

# Principles and Practices of Financial Management (PPFM)

for Aviva Life & Pensions UK Limited FP With-Profits Sub-Fund

(Including policies in the Non-Profit Sub-Fund that have  
with-profits units invested in the FP With-Profits Sub-Fund)

1 January 2020



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# Aviva Life & Pensions UK Limited FP With-Profits Sub-Fund PPFM

## 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 2.

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 3 shows the composition of funds under Aviva Life & Pensions UK Limited.

This document covers with-profits business in the FP With-Profits Sub-Fund of Aviva Life & Pensions UK Limited (the 'Sub-Fund'). This sub-fund was created on 1st October 2017, when all the policies of the FP With Profits Fund of Friends Life Limited were transferred to Aviva Life & Pensions UK Limited as part of a court approved scheme (see section 1.5). 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 FP With-Profits Sub-Fund are Friends Life Limited, Friends Life and Pensions Limited, Friends Provident Life and Pensions Limited, Friends Provident Pensions Limited, Friends Provident Life Office, United Kingdom Temperance and General Provident Institution, London and Manchester Assurance Company Limited, NM Life Assurance Limited and Friends Provident Life Assurance Limited.

Other names will be relevant to policies in our other with-profits sub-funds. Appendix 4 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 this Sub-Fund 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-fund 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 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-Fund 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 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 1 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.

# 2 Targeting payouts

## 2.1 Principles

We will manage the Sub-Fund in accordance with all legal and regulatory requirements. This will include managing the Sub-Fund in accordance with the Scheme and observing all contractual terms set out in policy documents.

In the event of any conflict between the terms of the Scheme and this PPFM, the terms of the Scheme will take precedence.

We will manage the Sub-Fund in a sound and prudent manner and with due regard to the interests of its policyholders and with a view to treating all policyholders fairly.

We will manage the Sub-Fund with the aim of ensuring that all guaranteed benefits can be paid as they fall due.

We will use appropriate models, methods and techniques in order to manage the Sub-Fund and determine payouts.

For most classes of with-profits policy, payouts will be determined having regard to Adjusted Asset Shares with the aim of ensuring that fairness is maintained between different groups and generations of policies.

For classes of policy where Adjusted Asset Share does not represent a fair guide to payouts, or where it is not calculated, payouts will be determined using other methods. Approximations will not materially affect resulting payouts or bonuses compared to the result of more precise methods which could practicably have been used at a reasonable cost.

The cost of guarantees on post demutualisation policies will be shared by all post demutualisation policies. For this reason we may deduct a guarantee charge from Asset Shares. We also maintain a Guarantee Charge Account ('GCA') for the post-demutualisation business to ensure that the charges deducted are no more than necessary and to ensure that there are no cross subsidies between pre and post demutualisation business. If in retrospect excessive charges have been deducted, we will refund the excess to the remaining post-demutualisation policies by targeting to pay more than 100% of Asset Share.

## 2.2 Target payouts

Target payouts on maturity or contractual retirement are based on 100% of Adjusted Asset Share (as defined in section 2.3.2).

Target payouts on surrender are, where appropriate, based on 100% of those applicable on maturity and contractual retirement.

For post-demutualisation business we may reflect the balance of the Bonus Smoothing Account as follows: when the balance of the Bonus Smoothing Account is positive we may aim to exceed target payouts; when the balance of the Bonus Smoothing Account is negative we may aim below target payouts. From time to time payouts will differ from target as a result of smoothing. At any particular time the payout we aim at may be further amended to avoid excessive changes in payout from one period to the next (see section 3 for more details).

Payout targets are derived for groupings of individual policies (by policy term and premium status (single, regular or paid-up) within bonus series) and not on an individual policy by policy basis. Sample policies, representative of the grouping, are used in the targeting process.

Our current practice when setting bonus rates for those policies managed by reference to sample Adjusted Asset Shares, is to aim to ensure that the overwhelming majority of individual maturity values lie within the target payout range. The current target payout range is to not deviate by more than 20% from the Adjusted Asset Share.

Compliance is measured by reference to representative sample policies.

No account is taken of guarantee payments of more than 100% of Adjusted Asset Share.

Scales of final bonus are set to produce payouts equal to the targets for each grouping. Rates of final bonus are rounded. Where guarantees exceed target payouts rates of final bonus will be zero.

Actual payouts for individual policies may therefore deviate from Adjusted Asset Share for one or more reasons: because guaranteed payouts exceed targets; as a result of rounding in the rate of final bonus; to the extent that a policy differs from the representative policy; and to reflect the impact of smoothing.

Benefits on death vary across different classes of business and are determined by the contractual terms of the policy. No direct payout targets are determined. For conventional whole of life policies, principally designed to provide a cash sum on death, Asset Share is inappropriate as a measure of target payout. For these policies bonus scales are the same as those for equivalent savings plans. Surrender values reflect the present value of the benefits which, if the policy is not surrendered, would eventually be paid.

Some conventional with-profits savings policies that have been altered at the policyholder's request do not directly use Adjusted Asset Share to determine payout values. For these policies, the basic sum assured or basic annuity are adjusted at the time of alteration, and future bonuses are then declared based on the rates applicable to unaltered policies.

For Conventional Group policies that do not provide a final bonus or have a single rate of final bonus that does not depend on duration, the results of individual or sample Asset Share calculations would not affect the bonus declaration. Bonus rates are set by reference to aggregate Asset Shares for that class of business, adjusted to reflect the value of guarantees relative to other classes of policy. Surrender scales aim to mirror the uniformity of maturity payout scales and the more extensive smoothing of payouts (see section 4). Those Conventional Group policies that do not use individual or sample Asset Shares to determine payouts are: Executive Benefit Plans, Budget Pension Plans, Annual Premium (Hypothecated) Schemes, Group Pension Plans (Final Salary Pension Schemes) and Group Additional Voluntary Contribution Plans.

## 2.3 Asset Share methodology

### 2.3.1 Asset Shares

Asset Shares are calculated on a specimen policy basis from assumptions derived from the actual experience of the Sub-Fund.

Asset Shares for pre demutualisation policies within the Main and UKP bonus series are accumulated as:

- premiums paid;
- plus investment return (can be negative) earned on the underlying investments calculated as described in section 2.4.1;
- less a deduction for the costs of selling and administering the policy;
- less the cost of death or other risk benefits;
- less an adjustment in respect of taxation as appropriate for the type of policy.

The total costs of selling and administering the policy that may be deducted from Asset Share were based on internal expense apportionment investigations up to the Demutualisation Date and have been defined thereafter in the Demutualisation and subsequent Schemes. In apportioning these costs between individual policies post demutualisation:

- Where policyholders have previously been given the expectation that the contractual charges are the costs that will be taken into account in calculating discretionary benefits as well as contractual benefits (e.g. New Generation Pensions where the only expense charge is an annual management charge), then it is the contractual expense charge that is deducted from Asset Share.
- Where differences in contractual charges imply a different allocation of expenses to policies of the same type, for example because more expenses are allocated to large policies than to small ones, then the costs deducted from Asset Share will, where reasonably possible, reflect this difference.

The cost of shareholder transfers of one ninth of the cost of bonuses awarded to conventional with-profits policies is not deducted from Asset Share. A provision was set aside at the Demutualisation Date to meet the expected cost of such future shareholder transfers. The difference between the size of the provision and the actual cost of such shareholder transfers is treated as a miscellaneous profit or loss and considered in determining Adjusted Asset Shares as described below.

The individual Asset Shares for the policies in the FPLMA bonus series were determined on 4 January 2000, the effective date of transfer into FPLO. Subsequent Asset Shares are based on these values accumulated as above.

Asset Shares for post demutualisation policies are accumulated as:

- the investment element of premiums paid (i.e. premiums paid less contractual expense charges);
- plus investment return (can be negative) earned on the underlying investments calculated as described in section 2.4.1;
- less annual management charges and any other expense charges specified in the contract;
- less charges to cover the cost of death or other risk benefits;
- less a charge in respect of tax on the underlying investments.

### 2.3.2 Adjusted Asset Shares

Adjusted Asset Shares are determined by making enhancements to or taking deductions from the Asset Shares described above.

#### 2.3.2.1 Pre demutualisation policies

The adjustments are determined by comparing the value of the assets in the Sub-Fund with the best estimate value of the liabilities. If the value of the assets exceeds the value of the liabilities plus a risk-related margin recommended by the With-Profits Actuary, then the adjustment to Asset Shares will be a percentage enhancement broadly equal in total value to the excess value of the assets. If the value of the assets is less than the value of the liabilities plus the risk-related margin, the adjustment to asset share will be a percentage reduction broadly equal to the shortfall in the value of the assets.

We normally recalculate the appropriate adjustment once each year.

The latest published adjustment as a percentage of Asset Share is available from the With-Profits Summary on our website at [aviva.co.uk/ppfm](http://aviva.co.uk/ppfm).

FPLMA series policies were not entitled to participate in profits or losses arising from miscellaneous sources before 1 January 2017 and received an investment return yield augmentation of 0.6% per annum from 4 January 2000 until 31 December 2009 to compensate for this. Lower adjustments to Asset Share are now applied to these policies, reflecting that they were not subject to a guarantee charge in the past, unlike other business.

### **2.3.2.2 Post demutualisation policies**

For post demutualisation policies the only adjustments are deductions from Asset Shares which are made, if necessary, to cover the cost of guaranteeing the unit price at the dates specified in the policy conditions. The adjustment is expressed as an annual percentage of Asset Share. The adjustment may vary to reflect differences in the expected cost of providing guarantees for different types of policy. Rates of deduction are reviewed annually and are set so that in total the expected value of future adjustments, together with the amount of the Guarantee Charge Account (see below), is equal to the expected future cost of guarantees on a prudent basis. Policies are split into broad bands with similar types of unit price guarantee. The relative costs of these guarantees are assessed for new policies and where these are significantly different, the rates of adjustment for these bands of policies (new and existing) will reflect these differences. For a few products unit prices are only guaranteed on death and the adjustment is nil.

The adjustments that we make are transferred to a Guarantee Charge Account for post demutualisation policyholders. Whenever a maturity or retirement claim is paid where the guaranteed amount is greater than 100% of Adjusted Asset Share, the Guarantee Charge Account is debited by the difference. Maintaining this account ensures that all deductions from Asset Share in respect of post demutualisation policyholders are used only to benefit post demutualisation policies. Should the Guarantee Charge Account become overfunded then Adjusted Asset Shares for post demutualisation policyholders would be enhanced to reduce this overfunding.

The Bonus Smoothing Account and Guarantee Charge Account may be combined for the purpose of adjusting Asset Shares for post demutualisation business.

Details of the current enhancements or deductions are available in the With-Profits Summary on our website at [aviva.co.uk/ppfm](http://aviva.co.uk/ppfm).

## **2.4 Asset Share assumptions**

### **2.4.1 Investment Return Credited to Asset Shares**

Since demutualisation, the assets of the Sub-Fund have been pooled, and the investment return used in Asset Share calculations derived, according to the approach described in section 5.

Before demutualisation, investment returns were either based on the actual return achieved by the assets deemed to be backing the with-profits policies, or, prior to 1988, assumed that given percentages of the Sub-Fund were invested in particular asset classes and were then calculated by applying market indices.

A deduction of 0.25% was made in the calculation of the annual investment return attributable to the Asset Shares of policies in the UKP bonus series to reflect the differing relative strengths and investment mix of the FPLMA Fund and the UKP Fund at the time of the merger. The deduction was applied from 1993 until 31 December 2016.

At the time of the transfer of FPLMA policies to FPLMA on 4 January 2000, the FPLMA Fund was stronger than the FPLMA Fund and maintained a different investment strategy. As a result, FPLMA bonus series Asset Shares were calculated based on a notionally higher Equity Backing Ratio (see Section 5.4) until 8 July 2001, an investment return enhancement of 0.6% per annum then applied from 9 July 2001 to 31 December 2009. A further investment return enhancement of 0.6% per annum was applied from 4 January 2000 to 31 December 2009, in lieu of potential miscellaneous profits to which policyholders had previously been entitled (see section 2.3.2).

### **2.4.2 Expense charges**

Expenses deducted from the Asset Shares of pre demutualisation policies for periods prior to demutualisation were based on the actual expenses and commission attributable to the with-profits business of FPLMA. Where expense apportionments did not exist (before around 1980 for Main Series policies), estimates were used.

Up to 31 December 2009, expenses deducted from Asset Shares were slightly less than those charged to the Sub-Fund, with the additional charge to the Sub-Fund met from a provision set up at demutualisation. From then until 1 January 2015 expenses charged to the Sub-Fund and deducted from Asset Shares were the same, except for unithised policies where the charges deducted from Asset Shares were expressed as a percentage of Asset Share. Any one-off charges after 1 January 2015 (see 7.2 below) will not be deducted from Asset Shares.

For post demutualisation policies, the contractual annual management charge and any other contractual expense charges specified in the policy conditions are deducted from Asset Shares. The annual management charge covers both administration and investment management expenses.

If actual expenses are different from those charged the profit or loss is borne by the shareholders. The charges reflect the tax relief that we expect to receive on expenses and the tax that shareholders will pay on profit from these policies.



### **2.4.3 Cost of other risk benefits**

An adjustment is made to Asset Shares to reflect the cost of providing death, critical illness and any other risk benefits to the with-profits policyholders, where these benefits are in excess of Asset Share. For UWP policies this is equal to the value of the 'mortality charge' deducted from units. For other classes of policy the adjustment is assessed annually on a per policy basis by calculating the difference between the value of the risk benefit and the Asset Share for that policy and multiplying this by the probability that the risk event might have occurred. This probability is assessed from the average experience of the policies within each class.

For policies where death benefits are less than Asset Share, the adjustment is positive and is added when accumulating the Asset Shares.

For pre demutualisation policies, any difference between the actual cost of providing risk benefits and the charges deducted from Asset Shares is treated as a miscellaneous profit or loss.

For post demutualisation policies, if the actual costs of providing risk benefits are different to the charges deducted from Asset Shares the profit or loss is borne by the shareholders.

### **2.4.4 Treatment of taxation in Asset Share calculations**

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. A provision was set aside on demutualisation and continues to be maintained within the Sub-Fund to meet this taxation.

Any differences between the Asset Share deductions and the actual tax charged to the Sub-Fund (which is determined in accordance with the Scheme) in respect of pre demutualisation with-profits policies, and between the provision for taxation on shareholder transfers and the actual tax paid on shareholder transfers, are treated as a miscellaneous profit or loss for the Sub-Fund.

For post demutualisation policies, a tax adjustment is only made in respect of investment income and capital gains or losses. As mentioned above, the expense charges for these policies make allowance for expected tax relief on expenses and on shareholder profit.

## **2.5 Controls and documentation**

We maintain appropriate systems in order to determine payouts for with-profits policies. These systems may be developed or replaced from time to time but we ensure that this does not affect our ability to comply with the PPFM.

We do not intend to change the Asset Share methodology used to accumulate Asset Shares to the Demutualisation Date. We would consider changing the methodology applied in respect of subsequent years if new techniques were developed.

Historic Asset Share assumptions are not generally reviewed or updated. However, we would consider making a change if a material error were discovered that led to inequity between classes of policyholder.

High level descriptions of methodology and systems have been produced. More detailed descriptions of parts of the process to determine payout levels are typically documented within spreadsheets used in the process.

For each review an electronic file is created which is used to record assumptions, backing calculations, notes and correspondence relevant to the review.

# 3 Bonus policy and smoothing

## 3.1 Principles

### General

Distributions of surplus to policyholders of the Sub-Fund and to shareholders will be determined by the Board after taking into account the advice of the WPA and after consideration by the WPC. In giving this advice the WPA will take into account:

- the need to ensure that the with-profits sub-funds and the Non-Profit Sub-Fund in aggregate are able to meet the liabilities of the Company and that the Non-Profit Sub-Fund is able to meet its own liabilities;
- the current and projected capital needs of the Sub-Fund;
- the investment strategy of the Sub-Fund;
- the bonus policy as set out below;
- the need for an appropriate level of security in the Sub-Fund for policyholders' benefits, taking into account the nature of the different types of policy;
- the need to ensure that different groups of policyholders are treated fairly; and
- the need to account for smoothing costs separately for pre and post demutualisation business.

Shareholders are entitled to an amount equal to one ninth of surplus distributed to pre demutualisation conventional with-profits policyholders.

The Sub-Fund is entitled to 40% of the profit emerging from the non-profit and pre demutualisation unitised with-profits policies in the Sub-Fund. The Non-Profit Sub-Fund is entitled to the remaining 60%. Both the Sub-Fund and the Non-Profit Sub-Fund are entitled to anticipate all or part of their interest in this surplus as long as any transaction is undertaken on an arms length basis.

Post demutualisation policies are entitled to the investment return net of appropriate tax and investment expenses on the assets underlying their Asset Shares but not to any other source of profit.

Bonus rates, MVRs and the methods for calculating surrender value will be kept under regular review in order to manage policies in line with the Principles detailed in this section and to maintain fairness between policyholders of different generations and bonus series and between those leaving the Sub-Fund and those remaining. New bonus series may be created if reasonable equity with other policyholders cannot be maintained by linking the business to an existing bonus series.

### Regular bonus

Regular bonuses will be added when appropriate to provide policyholders with additional guaranteed benefits. When necessary, we will restrict regular bonus rates for particular bonus series in order to assist the Sub-Fund to continue to meet its capital needs or to ensure the maintenance of a reasonable balance between the guaranteed benefits and final bonuses payable at maturity or on retirement.

### Final bonus

Final bonus rates will be determined for each bonus series in order broadly to reflect any excess of the Adjusted Asset Share over the amount already guaranteed, including previous regular and interim bonuses.

### Smoothing

From time to time, payouts on maturity and surrender may be more or less than the targeted proportion of Adjusted Asset Share as a result of a smoothing process. The smoothing process will be managed so that the cost of smoothing to the Sub-Fund is broadly neutral over time. To assist in achieving this, a separate Bonus Smoothing Account ('BSA') will be maintained for post-demutualisation business and smoothing will be operated such that the balance of the BSA normally remains within the limits stated below. The BSA and the GCA may be operated as a single account.

## 3.2 Introduction

Smoothing of payouts applies in a number of ways, for example: by paying more or less than the target percentage of Adjusted Asset Share in order to reduce the volatility of payouts; by holding bonus rates and MVRs unchanged between declarations; by grouping policies together and basing bonus rates for that group with reference to a sample policy; and by having a smoothed scale of final bonus rates.

Policy types that do not provide a final bonus or have a single rate of final bonus that does not depend on duration smooth payouts to a greater extent than those where a term-related final bonus may be paid.

### 3.3 Regular bonus rates

Regular bonus rates are reviewed at least once each year. The rates declared do not normally change by more than 1.5 percentage points from the equivalent rate declared approximately a year previously (declarations are not always made at precisely the same time of the year).

Each bonus series has its own regular bonus rate. This is normally the rate of future bonus which, if maintained indefinitely, would provide an adequate margin for final bonus, consistent with the current investment strategy. The margin is sufficient to absorb the impact of a period of extremely poor investment performance and leave the projected Adjusted Asset Share at maturity larger than the guaranteed benefits. If an adequate margin cannot be maintained at any rate of regular bonus, no regular bonus is declared for that bonus series.

The consistency between the rates for different series in other respects is also taken into account. For example, we may wish to maintain consistent differentials between different bonus series representing life and pension business, pre and post demutualisation business, and business with different annual management charges.

For policies that do not pay a final bonus, the need to distribute surplus in the immediate future is balanced with the need to prevent onerous future guarantees being created. The current and projected ratios of payouts to aggregate Adjusted Asset Share for that class of policies are compared and a rate declared that will reduce or increase the ratio towards the target level.

For some minor series, regular bonus rates may be linked to rates for a larger series.

For some classes of policy, interim bonus may be payable for the period between the previous bonus declaration date and the policy payout date. Rates are declared at each bonus declaration and are generally, but not always, set equal to the regular bonus rate declared at that time. However, interim bonus rates are not guaranteed and could be changed at any time.

### 3.4 Smoothing and the bonus smoothing account

A Bonus Smoothing Account ('BSA') is maintained for post demutualisation business to help ensure that a transfer of assets is not made between different classes of policy as a result of smoothing.

The BSA is used to control the extent to which payouts diverge from Adjusted Asset Share. Payouts in excess of this are funded from the BSA (except to the extent to which they are a guarantee cost – see section 2.3.2) and payouts below Adjusted Asset Share replenish the BSA.

The BSA is not normally allowed to exceed 4% nor fall below 0% of the aggregate post-demutualisation Adjusted Asset Shares. If the BSA moves or is projected to move outside this range, we will increase or reduce the adjustment to Asset Share to bring it back into the range.

Our current practice is to limit the change in payout to be less than 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 above) then the smoothing limit is 7.5%.
- If the payout using the current final bonus rate lies outside the target payout range (see 2.2 above) then the smoothing limit is 10%.

In normal circumstances, the maximum amount of smoothing in one year will be 20%. If circumstances change so that there is a significant risk that the assets of the fund will not cover the liabilities, then a larger smoothing limit percentage may be used, or smoothing may be suspended.

Final bonus rates may also be subject to adjustment so that the progression of final bonus rates across policy durations within a bonus series is reasonably smooth.

### 3.5 Final bonus rates

The final bonus rates payable at maturity or contractual retirement on conventional with-profits and UWP policies are reviewed at least twice each year. Final bonus rates are generally investigated after any proposed changes to regular and interim bonuses have been determined.

At each declaration the application of the smoothing strategy is determined. Issues considered would typically include:

- the current size of the BSA for post demutualisation business;
- how much of the desired and necessary change in payouts should be reflected in the next proposed declaration;
- the current economic environment and anticipated future market conditions; and
- guidelines for producing the various options for final bonus rate scales to be considered by the WPA before making a recommendation. The guidelines usually include: a target level of payout as a percentage of Adjusted Asset Share; a maximum percentage change in payouts compared to previous declaration(s); and whether the percentage changes in payouts should reflect how close payouts currently are to target.

Adjusted Asset Shares and payouts (based on the proposed rates of regular and interim bonuses and possibly on more than one set of final bonus rates) are calculated for a representative sample of policies. The ratios of payouts to Adjusted Asset Share are compared. Revised final bonus rates are then determined to meet the smoothing strategy in respect of the sample policies, subject to rounding. Where necessary, the scale is then extended to other policy terms, normally by interpolation.

### **3.6 Policies outside the main classes**

Conventional with-profits whole of life policies receive final bonus rates paid on death based on those paid at the maturity of conventional with-profits endowment policies with the same duration in force. Other very small classes of conventional policy have their bonus rates linked to other series for which sample policies are investigated.

For some UWP bonus series, experience is similar enough to other series to allow final bonus scales to be determined by making proportionate adjustments to the final bonus scale proposed for another series. The validity of these approximations is checked at least once every three years.

Payouts and hence final bonus in respect of units credited to group pension policies at demutualisation in lieu of an allocation of shares will receive little or no smoothing.

### **3.7 Approximations used in determining bonus rates**

The effect of approximations is intended to be neutral, both within each class or generation of policyholders and in the aggregate.

In the majority of cases, the most significant approximations for conventional with-profits policies are the use of sample policies to represent the whole population, and interpolating between five year terms to derive bonus rates for intermediate durations.

### **3.8 Equity between policyholders and shareholders**

The amount of the transfer to shareholders in respect of regular bonuses under conventional with-profits policies is sensitive to the valuation basis used in calculating reserves. This amount is small in the context of the total transfer and any changes in basis will not have a material impact.

On demutualisation, a provision was set aside in the Sub-Fund for additional shareholder tax that might arise on transferred business (referred to in the Scheme as the 'Determined Value Amount'). To the extent that this proves to be insufficient the liability of the Sub-Fund is capped and the obligation falls upon the shareholder. To the extent this proves to be an overestimate, however, any excess will be retained for the benefit of pre demutualisation with-profits policyholders.

The nature of the shareholder's interest in UWP business is such that guaranteed bonuses and changes in the levels of MVRs and final bonuses do not impact on equity between policyholders and shareholders.

# 4 Surrender values

## 4.1 Principles

We may apply an MVR to the value of units on surrender of a UWP policy when unit values exceed Adjusted Asset Share and are not guaranteed (details of when the unit price is not guaranteed are set out in the relevant policy document).

Surrender value bases for conventional with-profits policies and rates of final bonus payable on UWP policies will be set in order to achieve Adjusted Asset Share averaged across all policies within each class.

We may smooth the change from time to time in surrender payouts although this will usually be to a lesser extent than for maturity payouts.

## 4.2 Target payouts and smoothing

For those classes where bonuses are set by reference to Adjusted Asset Shares, we aim to pay out Adjusted Asset Shares on surrender, averaged across all policies within each class, other than when a policy is surrendered near to the time at which a guaranteed value is available (when the surrender value may be increased to take account of the guaranteed value) or when a policy or increment is surrendered before it first become eligible for final bonus.

We smooth payouts on surrender, although not necessarily to the same extent as payouts on maturity. Due to fluctuations in underlying asset values and hence Adjusted Asset Shares, surrender values are likely to deviate from target payouts during the periods between each review.

Our current practice when setting surrender scales for those policies managed by reference to sample Adjusted Asset Shares, is to aim to ensure that a large majority of individual surrender values do not deviate by more than 20% from Adjusted Asset Share. Compliance with the maximum 20% deviation objective is measured by reference to representative sample policies.

## 4.3 Conventional policies

Surrender value bases for the main classes of conventional with-profits policies are reviewed at least once each year. Smaller lines have less frequent reviews.

Currently, at each review, sample policies are selected from the main classes of conventional with-profits policies. The sample policies represent policies with different terms expired, different start and end dates, and various other policy characteristics. Adjusted Asset Shares and surrender payouts are calculated for the sample policies as at the investigation date, based on the current surrender value basis and the rates of bonus currently in force.

We would consider changing the surrender value basis if the results of the investigation described above indicate that current surrender values differ significantly from the target payouts on surrender for some or all of the sample policies.

An Asset Share based approach is not used for whole of life policies nor for other types of policy for which it would not be appropriate.

## 4.4 UWP policies

We may apply an MVR to the value of units on surrender of a UWP policy when unit values exceed Adjusted Asset Share and the unit price is not guaranteed. Details of when the unit price is not guaranteed are set out in the relevant policy document. Where applied, MVRs will be actively managed to reflect changes in the values of the assets backing the UWP business.

MVRs for UWP policies are kept under constant review and, when any apply, the scales typically change several times a year. In particular, a review of MVRs takes place after a significant change in the value of the assets backing the UWP business or in conjunction with a change in bonus rates. MVRs may be introduced or changed at any time.

Sample policies are selected to represent a range of policies from the main UWP bonus series. Adjusted Asset Shares and surrender payouts are calculated for the sample policies as at the investigation date, based on current MVRs and rates of bonus (which may include final bonus if the policy is entitled to such a bonus on surrender).

The results of these investigations are analysed for the various sample policies. MVRs are amended if the results indicate that current average surrender values differ significantly from Adjusted Asset Share on surrender for some or all of the sample policies.

Where MVRs are indicated for only a small number of policies, we may decide not to apply them.

Some policies allow partial surrenders. For these policies the Adjusted Asset Share is reduced in proportion to the maturity benefit or unit value cancelled. Some policies allow regular withdrawals to be taken free of MVR up to a specified percentage of the premium each year.

# 5 Investment strategy

## 5.1 Principles

The investment strategy for the Sub-Fund will be determined after taking into account:

- our aim to achieve above average returns in the longer term;
- the current and projected financial position of the Sub-Fund, ignoring for this purpose the need to repay any capital support provided under the support mechanism;
- advice from the investment manager for the Sub-Fund;
- advice from the WPA, and from relevant Aviva group committees;
- the investment expectations of all classes of policyholder resulting from information provided to them;
- the advantages of reducing overall volatility by investing in a wide range of assets; and
- the investment strategies of the with-profits sub-funds of peer companies.

From time to time, we may make short term tactical asset allocation decisions which may deviate from these Principles.

The assets underlying different groups of policies or types of reserve in the Sub-Fund may be grouped into separate pools (for example pre and post demutualisation business, or parts of them) and the investment strategy for each of the resulting pools determined separately.

We allow the investment manager to use derivatives as part of an investment strategy to help manage risk or to aid efficient portfolio management. We use a range of derivative counterparties in order to limit exposure in the event of default.

Assets that would not normally be traded may be held by the Sub-Fund. These may include investments in Aviva group companies and properties occupied by Aviva group companies. Some such assets were allocated to the Sub-Fund at demutualisation. New investments may also be made. Such assets may continue to be held or may be acquired provided that, in our opinion, after taking advice from the WPA, they offer sufficient expectation of reward to the Sub-Fund to compensate for lack of liquidity and any other disadvantages.

## 5.2 Allocation of assets to liability classes

The assets of the Sub-Fund are notionally allocated between different classes of policies and other liabilities of the Sub-Fund as described below:

- A 'Return Assets' pool backing Adjusted Asset Shares (reduced by the amount of any asset share shorting, see section 5.7). These assets may be further subdivided into smaller pools according to the type of policy, for example a notional allocation between pre and post demutualisation policies.
- A 'Remaining Assets' pool backing best estimate reserves attributable to non-profit policies in the Sub-Fund, reserves for guarantees such as Guaranteed Annuity Rates (GARs), and the remaining assets in the Sub-Fund. These assets may be further subdivided into smaller pools according to the type of policy.

Having allocated the assets as above, the assets are managed as separate asset pools by the investment manager. The target asset allocation of the pools 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. Performance against the target asset mix is currently reported upon quarterly.

The investment return attributed to assets in the Return Assets pool is used in the calculation of the Adjusted Asset Shares, suitably allocated between policies where there is subdivision according to the type of policy.

In future, we may allocate the assets of the Sub-Fund to differently constituted pools if we consider that this would enable us to treat policyholders more fairly at that time.

## 5.3 Cash flow and matching

Cash flows are monitored at a high level and various cash flow projections (updated at least annually) are available to help ensure the Sub-Fund maintains sufficient liquidity.

We currently operate a matching strategy for the assets within some of the asset pools whereby assets are selected whose values broadly move in line with the values of the underlying liabilities following changes in investment conditions:

- non-profit liabilities are matched by fixed interest assets of appropriate type and duration;
- unit-linked liabilities are reinsured to the Non-Profit Sub-Fund, which either exactly matches the liability by investments in the appropriate unit funds or reinsures them in turn to insurance companies outside the Aviva group;

- liabilities in respect of GARs are hedged by fixed interest investments and derivatives whose value is linked to changes in interest rates; and
- assets held in respect of the expected cost of basic benefit guarantees comprise fixed interest investments and derivative contracts whose value is linked to changes in equity markets.

These matching strategies are actively reviewed and may be changed at any time in the future if appropriate.

## 5.4 Equity Backing Ratio

The equity backing ratio (EBR) is 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.

In pursuit of the strategy to achieve above average returns over the longer term, we have a preference to invest in EBR assets, but not to the extent that the prospect of potentially better returns is more than offset by the risks of this preference.

The EBR is monitored closely as the returns from these asset classes are generally more volatile than returns from other classes. The EBR would be reduced if necessary to ensure the solvency position of the Sub-Fund was not compromised by an unsuitable asset mix.

Investment strategies, including the level of EBR, are normally only considered if they have less than an estimated 1 in 20 year probability of requiring capital support above the minimum specified in section 8 (excluding the Additional Account).

The latest mix of assets can be found in the With-Profits Summary on our website at [aviva.co.uk/ppfm](http://aviva.co.uk/ppfm).

The investment managers are required to manage the assets within specific limits around the target allocation. The investment managers are also required to hold a wide range of investments within each asset class for reasons of security and diversification. There is a maximum holding of fixed interest securities at each rating level. If an investment grade security is downgraded to below investment grade it would normally be sold within 6 months, subject to investment manager advice.

## 5.5 Non tradable assets

A small number of the assets of the Sub-Fund would not normally be traded and do not have a published market value. These assets can be classed in two categories:

- assets used by the Aviva group in its daily operations (e.g. office property); and
- assets that are not associated with the Aviva group but are not traded (e.g. private equity investments, certain hedge fund investments or commercial real estate loans);

Non tradable assets are held either for practical reasons (assets used by the Aviva group) or to offer additional diversification or investment opportunities. The values of non tradable assets held constitute less than 5% of the value of the Sub-Fund.

The valuations of non tradable assets may be updated less frequently than those of other investments for practical reasons. The values of non tradable assets are determined in accordance with advice from our investment manager and, where necessary, specialists in the valuation of these assets. Changes in the value of non tradable assets impact the value of the Asset Shares and therefore, over time, influence the level of bonus rates and payouts for with-profits business.

The holdings of non tradable assets are reviewed quarterly along with the remainder of the assets of the Sub-Fund.

In addition to these investment assets the Sub-Fund is entitled to 40% of the profit from non-profit and pre demutualisation unitised business within the Sub-Fund. The Sub-Fund's share of anticipated future profits is brought into account as an asset and therefore changes in the expected and actual profitability of the non-profit and unitised business do impact over time on the level of bonus rates and payouts for pre demutualisation policies.

## 5.6 Use of derivatives

Derivatives may be used:

- as part of efficient portfolio management;
- to reduce investment risk; and
- to help match liabilities whose values are very sensitive to changes in market conditions.

Derivatives are not used without appropriate collateral arrangements to limit counterparty risk.

## 5.7 Asset Share shorting

We may use an internal Asset Share shorting strategy to help protect the Sub-Fund against the increased costs of providing guarantees or applying smoothing in adverse market conditions. Shorting is applied to all asset classes according to their proportion within the Asset Share liabilities.

Shorting involves holding fewer assets in the Asset Share pool than required to cover Asset Share liabilities, with the balance of the assets being held outside the Asset Share pool and invested in low risk assets. If the shorted assets perform worse than the low risk assets, the profit to the Sub-Fund will meet the increased guarantee or smoothing costs in these circumstances. If in favourable market circumstances, the shorted assets perform better than the low risk assets, the loss to the Sub-Fund will be offset by the reduced guarantee or smoothing costs.

## **5.8 Secured funding and securities lending**

Both of these activities entail receiving payment from other financial institutions in return for lending assets to them and this involves the temporary transfer of legal title of securities being 'lent'. Collateral is required for security which minimises any risk involved (although in the case of secured funding, the credit risk of the collateral may be higher than that of the assets lent). Secured funding and securities lending form a small part of our overall strategy.

## **5.9 Controls**

The Sub-Fund has its own investment mandate, which gives specific instructions to the investment manager. The mandate and any changes to be made to it are approved in line with the Aviva delegated authority framework and agreed with the investment manager.

An Investment Committee chaired by a non-executive director of the Company meets regularly to oversee investment activities. Investment matters are also considered by the internal Asset/Liability Committee. These committees approve the use of any new investment instruments together with the circumstances in which they may be used.



# 6 Exposure to business risk and new business

## 6.1 Principles

The Sub-Fund only bears losses arising from business risks (including compensation costs) relating to pre demutualisation policies, and then only if the event giving rise to the loss occurred before the Demutualisation Date.

Post demutualisation policies are exposed to investment risks but have no significant exposure to business risks except in exceptional circumstances.

We do not intend to take on further business risks to which with-profits policies will be exposed.

The Sub-Fund was closed to new business on 1 October 2017 although we still accept increments to existing policies and new members to existing group schemes.

## 6.2 Business risks

With-profits policies are exposed to a number of business risks relating to the operations of the Sub-Fund.

Management of all risks is monitored through governance arrangements set up by the Board. Processes to manage and monitor the impact of the main business risks have been set up and when necessary mitigating actions are taken.

The benchmark for assessing and reviewing business risk is the potential impact on the solvency position of the Sub-Fund. 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 include 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.

The table on the next page sets out the most significant business risks alongside the action that has been taken to mitigate these risks:

Business risks and mitigating action taken to reduce their impact	
Business risk	Action taken to reduce impact
1a) Guarantees associated with with-profits policies, i.e. the guaranteed annuity rates attaching to some policies and other contractual guarantees attaching to most policies.	Explicit reserve set up, ongoing monitoring and investment strategy to limit the exposure to changes in market conditions. The maintenance of a Guarantee Charge Account for post demutualisation policies.
1b) Guarantees built up by regular bonus additions.	Limiting the build up of these guarantees by restraining regular bonus rates and, if necessary, holding back the distribution of miscellaneous surplus and, for post demutualisation policies, making regular deductions from Asset Share to help fund the cost if necessary.  Using derivative contracts and Asset Share Shorting (see section 5.7) to minimise the prospect of guarantee costs and the value of assets backing them diverging due to market movements.
2) Variances in the value of non-profit business within the Sub-Fund.	Reassurance to help protect against adverse mortality experience. Investment strategy to limit the exposure to changes in market conditions.  An internal arrangement under which the Non-Profit Sub-Fund takes responsibility for any losses arising from the default of external reinsurers of unit-linked business in the FP With-Profits Sub-Fund
3) Other miscellaneous business risks impacting the with-profits business, in particular: Investment, Expense, Mortality, Taxation, Reinsurance and Regulatory risk.	Explicit accountabilities allocated to key staff to monitor and manage risks. Expense risk reduced by periodic agreements between the Sub-Fund and the Non-Profit Sub-Fund and by a hedge against high inflation.

4) Potential compensation claims in respect of allegations of mis-selling or other regulatory transgressions in relation to pre demutualisation business.	Ensuring management actions, where appropriate, are consistent with sales literature. Appropriate reserving for potential risk. The Shareholder Fund bears the risk for post demutualisation new business and for non-sales related transgressions after demutualisation.
5) A deficit arising in the Friends Provident staff final salary pension scheme	Pension scheme is closed to new entrants and future accrual of benefits. Investment strategy is to limit the exposure to changes in market conditions.

The risks above all influence the amount and timing of the surplus that emerges in the Sub-Fund. As a result, the Adjusted Asset Shares make allowance for the expected future impact of the business risks.

The business risks outlined above are borne across all pre demutualisation with-profits business.

### 6.3 Post-demutualisation policies

For policies written post demutualisation and investing in the FP With-Profits Sub-Fund, the Non-Profit Sub-Fund and the Shareholder Fund bear any costs related to business risk (including compensation). Only the with-profits units on new policies form part of the Sub-Fund.

# 7 Charges, expenses and taxation

## 7.1 Principles

The expense charges which can be made to the Sub-Fund in respect of pre demutualisation policies for the acquisition and set-up of new policies, the maintenance and termination of existing policies and for managing investments may not exceed the charges which would be made by a third party provider nor significantly exceed the costs which would be incurred by the Company if its business consisted solely of the Sub-Fund.

Expense charges to post demutualisation policies, other than investment charges, are specified in policy documents. Actual expenses are charged to the Non-Profit Sub-Fund.

The tax charge (or credit) to the Sub-Fund will be calculated on the basis that the Sub-Fund is a separate proprietary company, as set out in more detail in paragraph 39 of the Scheme and as calculated in accordance with Appendix 5.

The tax charge deducted from Asset Shares of post demutualisation policies is equal to the tax charged to investment income appropriate to the class of policy plus the best estimate of the value of the tax chargeable to gains or recoverable from losses.

## 7.2 Charges and expenses

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.

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 Sub-Fund in respect of pre-demutualisation business.

The actual expenses of selling and administering post demutualisation policies are charged to the Non-Profit Sub-Fund. If actual expenses differ from the charges then the profit or loss is borne by the shareholders, who own the surplus from the Non-Profit Sub-Fund in which new business is written, so there is no risk to post demutualisation policyholders.

These charges are paid by the Sub-Fund in lieu of the expenses incurred in running the with-profits business.

The fees charged to the Sub-Fund 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.

In developing the MSA, independent consultants were engaged to provide benchmarking data for the With-Profits Committee.

The charges paid by the Sub-Fund include a contribution to meeting a deficit in a closed defined-benefit pension scheme (the Friends Provident Pension Scheme) to which staff who do or used to administer the Sub-Fund's policies belong.

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.

Commission expenses are directly allocated to the Sub-Fund where appropriate.

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 Diligenta.

We have agreements with Aviva Investors Global Services Limited and other external managers to provide investment management services. Termination of the agreement with Aviva Investors Global Services Limited requires 12 months' notice, however the agreement includes clauses which permit earlier termination in certain circumstances. The most significant other arrangement is with Schroder Investment Management Limited, which requires 6 months' notice for termination.

Outsourced services are paid for out of the charges debited from the Sub-Fund.

The fees payable to the Non-Profit Sub-Fund in respect of the pre-demutualisation business are described below.

Administration fees for existing business are per policy fees with inflationary increases.

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.

Fees for requested developments affecting the Sub-Fund 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.

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 estate.

Expenses and commission to be deducted from Asset Shares may differ from the amounts charged to the Sub-Fund. There are no additional charges to the Asset Shares of with-profits policies when the expenses and commission incurred in managing the with-profits business exceed the amounts charged. However, any difference between the amounts that are charged to the Sub-Fund and the charges to Asset Share will be a miscellaneous profit or loss and would impact the excess capital of the Sub-Fund and hence the Adjusted Asset Shares of the pre demutualisation policies.

Except for assets covered by sections 5.5, 5.6 and 5.8 the cost of investment management for the Sub-Fund was initially set out in the Demutualisation Scheme but is now subject to periodic review.

## 7.3 Taxation

Full details of our taxation practices can be found in Appendix 5.

# 8 Solvency Risk Appetite, capital support and management of the estate

## 8.1 Principles

The Scheme requires us to maintain a Solvency Risk Appetite for Aviva Life & Pensions UK Limited. The Solvency Risk Appetite will be determined taking into account the level of risk we consider acceptable of not being able to meet regulatory capital requirements from time to time in adverse future circumstances.

The Solvency Risk Appetite will not be materially weakened other unless we have taken account of appropriate actuarial advice and have consulted the WPC, the Financial Conduct Authority and the Prudential Regulation Authority.

Separate Support Accounts are required by the Scheme to be maintained for the pre and post demutualisation business in the Sub-Fund. At any time, the amounts of the Support Accounts available for the Sub-Fund are determined in accordance with the relevant provisions of the Scheme, reduced by any support already provided to the Sub-Fund.

If and to the extent that the Scheme or PPFM requires, assets will be transferred into the Sub-Fund from the Support Accounts. Any interest payable on a transfer will be on terms which no more than recompense the Non-Profit Sub-Fund or Shareholder Fund for the return it would otherwise have earned on the assets transferred.

Our objective is to manage the Sub-Fund so that it, plus the Support Account assets (although not the post demutualisation Support Account), will cover the major part or all of the Sub-Fund's regulatory capital requirements.

We aim to achieve a fair distribution of the estate to those pre demutualisation with-profits policies entitled to share in it, over the remaining lifetime of those policies.

## 8.2 Management of the estate

Distribution of the estate to pre-demutualisation with-profits policyholders is achieved via the mechanism described in 2.3.2 above. Post demutualisation with-profits policyholders are not entitled to any of the estate, although the post-demutualisation Bonus Smoothing Account and any excess in the post-demutualisation Guarantee Charge Account will be distributed only to post-demutualisation policyholders.

The Sub-Fund is managed in line with its Risk Appetite Framework so that the risk that liabilities exceed assets is small. There is a preferred range for the estate, 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.

When the assets of the Sub-Fund (excluding those backing non-profit policies) fall below £250m, we may declare a one-off bonus or a series of fixed future bonuses to exhaust the surplus in the Sub-Fund. 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).

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.

## 8.3 Capital support arrangements

The Sub-Fund will be managed on the basis of the assets within the Sub-Fund, plus the assets backing the pre-demutualisation Support Account. Other than in extreme circumstances, we will not use the Support Accounts for the FP With-Profits Sub-Fund to support another with-profits sub-fund.

Our Solvency Risk Appetite requires us to maintain in all but the most extreme circumstances, assets in excess of regulatory capital requirements. This excess is expected to be more than sufficient to cover the Support Accounts for the Sub-Fund and those other with-profits sub-funds which also have Support Accounts.

The amount of the pre-demutualisation Support Account was £43m at 31 December 2016. That of the post-demutualisation Support Account was £20m. Each will reduce at subsequent year-ends in accordance with a schedule specified in the Scheme.

The Scheme sets out when and how large a temporary transfer must be made into the Sub-Fund from the Support Accounts. It also sets out when and to what extent a transfer may be repaid. For the pre-demutualisation Support Account, the transfer is to ensure that the assets of the Sub-Fund are at least equal to the liabilities. For the post-demutualisation Support Account, it is to ensure that the amount of the Guarantee Charge Account plus the expected value of future deductions from Asset Shares are sufficient to cover the cost of guarantees in respect of post-demutualisation policies.

The Scheme also provides that a temporary transfer into the Sub-Fund must not be made or must be limited so that the sum of:

- the value of the assets of the Non-Profit Sub-Fund (excluding the RIEESA);
- the value of the assets of Shareholder Fund; and
- the value of net assets attributable to the shareholder in other non-profit sub-funds;

does not fall below the sum of:

- the Technical Provisions for the Non-Profit Sub-Fund (excluding those in respect of any policies attributed to the RIEESA);
- the liabilities of the Shareholder Fund; and
- the Minimum Capital Requirement for the Company (excluding any part of that Minimum Capital Requirement in respect of a with-profits sub-funds or the RIEESA which is being met by that with-profits sub-fund or the RIEESA respectively).

# Appendix 1 – Glossary

## **Actuary**

An actuary is a person with a professional qualification specialising in financial risk and particularly insurance risk.

## **Adjusted Asset Share**

Asset share adjusted for enhancements or deductions as described in section 2.3.2.

## **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 WPA 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 Share**

A measure of the share of assets attributable to a with-profits policy, calculated by accumulating premiums paid at the rates of return earned on the assets assumed to be backing the policy, after allowing for deductions for partial payments of benefits and charges such as expenses, mortality and tax (see section 2.3.1).

## **Aviva group**

Aviva plc or any of its subsidiaries.

## **Bonus Smoothing Account (BSA)**

Bonus Smoothing Account. Used to assist in the smoothing of policy payouts (see section 3.4).

## **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 policy**

A with-profits policy that is not a unitised with-profits policy. Conventional with-profits policies generally have a guaranteed monetary amount payable on death or on a fixed date or an amount of annual income payable from a fixed date. The amounts may be increased by the addition of bonuses and are payable provided that all premiums due have been paid.

## **Counterparty**

The other party with whom we carry out an investment transaction. The value of the investment is at risk if the counterparty fails.

## **Demutualisation Date**

The date that the Demutualisation Scheme took effect, 9 July 2001.

## **Demutualisation Scheme**

The scheme of transfer on 9 July 2001 by which FPLO effectively became a shareholder-owned company rather than a company owned by its policyholders by transferring policies to FPLP (now part of the Company). This scheme was superseded and the relevant provisions are included in the current Scheme.

## **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.

## **Estate**

The assets held in a with-profits sub-fund in excess of those required to pay policy benefits and other liabilities, which include payments of guaranteed benefits and future bonuses based on Asset Share. The estate may be used to pay the guaranteed benefits under policies in that with-profits sub-fund if the reserves turn out to be insufficient. In practice, this means that the estate will vary in size from year to year, as it is in effect the balancing item between the total value of the investments of the with-profits sub-fund and the size of the reserves required.

## **Financial Conduct Authority**

One of the two regulators of financial services in the UK.

## **Final bonus**

A bonus which may become payable on a death, critical illness or maturity claim or on surrender or switch out of with-profits. Final bonuses are normally defined as a percentage of either the total value of with-profits benefits (including regular and interim bonuses) or of the regular and interim bonuses, depending on the type of policy. A final bonus is sometimes called a terminal bonus.

## **FLH**

Friends Life Holdings plc, another company in the Aviva group.

## **FPLAL**

Friends Provident Life Assurance Limited (all the policies of which were transferred under a 2011 Scheme and which have now been transferred to the Company under the current Scheme).

## **FPLO**

Friends Provident Life Office – all the policies of which were transferred under the Demutualisation Scheme.

## **Guarantee Charge Account (GCA)**

An account maintained to cover the cost of guarantees built up by regular bonus additions on post demutualisation with-profits policies. If guarantees exceed Adjusted Asset Share then the difference is paid from the GCA. Charges to cover the cost of guarantees are added to the account. The value of the GCA also rises and falls with changes in the value of investments backing the account.

## **Internal Model**

A method for calculating the Solvency Capital Requirement (SCR) and Risk Margin of an insurance company which has been individually approved by the Prudential Regulation Authority or which has not yet been approved but which is used by the Company for internal management purposes.

## **Market Value Reduction (MVR)**

A reduction that may be applied in accordance with the provisions of the policy to the payout under a UWP policy on surrender or on switch out of with-profits. The aim of applying an MVR is to protect policyholders who do not surrender from the impact on the Sub-Fund of surrendering policies taking more than their fair share of the funds.

## **Maturity**

The payment of policy benefits due on the maturity date specified in the policy. In the case of pension policies, the relevant date is called the normal retirement date or selected retirement date, when the pension payable under the policy would generally commence.

## **Minimum Capital Requirement**

One measure of the minimum amount of capital, in addition to its Technical Provisions, that an insurance company is required by its regulator to hold, in accordance with the PRA rules.

## **PPFM**

Principles and Practices of Financial Management (this document).

## **Prudential Regulation Authority (PRA)**

One of the two regulators of financial services in the UK.

## **Regular bonus**

A bonus that is added on a regular basis throughout the life of a with-profits policy, providing an addition to the guaranteed benefits payable to the policyholder. Regular bonuses are sometimes called annual bonuses, or, in the case of conventional with-profits policies, reversionary bonuses.

## **Remaining Assets**

Assets other than the Return Assets.

## **Reserves**

The assets which, together with premiums still to be paid, are expected in normal circumstances to produce sufficient income or proceeds from their sale to enable us to pay all benefits to policyholders in that with-profits sub-fund when they are due, and to meet the administration and other costs associated with these policies.

## **Return Assets**

Assets backing Adjusted Asset Shares (reduced by the amount of any asset share shorting) used to determine the investment return credited to Asset Shares.

## **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.

## **Risk Appetite Framework**

A framework to support decision making in relation to the with-profits sub-funds. It aims to manage the with-profits sub-fund so that the estate is within a preferred range.

## **Risk Margin**

Reserves in addition to best estimate liabilities and current liabilities which an insurance company is required by the Prudential Regulation Authority to hold.

## **RPI**

Retail Price Index.

## **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-funds. The assets of the Shareholder Fund are available to meet the Solvency Risk Appetite and, to the extent not required for this, may be distributed to shareholders.

## **Solvency Capital Requirement (SCR)**

The minimum amount of assets which an insurance company is required, by the Prudential Regulation Authority, to hold in addition to reserves covering its best estimate liabilities, current liabilities and Risk Margin.

## **Solvency Risk Appetite**

A framework that describes the level of capital that the Company will aim to hold, with the aim of ensuring that the security provided by the Sub-Fund for policyholder benefits is maintained at an adequate level, taking into account the risks borne by the Sub-Fund.

## **Sub-Fund**

Sub-Fund is used to refer to the Aviva Life & Pensions UK Limited FP With-Profits Sub-Fund

## **Support Account**

An amount required to be maintained in respect of certain with-profits sub-funds by the Scheme and in accordance with the Solvency Risk Appetite.

## **Technical Provisions**

The reserves an insurance company must hold to cover insurance and reinsurance obligations towards policyholders, as defined in the PRA rules.

## **Unitised with-profits (UWP) policy**

A policy (or part of a policy) under which the value of the benefits is measured by reference to with-profits units allocated to that policy.

## **With-Profits Actuary (WPA)**

An actuary employed by the Company who has the responsibility under Financial Conduct Authority rules for advising the Board on its application of discretion in relation to with-profits policies.

## **With-Profits Committee (WPC)**

A committee established to advise the Board on the fair treatment of with-profits policyholders and the management of the with-profits sub-funds.

## **With-profits sub-funds**

Any one of the with-profits sub-funds within the Company.



# Appendix 2 – 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 3 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 4 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: FP With-Profits Sub-Fund**

The business of the FP With-Profits Sub-Fund was originally mainly that of Friends Provident Life Office ('FPLO'), which demutualised (changed from being a company owned by its policyholders to one owned by shareholders) on 7 July 2001. All policies transferred to what is now the FP With-Profits Sub-Fund at demutualisation. These are referred to as 'pre demutualisation' policies and include with-profits and non-profit policies.

Prior to demutualisation, FPLO had taken over the business of United Kingdom Provident Institution and London and Manchester Assurance so the FP With-Profits Sub-Fund also includes policies written by those companies.

After demutualisation new ('post demutualisation') policies were generally not issued directly in what is now the FP With-Profits Sub-Fund. Rather they were issued in what is now the Non-Profit Sub-Fund, with the with-profits part being provided by what is now the FP With-Profits Sub-Fund. New with-profits business stopped being accepted on 30 September 2017, although increments to existing policies and new members to existing group schemes are still accepted.

Different series of policies exist for which bonus rates are declared which apply to all policies within the series. The bonus series for pre-demutualisation policies comprise all bonus series for conventional with-profits policies and the following bonus series for the unitised with-profits policies:

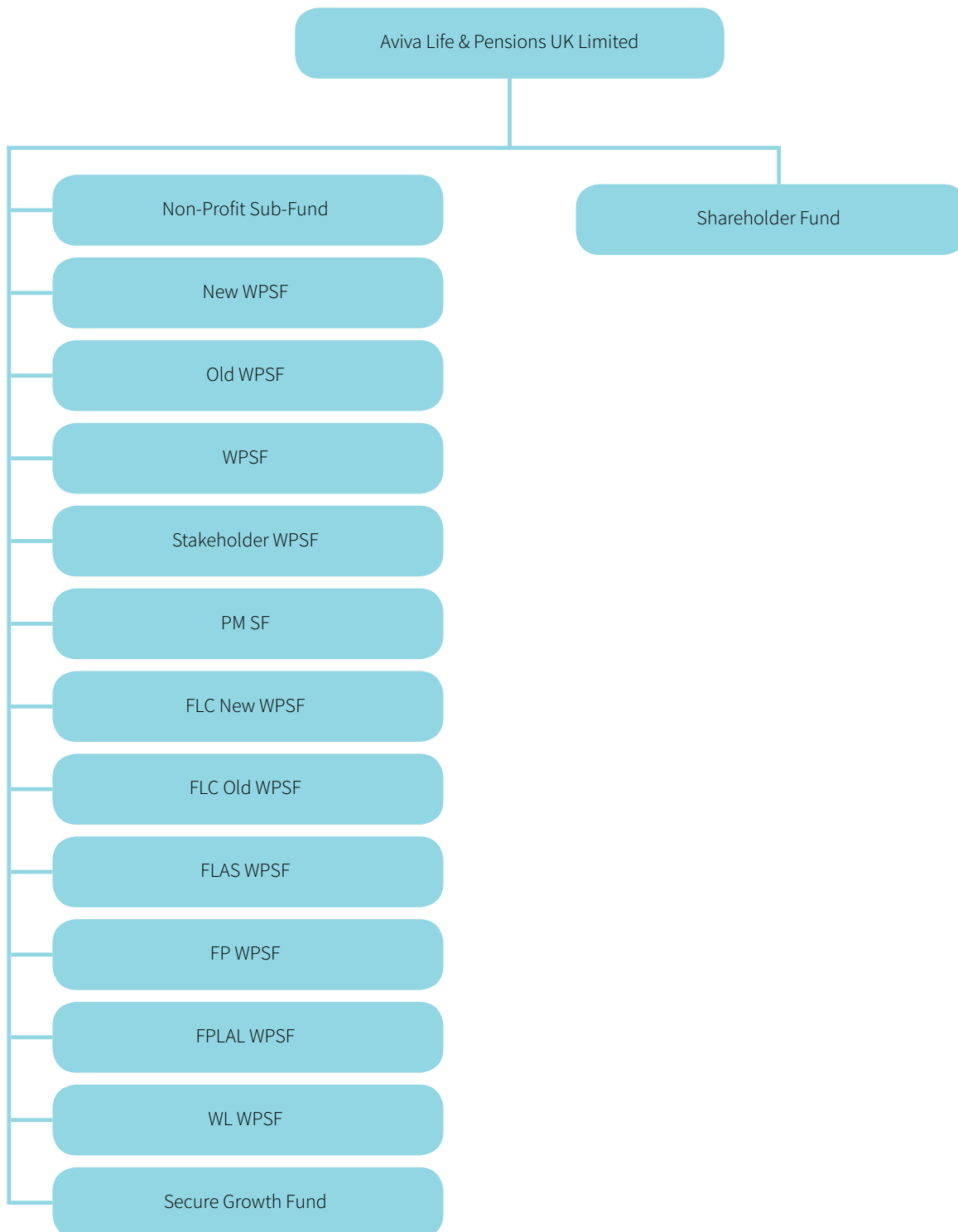
- FP Life and Pensions Series 1-7
- All United Kingdom Provident (UKP) Series
- All ex London and Manchester policies (FPLMA Series)
- New Generation Pensions Series pre 26 November 2001

(note that although group schemes commencing on or after 9 July 2001 are treated as post demutualisation, increments to existing schemes between 9 July and 25 November 2001 are treated as pre demutualisation)

- FP Overseas Life Assurance Business Series 1-2
- Policies originally issued by Friends Provident Life Assurance Limited before 9 July 2001

Pre and post demutualisation policies have different entitlements to share in the profits of the Sub-Fund. Post demutualisation policies share in 100% of the investment profits (or losses) in respect of the assets backing their policies less an appropriate amount for tax and investment expenses. They do not share any other sources of profit. All other profit from the Sub-Fund is apportioned between pre demutualisation with-profits policyholders and shareholders as set out in this PPFM. Increases since demutualisation to pre-demutualisation policies generally share in profits in the same way as post-demutualisation policies

# Appendix 3 – 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 4 – 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(s)
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

Company policy taken out with	Current Aviva Life & Pensions UK Limited 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
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

# Appendix 5 – Taxation details

Capitalised terms in this Appendix, to the extent not defined elsewhere in this PPFM, bear the meanings given to them by the Scheme. References to ‘the Board having taken account of appropriate actuarial advice’ shall be construed in accordance with the Scheme.

- 1 Under paragraph 39 of the Scheme, the tax charge (or credit) to the Sub-Fund will be calculated on the basis that the Sub-Fund is a separate proprietary company subject to taxation in the United Kingdom. That calculation will be performed on the basis set out in this Appendix.

On demutualisation, a provision was set aside in the Sub-Fund for additional shareholder tax that might arise on transferred business (referred to in the Scheme as the ‘Determined Amount Value’). To the extent that this proves to be insufficient the liability of the Sub-Fund is capped and the obligation falls upon the shareholder. To the extent this proves to be an overestimate, however, any excess will be retained for the benefit of pre demutualisation with-profits policyholders.

- 2 The charge in respect of tax to the Sub-Fund will be credited to the Non-Profit Sub-Fund which will bear the tax charge for the Company other than that attributable to the Shareholder Fund.
- 3 It is assumed that the separate proprietary company:
  - (a) does not form part of a group or other association (whether with another company, including with-profits sub-funds treated for tax calculation purposes as separate companies under paragraph 39.1 of the Scheme or any other sub-fund) for the purpose of any tax provision which allows Tax Reliefs in one company or sub-fund within such group or association to be used against income, profits or gains arising in another company or sub-fund within that group or association;
  - (b) does not form part of a group or other association (whether with another company, including with-profits sub-funds treated for tax calculation purposes as separate companies under paragraph 39.1 of the Scheme or any other sub-fund) for any other tax purpose save to the extent that the presence of an actual group or association ensures that a liability to VAT, stamp duty, stamp duty land tax or any similar transaction tax does not arise which would have been incurred had such a group or association not existed; and
  - (c) recovers the same proportion of input VAT as that recovered by the VAT group (for the purposes of the Value Added Tax Act 1994, section 43) of which the Company at any time is a member.

unless (in respect of (a) or (b)) the Board, having taken account of appropriate actuarial and tax advice, considers that it would, as the case may be, be appropriate in a particular circumstance to assume that the separate proprietary company does form part of a group or other association within (a) above, or does form part of a group within (b) above, or (as the case may be) does not form part of a group within (b) above.

- 4 Any Tax Reliefs calculated as available to be carried forward into a subsequent period in the separate proprietary company calculation for the Sub-Fund will be treated as available in subsequent calculations to offset appropriate taxable income or gains notwithstanding that there may be no corresponding Tax Relief carried forward in any calculation for the Company as a whole.
- 5 Tax Reliefs calculated as available in any separate proprietary company calculation for the Sub-Fund may only be utilised in calculations for that separate proprietary company and will not be available to be taken into account in the calculation of any other with-profits sub-fund.
- 6 In calculating the tax charge (or credit) the provisions of the Finance Act 2012 relating to apportionment of items between classes of business will be applied separately to the separate proprietary company.
- 7 The separate proprietary company will include only those assets and liabilities allocated to the Sub-Fund under the provisions of the Scheme net of any internal reinsurance arrangements. Where any asset or group of assets is held in a with-profits sub-fund or sub-funds for the benefit of more than one with-profits sub-fund then the tax charge (or credit) to each such with-profits sub-fund in respect of that asset or group of assets will be allocated on a commercial basis. The internal reinsurance arrangements mentioned in paragraph 30 of the Scheme and any similar arrangements will be treated as if they were reinsurance with an unconnected reinsurer, with the exception that the ceded liabilities will retain the same tax categorisation in the reinsuring sub-fund in cases where Basic Life Assurance and General Annuity Business (‘BLAGAB’) liabilities would otherwise be regarded as non-BLAGAB (or vice versa). Consequently, liabilities ceded will be left out of account and liabilities reassured will be treated as liabilities directly assumed. The purpose of this is to prevent the application of section 90 Finance Act 2012.
- 8 The receipt (or repayment) of a Temporary Transfer under paragraph 60 of the Scheme will not be treated as giving rise to a taxable profit or loss of the separate proprietary company. Assets held within the Support Accounts will not be allocated to the Sub-Fund for the purposes of the separate proprietary company calculation unless and until a Temporary Transfer of the same is made. Any payment of an Enhancement pursuant to paragraph 60 of the Scheme will not be treated as giving rise to a deduction for tax purposes and an amount equal to the Enhancement under paragraph 60 of the Scheme will not be treated as giving rise to income for tax purposes. The separate proprietary company calculation includes all the non-profit business in the Sub-Fund including the business where the Non-Profit Sub-Fund has an entitlement to an amount equal to 60 per cent of the surplus (the Schedule 3 Amount).

- 9 Subject to any specific provisions to the contrary, transactions between the Sub-Fund and other policyholder sub-funds within the Company will generally be treated as though they are transactions between the separate proprietary company and a third party. However, no VAT will be treated as arising on supplies of services between policyholder sub-funds within the Company and no withholding tax will be deducted from any payment made to other policyholder sub-funds within the Company.
- 10 Where paragraph 40 of the Scheme requires transfers of assets from or to the Sub-Fund to be carried out at market value, tax will be attributed to the separate proprietary company on the basis of the market value (as described in paragraph 40 of the Scheme) at the time the transfer takes place. An asset transferred to the Sub-Fund will, therefore, be treated as acquired then at market value. Similarly an asset transferred from the Sub-Fund will be treated as having then been disposed of at market value for tax purposes and an appropriate tax calculation will be made and taken into account in the overall tax charge for that period.
- 11 A deferred tax liability (or asset) will be calculated for the separate proprietary company on the basis adopted by the Company generally and in accordance with the principles set out above and the requirements of the Scheme.
- 12 Whenever any amount of corporation tax is payable by the Company on account as required under the 'Corporation Tax Self Assessment' regime, the amount attributable to the separate proprietary company will be calculated in accordance with the principles set out above. Further adjustments will be made where appropriate on agreement of the final liability of the Company.

| Retirement | Investments | Insurance | Health |

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