

Guardian Assurance Ltd's
Annual Report to With-Profits Policyholders
for the year to 31 December 2014

June 2015

In this report you can find details of how we managed our with-profits business in 2014 and how account was taken of our with-profits policyholders' interests.

About this report

The Financial Conduct Authority (FCA) requires us to produce a report each year for our with-profits policyholders stating whether or not, during the financial year in question, we believe we have complied with our stated Principles and Practices of Financial Management of With-Profits Business (PPFM).

In addition, the independent With-Profits Committee is involved in the ongoing assessment of our compliance with the PPFM, providing an element of independent judgement throughout the process. (You can find more details on this in the section 'How we make sure we're compliant with the PPFM' below.)

Our PPFM

Our PPFM sets out in detail our with-profits management strategy and processes. You can view it on our website at – www.guardianfs.co.uk – or write to us at Guardian Assurance Ltd, Ribble House, Ballam Road, Lytham St Annes, Lancashire, FY8 4JZ.

Our PPFM is split into two sections: Principles and Practices. The Principles set out our general approach to the management of with-profits business and are not expected to change often. The Practices cover the day-to-day operation of our with-profits business within the Principles framework.

Guardian Assurance and with-profits

Guardian Assurance Ltd can trace its history back to 1821 when the Guardian Fire and Life Company was formed. In 1901 Guardian Fire and Life Company was re-branded as Guardian Assurance and in 1968 Guardian Assurance merged with another life office - the Royal Exchange. In 1970, 5 Life Funds (Guardian, Royal Exchange, Atlas, Caledonian and Licences and General) of the combined group were merged to form the with-profits fund ("the Fund") of Guardian Assurance Ltd.

The Fund contains both with-profits and non-profit business including unit-linked business. The with-profits policyholders receive 90% of the profits arising in the Fund and the shareholder receives 10% of the profits. The ultimate shareholder is now Cinven, a leading European private equity company founded in 1977, following the sale of Guardian by AEGON in 2011.

In 1998 the Fund was restructured and became closed to new business. As part of the restructure the Fund received a cash injection from the then shareholder in return for 70% of the future profits arising on the major classes of unit-linked business written in the Fund. The cash injection was invested in the Fund.

Since the Fund became closed to new business, the estate held within the Fund is no longer required as working capital and is being distributed gradually to the with-profits policyholders by way of higher bonus rates than would otherwise have been the case. Only with-profits policies that were in-force at the time of the announcement of the restructure benefit from the distribution of the estate.

Changes to the Guardian Assurance With-Profits Fund from 30 June 2012

At 30 June 2012, some changes were made to the way that With-Profits policies are managed in future. These changes were made by Guardian in consultation with and with the agreement of our then regulator, the Financial Services Authority. The impact of these changes on our with-profits policyholders is a faster and more equitable

distribution of the free estate (basically, the profits retained within the With-Profits Fund over the last 190 years). In simple terms, this means that final bonus rates for policies terminating, at least in the near term, will be higher than they would have been otherwise, although these are also impacted by financial market movements.

The changes have been made to reduce the risks carried within the With-Profits Fund with the aim of enhancing future pay-outs to with-profits policyholders wherever possible. For some with-profits policyholders, this will mean higher future final bonus rates than would have been the case had this restructure not taken place. For other with-profits policyholders, where the value of the guaranteed benefits exceeds the assets accumulated in respect of their policy and the cost of the guarantee is already being met by the free estate, there will be no change.

Our PPFM was updated during 2012 to reflect these changes. Further details are available on our website at – www.guardianfs.co.uk – or write to us at Guardian Assurance Ltd, Ribble House, Ballam Road, Lytham St Annes, Lancashire, FY8 4JZ.

With-profits contracts

All with-profits contracts offer a guaranteed rate of return. The rate varies by type of with-profits contract and over the years the Fund has written a large variety of with-profits contracts as described below. Note that references to guarantees are in the context of the specific points in time where guarantees may apply (e.g. maturity, death, retirement at selected retirement date, regular income withdrawals, withdrawals at a specific anniversary). Guarantees do not generally apply on early surrender.

The main classes of with-profits business are: -

Deferred annuity contracts namely: -

- Pension Plus
- Versatile Individual Pension Plan
- Buy-Out Plan
- Personal Pension
- Participating Pension
- Chargeable Rates
- Deposit Administration
- Pension Saver

Life Assurance contracts namely: -

- Endowments
- Whole of Life

Unitised With Profits contracts namely: -

- Freedom
- Choices

How we make sure we're compliant with the PPFM

We take advice from the With-Profits Actuary on all aspects of the operation of with-profits business. This ranges from bonus declarations to the systems and procedures needed to treat with-profits policyholders fairly. The With-Profits Actuary advises on whether any changes we make are consistent with the PPFM and produces routine reports for us. One of these is a detailed report explicitly covering compliance with the PPFM during the previous financial year.

Also, the independent With-Profits Committee provides an element of external judgement on compliance with the PPFM. This committee includes members that are external to the Company. The With-Profits Committee Terms of Reference are published on our website and reviewed annually. They describe the duties of the With-Profits Committee, which include assessing how the rights and interests of with-profits policyholders have been addressed and monitoring compliance with the PPFM. The With-Profits Committee have reviewed this report and there were no additional matters which they wished to bring to policyholders' attention.

The Board meet regularly throughout the year and its directors take advice from the With-Profits Committee. At these Board meetings the attendance of the With-Profits Actuary, as well as certain directors and management of Guardian Assurance, is required. As a matter of course during the year, the With-Profits Actuary routinely discusses matters with the With-Profits Committee.

Our with-profits decisions

Within our with-profits business, we have discretion (in other words we make all the decisions as to what to do) in the following key areas:

- Investment policy
- The level of annual bonus rates
- The level of terminal bonus rates, market level adjustments and surrender values
- The level of expenses allocated to asset shares
- The level of taxation allocated to asset shares
- Deductions for the expected future costs of guarantees within the calculation of asset shares
- The level of Bonus Surplus allocated to asset shares from the distribution of the estate. (The estate is the excess assets over and above the amount required to meet liabilities to policyholders.)

Investment policy

The investment policy is set out in Section 4.6 of the PPFM. The investment mix of each with-profits policy differs depending on the maturity of the business and the proportion of the final pay-out which is guaranteed. The Fund adopts a close matching policy such that any guaranteed payouts, including basic sums assured, annual bonuses and annuities in payment are matched in terms of size and timing by the projected cash flows from the fixed interest assets held.

Benefits that are not guaranteed, such as accrued terminal bonus, are generally backed by UK equities. The estate is invested in a mixture of UK fixed interest securities and UK equities. Further details are given in the PPFM.

The current equity investment objective is to track the FTSE 350 published index and actual investment performance is monitored against this benchmark on a monthly basis. In accordance with Section 4.6 of the PPFM, Equity derivatives may also be used as appropriate, e.g. to provide protection against adverse market movements. A series of equity derivatives was purchased by the With Profits Fund over 2014 to provide some protection for conventional with profit endowment maturities until 2019.

The investment strategy adopted during the year has been consistent with that set out in the PPFM and the equity backing ratios, which vary from class to class and also by duration, have been in the range set out in the PPFM.

The gross investment returns achieved over the 12-month period to 31 December 2014 were used directly in the calculation of the asset shares during 2014 based on the assumed asset mix of the relevant asset share.

Annual bonus rates

The relevant practices are set out in Section 4.3 of the PPFM. The practices set out that, for other than Deposit Administration, Pension Saver and Group Funding, annual bonus rates were reduced at the 31st December 2004 declaration to such a level that no further reductions were planned. Consistent with this approach, for the relevant classes of with-profits business, the annual bonus rates declared for 2014 were equivalent to the rates for 2013.

The declared yearly bonus rates are given below, with the previous year's rates for comparison.

Yearly bonus declared in arrears

	31 December 2014	31 December 2013
Pension Plus	0.5%	0.5%
Versatile Individual Pension Plan	0.5%	0.5%
Buy-Out Plan	0.5%	0.5%
Personal Pension	1.0%	1.0%
Participating Pension	1.0%	1.0%
Chargeable Rates	2.6%	2.6%
Life Assurances	1.0%	1.0%

Yearly bonus declared in advance

	1 April 2014	1 April 2013
Choices Unitised With-Profits – Basic / Bonus Interest Rate	0.5% / 1.0%	0.5% / 1.0%
Freedom Unitised With-Profits	1.25%	1.25%

Terminal bonus rates, market level adjustments (MLAs) and surrender values

The relevant practices are set out in Sections 4.4 and 4.5 of the PPFM. The amounts payable under Deposit Administration and Pension Saver are predominantly based on 15 year gilt yields and the amounts payable under Chargeable Rates policies are based on the relevant premium rates and fixed interest yields. For Deposit Administration, Pension Saver and Chargeable Rates this approach has been followed throughout 2014.

For other classes of with-profits business the calculation of asset shares is fundamental to the amount payable. The way in which asset shares should be calculated is described in section 4.2 of the PPFM and asset shares were calculated in this way throughout 2014.

Terminal bonus rates are determined having regard to any excess, for groups of policies, of asset shares above the value of the guaranteed benefits including annual bonuses added. Terminal bonuses are reviewed monthly and the practices explain the circumstance that results in changes to terminal bonus rates. The practices explain that for the majority of deferred annuity business the guaranteed benefits at retirement exceed the asset share by a significant amount and hence the terminal bonus rate is zero.

There was a minor change to the Terminal Bonus calculation methodology for pre-1982 deferred annuities to reduce the volatility that results from reducing business volumes within a closed portfolio. The previous approach involved targeting the asset share for vesting policies over the following 12 months but the Guardian With Profits Committee approved a change such that specimen policy details will be used, based on the profile of the remaining in force liabilities. This approach of using specimen policies for this category of customers is consistent with market practice for With Profits funds that are closed to new business and may be extended to other categories as the policy volumes reduce.

The application of a MLA is assessed on a policy by policy basis and the practices detail the circumstances under which a MLA will be applied with respect to unitised with-profits business. These practices have been followed throughout 2014 and terminal bonus rates

were amended for certain classes of business with effect 1st January 2014 and 1st April 2014.

Surrender values are regularly reviewed throughout the year.

Expenses

Section 4.8 of the PPFM explains all normal management and administration expenses are met by the shareholder through a shareholder-owned service company. The Fund pays the shareholder an agreed level of expense based on an agreed amount per policy. The amount varies by type of policy and increases each year at a rate equal to the increase in the retail price index plus 1%. The Fund pays an agreed annual management charge to two external investment managers, Kames Capital, the fixed interest manager, and BlackRock, the equity manager, for investment services, which for 2014 was 0.085% per annum for bonds, 0.033% for equities plus an additional 0.011% for fund accounting. The With Profits Fund is liable for VAT on the investment expenses excluding equity, as the latter is a VAT exempt investment vehicle. The level of expenses borne by the Fund and similarly the amount of expenses allocated to asset shares during 2014 was consistent with these agreements.

Taxation

Section 4.2 of the PPFM states that the investment returns allocated to asset shares are adjusted for taxation where appropriate. Hence, the investment returns allocated to the life business are reduced for taxation whereas the returns with respect to pension business are not reduced. Any difference between the tax allocated to asset shares compared to the overall tax assessment of the Fund emerges as a miscellaneous profit or loss and is allocated to the estate. Since 30th June 2005, the additional tax resulting from the transfer out of the Fund of the shareholder's share of profits is met by the estate whereas previously it was charged directly to asset shares.

Deductions for guarantee costs

During 2014 no deduction was made for the cost of guarantees as such costs are currently met by the estate as outlined in Section 4.9 of the PPFM.

Estate

The approach to managing the estate is set out in practice 4.9 of the PPFM. The intention is to distribute the estate equitably to with profits policies in force at the time of the Fund's restructure at the end of 1998 by using Bonus Surplus to enhance asset share returns. Consistent with this intention, for 2014 a Bonus Surplus of 3% was declared, increased from 2.5% in 2013.

Consistent with the practices, the estate was also used during 2014 to provide capital support towards meeting the regulatory solvency requirements, the cost of guarantees, smoothing costs and any compensation or redress in connection with the way business written in the Fund has been marketed or sold.

Our directors' opinion on our with-profits management in 2014

We can confirm that, throughout 2014, we have met the requirements of the PPFM and we have exercised our judgement fairly, taking into account the interests of with-profits policyholders in a fair and reasonable manner. Our governance arrangements involve independent advisers on our With-Profits Committee providing some external judgement on the assessment of our compliance with the PPFM. We are satisfied with the operation of these arrangements (and the judgement exercised) throughout 2014.

**The directors of Guardian Assurance Ltd
June 2015**

Statement by the With-Profits Actuary

I can confirm that, in my opinion, the company's 2014 annual report and the discretion exercised by the company during 2014 have taken the interests of with-profits policyholders into account in a reasonable and proportionate manner. In reaching this conclusion I have taken account of the information and explanations provided to me by the company as well as the relevant rules and guidance of the Financial Conduct Authority, the Board for Actuarial Standards and the Actuarial Profession.

**Andrew Pennington
Fellow of the Institute and Faculty of Actuaries
With-Profits Actuary, Guardian Assurance Ltd
June 2015**

We're not allowed to give you advice, but if you'd like any further information on our with-profits contracts and how we run them, please contact us.

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