans to Aviva group companies is restricted as described below. Business risk may arise from the issue of capital instruments by Friends Life Holdings plc ('FLH') and Aviva plc with the benefit of a subordinated guarantee from the Company or from the issue of capital instruments by the Company to FLH. However, in both cases, this risk is substantially mitigated because the Sub-Fund is managed (and the capital instruments are structured) so that discretionary benefits under with-profits insurance policies are calculated and paid, disregarding, insofar as is necessary for policyholders to be treated fairly, any liability the Company may have to make payments under the capital instruments or guarantees. Payments under these instruments are not subordinate to the **Solvency Risk Appetite**, and circumstances could arise in which payments were required to be made in relation to the instruments which reduced excess capital in the Company below the **Solvency Risk Appetite** (or which further reduced it if it was already below that level). However, this risk is currently mitigated by the strategy and planning business standard which would be expected to require a plan for debt repayment, in particular payments due within the next three years and a requirement for the **With-Profits Actuary** to report annually to the **With-Profits Committee** on the impact of the Company's plans, including debt restructuring and repayment, on policyholder security.
- 4.2.8 The requirements applying to **strategic investments** by the Sub-Fund are described in section 3.2 and 6.3. Limits on the exposure to **strategic investments** are set out in the Company's **Strategic Investment** Policy as described in section 3.2.
- 4.2.9 Investments in other Aviva group companies and in **strategic investments** or loans to such companies are allocated to the **inherited estate** of the Old WPSF and the assets in excess of **Aggregate Asset Shares** for the New WPSF or **RIEESA** and profits or losses arising from such investments are applied accordingly.
- 4.2.10 The use of the **RIEESA** to write non-profit new business, to invest in strategic assets or to invest or make loans to Aviva group companies will, if necessary, be restricted so as to limit the risk that it may not be able to provide the required support to the Sub-Fund. The restrictions are described in section 6.3.
- 4.2.11 Neither the New WPSF nor the Old WPSF is currently giving any financial assistance or support to other sub-funds within the Company.
- 4.2.12 The New WPSF has received financial support from the **RIEESA** under a capital support arrangement described in the **Scheme**. No financial support has been provided from the RIEESA to the Old WPSF.
- 4.2.13 The Board regularly reviews risks to which the Sub-Fund is subject, bearing in mind the **Risk Appetite Framework**. It carries out a full review of such risks each year, including projecting the Sub-Fund's business over time under a variety of assumptions. As a result of this process the Board may implement measures to reduce or limit risks. Such measures may include changes to investment strategy for some or all asset pools, **hedging**, reinsurance of mortality and morbidity risks, underwriting strategy, terms on which new business is written, mix or marketing of new business, outsourcing, measures to improve persistency, reductions in regular and **final bonus** rates and changes in the parameters defining the Sub-Fund's **smoothing** policy.

- 4.2.14 Business risk arising from undertaking **quota share** reinsurance from other Aviva group companies is reduced by using an investment and bonus strategy to match this business which aims to closely follow that of the ceding company, though ultimately there is no requirement to do so.
- 4.2.15 The extent to which profits or losses from business risks arising from new and existing policies are reflected in with-profits payouts is described in section 2.4.
- 4.2.16 Compensation costs arising from mal-administration under the **management services agreement** are paid by Aviva Life Services UK Limited in accordance with the **management services agreement**.
- 4.2.17 The general approach to the **smoothing** of profits or losses from business risks to the extent that these are a determinant of amounts payable under with-profits policies is described in section 2.2.
- 4.2.18 There is no specific minimum level of profit or loss from business risks before the Sub-Fund will treat them as a determinant of the amounts payable under with-profits policies. The Board reserves the right to review this policy. Losses, may, subject to the **Scheme** requirements, in future be applied to with-profits policies where, in the opinion of the Board, such action is required to maintain **regulatory solvency** at an appropriate level. Changes in policy insofar as it affects **Transferred Policies**, will only be made if the Board considers that it is consistent with the interests of such policyholders for such profits or losses to be taken into account and the allocation is approved by the **With-Profits Committee**.
- 4.2.19 Except where stated otherwise in section 2.4, profits or losses from business risks are currently pooled across all with-profits policies of the Old WPSF and the New WPSF. Should losses which are currently borne by the **inherited estate** of Old WPSF, or the assets in excess of **Aggregate Asset Shares** for the New WPSF, or the **RIEESA** be applied instead to with-profits policies, it is likely that a degree of differentiation will be made. The particular classes or generations of policies which will bear such losses will depend on the nature of the loss and the circumstances at the time.
- 4.2.20 Other than compensation costs in respect of mal-administration, compensation costs from a business risk will generally be borne by either the assets in excess of **asset share** or shareholders, rather than as a charge to **asset shares**. No such charge is made to **asset shares** of with-profits **Transferred Policies**. For policies issued after 1 October 2009, there would only be a charge to **asset share** if the compensation payments could not be met by the Sub-Fund in excess of **asset shares**, or the **RIEESA** or assets attributed to the shareholders.
- 4.2.21 In the event of a surplus or deficit arising in the Staff Pension Fund, a portion of which may be attributable to the Sub-Fund in line with the table below, no surplus or deficit would be charged to **asset shares**. An annual review is undertaken of the funding of the Staff Pension Fund and the results, in relation to contributions allocated to the Sub-Fund, will be submitted to the **With-Profits Committee** and the Board. Any proposed adjustment, by way of a charge or credit to the Sub-Fund would be decided by the Board.

Deficit/Surplus arises in relation to service in relevant period	Party to bear/benefit
Pre 1999	Both the Sub-Fund and Aviva Life Services UK Limited in accordance with the principles set out by the Board and notified to our regulator.
1 January 1999 to 31 December 2008	By the Sub-Fund in respect of any deficits or surpluses arising from marketing and distribution services and by Aviva Life Services UK Limited in any other circumstances.
1 January 2009 to 31 December 2018	By the Sub-Fund
1 January 2019 onwards	By the Non-Profit Sub-Fund

## Section 5: Charges and expenses

### 5.1 Principles

- 5.1.1 Before expenses and tax charges are allocated to the Sub-Fund the agreement of the **With-Profits Actuary** is required that such allocations are reasonable, and in line with any **management services agreement**. Where the administration services are provided by an Aviva group company, fees will reflect the market price of acquiring such services less a discount.
- 5.1.2 Changes to the approach to expense allocation not defined in the MSA may occur if either party terminates or renegotiates the agreement. Such changes will require the approval of the **With-Profits Committee**.

### 5.2 Practices

- 5.2.1 The Company has outsourced administration, distribution and development functions to Aviva Life Services UK Limited. A **Management Services Agreement** (MSA) describes the services provided and the charges for the services.
- 5.2.2 Expenses are charged by Aviva Life Services UK Limited to the **Non-Profit Sub-Fund**. The **Non-Profit Sub-Fund** then charges fees to the Old WPSF, the New WPSF or the **RIEESA**.
- 5.2.3 These charges are paid by the Old WPSF, the New WPSF or the **RIEESA** in lieu of the expenses incurred in running the **with-profits business**.
- 5.2.4 The fees charged to the Sub-Funds will be reviewed periodically. The last review took effect on 1 January 2019, and the next review will take place five years after that date.
- 5.2.5 In developing the MSA, independent consultants were engaged to provide **benchmarking** data for the **With-Profits Committee**.
- 5.2.6 If the charges become disproportionate relative to the services provided, then the Company will consult with the **With-Profits Actuary** on any changes to the charges or the arrangement with Aviva Life Services UK Limited, which could include termination of the arrangement.
- 5.2.7 Commission expenses are directly allocated to the Old WPSF, the New WPSF or **RIEESA** where appropriate.
- 5.2.8 Outsourcing arrangements with Aviva Life Services UK Limited are reviewed regularly and are renegotiated as appropriate. Aviva Life Services UK Limited outsources some services outside of the Aviva Group. The most significant arrangement is with ReAssure.
- 5.2.9 The fees payable to the **Non-Profit Sub-Fund** are described below.
- 5.2.10 Fees for distribution services represent the costs incurred in providing the services to the New WPSF but part of the cost would be paid by the Old WPSF, reflecting the internal reinsurance of a proportion **with-profits business** from the New WPSF to the Old WPSF.
- 5.2.11 Administration fees for new and existing business, excluding defined benefit pension schemes, are per policy fees with inflationary increases. For defined benefit pension schemes, the charges are at cost.
- 5.2.12 The MSA defines the level of service to be provided and the steps to be taken should standards achieved fall below the defined levels. The scope and standard of service may be adjusted to treat policyholders fairly.
- 5.2.13 Any charges or deductions for expenses in relation to with-profits **Transferred Policies** other than those permitted under the terms of the policy or the MSA will only be imposed by the Board if having taken actuarial advice the Board considers them consistent with the interests of policyholders and they are approved by the **With-Profits Committee**.
- 5.2.14 Fees for requested developments affecting the Old WPSF, the New WPSF and the **RIEESA** are based upon agreed costs. These will be charged to the Sub-Fund to the extent that the developments will benefit the Sub-Fund in the future and/or are undertaken to cover regulatory requirements on the advice of the **With-Profits Actuary**.
- 5.2.15 Fees for developments can only be charged to **asset shares** with the agreement of the **With-Profits Committee**. Otherwise, fees for developments will be charged to the **RIEESA**, to the extent that they relate to the New WPSF, or to the estate of the Old WPSF, to the extent that they relate to the Old WPSF.
- 5.2.16 Where the **With-Profits Committee** seeks specific advice on proposals specifically relating to provisions carried forward from the **Reattribution Scheme**, the cost of such advice will normally be allocated to the New WPSF, with a proportion to the Old WPSF if this is deemed appropriate.
- 5.2.17 Fees for investment management services provided by Aviva group companies will be those charged to the Old WPSF and the New WPSF by the Fund Manager which reflect market terms adjusted for the size of the investment portfolio and their being a connected party, in line with the Investment Management Agreement. Fees charged for external investment management will be negotiated independently.
- 5.2.18 Mis-selling expenses (including both the expenses of carrying out the review and the cost of any compensation payable) that arise in respect of policies originally held within the CGNU Life and CULAC with-profits sub-funds will, to the extent that they are allocated to the Sub-Funds, be allocated to the New WPSF and the Old WPSF in the **New WPSF proportion** and the **Old WPSF proportion**.

- 5.2.19 The basis of allocation of development expenses, mis-selling expenses that arise in respect of with-profits policies written after 1 October 2009 and other non-policy specific expenses between the New WPSF and the Old WPSF and the **RIEESA** will be determined by the Board having regard to the advice of the **With-Profits Actuary**.
- 5.2.20 Other fees may only be charged to the Sub-Fund as agreed with the Board, having taken account of appropriate actuarial advice and consulted the **With-Profits Committee**.
- 5.2.21 The service agreements between the Sub-Funds and Aviva transfer risk from the Sub-Funds to Aviva. The risks transferred relate to falls in the volume of business and increases in expenses. The fees agreed with Aviva include a risk loading to allow for this. If the risk does not emerge, the risk loading will fall into the profit of Aviva.
- 5.2.22 Tax deductions charged to each of the New WPSF and the Old WPSF are determined as if the Sub-Fund were a standalone UK proprietary life insurance company. The tax charged may differ from this, if the Board, having regard to appropriate advice, considers that such a charge is inappropriate and the change has been approved by the **With-Profits Committee**. The investment return on the **RIEESA** will be periodically adjusted to reflect an appropriate allowance for tax. The tax will be equal to the tax that would have been borne by the New WPSF and the **RIEESA** during the period had they represented a standalone proprietary UK life assurance company less the tax that has been borne by the New WPSF during that period.
- 5.2.23 The basis of allocation of tax may be changed in the event of future changes in tax regulations or the rules of our regulator if the current basis would be unfair to policyholders or shareholders. Any change to the tax bases to be applied under such circumstances would be subject to the agreement of the **With-Profits Committee**.

## Section 6: Management of the inherited estate and the Reattributed Inherited Estate

### 6.1 Introduction

- 6.1.1 Under the **Reattribution Scheme**, the combined **inherited estates** of CGNU Life and CULAC were transferred to Aviva Life & Pensions UK Limited where they were apportioned between the Old WPSF, the New WPSF and **Non-Profit Sub-Fund**. A proportion of the combined **inherited estates**, determined in accordance with the **Reattribution Scheme**, was transferred to the Old WPSF (referred to as the Old WPSF **inherited estate** in the remainder of this section). The balance of the **inherited estates** formed the **Reattributed Inherited Estate**. The **Reattributed Inherited Estate** is held partly in the **Non-Profit Sub-Fund** as the **Reattributed Inherited Estate External Support Account (RIEESA)**, and partly in the New WPSF. The apportionment of the **Reattributed Inherited Estate** between the **RIEESA** and the New WPSF is at the discretion of the Board except that the assets of the New WPSF must at all times be sufficient to cover its **minimum asset requirement**. Assets of the New WPSF that are not required to cover its **minimum asset requirements** may be repaid to the **RIEESA** provided that there are sufficient **Core Eligible Assets** in the New WPSF to cover the balance on the **Aggregate Asset Shares** after the repayment.
- 6.1.2 The Board will manage the level of the **inherited estates** having regard to the interests of fair treatment of holders of policies allocated or reassured to the Sub-Funds and with the objective of maintaining the **inherited estates** at adequate but not excessive levels, based on the Company's **Risk Appetite Framework** as updated from time to time.
- 6.1.3 The **RIEESA** will be used to provide support to the New WPSF and the Old WPSF where such support is necessary. The **Scheme** imposes restrictions on the extent to which the assets of the **RIEESA** can be released to the shareholders and limitations on the extent to which the **RIEESA** and the New WPSF can be invested in strategic assets, Aviva group companies and non-profit business.

### 6.2 Principles

- 6.2.1 The Old WPSF **inherited estate** and the **Reattributed Inherited Estate** (collectively referred to as the **inherited estates**) will be managed in accordance with any applicable legal and regulatory requirements, including the Company's duty to maintain adequate financial resources and to take reasonable care to organise and control its affairs responsibly and effectively.
- 6.2.2 Bonus rates, new business levels and investment policy will be managed in order to keep the **inherited estates** at levels which, in the opinion of the Board (having regard to the advice of the **With-Profits Actuary**) is appropriate for the business. In determining the appropriate levels for the **inherited estates** the Board will take into account the levels of risk being "run", or expected to be run, by the business and in particular it will generally seek to maintain **inherited estates** at levels which are consistent with its risk appetite as described in the **Risk Appetite Framework** sections 6.2.6 and 6.3.3 below.
- 6.2.3 The **inherited estates** bear the risks associated with the provision of guarantees. In view of this an appropriate charge may be made to policies to maintain the **inherited estates** at an appropriate level. However, no charges will be made to **asset shares** for guarantees after 1 October 2009 with the following exceptions:
- Policies written prior to 1 October 2009 where an explicit charge (including for this purpose charges that were taken into account in new business illustrations) was being applied under the terms of the policy immediately prior to 1 October 2009.
  - Policies written after 1 October 2009 where the application of a charge is permitted under the terms of the policy.
- The **inherited estates** also bear the risks associated with the provision of **smoothing** to the extent that any **smoothing** costs can not be recovered from asset shares or reductions in the target payout percentages through the operation of the **smoothing accounts** referred to in section 2.6.18.

#### 6.2.4 Investment policy for the inherited estates

- 6.2.4.1 The investment policies for the Old WPSF **inherited estate** and the **Reattributed Inherited Estate** are set having regard to the risks that are borne by the Old WPSF and the New WPSF (taking into account the **RIEESA**) respectively. In either case, the policy will have regard to the expected and potential liabilities to be met from such assets as determined by the Board having taken **appropriate actuarial advice**.
- 6.2.4.2 The **Reattributed Inherited Estate** may be used to write new non-profit business and to invest in strategic assets or in loans to other Aviva group companies although the extent to which it may do so is restricted so as not to increase the risk of a failure to meet the regulatory capital requirements of the New WPSF, the Old WPSF or the non-profit business of the **RIEESA** to an unacceptable level. The Old WPSF **inherited estate** may also invest in new non-profit business, strategic assets or in loans to other Aviva group companies provided that in each case the allocation to the Old WPSF does not exceed the **Old WPSF proportion** of the combined allocations to the Old WPSF **inherited estate** and the **Reattributed Inherited Estate** and taking account of any **asset admissibility** regulations as necessary.

6.2.4.3 The **inherited estates** may, with the approval of the **With-Profits Committee**, invest in the value of future profits that are expected to arise in respect of non-profit business that has been written by the Company or any other member of the Aviva group prior to 1 October 2009 provided that:

- the investment will only be made for the purpose of achieving improvements in process efficiency by simplifying or improving the administration of the relevant policies and the amount of such investment will be limited so as to ensure that the cumulative strain on such business does not exceed £10m per annum. Any unused cumulative strain may be carried forward and used in future years but the maximum investment in any one year from this accumulation is £25m;
- the investment together with the planned investment in non-profit new business does not increase the risk of a failure to meet the regulatory capital requirements of the New WPSF or the Old WPSF or the non-profit business of the **RIEESA** to an unacceptable level;
- the price paid has been approved by the **With-Profits Committee**.

## 6.2.5 Uses of the inherited estates

6.2.5.1 The **inherited estates** may be used, at the Board's discretion, to:

- provide investment flexibility by enabling a higher proportionate investment in potentially higher reward but higher risk assets than would otherwise be the case
- provide a cushion of additional security against unexpected adverse events
- permit flexibility in the **smoothing** of maturity and **surrender** payouts for with-profits policies
- finance new business growth. The expectation is any financing would be repaid over the term of the policy
- meet such other purposes as permitted by law and consistent with the Company's duty to maintain adequate financial resource.

6.2.5.2 The **inherited estates** represent the **working capital** of the respective Sub-Funds. To the extent that the size of the **inherited estates** exceeds the levels that the Board considers to be necessary for their current and future use, distributions may be made from the Old WPSF **inherited estate** and releases may be made from the **RIEESA**. The **Scheme** imposes restrictions on the circumstances in which releases can be made from the **RIEESA** to the shareholders and it specifies circumstances in which distributions must be made from the Old WPSF **inherited estate**.

6.2.5.3 The **Scheme** does not prevent the Board from making discretionary distributions from the Old WPSF **inherited estate** in circumstances where the **Scheme** does not require distributions to be made, nor does it prevent the Board from making discretionary distributions from the Old WPSF **inherited estate** in excess of those required by the **Scheme**. The scope for discretionary distributions from the Old WPSF **inherited estate** will be established having regard to the Board's **Risk Appetite Framework**. Although the Board's **Risk Appetite Framework** may be changed from time to time, such changes will not override the **Scheme** requirements governing distributions from the Old WPSF **inherited estate** and releases from the **RIEESA**.

## 6.2.6 Risk Appetite Framework

6.2.6.1 The **Risk Appetite Framework** applies to both the Old WPSF and the New WPSF (including the **RIEESA**). In the remaining paragraphs of this section the **Risk Appetite Framework** is firstly described as it applies to the Old WPSF, after which any differences in its application to the New WPSF and the **RIEESA** are described.

6.2.6.2 A distribution from the Old WPSF **inherited estate** will be required where in the opinion of the Board, having taken **appropriate actuarial advice** it provides an excessive level of security to current and future policyholders of the Old WPSF (i.e. it exceeds the **Required Distribution Threshold**). No distribution will be made from the Old WPSF **inherited estate** where it is not sufficient to cover the regulatory capital requirement of the Old WPSF and no distribution will be made which would reduce the Old WPSF **inherited estate** to a level below the regulatory capital requirement. In effect the **Required Distribution Threshold** defines the upper end of a range for the Old WPSF **inherited estate** and the regulatory capital requirement defines the lower end of a range for the Old WPSF **inherited estate**. Together, these requirements provide an acceptable range for the Old WPSF **inherited estate**.

6.2.6.3 The acceptable range represents a relatively wide range for the size of the Old WPSF **Inherited estate** and the **Risk Appetite Framework** includes a narrower preferred range within the broader acceptable range. The Old WPSF is managed so that the **inherited estate** normally falls within the preferred range. Where the **inherited estate** falls within the preferred range the position is considered to be satisfactory and no action needs to be taken to target a specific level of **inherited estate**. This does not prevent the Board from taking actions that would have the effect of changing the position of the **inherited estate** within the preferred range but it is unlikely that actions would be taken that would result in the **inherited estate** moving outside of the preferred range.

6.2.6.4 Where the **inherited estate** falls outside of the preferred range the Board will consider whether it is appropriate to take actions to move the **inherited estate** back into the preferred range having regard to the advice of the **With-Profits Actuary** and the **With-Profits Committee**. In carrying out this assessment the Board would take into account:

- the extent to which the **inherited estate** falls outside of the preferred range;
- the expected development of the **inherited estate** position relative to the preferred range if no action were to be taken.

6.2.6.5 Although the Board would prefer the **inherited estate** to lie within the preferred range it will not take actions that it considered to be inappropriate, having regard to the continuing need to treat policyholders fairly, just to move the **inherited estate** back into the preferred range.

6.2.6.6 Where the **inherited estate** rises above the top end of the preferred range, the actions that might be taken include:

- a discretionary distribution from the **inherited estate**;
- changing the investment strategy of the **inherited estate** in a way which increases the potential risks and rewards (where the existing strategy was considered to be too cautious and the increase in risk was considered to be acceptable);
- increasing new business volumes or offering higher guarantees on new products;
- increasing **regular bonus** levels;
- increasing the EBR for the **Return Assets** within the constraints referred to in section 3.

The Board would be under no obligation to carry out any of these actions.

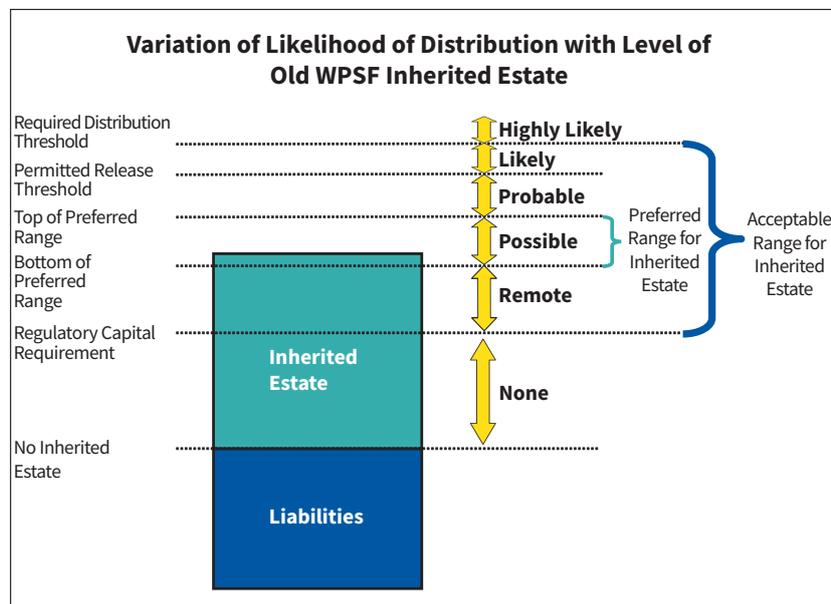
6.2.6.7 Where the **inherited estate** falls below the bottom end of the preferred range, the actions that might be taken include:

- adopting a more cautious investment strategy for the **inherited estate**;
- reducing the EBR for the **Return Assets** within the constraints referred to in section 3;
- reducing **regular bonus** levels (but still in accordance with the PPFM);
- reducing new business volumes or reducing the guarantees on new products;
- reviewing the proposed management actions in the event of further adverse experience.

6.2.6.8 In some adverse circumstances it may be necessary to change the PPFM Practices.

6.2.6.9 One of the management actions that may be taken is a discretionary distribution. Provided that the Old WPSF **inherited estate** lies within the preferred range, the Board considers that the level of security for policyholder benefits is satisfactory and in this event it is unlikely that a distribution will be made from the Old WPSF **inherited estate** except in response to specific circumstances. Specifically, distributions may be made to prevent significant changes to the increases in **final bonus** described in section 2.6.14.

6.2.6.10 The likelihood of a distribution from the Old WPSF **inherited estate** is illustrated in the diagram below. Purely for the purpose of illustration the Old WPSF **inherited estate** is shown as being positioned within the preferred range. The actual position of the Old WPSF **inherited estate** within the ranges shown in the diagram will vary from time to time as conditions (particularly economic conditions) change.

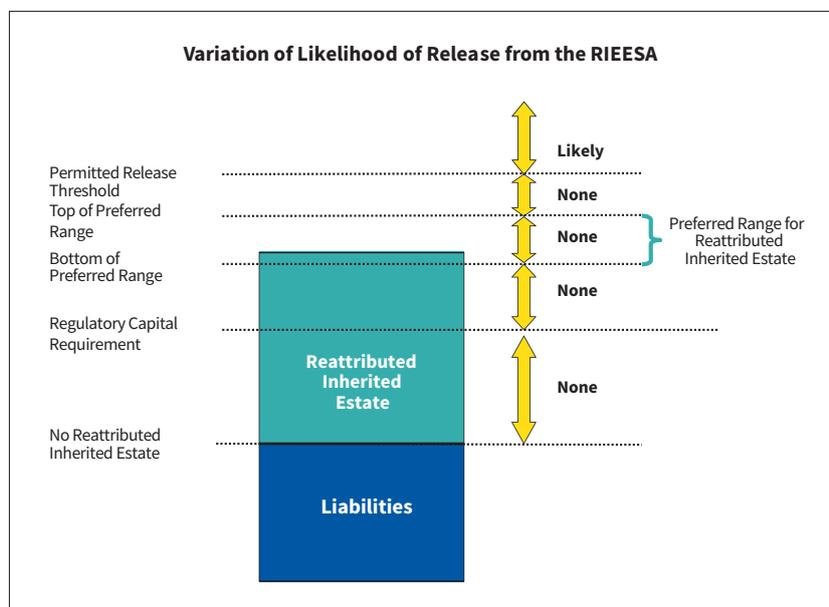


6.2.6.11 The diagram shows that the likelihood of a distribution increases as the size of the Old WPSF **inherited estate** increases. There is no possibility of a distribution where the Old WPSF **inherited estate** lies below the regulatory capital requirement. There is a remote possibility of a distribution where the Old WPSF **inherited estate** lies above the regulatory capital requirement but below the bottom end of the preferred range and it is possible that a distribution would be made if it were to lie within the preferred range. Where the Old WPSF **inherited estate** lies above the top end of the preferred range a distribution is probable.

6.2.6.12 In the diagram, the **Permitted Release Threshold** corresponds to a level of security that would enable releases to be made from the **RIEESA**. This represents a high but not excessive level of security and as such it represents a rather lower level of security than that which would require distributions to be made from the Old WPSF **inherited estate**. Although the **Permitted Release Threshold** does not have any direct application to the Old WPSF it serves to define a range within which a distribution from the Old WPSF **inherited estate** would become likely.

6.2.6.13 As mentioned above, the **Risk Appetite Framework** applies to the New WPSF and the **RIEESA** as it does to the Old WPSF. However, in this case there is no required upper limit for the size of the **Reattributed Inherited Estate** and the scope for discretionary releases to the shareholders is limited so that they can only be made where the **Reattributed Inherited Estate** exceeds the **Permitted Release Threshold**. No release can be made from the **RIEESA** which would result in the **Reattributed Inherited Estate** falling below the **Permitted Release Threshold**.

6.2.6.14 The likelihood of a release from the **RIEESA** is illustrated in the diagram below. Purely for the purpose of illustration the **Reattributed Inherited Estate** is shown as being positioned within the preferred range. The actual position of the **Reattributed Inherited Estate** within the ranges shown in the diagram will vary from time to time as conditions (particularly economic conditions) change.



6.2.6.15 The diagram shows that there is no possibility of a release from the **RIEESA** where the **Reattributed Inherited Estate** lies below the **Permitted Release Threshold**. Where the **Reattributed Inherited Estate** lies above the **Permitted Release Threshold** (and provided that the further **Scheme** requirements relating to permitted releases from the **RIEESA** described below are met) a release from the **RIEESA** to the shareholders becomes likely.

6.2.6.16 Whilst the **Risk Appetite Framework** does not have any implications for releases from the **RIEESA** unless the **Reattributed Inherited Estate** lies above the **Permitted Release Threshold**, it does have a significant impact on the management of the New WPSF in terms of the investment policy, bonus rates and new business levels. In particular, the **Reattribution Scheme** required that consistent policies will be adopted for the management of the Old WPSF and the New WPSF as if the Sub-Funds were a single entity and accordingly the management of the Sub-Funds under the **Risk Appetite Framework** applies to both the New WPSF and the Old WPSF.

## 6.2.7 Scheme Requirements in relation to Required Distributions from the Old WPSF inherited estate

6.2.7.1 Each year the Board will carry out an investigation to determine whether a distribution must be made from the Old WPSF **inherited estate**. A distribution from the Old WPSF **inherited estate** will be required where it exceeds the **Required Distribution Threshold** unless, in the opinion of the Board based on **appropriate actuarial advice**, including that of the **With-Profits Actuary**, such a distribution would give rise to a significant risk that the Old WPSF, viewed as a standalone entity, would be unable to meet its obligations to policyholders or its capital requirements.

6.2.7.2 No distribution from the Old WPSF **inherited estate** will be required to be made as a result of the first or second annual investigation following 1 October 2009. On the third annual investigation and at each annual investigation thereafter, a distribution could potentially be required.

6.2.7.3 Any distribution from the Old WPSF **inherited estate** will be applied to enhance policy benefits for with-profits policies which are allocated to the Old WPSF and to finance the associated shareholder transfer (including the incremental tax associated with that transfer). With-profits policies (other than Stakeholder Pension policies) that have been written by CGNU Life, Utmost PanEurope Designated Activity Company (formerly Aviva Life International) or in the New WPSF, since 21 November 2006 and which remain invested in with-profits and hybrid with-profits policies written by CGNU Life, CULAC and Aviva Life International (formerly NUIL) prior to 21 November 2006 which did not have a with-profits investment on 21 November 2006, will participate in any such distributions in respect of the **Old WPSF proportion** of their with-profits investment. The Board will determine the form of the distribution and its allocation amongst the with-profits policyholders, having regard to the fair treatment of policyholders and the advice of the **With-Profits Actuary** and will be subject to the approval of the **With-Profits Committee**.

6.2.7.4 A distribution may be made from the Old WPSF **inherited estate** irrespective of whether a release is made from the **Reattributed Inherited Estate** of the New WPSF at the same time.

## 6.2.8 Scheme Requirements in relation to Permitted Releases from the RIEESA

6.2.8.1 An investigation may also be carried out each year to determine whether a release can be made to shareholders from the **RIEESA**. A release may be made from the **RIEESA** to the shareholders provided that:

- the **Reattributed Inherited Estate** exceeds the **Permitted Release Threshold**; and
- in the opinion of the Board based on **appropriate actuarial advice**, including that of the **With-Profits Actuary**, such a release would not give rise to a significant risk that the New WPSF (including the RIEESA) would be unable to meet its obligations to policyholders and its capital requirements or that the Old WPSF would be unable to meet its obligations to policyholders (after taking into account the support available from the RIEESA).

6.2.8.2 No release will be made to the shareholders from the **RIEESA** before the sixth annual investigation after 1 October 2009. On the sixth annual investigation and at each annual investigation thereafter, a release could potentially be made provided that an annual investigation has been made in each of the two previous years and that in each of the three investigations the **Reattributed Inherited Estate** has been shown to exceed the **Permitted Release Threshold**.

6.2.8.3 A release may be made from the **RIEESA** irrespective of whether a distribution is made from the Old WPSF **inherited estate** at the same time. However, no release will be made if it would result in the financial strength of the New WPSF (taking into account the support available from the **RIEESA**) being less than that of the Old WPSF (determined after allowing for any proposed coincident distribution from the Old WPSF **inherited estate**). The amount released may not reduce the amount of the **Reattributed Inherited Estate** below the level of the **Permitted Release Threshold**.

6.2.8.4 The excess assets will be released either by transfer to the **Shareholder Fund** or by retention within the **Non-Profit Sub-Fund** (outside of the **RIEESA**) as determined by the Board taking into account the financial position of **Non-Profit Sub-Fund**. The **RIEESA** will be reduced by the amount of the excess assets that are released and in this event the support that is required to be provided to the Old WPSF and the New WPSF under the **Scheme** will reduce.

## 6.3 Practices

### 6.3.1 Investment policy for the inherited estates

6.3.1.1 Investment strategy for the Old WPSF **inherited estate** may differ from that of the assets backing **assets shares**. Currently it is mainly invested in fixed interest assets. In addition, any **strategic investments**, investments in Aviva group companies of the Old WPSF and the assets backing the **Old WPSF proportion** of unit linked reinsurance accepted from the PM Sub-Fund and the **Old WPSF proportion** of transferred non-profit business of CGNU Life and CULAC are held in the Old WPSF **inherited estate**. The investment strategy for the Old WPSF **inherited estate** adopts the Practices that are described in section 3.2.

6.3.1.2 Investment strategy for the **Reattributed Inherited Estate** differs from that of the rest of the New WPSF. The **RIEESA** is permitted to write non-profit new business, to invest in strategic assets and to make loans to other Aviva group companies and the assets in excess of **Aggregate Asset Shares** for the New WPSF are partly invested in the **New WPSF proportion** of unit linked reinsurance accepted from the PM Sub-Fund and the **New WPSF proportion** of transferred non-profit business of CGNU Life and CULAC. The **RIEESA** may invest in strategic assets (both quoted and unquoted) and in loans to other Aviva group companies provided that such assets are capable of providing appropriate support to the New WPSF or the Old WPSF if required. Any new investment in strategic assets must comply with the **strategic investment** policy and will be subject to the approval of the **With-Profits Committee**. Any new loans to other Aviva group companies will be subject to the approval of the **With-Profits Committee**. In this connection, the **strategic investment** policy as it applies to the **RIEESA** will take into account the restrictions imposed by COBS 20.2.36B(G) (which requires the Board to consider whether the purchase or retention of such investments would be fair to with-profits policyholders) and any new loan that is provided to an Aviva group company will be subject to the restrictions imposed by COBS 20.2.32(R) (which requires such loans to be on commercial terms that are expected to be beneficial to with-profits policyholders in the Sub-Fund without exposing policyholders to undue credit or group risk) notwithstanding the fact that the **RIEESA** does not form part of the assets of a **with-profits sub-fund**.

6.3.1.3 The **RIEESA** can be used to write new non-profit business and to invest in strategic assets or in loans to other Aviva group companies although the extent to which it may do so is restricted. This is achieved by ensuring that, after allowing for the new business plans or a proposed investment in strategic assets or in loans to other Aviva group companies, the regulatory capital requirements of the New WPSF, the Old WPSF and the non-profit business of the **RIEESA** can be met both in current conditions and in the event of an adverse shock. The method used to assess the impact of the further adverse shock is subject to the approval of the **With-Profits Committee**. For the purpose of the test, any invested asset held by the **RIEESA** will be assumed to have no value to the extent it would be required to provide support to the New WPSF or the Old WPSF in the event of the economic shock. Strategic assets and loans to other Aviva group companies that are purchased after 1 October 2009 are valued in accordance with advice from our investment managers irrespective of whether they are held by the **RIEESA** or the New WPSF or provided as capital support to the Old WPSF. Similarly, no credit is taken for the value of future profits that are expected to arise from non-profit business that has been allocated to the **RIEESA** or the New WPSF after 1 October 2009, or provided by the **RIEESA** to the Old WPSF as capital support. The **With-Profits Committee** will review the calculations and will confirm that they have been carried out appropriately prior to the implementation of the plans.

6.3.1.4 The continuing suitability of the above test is reviewed from time to time. It is envisaged that the test will be modified in the event that there is a material change in the rules for determining the capital requirements of the Sub-Fund or in the event that non-economic risks become significant in the context of the overall level of risk. Any change to the process for determining the restriction will be subject to the approval of the **With-Profits Committee**.

6.3.1.5 The investment policy for the Old WPSF **inherited estate** and the **Reattributed Inherited Estate** will be reviewed at least annually and in particular, where there have been significant unanticipated changes in experience (such as falls in stock-market values) since the previous review. In the event that such a review reveals that there is an unacceptable risk of a failure to meet the regulatory capital requirements of the New WPSF, the Old WPSF or the non-profit business of the **RIEESA**, the Board will take such actions as are necessary to reduce the risk to a satisfactory level, subject to the sound and prudent management of the Company and the fair treatment of with-profits policyholders.

### 6.3.2 Uses of the inherited estates

6.3.2.1 In managing the Old WPSF **inherited estate**, current practice is to use it to pay the costs of the following items where they arise in connection with policies that are allocated to the Old WPSF:

- the additional tax associated with shareholder transfers out of the Sub-Fund
- any cost of compensation for mis-selling of business that the Sub-Fund has an interest in
- guaranteed annuity option costs in respect of contracts under which the principle policy benefit is expressed in terms of a cash sum at retirement and other guarantee costs where these exceed the policy value indicated by **asset share**
- costs arising from payouts at MVR free points
- costs arising in respect of payouts of money back guarantee being different to expected
- costs arising from the **Mortgage Endowment Promise**
- costs associated with restricting charges to **asset shares** for certain contracts, including the cost of shareholder transfers
- any expenses not charged to **asset share**
- cost of any approximations in the calculations.
- any financing of **smoothing** of payouts (over the longer term the cost of **smoothing** is expected to be neutral)

6.3.2.2 Similarly, current practice is to use the **Reattributed Inherited Estate** to pay the above costs where they arise in connection with policies that are allocated to the New WPSF. In this case such costs are borne either directly by the part of the **Reattributed Inherited Estate** that is held in the New WPSF, or indirectly by charging such costs to the New WPSF with reimbursement from the **RIEESA** under the capital support arrangements where necessary.

6.3.2.3 In addition, the **inherited estates** may be used to pay other costs as agreed by the Board, having regard to the advice of the **With-Profits Actuary**. The approval of the **With-Profits Committee** will be required prior to any changes to the type of expenses or charges that are deducted from the **inherited estates**, or the basis of their calculation, from those which were being deducted from the with-profits funds of CGNU Life and CULAC immediately prior to 1 October 2009.

6.3.2.4 In the case of unitised contracts with investments in a **unitised with-profits** fund, expected profits on new policies are compared with the projected shareholders' transfers at the point of sale (currently 10% of surplus available for distribution). On the basis of this comparison, the Board, having regard to the advice of the **With-Profits Actuary**, may restrict future shareholders' transfers in respect of such business to a lower percentage than 10% rather than charge the difference to the **inherited estates** as is currently the case.

6.3.2.5 The **Reattributed Inherited Estate** may be used to write non-profit new business or invest in strategic assets or loans to other Aviva group companies in circumstances where such business or investments are not made by the Old WPSF **inherited estate**.

6.3.2.6 Discretionary distributions may be made from the Old WPSF **inherited estate** as determined by the Board based on **appropriate actuarial advice** including that of the **With-Profits Actuary**, in order to enhance benefits.

### 6.3.3 Risk Appetite Framework

6.3.3.1 The Sub-Funds are managed so that the risk that liabilities exceed assets is small. There is a preferred range for the **inherited estates**, the bottom of which is set such that the level of risk over 1 year (that assets would fail to exceed liabilities) is broadly equivalent to 1 year historic default probabilities on AA rated corporate bonds. The top of the preferred range is broadly 135% of the bottom of the preferred range. The top of the preferred range is known as the Capital Threshold.

6.3.3.2 Discretionary distributions may be made from the Old WPSF **inherited estate** in accordance with the **Risk Appetite Framework** and referencing the preferred range. The Board will determine whether such distributions should be made subject to the rules of our regulator, the fair treatment of policyholders, the approval of the **With-Profits Committee** and having regard to the advice of the **With-Profits Actuary**.

### 6.3.4 Scheme Requirements in relation to Required Distributions from the Old WPSF inherited estate and Permitted Releases from the RIEESA

6.3.4.1 In addition to the regular assessment of the level of surplus in the Sub-Funds relative to their preferred ranges, as part of the ongoing management of the Sub-Funds, the Board will carry out annual investigations to determine whether a distribution is required to be made from the Old WPSF **inherited estate**. The Board may carry out investigations to determine whether a release can be made from the **RIEESA**. These investigations will establish whether the assets of the Old WPSF and the assets of the New WPSF (taking into account the **RIEESA**) exceed those which are needed to provide specified levels of security to current and potential future policyholders in those sub-funds. The investigations will be carried out as at 31 December in each calendar year.

6.3.4.2 In the case of the Old WPSF the investigations will determine the **Required Distribution Threshold**; the Required Distribution Threshold is, broadly, 120% of the top of the preferred range. If the Required Distribution Threshold has been exceeded then a distribution will be required. The minimum distribution will be the excess over the Required Distribution Threshold. For this purpose the cost of the distribution will be determined as the increase in the realistic liabilities of the Old WPSF as a result of the benefit enhancements together with the associated shareholder transfer (and tax thereon).

6.3.4.3 In the case of the New WPSF the investigations will determine the **Permitted Release Threshold**; the Permitted Release Threshold is, broadly, 110% of the top of the preferred range. A release will be permitted where the Permitted Release Threshold has been exceeded at the current investigation and at each of the annual investigations undertaken for the previous two years (subject to the additional constraints referred to below).

In this event the maximum potential release, before applying the additional test described in the next paragraph below, will be determined by multiplying the Permitted Release Threshold at the current investigation date by a percentage which is equal to the minimum of the excess coverages of the Permitted Release Threshold at those three investigation dates. For this purpose the prior year excess coverages will be recalculated (and so reduced) if necessary to allow for any releases from the **RIEESA** following those investigations.

6.3.4.4 Any release from the **RIEESA** will be restricted so as to ensure that both the Capital Threshold coverage of the New WPSF is not less than the Capital Threshold coverage and the Moderated Capital Threshold coverage of the Old WPSF. The Moderated Capital Threshold for the Old WPSF is calculated in exactly the same way as the Capital Threshold except in relation to the assumed investment approach which will be assumed to be the same as the New WPSF.

6.3.4.5 The ongoing suitability of the tests described above is reviewed by the Board from time to time having regard to **appropriate actuarial advice**. Changes may be made for a number of reasons such as changes to the model that is used for establishing the preferred range of surplus. Any changes will be subject to the approval of the **With-Profits Committee**.

6.3.4.6 Distributions from the Old WPSF **inherited estate** and releases from the **RIEESA** will be determined by the Board having regard to the advice of the **With-Profits Actuary**. In considering whether a distribution or release would give rise to a significant risk that the Old WPSF or the New WPSF would be unable to meet their obligations to policyholders or their capital requirements (after taking into account the support available from the **RIEESA**) the **With-Profits Actuary** will take into account:

- Pending changes in regulatory requirements or tax legislation or the risks of such change in the future.
- The extent to which the regulatory capital requirement is covered.

6.3.4.7 Distributions from the Old WPSF **inherited estate** and releases from the **RIEESA** will in any event be restricted if necessary so as to ensure that the value of the assets remaining in the Old WPSF or the New WPSF (including the **RIEESA**) respectively is at least equal to the realistic liabilities plus 120% of the regulatory capital requirement for such Sub-Fund without support from other sub-funds or the **Shareholder Fund**.

6.3.4.8 Within 30 days of the Board determining the amount of any release of **RIEESA**, notice will be given to our regulator and the release will take place after a period of 60 days.

### 6.3.5 Sub-Fund mergers and closures

6.3.5.1 When either:

- the assets of the Old WPSF (excluding those backing non-profit policies) fall below £100m, or
- there are no **Transferred Policies** left in force,

we may, subject to consulting the **With-Profits Committee**, taking **appropriate actuarial advice** and notification to our regulator, merge the Old WPSF and the New WPSF. If the Old WPSF surplus proportion was greater than the surplus proportion of the New WPSF, policy benefits for policies in the Old WPSF would be increased to bring the surplus proportions into line. Similarly, if the Old WPSF surplus proportion was less than the surplus proportion of the New WPSF, sufficient assets within the **RIEESA** to bring the surplus proportions in line would be separately designated as **RIEESA 2** and would subsequently be available for distribution to shareholders subject to certain conditions.

6.3.5.2 When the combined value of the assets (excluding those backing non-profit policies) of the Old WPSF and the New WPSF together, or the merged Sub-Fund if the two Sub-Funds have been merged, fall below £250m we may declare one-off bonuses or a series of fixed future bonuses to exhaust the surplus in the Sub-Fund(s).

This would be carried out for the Old WPSF and the New WPSF simultaneously if they still exist separately. The policies will then become non-profit policies and any future profit or loss arising from them will fall to the **Non-Profit Sub-Fund** of which they will then form part.

6.3.5.3 We may also at any time merge any **with-profits sub-funds** with any other sub-fund, with-profits or non-profit, or sub-divide any with-profits sub-fund, provided that **appropriate actuarial advice** has been taken, the **With-Profits Committee** has been consulted and we are satisfied that the merger takes account of our duty to pay due regard to the interests of its policyholders and to treat them fairly. The Old WPSF and New WPSF can only be merged with other sub-funds after they have themselves been merged or if they are both being merged into a third sub-fund at the same time.

## Section 7: Volumes of with-profits new business and arrangements on stopping taking with-profits new business

### Introduction

Since the implementation of the **Reattribution Scheme** on 1 October 2009 with-profits new business is written in the New WPSF and the **Old WPSF proportion** of the liabilities is internally reinsured to the Old WPSF on original terms. The financial strength of the With-Profits Sub-Fund will be regularly reviewed and consideration will be given to whether it would be appropriate to allocate a proportion of new **with-profits business** to that Sub-Fund through internal reinsurance from the New WPSF.

### 7.1 Principles

- 7.1.1 The Company will set planned volumes of new business by determining a level and mix of new business which meets the Company's business objectives and which is unlikely to have a material adverse effect on the interests of the existing policyholders.
- 7.1.2 New with-profits policies will not be allocated to the Old WPSF other than by way of internal reinsurance of liabilities that are allocated to the New WPSF. For new business, the **Old WPSF proportion** of the net liabilities of the New WPSF (after any internal reinsurance to the With-Profits Sub-Fund) will be reinsured to the Old WPSF. The Board may reduce the proportion in which new policies which are with-profits policies are reinsured to the Old WPSF to less than the **Old WPSF proportion** with the consent of the **With-Profits Committee**.

### 7.2 Practices

- 7.2.1 Volumes of business are currently low by historic standards and so there is no formal process to limit the volume of new business. Should volumes increase, a process to assess the maximum level of new business into the Sub-Fund will be introduced.
- 7.2.2 The Company does not set a specific minimum proportion or scale of new **with-profits business** to justify the Sub-Fund staying open to new business. Decisions on the future of the Sub-Fund will be taken in the light of the circumstances at the time. The **Risk Appetite Framework** will also be considered.
- 7.2.3 The Company may choose to cease to write new business for particular product groups either because of lack of demand or unacceptable terms to secure new business.
- 7.2.4 The Company manages the Sub-Funds on the basis they remain open to new business. Should future circumstances be such that we ceased taking on new business, we will inform our regulator and with-profits policyholders within 28 days and submit a run off plan to our regulator as soon as possible, and at latest within 3 months. The specific actions we take would depend upon the circumstances around the decision to stop writing new business. In any such event we will pay due regard to the information needs of our customers and communicate with all impacted with-profits policyholders according to the rules of our regulator.

## Section 8: Equity between the Sub-Funds and shareholders

### Introduction

We give careful consideration to any aspect of our operating practice that has a bearing on the interests of with-profits policyholders to ensure that there is no undisclosed, or unfair, benefit to shareholders.

### 8.1 Principles

- 8.1.1 The percentage of surplus available for distribution arising in the New WPSF and the Old WPSF to be apportioned to with-profits policyholders shall not be less than 90% unless a different level is specified in the Company's Articles of Association or in a relevant court-approved insurance business transfer scheme. The remainder of the surplus available for distribution is to be apportioned to shareholders, or as otherwise directed by the Board.
- 8.1.2 The maximum level of surplus available for distribution that may be apportioned to shareholders cannot be altered without:
- in respect of all business, a change to the Company's Articles of Association following prior notification and approval by the shareholders, and the approval of our regulator or the Court, and an independent expert
  - in the context of an insurance business transfer scheme, prior notification to policyholders, the approval of an independent expert and sanction by the Court.
- 8.1.3 For future new business, the Board may change the terms for the sharing of profits between shareholders and policyholders by setting up a new **with-profits sub-fund** for business that would be subject to the new profit-sharing arrangement.
- 8.1.4 The Company reserves its right to proceed with any reorganisation or transfer of business or merging or dividing or closing the Sub-Fund or any combination of the above provided that any such arrangement complies with legal and regulatory requirements (including the terms of the Scheme).
- 8.1.5 The requirement to maintain the Old WPSF and the New WPSF as separate sub-funds of the Company may cease at some time in the future as set out in 6.3.5.

In these circumstances the Board, having taken **appropriate actuarial advice**, may merge the two sub-funds by transferring the policies, assets and liabilities of the Old WPSF to the New WPSF from a date to be specified. Prior to the merger taking place a final investigation will take place which will determine whether any part of the Old WPSF **inherited estate** should be distributed immediately prior to the date of the merger. Full details of the terms on which a merger can take place are contained in the Scheme.

### 8.2 Practices

- 8.2.1 The proportion of surplus available for distribution that is apportioned to shareholders is currently predominantly at the maximum level.
- 8.2.2 For **conventional with-profits business**, shareholder transfers, surplus available for distribution and the cost of new bonuses are discounted to allow for the period until it is due for payment i.e. on death or maturity of the policy. If the basis used for the discounting changes, the amount allocated to shareholders would also change. The cost of bonuses used in the calculations includes any distributions made in anticipation of a profit in the form of **final** or **interim bonuses**.
- 8.2.3 For **unitised with-profits business**, the cost of new bonus is calculated as the increase in unit values excluding any guaranteed amounts in which shareholders are not entitled to share, plus the value of any **final bonuses** payable, reduced by the value of any MVR applied.
- 8.2.4 The shareholder transfer on new **unitised with-profits business** may be restricted in line with 6.3.2.4
- 8.2.5 The pricing of categories of policies is in no case significantly or systematically reducing the **inherited estate** including taking into account the shareholder transfer.

## Appendix A: Glossary

### Additional Benefit

**Elected policies** where a cash incentive payment was not payable were allocated an increase in benefit known as the additional benefit.

### Aggregate Asset Shares

The **aggregate asset shares** represent the market value of the assets that must be held irrevocably within the New WPSF to meet the benefits and expenses of with-profits policies that are allocated to the New WPSF. This will be equal to the **asset shares** of the policies allocated to the Sub-Fund.

### Amount paid on death

The total amount payable if the insured person dies while the policy is still in force.

### Amount paid on maturity

The total amount payable at the date originally agreed as being the **termination date** of the policy if it is still in force at that time.

### Amount payable on surrender

The total amount payable if the policyholder decides to cash in (or transfer in respect of a pension) the benefits at a date other than the originally agreed **termination date**.

### Annual management charge

A deduction made from **unitised with-profits** policies to cover administration and investment management expenses. This is taken either explicitly by the cancellation of units or implicitly through being built into the bonus rate declared.

### Appropriate actuarial advice

'The Board having taken account of appropriate actuarial advice' means that the Board has taken such internal actuarial advice as the Board decides in the context of the relevant matter, which must always include the advice of the **With-Profits Actuary** in matters relating to the security or benefit expectations of holders of with-profits policies. The Board may also in its absolute discretion obtain external actuarial advice, and in this case, the reference shall be to the Board having also taken account of that external actuarial advice

### Asset admissibility

To prevent too much of the assets (investments) being held in one particular asset there were limits set by our regulator as to what types of asset, amount of an individual asset, and the amount of a class of asset that could be allowed to be included in the valuation. The regulator no longer applies such rules; however the Company applies its own restrictions on the assets held.

### Asset share

The premiums paid, less deductions for expenses, guarantees, tax and other charges, plus any allocations of business profits, accumulated at the investment return achieved on relevant assets of the Sub-Fund.

### Benchmark

The standard position, for example, for the percentage of assets to be held in equities, fixed-interest and property and against which any difference would be measured for assessing performance of investment managers.

### Cash Equivalent Amount

The cash equivalent of the incentive payment determined for Additional Benefit Policies at 1 October 2009.

### Conduct of Business Sourcebook (COBS)

The **FCA** and **PRA** produce various business standards rulebooks which provide the detailed requirements relating to firms day-to-day business. One of these rulebooks is the Conduct of Business Sourcebook which sets out the requirements applying to firms with investment business customers.

### Conventional with-profits

Life and pension policies written with an initial guaranteed benefit, and all charges allowed for within the determination of the bonus rates. The policies are invested in the Sub-Fund and share in the return on the Sub-Fund through the addition of bonuses.

## Core Eligible Assets

Assets in the form of investments other than non-profit business, strategic assets or in other Aviva group companies.

## Counterparty

Investment contracts impose an obligation on both parties to meet with the terms of the contract. The other party is known as the **counterparty**.

## Counterparty limits

The Company set limits on the amount of investments it can have with a particular **counterparty**. This prevents excessive exposure to one company and the risk that would entail.

## Credit limits

These are the limits within which a type of asset may be held with reference to the underlying **credit rating** (e.g. AAA).

## Credit rating

This is an assessment of relative financial risk by an independent agency, e.g. Standard and Poor's.

## Efficient portfolio management

This is the construction of an asset portfolio so as to achieve the maximum expected return for a given level of risk.

## Elected Policy

An **eligible policy** for which the holder elects to receive an incentive payment and to relinquish his or her entitlement to participate in any future distributions from the former **inherited estate** of CGNU Life and/or CULAC.

## Eligible policy

With-profits policies (not Stakeholder) issued by CGNU Life and CULAC, including NUL (RBS) and Aviva Life International (formerly NUIL) reinsurance, which satisfied the eligibility conditions to participate in the reattribution.

## Endowment assurance

A life assurance plan that pays a sum of money on the survival of the life assured to a specific date, or upon their earlier death, in return for regular premiums or a one-off payment.

## Equity Backing Ratio (EBR)

The proportion of **Return Assets** invested in equities (company shares), property or other assets that are considered to have a similar level of expected return.

## FCA

The Financial Conduct Authority (FCA) regulates the financial services industry in the UK. Its aim is to protect consumers, ensure the industry remains stable and promote healthy competition between financial services providers. The FCA and PRA replaced the FSA when they were given their powers by the Financial Services Act 2013.

## Final bonus

This may be added to investments in the Sub-Fund when a claim arises. The **final bonus** is not guaranteed and may be changed or removed at any time.

## FSA

The Financial Services Authority (**FSA**) was an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. It regulated the financial services industry in the UK until 2013 when it was split into two separate regulatory authorities, the **FCA** and the **PRA**.

## Glide path

Sometimes payouts on maturity, retirement or earlier **surrender** are at a level above or below that justified by **asset shares**. This happens as a result of the **smoothing** of investment performance, a feature of with-profits policies. The planned smooth progression of payouts back to the level of **asset shares** is known as the **glide path**. This can also refer to the mechanism designed to ensure that **surrender** values blend into the expected maturity payout, as the context requires.

## Group of policies

Unless stated otherwise or the context suggests otherwise, a group of policies is defined as a group of similar policies for which we declare the same **final bonus** so that an appropriate percentage of **asset share** is paid.

## Hedging

Specific investments can be made to reduce the risks with a particular asset or liability. This is known as **hedging**.

## Hypothecation

Assets held to back the policy liabilities are notionally allocated to specific liabilities so as to match them as far as possible. This is known as **hypothecation**.

## Index performance

The returns on published indices are used to determine a comparable measure of the performance of the Sub-Fund's assets.

## Inherited estate

The **inherited estate** is the excess of assets held within the Sub-Fund, over and above the amount required to meet the liabilities. The assets over and above the assets backing guarantee costs in excess of **asset share** are sometimes known as the realistic **inherited estate**. The liabilities, for this purpose, include those that arise from the regulatory duty to treat customers fairly in setting discretionary benefits, such as **final bonuses**. The **inherited estate** acts as **working capital** of the business. It is used to support the business by, for example, providing investment flexibility and a 'cushion' against adverse stock market conditions.

## Initial guaranteed benefits

When a **conventional with-profits** policy is taken out the policy defines a benefit that is guaranteed to be paid at maturity or earlier death or other specific times (together with any bonuses declared subsequently on the policy) as long as all premiums are paid when they are due and the policy is kept in force.

## Interim bonus

Where a **regular bonus** rate has only been declared up to a certain date, then an **interim bonus** covers the period before a next declaration for claims made during that period.

## Legacy

Previous companies or sub-funds which have been transferred into a new company or sub-fund.

## Management services agreement

This is the agreement under which the service company, Aviva Life Services UK Limited, provides management and administration services to the Company.

## Market value reduction (MVR)

This applies to **unitised with-profits** products only. It is a reduction that may be applied to the total unit value if the policyholder moves money out of the Sub-Fund. It is applied to achieve a fair level of payouts, and to be fair to the remaining policyholders. It is most likely to be applied following large or prolonged stock market falls or when returns are below those normally expected. The policy conditions specify when it is guaranteed that an MVR will not be applied.

## Minimum asset requirement

The minimum value of the assets required to be held within a **with-profits sub-fund** under the rules of our regulator.

## Mortgage endowment promise

This applies to all notified with-profits mortgage endowment policies where there was a shortfall between the projected amount at maturity (at a rate of 6% per annum net of tax) and the target mortgage amount as at 31 December 1999.

## Mortality costs

These are the cost of providing life cover over a specific period.

## Mortality rates

These are the expected or actual proportions of people dying at a certain age.

## New WPSF proportion

The **New WPSF proportion** equals 88.25%, calculated as at 1 October 2009 in accordance with the **Reattribution Scheme**.

## Non-contractual cancellations (of units)

For **unitised with-profits** policies, units that are cancelled on dates other than on maturity, death or other specified dates in the policy conditions.

## Non Elected Policy

An eligible policy for which the holder elected not to receive an incentive payment or did not return the relevant voting form by the closing date applicable to the election.

## Non-Profit Sub-Fund

A sub-fund of the Company to which non-profit life assurance and general annuity business is written.

## Old WPSF proportion

The **Old WPSF proportion** equals 11.75%, calculated as at 1 October 2009 in accordance with the **Reattribution Scheme**.

## Permitted Release Threshold

The Permitted Release Threshold represents the minimum level that provides a high level of security. The Permitted Release Threshold has been set at, broadly, 110% of the top of the preferred range. Surplus held by the New WPSF and RIEESA in excess of the Permitted Release Threshold calculated for the New WPSF is potentially available for release to shareholders.

## Pooling

The sharing of investments or risks between sub-funds or parts of sub-funds.

## PRA

The Prudential Regulation Authority (PRA) is a part of the Bank of England and responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. It sets standards and supervises financial institutions at the level of the individual firm. The FCA and PRA replaced the FSA when they were given their powers by the Financial Services Act 2013.

## Quota share

This is a form of reinsurance where a group of sub-funds or companies agree that for all new business they will each take a set percentage of the risk, this being their quota.

## Quoted/unquoted investments

**Quoted investments** are those for which there is a regular price quoted, usually on one of the world's stock markets. These then have an easily assessed point in time value and ability to trade. **Unquoted investments** are not part of an organised market and so may be more difficult to value or trade.

## Reattributed Inherited Estate

The **Reattributed Inherited Estate** is the proportion of the combined **inherited estates** of CGNU Life and CULAC, determined in accordance with the **Reattribution Scheme** which was deemed to relate to **elected policies**. The **Reattributed Inherited Estate** is held partly in the **Non-Profit Sub-Fund** as the **Reattributed Inherited Estate External Support Account (RIEESA)**, and partly in the New WPSF within the within the assets in excess of **Aggregate Asset Shares** for that sub-fund.

## Reattributed Inherited Estate External Support Account (RIEESA)

The **Reattributed Inherited Estate External Support Account** is an identifiable separate account within the **Non-Profit Sub-Fund** which may be used to support the Old and New With-Profits Sub-Funds.

## Reattribution Scheme

The Reattribution Scheme of Transfer (the Reattribution Scheme) for the reattribution of the **inherited estates** of CGNU Life and CULAC and the transfer of the insurance business of CGNU Life, CULAC and NULR to the Company on 1 October 2009.

## Regular bonus

This is the distribution of surplus added to the policy each year. For **unitised with-profits** policy investments this is done by increasing the price of the units held in the Sub-Fund (or in the case of the **unitised with-profits** Income Fund by allocating additional units to the policy each month) which increases the amount guaranteed to be paid on death or at points where a MVR would not apply. For **conventional with-profits** policies this is done by allocating a bonus which increases the amount guaranteed to be paid on death and, if the investment has a maturity date, at the end of the term.

## Regulatory solvency

The required minimum level of assets in excess of liabilities including any required regulatory buffer.

## Remaining Assets

The assets in the Old WPSF and New WPSF (including the RIEESA) other than those representing the **Return Assets**.

## Required Distribution Threshold

The Required Distribution Threshold represents the minimum level that provides such a high level of security that any assets held by the Old WPSF in excess of this level should be distributed. The Required Distribution Threshold is, broadly, 120% of the top of the preferred range.

## Return Assets

The pools of assets which are used to determine the investment return to be credited to **asset shares**. Separate pools of **Return Assets** are held for different categories of business as described in section 3.2. The investment return to be credited to **asset shares** is equal to the investment return on the relevant pool of **Return Assets**.

## Risk Appetite Framework

Management strategy taken to ensure the **inherited estate** or **Reattributed Inherited Estate** remain within agreed ranges.

## Scheme

The Scheme of transfer of policies and assets from Friends Life Limited and Friends Life and Pensions Limited to Aviva Life & Pensions UK Limited on 1 October 2017.

## Shareholder Fund

Assets held within the Company that are not within the **with-profits sub-funds** or the **Non-Profit Sub-Fund**. The assets of this fund are available to meet the **Solvency Risk Appetite** and, to the extent not required for this, may be distributed to shareholders.

## Smoothing

The claim payout under a with-profits policy aims to dampen the volatility of return from the underlying assets.

## Smoothing Account

An account credited or debited with smoothing payment additions or deficits operated with the aim of ensuring the cost of smoothing over time is neutral.

## Solvency Risk Appetite

The Solvency Risk Appetite describes the Company's approach to the management of its capital position.

The Solvency Risk Appetite is the preferred level of capital in excess of the minimum required by regulations. It provides protection to the Company against the risk of breaching regulatory requirements and restricts the ability of the Company to pay dividends.

## Specimen policy

The Company uses specimen policies in its calculations where it is not feasible to use all policy data. A specimen policy may, for example, be a suitable example policy that represents the relevant block of business. It may be a policy that is based on averaging the available policy data for the block of business. Alternatively, the specimen policies may be a group of actual policies that, in combination, represent a significant proportion of the block of business.

## Strategic investment

Investments in companies in which the Sub-Fund, or any other Aviva group company, has a strategic connection or interest, other than investments in other Aviva group companies or properties that are used by such companies to undertake their business.

## Surrender

The termination of a contract prior to maturity or for a pension policy earlier than its initial selected retirement date.

## Termination date

When an endowment policy is taken out there is an agreed date, the maturity date, when the benefits will be paid so long as the policy is kept in force. For a pension policy it is the selected retirement date at commencement of the policy.

## Transferred Policies

**Eligible policies** that were transferred under the **Reattribution Scheme**.

## Unitised with-profits

**With-profits business** in which each premium paid purchases a number of units at the price relevant on that day. The unit price increases at a daily rate through the application of the **regular bonus** rate declared. A **final bonus** and/or market value adjustment may also apply at the time of a claim. An **annual management charge** is made, implicitly or explicitly.

## With-Profits Actuary

The **With-Profits Actuary** has responsibility for advising the Board in relation to its exercise of discretion as it affects the with-profits policyholders.

## With-profits business

This is that part of the business which includes the issuing of with-profits policies.

## With-Profits Committee

A committee set up in line with COBS requirements for PPFM governance arrangements to provide some independent judgment in assessing compliance with the PPFM and addressing conflicting rights and interests of policyholders and, if applicable, shareholders

## With-profits sub-fund

This is a pool of assets held in respect of **with-profits business** which can back a combination of with-profits and non-profit policies. There are a number of with-profits sub-funds within the Company, of which the Old and New With-Profits Sub-Funds are two.

## Working capital

An amount representing the fair market value of the with-profits assets less the realistic value of liabilities of a **with-profits sub-fund**. This is also known as the **inherited estate** of a **with-profits sub-fund**.

## Appendix B: Background

### Company Information

Aviva Life & Pensions UK Limited is an authorised life insurance company incorporated in England. Its registered office and head office are in York, where many of the main business divisions are also centred. It contains policies originally issued by a number of other life insurance companies, whose history is briefly described below.

### *Norwich Union, Provident Mutual, Commercial Union and General Accident*

Norwich Union was founded as a mutual company, owned by its with-profits policyholders, as Norwich Union Life Insurance Society in Norwich in 1808. On 15 June 1997 the company 'demutualised' to form Norwich Union Life & Pensions Limited (NULAP), a company owned by shareholders.

Provident Mutual was founded in 1840 as a Friendly Society, converting to a mutual company in 1874. Commercial Union (CU) was formed as a proprietary company in 1861 in London, England, and CU Life Assurance Company was the company for life business. General Accident (GA) was formed as a proprietary company in 1885 in Perth, Scotland.

In 1995 Provident Mutual demutualised and merged with GA, and Provident Mutual closed to new business. The with-profits business of Provident Mutual was maintained as a separate sub-fund of GA.

In 1998, CU and GA merged to form CGU plc, and GA Life Assurance Limited changed its name to CGU Life Assurance Limited. From October 1998, new with-profits business was written by CGU Life Assurance Limited.

On 30 May 2000, Norwich Union plc (which owned NULAP) merged with CGU plc, to form CGNU plc. CGU Life Assurance Limited changed its name to CGNU Life Assurance Limited. The combined company continued to trade under the Norwich Union brand until June 2009, when it started to trade under the Aviva brand. NULAP then changed its name on 1 June 2009 and became Aviva Life & Pensions UK Limited. However, new with-profits business continued to be written by CGNU Life Assurance Limited throughout this period.

On 1 October 2009, policies in CGNU Life, CU Life Assurance Company and Norwich Union Life (RBS) Ltd were transferred to two new sub-funds in Aviva Life & Pensions UK Limited, the Old With-Profits Sub-Fund and the New With-Profits Sub-Fund. The company also had two further with-profits sub-funds, the NULAP With-Profits Sub-Fund containing the original NULAP business (now known as the With-Profits Sub-Fund), and the PM Sub-Fund containing business previously transferred in from Provident Mutual.

Stakeholder pensions business has been written in a separate with-profits sub-fund (the Stakeholder With-Profits Sub-Fund), firstly in CGNU Life and, since October 2009, in Aviva Life & Pensions UK Limited.

On 1 January 2015, the business of Aviva Life & Pensions Ireland Limited was moved into Aviva Life & Pensions UK Limited.

### *Friends Life companies*

On 13 April 2015, Aviva plc bought the Friends Life group, including Friends Life Limited (FLL) and Friends Life and Pensions Limited (FLP). FLL, previously called Friends Provident Life and Pensions Limited, was established on 9 July 2001 and took over the business of Friends Provident Life Office (FPLO) – a mutual company. FPLO had previously taken over the business of the United Kingdom Provident Institution and the London and Manchester Assurance group.

On 1 December 2011, the business of Friends Provident Life Assurance Limited, formerly NM Life Assurance Limited, was moved into FLL.

On 28 December 2012, most of the business of Friends Life Company Limited (FLC) (which included policies issued by AXA Equity & Law Life Assurance Society) and Friends Life Assurance Society, formerly Sun Life Assurance Society, was moved into FLL. Then on 28 December 2013, most of the business of Friends Life WL Limited (FLWL), formerly Winterthur Life UK Limited, was moved into FLL. The remainder of the business of FLWL and FLC was moved into FLP.

Following the purchase of the Friends Life companies by Aviva, all the business of Friends Life Limited, and Friends Life and Pensions Limited was moved into Aviva Life & Pensions UK Limited with effect from 1 October 2017, as part of the Scheme.

### **Scheme of Transfer**

On 29 March 2019 under a Scheme of transfer, certain policies in Aviva Life & Pensions UK Limited were transferred to Aviva Life & Pensions Ireland Designated Activity Company and then immediately reinsured back to the funds they came from.

All of the policies formerly in Aviva Life & Pensions UK Limited Irish With-Profits Sub-Fund were transferred to the Irish With-Profits Fund of the Irish Aviva Life & Pensions Ireland Designated Activity Company. The most common names that exist on these policies are Aviva Life & Pensions Ireland Designated Activity Company, Aviva Life & Pensions Ireland Limited, Norwich Union Ireland, Norwich Union Insurance Ireland Limited, Hibernian Life Limited and Hibernian Life & Pensions Limited.

### ***Fund structure of Aviva Life & Pensions UK Limited***

The diagram in Appendix C below shows the current fund structure within Aviva Life & Pensions UK Limited.

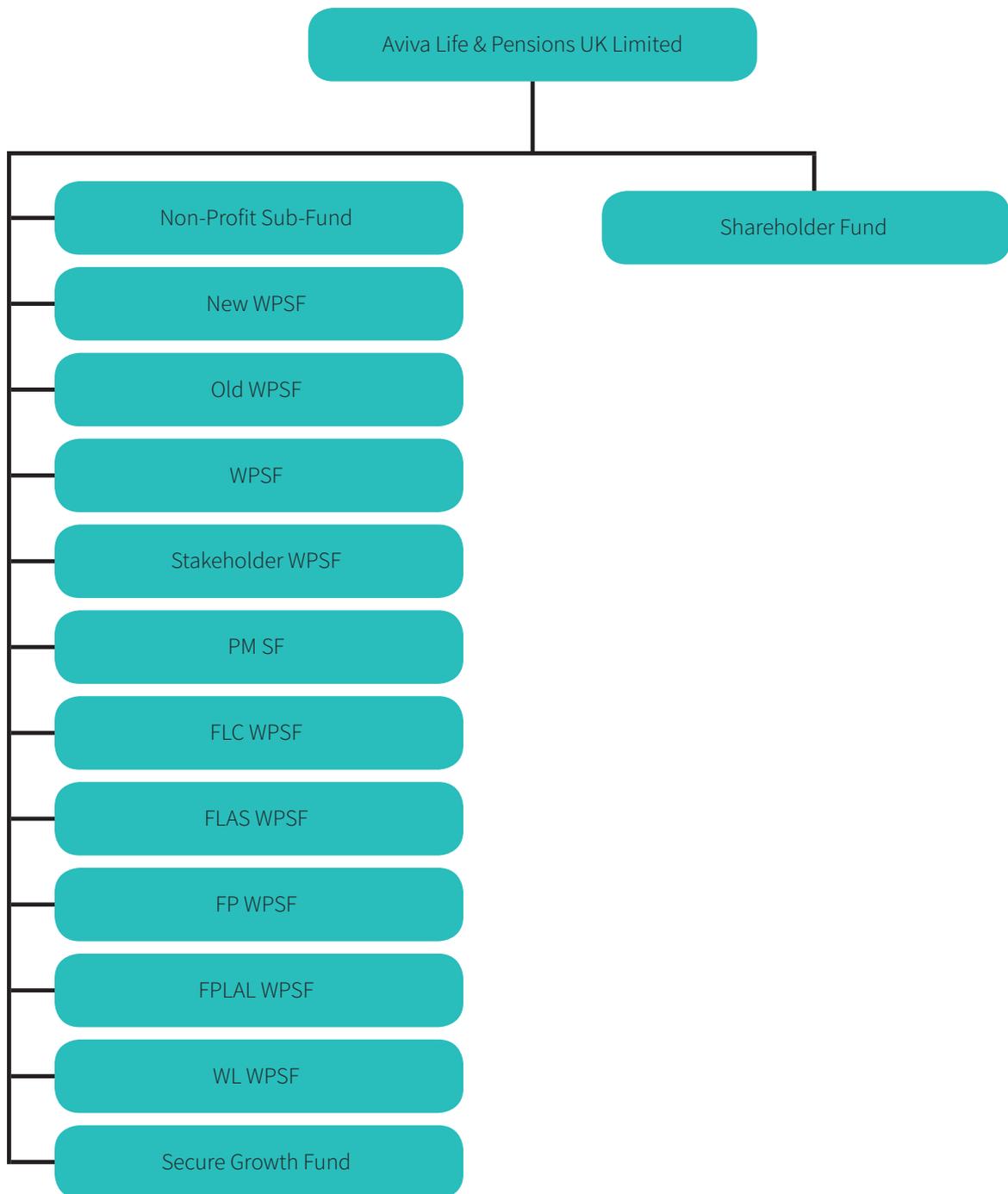
The mergers and transfers outlined above along with other historic mergers and acquisitions involving these companies have resulted in policies sold by a wide range of companies now being in the Company's with-profits sub-funds. The table in Appendix D shows the names of the current with-profits sub-funds together with the original company names under which the policies may have been issued.

### **Sub-Fund Background: Old With-Profits Sub-Fund and New With-Profits Sub-Fund**

The Old With-Profits Sub-Fund (Old WPSF) and New With-Profits Sub-Fund (New WPSF) were established as part of the Reattribution Scheme. Under the Scheme, customers with eligible with-profits policies (or with-profits parts of unit linked policies) could elect to have their policy allocated to the New WPSF. Non-elected eligible policies were allocated to the Old WPSF. Ineligible with-profits policies were allocated to the New WPSF with a proportion, the Old WPSF proportion, internally reinsured to the Old WPSF.

New with-profits policies from 1 October 2009 are written in the New WPSF, and the Old WPSF proportion of each is reinsured to the Old WPSF.

## Appendix C: Aviva Life & Pensions UK Limited – Fund structure chart



Note that there are also two further sub-funds, the Belgian Sub-Fund and With-Profits Sub-Fund 5, whose business is wholly reinsured outside the Aviva group.

## Appendix D: Original issuing companies

This table shows the current name of each of the with-profits sub-funds, and the possible names of the companies that originally wrote the policies.

Company policy taken out with	Current Aviva Life & Pensions UK Limited With-Profits Sub-Fund
Friends Life Company Limited AXA Sun Life plc AXA Equity and Law Life Assurance Society	FLC With-Profits Sub-Fund
Friends Life Assurance Society Limited Sun Life Assurance Society plc	FLAS With-Profits Sub-Fund
Friends Life Limited Friends Life and Pensions Limited – excluding Secure Growth Fund policies Friends Provident Life and Pensions Limited Friends Provident Pensions Limited – excluding Secure Growth Fund policies Friends' Provident Life Office United Kingdom Temperance and General Provident Institution London and Manchester Assurance Company Limited NM Life Assurance Limited – unitised policies Friends Provident Life Assurance Limited – unitised policies	FP With-Profits Sub-Fund
Dominion-Lincoln Assurance Limited The National Mutual Life Assurance Association of Australasia Limited NM Life Assurance Limited – conventional policies NM Schroder Life Assurance Limited Schroder Life Assurance Limited The Lincoln Life Assurance Company Limited FP Life Assurance Limited Friends Provident Life Assurance Limited – conventional policies	FPLAL With-Profits Sub-Fund
General Accident Life Assurance Limited Yorkshire-General Life Assurance Company Limited The General Life Assurance Company Yorkshire Insurance Company Limited Scottish Insurance Corporation Limited N&P Life Assurance Limited Commercial Union Life Assurance Company North British and Mercantile Insurance Company Limited London and Scottish Corporation Limited CGU Life Assurance Limited CGNU Life Assurance Limited – except stakeholder plans Norwich Union Life (RBS) Ltd – except stakeholder plans Aviva Life & Pensions UK Limited – except annuity business and stakeholder plans	New and Old With-Profits Sub-Funds

Company policy taken out with	Current Aviva Life & Pensions UK Limited With-Profits Sub-Fund
The Provident Clerks' Mutual Life Assurance Association Provident Clerks' and General Mutual Life Assurance Association Provident Mutual Life Assurance Association	Provident Mutual Sub-Fund
Welfare Insurance Company Limited London and Manchester Pensions Limited Friends Provident Corporate (Pensions) Limited Friends Provident Pensions Limited – Secure Growth Fund policies Friends Life and Pensions Limited – Secure Growth Fund policies	Secure Growth Fund
CGNU Life Assurance Limited – stakeholder plans Norwich Union Life (RBS) Ltd – stakeholder plans Aviva Life & Pensions UK Limited – stakeholder plans	Stakeholder With-Profits Sub-Fund
Norwich Union Life Insurance Society Norwich Union Life & Pensions Limited Aviva Life & Pensions UK Limited – annuity business	With-Profits Sub-Fund
National Westminster Life Assurance Limited Royal Scottish Assurance plc	With-Profits Sub-Fund 5
The Colonial Mutual Life Assurance Society Limited Colonial Mutual Life (Unit Assurances) Limited Colonial Life (UK) Limited Friends Life WL Limited Winterthur Life UK Limited Provident Life Association Limited	WL With-Profits Sub-Fund



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