ReAssure Limited
Guardian Assurance With Profits Fund
October 2020

Principles and Practices of Financial Management of With Profits Business

ReAssure

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ReAssure

1. Introduction

1.1 The document has been prepared in accordance with the requirements of the FCA's Conduct of Business Sourcebook COBS 20 and details the Principles & Practices of Financial Management (PPFM) followed by ReAssure in respect of the with-profits business held in the Guardian Assurance With Profits Fund (**GAWPF**). The name **GAPWF** has been used through this document to refer to the fund previously known as the Guardian With Profits Fund within ReAssure Life Limited and all its previous names (e.g. as described in sections 3.1.2 to 3.1.4). This version of the PPFM was adopted for **GAWPF** on 31st March 2018 and supersedes the previous version dated 30th June 2017.

1.2 The purpose of the document is to help further the understanding of current and potential with-profits investors and their financial advisers as to the way in which ReAssure (the "**Firm**") manages the with-profits business held in the **GAWPF**, including that accepted by way of reinsurance from Countrywide Assurance plc, and provide details on the governance procedures for such business.

1.3 If any changes are proposed to the Principles, with-profits policyholders will be notified in writing three months in advance of the effective date of the proposed changes. If any changes are made to the Practices, policyholders will be notified within 12 months of the effective date of change.

1.4 An annual report will be produced by the **Firm** confirming whether, throughout the financial year to which the report relates, the **Firm** believes it has complied with the PPFM and setting out the reasons for that belief. The first such report was produced in 2006 in respect of the 2005 calendar year.

1.5 Annexed to the report detailed in 1.4 will be a report from the **Firm's With- Profits Actuary** as to whether, in his opinion and based on the information and explanations provided to him by the **Firm**, the report detailed in 1.4 and the discretion exercised by the **Firm** over the period in question have taken into account the interests of with-profits policyholders in a reasonable and proportionate manner. The first such report was produced in 2006 in respect of the 2005 calendar year.

1.6 In accordance with the **Firm's** governance arrangements the Fairness Committee provide an element of independent judgement in the ongoing assessment of compliance with the PPFM. A majority of the members of the Fairness Committee have to be independent of Phoenix Group.

1.7 Explanations of words and phrases highlighted in bold are given in the Glossary at the end of the document.

2. Variation Provision

2.1 The Directors believe that the Principles should not, normally, vary in the short term as they set out the general approach to the management of with-profits business. The Practices cover more detailed points and may vary more frequently. Notification of any variations to Principles or Practices will be given in accordance with requirements applicable from time to time.

2.2 Notwithstanding the foregoing:

2.2.1 The Directors expressly reserve the right to vary the Principles and Practices at any time if appropriate in order to achieve any of the following - to maintain the financial solvency of the **GAWPF**, to meet legal or regulatory requirements as identified or applied from time to time, or otherwise to maintain equity amongst different categories or generations of with-profits policyholders in the changed circumstances that may prevail from time to time.

2.2.2 The Directors are obliged at all times to manage the with-profits business of the **Firm** in accordance with the terms of a High Court approved Scheme dated December 2016 (see section 3.1 for further detail) and with the Articles of Association of the Company.

2.2.3 The Directors are obliged to give effect to legal and regulatory requirements as they apply to the **Firm** in a way that meets those requirements.

3. Principles of Financial Management of With-Profits Business

3.1 Background to the Principles

3.1.1 ReAssure Limited ("ReAssure" or the "Firm") is a life insurance company that is part of Phoenix Group. Phoenix Group acquired ReAssure in July 2020. In recent years, ReAssure has grown by acquiring existing blocks of business from other companies, or by purchasing other insurance companies outright. Swiss Re bought the Guardian group of companies in January 2016 and Guardian Assurance Limited was renamed ReAssure Life Limited in June 2016.

On 31 December 2016 the assets and liabilities of ReAssure Life Limited were transferred to ReAssure under the terms of the High Court approved Scheme in accordance with Part VII of the Financial Services and Markets Act 2000. The Guardian Assurance With Profits Fund is now a ring-fenced fund in ReAssure which means that it is managed and accounted for separately from all other funds of ReAssure.

3.1.2 In 1998 the **GAWPF** was restructured and became closed to new business. From that date 70% of the profits arising on the major classes of unit- linked business written in the Fund were reassured to other **shareholder**-owned companies. The **GAWPF** received a cash injection, in return for these reassured profits, which was invested in the Fund. Under the terms of a reassurance agreement dated 30th June 2012, the remaining 30% of profits arising on these classes of unit-linked business written in the **GAWPF** were also reassured on the same terms to other **shareholder**-owned companies, in return for which the **GAWPF** received a further cash injection, which was invested in the Fund.

3.1.3 Since the **GAWPF** 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, as the business declines. Only with profits policies that were in-force at the time of the announcement of the 1998 restructure benefit from the distribution of the **estate**.

3.1.4 Under the terms of a restructuring of the **GAWPF** which took effect on 1st January 2012, non-profit annuity polices were transferred from the fund to the Guardian Assurance Non Profit Fund (**GANPF**). In addition, **guaranteed benefits** of with-profits annuity policies were reassured to the **GANPF** from the With Profits Fund of Guardian Assurance. This restructuring is expected to enable a faster and more equitable distribution of the **estate**.

3.1.5 The operation of the **GAWPF**, in addition to this PPFM document, is now governed by a scheme of transfer (the "Scheme"), a legal document entered into by ReAssure Life Limited (formerly Guardian Assurance) and ReAssure in December 2016.

3.1.5.1 All policies and corresponding assets and liabilities which were allocated to the **GAWPF** (other than those policies allocated to the **Guardian Defined Unit Linked Business**– refer to 3.1.5.2) prior to 31 December 2016 were allocated to a newly created with-profits fund within ReAssure called the Guardian Assurance With-Profits Fund (**GAWPF**);

3.1.5.2 The **Guardian Defined Unit Linked Business** comprises defined unit-linked and **unitised with-profits** business, namely Choices Pension, Freedom Life and Group Money Purchase contracts. Prior to 31 December 2016 these contracts formed part of the **GAWPF** but from that date they were allocated to the **ReAssure Non-Profit Fund**. The non-linked cash flows from the **Guardian Defined Unit Linked Business** were previously wholly reinsured to the **GANPF** following the **GAWPF** restructures in 1998 and 2012. Therefore the reallocation of the **Guardian Defined Unit Linked Business** ensures that their location is consistent with their economic position; the risks insured and any profits or losses arising from that business are allocated to the **shareholder**.

3.1.5.3 The unit linked Funds of the **Guardian Defined Unit Linked Business** were allocated to the **ReAssure Non-Profit Fund**. The assets and liabilities were allocated to corresponding new Linked Funds established within the **ReAssure Non-Profit Fund**. Where necessary, the investments in Linked Funds of any unit linked policies remaining within **GAWPF** were internally reinsured to these new Linked Funds established in the **ReAssure Non-Profit Fund**.

3.1.5.4 All policies and corresponding assets and liabilities which were, prior to 31 December 2016, allocated to the **GANPF** (or the Guardian PHI Fund) were allocated to the **ReAssure Non-Profit Fund**.

3.1.5.5 Hybrid policies (including those with Unitised With-Profit fund links) and any increments thereon, were allocated to the **ReAssure Non-Profit Fund** but the **unitised with-profits** investment element of these policies is reinsured into the **GAWPF**. This investment element, including the approach to bonus setting and **estate** distribution, continues to be managed in line with the PPFM of **GAWPF**.

3.1.5.6 The Scheme continues to provide for the ring-fencing of the **GAWPF** (including its free assets or "**estate**") for the benefit of the with-profits policyholders in the **GAWPF** (and policyholders with **unitised with-profits** investment element reinsured into the **GAWPF**). Profits are shared in the proportions 90:10 between with-profits policyholders and the **shareholder**s of ReAssure following the transfer.

3.1.6 In addition to the **shareholder's** 10% interest in the **GAWPF**, there exist investment and expense management agreements. The investment managers receive an annual management charge in return for managing the investments of the **GAWPF**. The **shareholder** provides all other administrative services to the **GAWPF** in return for an expense allowance that is based on unit cost levels in the base year of the agreement, plus an allowance for expense inflation which is related to RPI.

3.1.7 '**Firm**' in this document refers to ReAssure Limited.

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3.2 The Amount Payable under a With-Profits Policy

3.2.1 For traditional (non-unitised) with profits (Pension Plus, Versatile Individual Pension Plan, Buy-Out Plan, Personal Pension and Participating Pension), amounts payable under with profits policies are guided by the calculation of "**asset shares**" (see 4.2). For Life Assurances, see 3.2.8 below.

3.2.2 To the extent considered appropriate, the investment returns that underpin the calculation of **asset shares** may be adjusted for expected costs of guarantees and costs for the use of capital. **Asset share** returns may be enhanced by **Bonus Surplus**.

3.2.3 Consistent with the concepts of pooling and **smoothing**, bonus rates are not set by reference to individual policy **asset shares**, rather by reference to the **asset shares** of groups of individual policies with similar characteristics (e.g. by in-force duration to the last whole year). The use of an average policy approach, which removes the volatility in **Terminal bonus** rates arising from changes in the business profile, is consistent with this principle.

3.2.4 The methods used to set pay-outs to policyholders aim to ensure that pay- outs represent fair value in relation to the investment return achieved, the risks borne by the **GAWPF** and the characteristics of the policy type.

3.2.5 Any changes to the methods used to set pay-outs require the approval of the **Board**.

3.2.6 No changes would normally be made to any historic assumptions or parameters underpinning the calculation of **asset shares**, unless an error in such assumptions or parameters was subsequently discovered. However, future changes may be appropriate on account of, for example, developments in actuarial techniques, enhanced systems capabilities or legal judgements or to take into consideration tax assessments when finalised.

3.2.7 The Practices contain details of the approximations underpinning the calculation of the amounts payable to with-profits policyholders. Examples of such approximations would be the application of monthly (rather than daily) investment returns in the calculation of **asset shares** and the grouping together of policies with similar characteristics in determining affordable **annual bonuses**, **final bonuses** and **market level adjustments**. Any approximations are applied consistently and are intended to have a broadly neutral effect over time and within product type.

3.2.8 For Life Assurances (comprising endowment and whole of life assurance), amounts payable are guided by comparing the **prospective value** of the future benefits to be paid (including the **shareholder's** share of surpluses), plus the **prospective value** of the future expenses to be incurred, less the **prospective value** of the future premiums receivable, with the value of the assets being held to support these policies as a group. The returns on the assets held to support these policies as a group may be enhanced by **Bonus Surplus**.

3.2.9. Unless otherwise stated within this document, for Life Assurances all references to

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asset shares throughout this document should be taken to mean the value of the assets being held to support these policies as a group, including any enhancements from **Bonus Surplus**.

3.3 Overriding Principle

3.3.1 The overriding principle that the **Firm** seeks to apply (subject to regulatory and legal requirements as interpreted and established from time to time) in determining **annual, terminal** & **final bonus** rates and **market level adjustments** (MLAs) is to maintain equity between different classes and durations of policyholders ("the Overriding Principle"). Bonus declarations are made at the absolute discretion of the **Board**.

3.3.2 When determining **annual, terminal** & **final** bonus rates and **MLAs** from time to time in accordance with the Overriding Principle, the **Firm** shall have regard to **asset shares** and the other matters and provisions described in these Principles and in the Practices annexed. The concept of **asset shares** does not, however, represent a policyholder entitlement but is a guide to meeting the objective that bonus declarations, from time to time, accord with the Overriding Principle.

3.4 The Approach to setting Annual bonus Rates

3.4.1 The general approach to setting **annual bonus** rates is to project current **asset shares** to maturity, assuming estimates of future investment returns. These projections can be used to ascertain if **annual bonus** rates are supportable in the future.

3.4.2 Different rates of **annual bonus** apply depending on the characteristics of the individual classes of business written by the **Firm** (e.g. guaranteed growth rates, investment mix and tax).

3.4.3 For other than Deposit Administration, Pension Saver and Group Funding, the **annual bonus** rates were reduced at the 31st December 2004 declaration to such a level that no further reductions are planned. The investment strategy is consistent with the intention of not reducing annual rates further - as outlined in 3.7 below.

3.4.4 If future investment returns are significantly better than expected then **terminal bonus** rates will be increased above those that would have otherwise applied. **Annual bonus** rates would be reduced if future returns are significantly worse than expected or as required by the Overriding Principles.

3.4.5 Deposit Administration and Pension Saver **annual bonus** rates are set by reference to gilt yields as outlined in the Practices. Group Funding bonus rates are set by reference to the **premium rates** and fixed interest yields as outlined in the Practices.

3.4.6 The same rate of **annual bonus** normally applies to all policies within a class irrespective of when policies were taken out.

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Differences between generations are dealt with, where possible, through the **terminal bonus** structure and/or MLA. This could change if the **asset shares** of particular cohorts of policyholders were low relative to their guaranteed benefits. In such a circumstance, it could be appropriate for lower **annual bonus** rates to apply to that cohort.

3.5 The Approach to setting Terminal Bonus Rates and/or Market Level Adjustments (MLAs)

3.5.1 **Asset shares** are calculated for groups of policies with similar durations within each policy class.

3.5.2 **Terminal bonuses** are then normally declared or applied having regard to any excess, for groups of policies, of **asset shares** above the value of **guaranteed benefits** (including **annual bonuses** already added). This principle applies to all claim types, including surrenders.

3.5.3 **MLAs** are then normally applied having regard to any shortfall, for groups of policies, of 100% of **asset share** below corresponding unit values (including **annual bonus** additions). This principle only applies to claim types under which a **MLA** may be applied (e.g. surrenders)

3.5.4 **Terminal bonus** rates are influenced by the experience of the **GAWPF** over the policy lifetime, particularly as regards investment return, and also by the amount of guaranteed basic benefit allocated at outset. Hence the **premium rates** in force at outset may influence the **terminal bonus** rate at the claim date.

3.5.5 The general objective is to pay, for groups of policies, 100% of the **asset share** at maturity or on early surrender. For practical purposes some **smoothing** of **terminal bonus** rates may be applied and maturity values for groups of policies will generally be within the range 95% to 105% of **asset share** and 90% to 110% on early surrender. The exception is policies where no **terminal bonus** can be afforded due to high **guaranteed benefits**, and in these cases it may be unavoidable that more than 105% of **asset share** is paid. In these cases the excess will be borne by the **estate**, and not directly by other maturing policies, except in the case of benefits reassured to the **Non-Profit Fund** where the obligation to pay the **guaranteed benefits** is borne by the **Non-Profit Fund** and, ultimately, by the **Shareholder**.

3.5.6 The different rates of **terminal bonus** applying will be determined at the discretion of the **Firm** having regard to the characteristics of individual classes of business (e.g. guaranteed growth rates, investment mix, tax).

3.5.7 It may not always be appropriate to set **terminal bonus** rates that target 100% of **asset share** on claim. For example as the volume of in-force with profits business reduces, the degree of **smoothing** may need to change to ensure the remaining policyholders are to obtain fair values at the point of claim.

3.5.8 It may be appropriate to pay less than 100% of **asset share** on claims if, otherwise, the interests of the remaining policyholders could be unduly adversely affected. This situation could arise if, for example, a group of policyholders sought to withdraw at a time when significant upward **smoothing** was taking place.

3.5.9 It would not be appropriate to pay 100% of **asset share** on claims if this could jeopardise the solvency of the **GAWPF** or would be contrary to the Overriding Principle.

3.6 <u>The Approach to Smoothing</u>

3.6.1 No significantly different approach to **smoothing** would normally be made by type of claim.

3.6.2 The **Firm's** intention is that the cost of **smoothing** should be neutral over time. This means that, at different times, pay-outs to policyholders may be guided by more or less than 100% of **asset shares**.

3.6.3 There are specific costs of **smoothing** over the shorter term that the **Firm** believes should not be exceeded.

3.6.4 The calculation of **MLAs** for unitised business and surrender values for traditional (non-unitised) business is normally only made by reference to underlying asset values. However, there may be occasions where policyholder behaviour has an impact; for example, if a group of policyholders sought to withdraw at a time when significant upward **smoothing** was taking place.

3.7 <u>Investment Strategy</u>

3.7.1 The fixed interest portfolio is invested with the objective that, as far as is reasonable, the projected cash flows from the portfolio match, both in terms of size and timing, the guaranteed with-profits liabilities, such as **basic sums assured**, accrued **annual bonuses**, as well as the expected future **annual bonuses**. The same applies for **non-profit liabilities** held within the **GAWPF**.

3.7.2 Benefits which are not guaranteed, such as accrued **terminal bonus**, are generally backed by UK equities.

3.7.3 For with-profits pension policies where no **terminal bonus** can be afforded, the investments backing the **asset share** will be entirely fixed interest stocks.

3.7.4 In certain circumstances the **Firm** may rely on assets held within the **shareholder's** fund in order to maintain the investment strategy of the **GAWPF**.

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3.7.5 It may be appropriate to utilise **derivatives** to protect the **GAWPF** or specific cohorts of policyholders within the **GAWPF** against adverse market movements (e.g. equity falls or changes in fixed interest yields). It may also be appropriate to utilise **derivatives** for short-term asset allocation purposes or to increase diversification by gaining exposure to different asset classes or for efficient portfolio management.

3.7.6 Exposures to individual **counterparties** (including **derivative** exposures) across the entire **GAWPF** would not normally exceed regulatory **admissibility limits**. An appropriate spread of assets between counterparties will be held in order to reduce risk.

3.7.7 Management meet regularly with the investment managers to discuss all investment issues pertaining to the **GAWPF**.

3.7.8 The **GAWPF** would not usually expect to invest significant amounts in assets that would not normally be traded because of their importance to the **Firm**.

3.8 Business Risk

3.8.1 **GAWPF** no longer writes new business but is legally obliged to accept incremental business and the exercise of options on certain life and pension policies. The risks of writing such business are reduced as generally the terms on which it is accepted can be varied by the **Firm** at any time. Currently the volumes received of such business are very small.

3.8.2 Certain existing business risks have been identified by the **Firm** and appropriate reserving has been put in place. Any currently unrecognised business risks that might fall to the **Firm** could impact on future returns to with-profits policyholders. This would depend on the nature of any such risks and their size.

3.9 Management and Administration Expenses

3.9.1 All normal management and administration expenses, other than investment expenses, are met by the **shareholder** through the **shareholder**-owned service company ReAssure UK Services Ltd. The **GAWPF** pays the **shareholder** an agreed level of expenses, which is set as the base date unit costs increased by **RPI** plus 1% each year.

3.9.2 The **GAWPF** pays agreed annual management charges to the **investment managers** for investment management services.

3.9.3 **Policy charges** on **unitised with-profits** policies are the same as for other unit-linked policies within the Guardian Defined Unit Linked Business, and can be increased by the **Firm**.

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3.10 Management of the Estate

3.10.1 The **Firm** aims to distribute the **estate** equitably to the with-profits policies in force at the time of the announcement of the **GAWPF**'s 1998 restructure in accordance with the Overriding Principles. The distribution of the **estate** is achieved by using **Bonus Surplus** to enhance **asset share** returns.

3.10.2 The **Firm** aims to maintain a sufficient level of **estate** within the **GAWPF** to meet the regulatory requirements that would apply were the **GAWPF** a separate firm.

3.10.3 The **estate** provides capital support towards meeting **regulatory solvency requirements**.

3.10.4 The **estate** is used to meet the cost of guarantees (which includes meeting the excess when more than the **asset share** is paid out), the costs for the use of capital and any **smoothing** costs.

3.10.5 The **shareholder** has no entitlement to the **estate** other than by way of 10% of the profits that emerge through the distribution of the **estate**.

3.11 Management Actions when the fund is of sufficiently small size

3.11.1 Once the admissible value of the assets in the **GAWPF** falls below a stated level then management actions can be considered to merge the **GAWPF** with another with-profits fund and also to consider potential conversion to non-profits status. These actions would be subject to approval of the Fairness Committee, **Board** of Directors, Regulators and an Independent Expert appointed to review the exercise to ensure with-profits policyholders are treated fairly.

3.12 Equity between the With Profits Fund and Shareholder

3.12.1 In accordance with the High Court Approved Scheme Dated December 2016, **shareholder**s receive 10% of the profits arising in the **GAWPF**.

3.12.2 It was established at the time of the **GAWPF**'s 1998 restructure that the Fund has no **Orphan Estate**.

4. Practices of Financial Management of With-Profits Business

4.1 General

4.1.1 The **GAWPF** has written a variety of with-profits business over many years. In particular, there is a wide range of policies with differing levels of guarantee in existence.

4.1.2 The **GAWPF** no longer writes new business but is legally obliged to accept incremental business and the exercise of options on certain life and pension policies. The risks of writing such business are minimised as generally the terms on which it is accepted can be varied by the **Firm** at any time. Currently the volumes received of such business are very small.

4.1.3 Any 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, and withdrawals at a specific anniversary).

4.1.4 The main classes of with-profits business are as follows:

4.1.4.1 <u>Pension Plus, Versatile Individual Pension Plan and Buy-Out Plan</u>

These are annual or single premium deferred annuities with a guaranteed cash option at the normal retirement date. Increments are accepted, but the **premium rates** are not guaranteed and hence can be varied to reflect market conditions. Current interim **annual bonus** rates are 0.5%, and **terminal bonus** rates are 0% for most of the business and likely to remain so as the value of the guaranteed annuities exceed the **asset share** by a significant amount. Bonus rates are not guaranteed.

Guaranteed rates of return on offer at outset were typically in the range 1.75% p.a. to 7.75% p.a.

4.1.4.2 <u>Personal Pension & Participating Pension</u>

These are Section 226 retirement annuities with a guaranteed cash option. Policies are written to age 70 but have guaranteed early retirement terms from age 60. Increments are accepted on guaranteed terms, but only on a limited number of policies which have been previously endorsed to accept increments. Current interim **annual bonus** rates are 1.0%. Bonus rates are not guaranteed.

Guaranteed rates of return on offer at outset were typically less than 3.5% p.a.

4.1.4.3 Life Assurances

These are endowment and whole of life assurances. The majority are simple bonus contracts but there is also an older compound bonus series. Current interim **annual bonus** rates are 1.0% for both simple and compound bonus. Bonus rates are not guaranteed.

Guaranteed rates of return on offer at outset were typically less than 0.5% p.a.

4.1.4.4 Chargeable Rates

This is a grouped Funding type of group pension scheme contract with a guaranteed cash option. Bonus rates are fully allowed for in the premium rates (but not guaranteed) on the basis of investment in fixed interest securities. The **annual bonus** rate is 2.6% and the **terminal bonus** rate is 10%.

4.1.4.5 Freedom Unitised With-Profits

These are unit-linked life policies with **unitised with-profits** fund links. Following the Part VII transfer in December 2016 the policies (and increases) were allocated to the **ReAssure Non-Profit Fund** with the **unitised with-profits** investment element of these policies reinsured into the **GAWPF**.

Unit values are guaranteed (i.e. the with-profits unit price cannot go down), and unit prices increase daily at the current bonus interest rate, which is not guaranteed. The current bonus interest rate is 1.25% for Long Term Units and 1.0% for Short Term Units.

The guaranteed rate of return is 0% p.a. in the unit values.

4.1.4.6 Choices Unitised With-Profits

These are unit-linked personal pension policies with **unitised with-profits** fund links. Following the Part VII transfer in December 2016 the policies (and increases) were allocated to the **ReAssure Non-Profit Fund** with the **unitised with-profits** investment element of these policies reinsured into the **GAWPF**.

The bonus structure is the same as Freedom above except that the unit price is increased by basic interest and bonus interest, which are not guaranteed. The current basic interest rate is 0.5% and the current bonus interest rate is 1.0% for Long Term Units and 0.75% for Short Term Units.

The guaranteed rate of return is 0% p.a. in the unit values.

4.1.4.7 Deposit Administration

Deposit Administration is a group scheme deposit-type contract. The contract is backed by fixed interest securities and bonus rates are declared for each past year of deposit, based on the redemption yields of 15 year gilts at the time of deposit. For the purposes of determining bonus rates after 15 years deposits are notionally reinvested. The guaranteed rate of return is 0% p.a.

4.1.4.8 Pension Saver

This is a group scheme contract similar to Deposit Administration, except that only one bonus interest rate is declared, based on a weighted average of the amount of premium invested in each past year and the redemption yield available on 15 year gilts at the time of investment. For early deposits notional reinvestment after 15 years is assumed. The contract is backed by fixed interest securities.

The guaranteed rate of return is 0% p.a.

4.1.5 The assumed investment mix of each with-profits class above will differ, depending on the maturity of the business and the proportion of the final pay-out which is guaranteed.

4.1.6 The **GAWPF** has also written a significant amount of non- profit and unit-linked business, primarily term assurances, immediate and deferred annuities, and Freedom and Choices unit-linked (non-with-profits) policies. Under the terms of a restructuring of **GAWPF** which took effect on 1st January 2012, non-profit annuity policies were transferred from the Fund to the **GANPF** and **guaranteed benefits** of with-profit annuity policies were reassured to the **GANPF**. Following the PartVII transfer in December 2016 the **Guardian Defined Unit Linked Business** (including Freedom and Choices) was allocated to the **ReAssure Non-Profit Fund**.

4.1.7 Under the terms of the **GAWPF** restructure in 1998 the cost of certain guarantees were retained by **GAWPF**. In particular, the cost of a Maturity Guarantee under a unit linked contract written by Guardian Linked Life Assurance Ltd.

4.2 The Amount Payable under a With-Profits Policy

4.2.1 The amounts payable under Deposit Administration and Pension Saver policies are predominantly based on 15 year gilt yields as described above in 4.1.4. The amounts payable under Chargeable Rates policies are based on the **premium rates** and fixed interest yields as described in 4.1.4.4 above.

4.2.2 The amounts payable under other with-profits policies are guided by the calculation of **asset shares**, which would normally be calculated on a monthly basis but no less frequently than annually.

4.2.3 For **unitised with-profits** (Freedom and Choices) policies, **asset shares** reflect the accumulation of premiums applied less policy charges, less contributions towards the expected cost of guarantees where appropriate, less investment expenses, less costs for the use of capital where appropriate, less the **shareholder**'s share of the cost of bonus, less any partial withdrawals made by the policyholder, at the rate of investment return on the underlying assets notionally backing the relevant policies, adjusted for tax where appropriate and increased for **Bonus Surplus** where appropriate.

4.2.4 For traditional (non-unitised) with-profits policies (Pension Plus, Versatile Individual Pension Plan, Buy-Out Plan, Personal Pension, and Participating Pension), **asset shares** reflect the accumulation of premiums applied less expenses including commission, less contributions towards the expected costs of guarantees where appropriate, less costs for the use of capital where appropriate, less the **shareholder**'s share of the cost of bonus, less an allowance for mortality experience at the rate of investment return on the underlying assets notionally backing the relevant policies, adjusted for tax where appropriate and increased for **Bonus Surplus** where appropriate.

4.2.5 For Life Assurances, asset shares are no longer determined and instead the amounts payable are determined as set out in 3.2.8 above and 4.4.3 below.

4.2.6 The key parameters underlying the calculation of asset shares are as follows:-

4.2.6.1 Investment Returns

Prior to 1st January 2010, assumed investment returns in the **asset share** model were normally based on published indices for equities and fixed interest securities. Since 1st January 2010, the actual investment returns achieved by the **GAWPF**'s investment managers have been used. Actual investment performance is reported on a monthly basis by the **GAWPF**'s investment managers. Actual returns on property investments held in the **GAWPF** up to 2000 are also used.

4.2.6.2 Asset Allocation

The investments notionally backing with-profits business vary by class of business and by duration in force. It is assumed that a proportion of each future premium and the accrued **asset share** is invested in fixed interest assets. The proportion and duration of the modelled fixed interest investment is such that the projected cash flows from the fixed interest investments match the guaranteed with-profits liabilities, such as basic **sums assured**, accrued **annual bonuses**, as well as the expected future **annual bonuses**. Any proportion of the **asset share** or premium not needed to match the projected guaranteed payments is assumed to be invested in equities (except for short-term **unitised with-profits** which may be invested in fixed interest). This is consistent with the investment strategy of the **GAWPF**.

4.2.6.3 Taxation

The GAWPF as a whole is subject to a tax charge as though it were a separate proprietary life insurance company. Investment returns are adjusted for taxation where appropriate, based on estimates of the rate of taxation actually paid by the GAWPF over the appropriate period.

4.2.6.4 Expenses traditional (non-unitised) with-profits policies

Since 1st January 2000, expenses other than investment expenses are met by the **shareholder** through a **shareholder**–owned servicing company. The **GAWPF** pays the **Firm** an agreed level of expenses, which is set as the base date unit costs increased by **RPI** plus 1% each year.

The per policy expenses, since 1st January 2000, assumed in the **asset share** model are based on the agreed level of expenses. Prior to 1st January 2000, policy expenses assumed within the model are based on the results of annual expense investigations, which allocate expenses to each class of business. Actual past rates of commission are used.

Since 1st January 2010, the model has made direct allowance for the investment expenses incurred.

4.2.6.5 Annual Management Charges (Unitised Policies)

This charge is consistent with that taken from unit Linked Funds of the **Guardian Defined Unit Linked Business**. The charge can be varied.

4.2.6.6 Mortality

An approximate allowance is made for mortality experience.

4.2.6.7 Cost of Guarantees and costs for the use of Capital

Currently no deduction is made for the cost of guarantees nor for the use of capital as such costs are met by the **estate**. This is expected to continue into the future subject to the Overriding Principle.

4.2.7 The determination of amounts payable to with-profits policyholders in respect of **guaranteed or contractual benefits** or by way of bonus declarations (which are the absolute discretion of the **Board** having regard to the surplus available for distribution and in accordance with the Overriding Principle) have regard to methods of assessment approved by the **Board**. Records of the parameters and assumptions used are retained within the Finance Actuarial function of the **Firm**.

4.2.8 Any change to the methods used to assist in the determination of the amounts payable to with-profits policyholders requires the approval of the **Board** (in accordance with the Overriding Principle), as do changes to the current parameters or assumptions (apart from the routine incorporation of new investment returns).

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4.3 The Approach to setting Annual bonus Rates

4.3.1 The general approach to setting **annual bonus** rates is to project current **asset shares** to maturity, assuming estimates of future investment returns. These projections can be used to ascertain if **annual bonus** rates are supportable in the future.

4.3.2 Different rates of **annual bonus** apply depending on the characteristics of the individual classes of business written by the **Firm** (e.g. guaranteed growth rates, investment mix, and tax). The **annual bonus** rates do not currently vary between single premium and annual premium business.

4.3.3 For other than Deposit Administration, Pension Saver and Group Funding, rates were reduced at the 31st December 2004 declaration to such a level that no further reductions are planned. Interim bonus rates are currently at the levels quoted in 4.1 above, and the **Firm** anticipates that **annual bonuses** can be maintained at this level in the future if investment returns are not significantly less than anticipated and mortality experience, particularly annuitant mortality, does not change significantly from that anticipated. The investment strategy is consistent with the intention of not reducing **annual bonus** rates further as outlined in 4.6 below.

4.3.4 If future investment returns are significantly better than expected then **terminal bonus** rates will be increased above those that would otherwise have applied. **Annual bonus** rates will be reduced if future investment returns are significantly worse than expected or as required by the Overriding Principles.

4.3.5 Deposit Administration and Pension Saver **annual bonus** rates are set by reference to 15 year gilt yields as outlined in 4.1 above. Group Funding bonus rates are set by reference to the **premium rates** and fixed interest yields as outlined in 4.1 above.

4.3.6 The same rate of **annual bonus** applies to all policies within a class irrespective of when the policies were taken out. Differences between generations are dealt with, where possible, through the **terminal bonus** structure and/or **MLA**. This could change if the **asset shares** of particular **cohorts of policyholders** were low relative to their **guaranteed benefits**. In such a circumstance, it could be appropriate for lower **annual bonus** rates to apply to that cohort.

4.3.7 The current practice for traditional non-unitised with-profits contracts is to declare **annual bonus** rates in arrears, normally once a year on 31December. Interim **annual bonus** rates are normally declared twice a year on 1 April and 31 December respectively. The 1 April declaration applies to appropriate claims in the period 1 April to 31 December and the 31 December declaration to appropriate claims in the period 1 January to 31 March.

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4.3.8 The current practice for **unitised with-profits** contracts is to declare the **annual bonus** rates in advance, normally once a year on 1 April. The unit prices then change each day on a basis consistent with the pre- declared rates of **annual bonus**.

4.3.9 There are no restrictions on the amount **annual bonus** rates can change from one year to the next.

4.4 The Approach to setting Terminal Bonus Rates, Market Level Adjustments and Surrender Values

4.4.1 **Terminal bonus** rates vary by type of policy and by the year a policy (or benefits within a policy) started to participate in the profits of the **GAWPF**.

4.4.2 The **Firm** expects to review **terminal bonus** rates monthly. In times of significant market volatility, these reviews could become more frequent. Conversely, in times of stable markets, these reviews could become less frequent. **Terminal bonus** rates can be changed at any time.

4.4.3 Life Assurance

4.4.3.1 For Life Assurances, **Terminal bonuses** are determined as the result of comparing the **prospective value** of the future benefits to be paid (including the **shareholder's** share of surpluses), plus the **prospective value** of the future expenses to be incurred, less the **prospective value** of the future premiums receivable, with the value of the assets being held to support these policies as a group. This comparison is carried out using the best estimate assumptions of the likely future experience that will be applicable to these policies as a group, and such assumptions will be updated at least annually. The returns on the assets held to support these policies as a group may be enhanced by **Bonus Surplus**.

4.4.3.2 On early surrender or transfer, formulaic calculations are applied to both the guaranteed maturity benefits (including accrued **annual bonus** additions) and any **terminal bonus** likely to be available at the rates then current, in order to derive a surrender or transfer value. These calculations require assumptions to be made about future investment returns, **annual bonuses** and mortality rates and, will therefore change from time to time. The objective is to pay on average 100% of the share of the assets being held to support these policies as a group. This average will fluctuate during the year within the range 90% to 110% of the value of the assets held in accordance with the **smoothing** outlined in 4.5.

4.4.3.3 Whilst on average the intention is to pay 100% of the value of the assets held on maturity and surrender (subject to the operation of the **smoothing** practice set out in 4.5 below), individual policy pay-outs are likely to be in a range of 70% to 130% of the value of the assets held. This relatively wide variation is mainly caused by the non-proportionate variation in the value of the assets held between similar policies with different levels of premium. The majority of policy pay-outs are much closer to the value of the assets held than might be implied by this relative wide range.

4.4.4 Pension Plus, Versatile Individual Pension Plan, Buy Out Plan, Personal Pension, Participating Pension

4.4.4.1 The approach to setting **terminal bonus** rates is similar to that for life assurance business except the benefits available at the normal retirement date are expressed in the form of a guaranteed level of annuity. **Terminal bonuses** are declared or applied having regard to any excess of **asset shares** above the value of **guaranteed benefits** (including **annual bonus**es already added). However, for the majority of the business, the **guaranteed benefits** at retirement exceed the **asset share** and hence the **terminal bonus** rate is zero and the pay-out may exceed 105% of **asset share**. Also, for Pension Plus business, the **terminal bonus** rates can be higher for younger policies than for older policies. This is because the **premium rates** have been changed several times in the past for these policies, and the **premium rates** for policies more recently taken out provided a lower level of guaranteed benefit and hence more scope for **terminal bonus**.

4.4.4.2 On early surrender or transfer an annuity is calculated consistent with the guaranteed annuity available at the normal retirement date, but reduced to reflect the fact that benefits are being taken early. The reduction is consistent with the implied guaranteed rate of return based on the premiums paid. If allowable based on the age of the policyholder an annuity of at least this amount will be paid. If an annuity cannot be offered because the policyholder is too young then a transfer value is offered based on the then current value of the reduced annuity. For groups of policies, the value of the reduced annuities are compared to the corresponding **asset shares** and, if appropriate, the value of the benefits available are increased to be equivalent, on average, to 100% of the **asset share**.

4.4.4.3 If, at normal retirement, the policyholder chooses to convert part of the annuity into cash (e.g. to take a tax-free cash sum or full cash sum or an open market cash option) then the annuity is converted into cash using the guaranteed cash option included in the policy conditions - usually 9 or 10. Hence, generally at current interest rates, the cash alternative is worth less than the guaranteed annuity. For early retirements, the annuity is also converted into cash using an age-related cash option factor. The age-related cash option factor is determined by interpolation from a market annuity factor at age 50 to the guaranteed cash option at the normal retirement age. In setting **terminal bonus** rates and early retirement terms allowance is made for the proportion of policyholders who are expected to take their benefits in the form of annuity.

4.4.4.4 Whilst the intention is to provide benefits which on average are equal to 100% of **asset share** (subject to the **smoothing** described in 5.4) the value of the **guaranteed benefits** is such that the benefits at normal retirement and earlier are generally in excess of **asset share**. For those groups of policies, where the cost of the **guaranteed benefits** is less than **asset share**, the benefits offered at normal retirement, and earlier, are enhanced so that on average the benefits available are equivalent to 100% of **asset share** (subject to the **smoothing** described in 5.4). Hence, the individual policy benefits offered are unlikely to be less than 70% of **asset share** and, given the valuable **guaranteed benefits**, may be substantially in excess of 100% of **asset share**.

4.4.4.5 **Asset shares** are not calculated for paid-up policies, altered policies or other minor classes of business. Consistent with past practice **terminal bonus** rates for these groups of policies are set equal to the equivalent relevant deferred annuity contract based on the year the policies started to participate in the profits of the **GAWPF**. Similarly, transfer values and early retirement terms for these policies are calculated using similar calculations as per the equivalent relevant deferred annuity contract.

4.4.5 Unitised with-profits (Freedom & Choices)

4.4.5.1 Terminal bonus

Asset shares for groups of policies with similar duration maturing in a particular year are calculated. For the groups of policies, **terminal bonus** rates are then calculated so that on average the claim value is equal to 100% of the **asset share**. This average will fluctuate during the year within the range 95% to 105% of the **asset share** in accordance with the **smoothing** outlined in 4.5. **Terminal bonus** rates are declared for each past year, and then each rate is applied to the average unit holding for each past year.

4.4.5.2 Final bonus

When the **GAWPF** was closed to new business at the end of 1998, a new type of **terminal bonus** was introduced, called '**final bonus**'. This bonus is necessary to ensure that the **unitised with-profits** policyholders who were in the **GAWPF** before it closed to new business receive their fair share of any part of the **estate** that is distributed. The approach to **terminal** and **final bonus** has not changed as a result of the Part VII transfer in December 2016.

4.4.5.3 The **Firm** aims to distribute the **estate** equitably to the with-profits policies in force at the time of the announcement of the **GAWPF**'s 1998 restructure in accordance with the Overriding Principle. For **traditional with-profits** policies, this is achieved by increasing the **terminal bonus** rates. However, policyholders with Choices and Freedom unit-linked policies can switch into the **GAWPF unitised with-profits** fund from other linked funds. Hence increasing all **terminal bonus** rates would benefit policyholders who were not invested in the with-profits fund when it became closed to new business. Increasing **terminal bonus** rates only for 1998 and earlier unit holdings would resolve this problem, but then annual premium policies which were only taken out shortly before the **GAWPF** closure would receive little benefit from the distribution of the **estate**. The solution was to increase the **terminal bonus** rate for 1998 units but also to introduce a new **final bonus**.

4.4.5.4 **Final bonus** rates are declared for each year from 1999 and the **final bonus** is calculated broadly as the annual premium paid in each year since 1999 multiplied by the **final bonus** rate for that year. For this purpose however, the annual premium is limited to a maximum of the annual premium that was being paid into the with-profits units on the day it was announced that the **GAWPF** was restructuring (31 December 1998).

4.4.5.5 <u>Market Level Adjustments</u>

A **market level adjustment** may be applied on early surrender (more than 5 years from NRD for Choices pensions) to the unit value.

4.4.5.6 When a partial withdrawal is made that exceeds the corresponding **asset share** on account of **MLA** not applying, the excess paid does not reduce the **asset share** associated with the remainder of the policy.

4.4.5.7 <u>Target Pay-out Ranges</u>

Whilst on average the intention is to pay 100% of **asset share** on maturity and surrender (subject to the operation of the **smoothing** practice set out in 4.5 below), individual policy pay-outs are likely to be in a range of 70% to 130% of **asset share**. The majority of policy pay-outs are much closer to **asset share** than might be implied by this relative wide range.

Asset shares are not calculated for relatively small number of **unitised with-profits** policies (e.g. certain altered policies). Consistent with past practice **terminal bonus** rates for these groups of policies are set equivalent to the appropriate **terminal bonus** rates for the equivalent **unitised with-profits** contracts. Similarly, surrender values for these policies are calculated using similar calculations as per other relevant **unitised with-profits** policies.

4.4.6 <u>Deposit Administration and Pension Saver.</u>

As described above, the benefits payable on Deposit Administration and Pension Saver contracts are set by reference to gilt yields. No **terminal bonus** is payable and **asset shares** are not calculated.

On surrender the amount payable is equivalent to the discounted value of the future benefits payable. Allowance is made for any expected reduction in basic and bonus interest rates.

4.4.7 <u>Chargeable Rates</u>

The bonus rates on Chargeable Rates contracts are consistent with those allowed for in the **premium rates** (but not guaranteed) on the basis of investment in fixed interest securities. **Asset shares** are not calculated for this class of business.

On surrender the amount payable is equivalent to the discounted value of the future benefits payable. Allowance is made for both future **annual bonus** and projected **terminal bonus**.

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4.4.8 There are no restrictions on the degree to which payouts may change on similar policies from one bonus declaration to the next.

4.5 The Approach to Smoothing

4.5.1 **Terminal bonus** rates are reviewed annually and set at a level so that, on average, for groups of similar policies maturing in a particular year, broadly 100% of **asset share** is paid at maturity. The **GAWPF** is closed to new business and the in force population is running off over time. The profile of cases upon which **Terminal bonus** is calculated can therefore vary significantly from one year to the next. This variety in policy profile can give rise to volatile **Terminal bonus** rates. Therefore an average policy approach can be used, where appropriate, with the aim of removing the volatility in **Terminal bonus** rates arising from the business profile.

4.5.2 Under current practice the **Terminal bonus** review is undertaken each April. There are no restrictions on the degree to which pay-outs may change on similar policies from one bonus declaration to the next. Rates are then normally reviewed monthly during the year, but normally only changed if the average maturity values for groups of maturing policies in a particular year are less than 95% of the **asset share** or more than 105% of the **asset share**. Whilst on average maturity pay-outs will be in the range 95% to 105% of **asset share** individual policy pay-outs are likely to be in a range of 70% to 130% of **asset share**. The majority of policy pay-outs are much closer to **asset share** than might be implied by this relative wide range.

4.5.3 Hence average maturity claim values may change by less than 5% when new **terminal bonus** rates are declared each April, but may change at any time by more than 5% if the comparison with **asset shares** requires a change in **terminal bonus** rates.

4.5.4 A similar approach to **smoothing** is adopted for surrender values. Surrender values are reviewed annually and set at a level so that, on average, for groups of similar policies the surrender values offered are broadly equal to 100% of **asset share**. Under current practice this review is undertaken in the fourth quarter of the year. There are no restrictions on the degree to which surrender values may change on similar policies when a revised surrender value basis is introduced. The average policy approach described in 4.5.1 can also be used in the derivation of surrender values as appropriate.

4.5.5 Surrender value bases are then reviewed quarterly during the year, but normally only changed if the average surrender values for groups of policies are less than 90% of the **asset share** or more than 110% of the asset share. Whilst on average surrender pay-outs will be in the range 90% to 110% of **asset share** individual policy pay-outs are likely to be in a range of 70% to 130% of **asset share**. The majority of policy pay-outs are much closer to **asset share** than might be implied by this relative wide range. Where appropriate surrender values include an allowance for **terminal bonus** and if **terminal bonus** rates change then the surrender values will also change. This helps to ensure that surrender values reflect changes in **asset shares**.

4.5.6 The **Firm**'s intention is that the cost of **smoothing** should be neutral over time. The cost of **smoothing** over any one year is met by the **estate**. The maximum cost of **smoothing** that may be borne by the **GAWPF** is effectively 5% of one year's claims.

4.5.7 If the **smoothing** mechanism and/or the approach to setting **terminal bonuses** described above were to jeopardise the solvency position of the **Firm**, pay-outs could then be allowed to fall below 100% of **asset shares**. Pay-outs could also rise above 100% of **asset shares** in order to avoid a **tontine effect** as the **GAWPF** runs down.

4.6 Investment Strategy for With-Profits Business

4.6.1 At the date of this document, the assets of the **GAWPF** are mainly invested in UK equities and UK Government and corporate bonds. This may change in line with the Investment Principles set out earlier.

4.6.2 The fixed interest portfolio is invested with the objective that, as far as is reasonable, the projected cash flows from the portfolio match, both in terms of size and timing, the guaranteed with-profits liabilities, such as **basic sums assured**, accrued **annual bonuses**, as well as expected future **annual bonus**es. The same applies for **non-profit liabilities** held within the **GAWPF**. This protects the **GAWPF** from strains arising from interest rate movements and also makes the future **annual bonus** rates largely immune to changes in interest rates. The **GAWPF** is not however protected against significant levels of default on corporate bond holdings.

4.6.3 Benefits which are not guaranteed, such as accrued **terminal bonus**, are generally backed by UK equities. The **estate** is invested in UK fixed interest securities and UK equities. From 1 June 2013 the equity investment objective is to closely track the performance of an index that represents the 350 largest companies on the London Stock Exchange.

4.6.4 For with profits pension policies where no **terminal bonus** can be afforded, the investments backing the **asset share** will be entirely fixed interest securities.

4.6.5 In certain circumstances the **Firm** may rely on **shareholder**'s funds in order to maintain the investment strategy of the **GAWPF**.

4.6.6 The **Firm**'s general policy is to hold an appropriate spread of assets between **counterparties** in order to reduce risk. Additionally, the **Firm** would normally expect at least 95% of its fixed interest securities to have credit ratings of BBB or higher. At times of significant downgrades the proportion of fixed interest securities below BBB could be greater than 5%. The **Firm** would not normally expect to become a forced seller of fixed interest securities should credit ratings on investments held fall from BBB or higher to below BBB.

4.6.7 The **Firm** would not normally invest in assets of sufficient concentration that would cause any **regulatory admissibility limits** to be breached. Investment guidelines provided to the Investment Managers must comply with the current regulatory environment.

4.6.8 Any substantial investment in new or novel investment instruments would require the approval of the **Board**.

4.6.9 The **GAWPF** would not usually expect to invest significant amounts in assets that would not normally be traded because of their importance to the **Firm**.

4.6.10 The **equity backing ratio** within each class of business may vary from policy to policy depending on when the policy was taken out and how long is left to maturity/retirement. Rates currently applicable are:

Life Assurance business is generally in the range 40% to 70%.

Unitised with-profits pension business is generally in the range 50% to 85% and **unitised with-profits** life business in the range 35% to 75%.

Pension Plus, Versatile Individual Pension Plan and Buy-out Plan is generally in the range of 0% to 20%.

Personal Pension and Participating Pension is generally in the range of 0% and 30%.

Chargeable Rates, Deposit Administration and Pension saver are matched entirely by fixed interest securities.

These changes may vary from time to time, as the **Firm** deems appropriate. A table of the above **equity backing ratio** by policy class is available on the **Firm**'s website and is updated every 3 months. Any significant change in asset mixes will be communicated separately to individual policyholders.

4.6.11 The **Firm** does not currently invest in overseas equities.

4.6.12 It may be appropriate to utilise **derivatives** to protect the **GAWPF** or specific cohorts of policyholders within the **GAWPF** against adverse market movements (e.g. equity falls or changes in fixed interest yields). It may also be appropriate to utilise **derivatives** for short-term asset allocation purposes or to increase diversification by gaining exposure to different asset classes or for efficient portfolio management. In particular, for with-profit endowment policies **derivatives** have been purchased to protect policies maturing prior to July 2019 against severe falls in equity markets.

4.6.13 Investment in derivatives may require collateral to be posted with a counterparty. Collateral, for this purpose, can take the form of cash or other acceptable assets within the **GAWPF**.

4.6.14 The control environment for the use of **derivative** instruments involves: approval by a senior investment manager that the initial investment is within permitted parameters;

segregation of duty between those who authorise deals and those who trade deals; and monthly discussion of **derivative** reports.

4.6.15 Management meet regularly with the investment managers to discuss all investment issues pertaining to the **GAWPF**.

4.6.16 Formal reviews of the investment strategy of the **GAWPF** would normally be made annually.

4.7 Business Risk

4.7.1 The **GAWPF** no longer writes new business but is legally obliged to accept incremental business and the exercise of options on certain life and pension policies. The risks of writing such business are reduced as generally the terms on which it is accepted can be varied by the **Firm** at any time. Currently the volumes received of such business are very small.

4.7.2 Certain existing business risks have been identified by the **Firm** and appropriate reserving has been put in place. Any currently unrecognised business risks that might fall to the **Firm** could impact on future returns to with-profits policyholders. This would depend on the nature of any such risks and their size.

4.7.3 Courses of action in the event of emerging business risks, subject to the Overriding Principle, include:

• Reducing the **estate** contribution to Asset Shares in order to protect the solvency of the GAWPF (including reducing or removing previous **estate** contributions)

• Reducing **annual bonus** rates.

4.8 Management and Administration Expense

4.8.1 All normal management and administration expenses, other than investment expenses, are met by the **shareholder** through the **shareholder**-owned service company ReAssure UK Services Ltd, and the **GAWPF** pays the **shareholder** an agreed level of expenses, which is set as the base date unit costs increased by **RPI** plus 1% each year.

4.8.2 The **GAWPF** pays agreed annual management charges to the **investment managers** for investment management services. The equity investment objective is now to track an index that represents the 350 largest companies on the London Stock Exchange, and the investment charge hence no longer includes a performance fee if investment performance exceeds an agreed benchmark. Stock lending may be used to reduce investment expenses further, which, whilst fully collateralised, does expose the **GAWPF** to some risk of default on the part of the borrower.

4.8.3 **Policy charges** on **unitised with-profits** policies are the same as for other unit-linked policies, and can be increased by the **Firm**. The difference between the charges and the actual expense and mortality experience on **unitised with-profits** policies forms part of the **Bonus Surplus**.

4.9 Management of Estate

4.9.1 The **Firm** aims to distribute the **estate** equitably to the with-profits policies in force at the time of the announcement of the **GAWPF**'s 1998 restructure in accordance with the Overriding Principle. The distribution of the **estate** is achieved by using **Bonus Surplus** to enhance **asset share** returns.

4.9.2 The **Firm** aims to maintain a sufficient level of **estate** within the **GAWPF** to meet the regulatory requirements that would apply were the **GAWPF** a separate firm.

4.9.3 The **estate** provides capital support towards meeting **regulatory solvency requirements**. It is intended that the **estate** be maintained at such a level that no capital support should be required from the **shareholder**.

4.9.4 The **estate** is used to meet the cost of guarantees (which includes meeting the excess when more than the **asset share** is paid out), the costs for the use of capital and any **smoothing** costs.

4.9.5 The **shareholder** has no entitlement to the **estate** other than by way of 10% of the profits that emerge through the distribution of the **estate**.

4.9.6 The transfer out of the **GAWPF** of the **shareholder**'s share of the profits arising in the **GAWPF** results in additional tax being payable. This additional tax is now met by the **estate** whereas prior to 30th June 2005 it was charged directly to **asset shares**.

4.9.7 Currently any compensation or redress in connection with the way business written in the **GAWPF** has been marketed or sold is met by the **estate**.

4.10 Management Actions when the fund is of sufficiently small size

4.10.1 The Part VII transfer in December 2016 introduced a "sunset clause". The rationale behind this is to protect the with-profits policyholders when the fund is of sufficiently small size.

4.10.2 Once the admissible value of the assets in the **GAWPF** falls below £375m (increased with effect from 2016 in line with RPI), the Scheme allows the Fund to be merged with another with-profits fund or the business to be converted to non-profits, subject to approval of the Fairness Committee, **Board** of Directors, Regulators and an Independent Expert appointed to review the exercise to ensure with-profits policyholders are treated fairly.

4.10.3 Once the admissible value of the assets in the **GAWPF** falls below £75m (increased with effect from 2016 in line with RPI), then the Scheme requires the Fund to be merged with one of the **Firm**'s other long term insurance business sub-funds and the benefits under any remaining with-profits policies converted to a non-profit basis, subject to approval of the Fairness Committee, **Board** of Directors, Regulators and an Independent Expert appointed to review the exercise to ensure with-profits policyholders are treated fairly.

4.11 Equity between the With-Profits Fund and the Shareholder

4.11.1 In accordance with a High Court Approved scheme dated December 2016, **shareholder**s receive 10% of the profits arising in the **GAWPF**

4.11.2 It was established at the time of the **GAWPF**'s 1998 restructure that the **GAWPF** has no **Orphan Estate**.

GUARDIAN ASSURANCE WITH PROFITS FUND

5. GLOSSARY OF TERMS WITHIN PRINCIPLES & PRACTICES OF FINANCIAL MANAGEMENT OF WITH-PROFITS BUSINESS

Annual bonuses: Amounts, which when added to policies, constitute guarantees at specific points in time as per the Policy Conditions. Bonus rates are normally reviewed annually.

Asset shares: Other than for Life Assurances, used as a guide to setting bonus rates – see 4.2. For Life Assurances see 3.2 and 4.4.

Basic Sum Assured An amount guaranteed at the outset of a policy to be paid at specific points in time in accordance with the Policy Conditions and dependent on the payment of a premium or a series of premiums.

Bonus Surplus: Bonus Surplus is an addition to the assumed asset share investment return to credit the asset share with the distribution of the estate and other sources of miscellaneous profits or losses earned by the With-Profits Fund. In principle, because the with-profits policyholders share in all the profits or losses of the With-Profits Fund the Bonus Surplus addition could be negative e.g. if the cost of the guarantees was significantly greater than anticipated or a currently unrecognised significant Business Risk emerged.

Cohorts of Policyholders: Groups of policyholders with similar characteristics (e.g. same month of policy commencement or premium payment).

Counterparty: An organisation or individual with which the Firm has made investments or against whom it has rights whether in pursuance of a contract entered into by the insurer or otherwise.

Derivatives: Financial instruments that are either contracts for differences, futures or options.

*Equity Backing Ratio (EBR):*The proportion of assets invested in equities.

Estate: The excess, on a realistic basis, of assets within the With-Profits Fund over and above the amount required to meet liabilities.

Final Bonuses: Non-guaranteed amounts that may be added to guaranteed benefits (including annual bonus additions) when a claim arises.

Firm: ReAssure Ltd.

GANPF: The non-profit fund of Guardian Assurance into which the non-profit annuity policies were transferred and to which the guaranteed benefits of the with-profits annuity policies were reassured pursuant to the restructuring described in paragraph 3.1.4, and in which 100% of the profit that is distributed is allocated to the shareholder. This fund was transferred to ReAssure in December 2016 under the terms of the High Court-approved Scheme in accordance with Part VII of the Financial Services and Markets Act 2000

GAWPF: The Guardian Assurance With Profits Fund, a sub-fund of ReAssure's long term insurance business fund containing much of the business that was previously held in the With

Profits Fund of Guardian Assurance . The with-profits policyholders receive at least 90% of the profits that are distributed, with the shareholder receiving the balance, normally 10%.

Guaranteed benefits: Amounts guaranteed to be paid at specific points in time in accordance with the Policy Conditions and dependent on the payment of a premium or a series of premiums.

Guaranteed Annuity Options: An option, which exists under certain group scheme pension contracts, to convert the fund available at retirement to an annuity on guaranteed terms as set out in the Policy Conditions.

Guardian Defined Unit Linked Business: the unit-linked (including unitised with-profits), business which, prior to the Part VII transfer in December 2016, formed part of the GAWPF and whose non-linked cash flows were 100% reassured to the GANPF (namely the Choices Pension, Freedom Life and Group Money Purchase contracts).

Market Level Adjustment (MLAs): A reduction in the value of units under a unitised with-profits policy that may apply when a claim arises at a point where no guarantee exists.

Non-Profit Fund: Prior to 31 December 2016, the non-profit fund of Guardian Assurance. From 31 December 2016 the ReAssure Non-Profit Fund.

Non-profit liabilities: Policies which do not share in the distribution of profits of the GAWPF, such as unit-linked policies.

Orphan Estate: A part of the estate that has been identified as not belonging to the current with-profits policyholders.

PHI Fund: The firm's non-profit fund that contains only permanent health business and in which 100% of the profit that is distributed is allocated to the shareholder.

Policy Charges: Charges as defined in the Policy Conditions (e.g. an annual management charge). Market Level Adjustments are not included in this definition.

Premium rate: The rate which determined how much initial guaranteed benefit was given at the outset of the policy for a given premium.

Prospective valuation: The current value of the future cash flows of a policy. These cash flows include benefits to be paid, expenses to be incurred and premiums to be received based on our best assumptions of future likely experience.

ReAssure Non-Profit Fund: The Firm's non-profit fund into which the Guardian Defined Unit Linked Business was transferred. 100% of the profit that is distributed is allocated to the shareholder

Regulatory Admissibility Limits: Limits specified by the Prudential Regulation Authority relating to the maximum amounts of specific asset types (and counterparty exposures) that can be counted towards solvency purposes.

Regulatory Solvency Requirements: The minimum excess of assets over liabilities that must be maintained in accordance with the requirements of the Prudential Regulation Authority.

RPI: Retail Price Index (a measure of inflation).

Shareholder: The shareholder is ReAssure Group PLC. Part of Phoenix Group.

Smoothing: The operation of smoothing fluctuations in investment returns and asset shares over time, when setting terminal bonus rates.

Terminal Bonuses: Non-guaranteed amounts that may be added to guaranteed benefits (including annual bonus additions) when a claim arises.

Tontine Effect: The effect associated with a declining fund, where the last remaining policyholder is entitled to the remaining surplus in the fund.

Traditional With-Profits: A with-profits policy that, in accordance with the Policy Conditions, offers a level of guaranteed benefit in return for the payment of a premium or an agreed series of premiums. Offers no facility to switch into a unit-linked contract.

Unitised-With Profits: A with-profits policy that, in accordance with the Policy Conditions, offers a level of guaranteed benefit linked to the payment of each individual premium. Guaranteed benefits (including annual bonus additions) are expressed in terms of a unit value. Offers the facility to switch into a unit-linked contract.

With-Profits Actuary: An actuary appointed under Chapter 4 of the Supervision Manual of the Financial Conduct Authority.