



**Windsor Life Assurance
Company Limited**

**2009 Annual Report to
With-Profits Policyholders
in the National Mutual
With-Profit Fund**

June 2010

WINDSOR HOUSE



National Mutual With-Profit Fund
Principles and Practices of Financial Management
Report to Policyholders on Compliance during 2009

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Report to Policyholders from the With-Profits Actuary



1. Introduction

- 1.1 Windsor Life Assurance Company Limited ("Windsor Life" or "the Company") maintains a document known as the Principles and Practices of Financial Management ("the PPFM") for each of its with-profit funds. This sets out the Principles and Practices that guide the management of the with-profit business held in the fund. A PPFM was first published in April 2004.
- 1.2 This report to policyholders examines the management during 2009 of the with-profit business invested in the National Mutual With-Profit Fund ("the Fund"). The latter is a ring-fenced sub-fund of Windsor Life's long term insurance business fund. It contains much of the business that was previously held in the National Mutual Fund of NM Pensions Limited ("NM Pensions"), whose business was transferred to Windsor Life on 31 December 2007. The National Mutual Fund was a sub-fund of NM Pensions, into which all the policies written by the National Mutual Life Assurance Society ("National Mutual") were placed on its demutualisation and the transfer of its business to NM Pensions in 2002. No new business is being written into the National Mutual With-Profit Fund, other than increases to existing policies.
- 1.3 This report sets out, with reasons, how Windsor Life complied with the obligations associated with the PPFM for the National Mutual With-Profit Fund during the course of 2009. These include the requirement to maintain appropriate governance arrangements designed to ensure that the Company complies with, maintains and records a PPFM. The report also describes the way in which Windsor Life exercised discretion in the conduct of its with-profit business and how it addressed the conflicting requirements of different groups of policyholders and shareholders.
- 1.4 In preparing this report, Windsor Life has taken advice from its With-Profits Actuary. Any terms used in the report have the meaning set out in the PPFM for the National Mutual With-Profit Fund, a copy of which can be downloaded from Windsor Life's website or obtained free of charge by writing to Windsor Life at its registered address.

2. Governance arrangements

- 2.1 The ultimate responsibility for the management of Windsor Life's with-profit business during 2009 resided with the Windsor Life Board ("the Board"). However, a sub-committee of the Board, known as the Fairness Committee ("the Committee"), performed a number of functions on behalf of the Board in relation to the Company's with-profit business. This included monitoring compliance with the PPFM, reviewing its contents and approving any proposals to alter it.
- 2.2 The Committee met at least quarterly during 2009. The three members independent of Windsor Life (or any of its fellow group companies) were present at the first three quarterly meetings in 2009. During the fourth quarter 2009 two of the independent members also became independent Non Executive Directors of regulated companies in the Admin Re Group as permitted by the revised Fairness Committee Terms of Reference. The three independent members of the Fairness Committee attended the Fairness Committee meeting in the fourth quarter 2009.



- 2.3 A With-Profits Actuary is appointed to provide advice on the exercise of discretion relating to matters affecting with-profit business. The With-Profits Actuary for Windsor Life throughout 2009 was Mr Paul Downey, an employee of Admin Re UK Limited, a fellow group company. He attended meetings of the Fairness Committee and also those parts of Board meetings where with-profit issues were discussed. He received copies of papers relating to the Company's with-profit business, such as bonus declarations, and had an opportunity to comment on them in advance of their wider circulation.
- 2.4 The With-Profits Actuary has prepared a report to the Board on the key aspects of discretion exercised during 2009 by the Company that affected the with-profit business in the National Mutual With-Profit Fund. A separate report from him to policyholders is annexed to this report.
- 2.5 The operation of the National Mutual With-Profit Fund was governed by a scheme of transfer ("the Scheme"), a legal document entered into by Windsor Life in 2007. The Scheme includes a set of "Principles of Financial Management" which guide the financial management of the National Mutual With-Profit Fund and circumscribe the contents of the PPFM.

3. Exercise of discretion

Bonus rates

- 3.1 Annual bonus rates for 2008 were approved by the Board in March 2009, having previously been reviewed and commented on by the Fairness Committee. Rates for both unitised and conventional policies were left unchanged at historically low levels (as noted in the PPFM the Final bonus rates act as the principal mechanism to achieve equity); this was intended to mitigate the risk of an excessive accumulation of policy guarantees impacting the investment freedom of the Fund and also reflected the adverse investment conditions experienced in the early part of the year. The action taken on bonus rates during the year was consistent with the Practices outlined in the PPFM.
- 3.2 Final bonus rates were set by the Board four times during 2009: in March, June, September and December. Again, the rates being recommended were reviewed and commented on beforehand by the Fairness Committee. Pay-outs were set by reference to asset shares, allowing for the investment return emerging during the year on the with-profit fund. At the March review, the change in pay-outs (a reduction) was subject to a higher cap than that used under normal circumstances. This reflected the need in difficult investment conditions to respect the conflicting interests of discontinuing policyholders and of those remaining in the Fund. The approach followed when setting final bonus rates during the year, including the items charged to asset shares, the grouping of policies and the use of smoothing, was consistent with the Practices outlined in the PPFM.

Surrender values

- 3.3 The methods and bases used to calculate surrender values were unchanged throughout 2009, being consistent with the description appearing in the PPFM.
- 3.4 A Market Value Reduction Factor ("MVR") was in force at the start of the year (having been introduced in 2008) and removed in August 2009. The level of the MVR was reviewed regularly by the With-Profits Actuary and any changes monitored by the Fairness Committee. The operation of the MVR was in accordance with the terms of the PPFM.



Pay-outs

- 3.5 A target range for maturities and surrenders was set for the with-profit policies in the Fund of between 80% and 120% of the underlying asset share, with the aim that over the longer term these pay-outs should in aggregate equal 100% of asset shares (before the application of any Market Value Reduction Factor). It is reasonable to conclude that at least 90% of pay-outs during 2009 fell within the target range. In addition, the approach used to set final bonus is designed with the aim that pay-outs should over the longer term in aggregate equal 100% of asset shares.

Investment strategy

- 3.6 The investment of the Company's assets is overseen by the Investment Committee, a sub-committee of the Board which met monthly during 2009. The elements relating to the with-profit fund were also monitored by the Fairness Committee.
- 3.7 The benchmark mix for the assets backing the Asset Shares of the with-profit policies in the Fund was altered with effect from 30 September 2009, so as to increase the proportion invested in equities and property from 55% to 60%. The permitted deviations from the benchmark remained unchanged throughout 2009.
- 3.8 The assets in excess of those required to cover the non-profit business in the Fund and the Asset Shares of with-profit policies are invested predominantly in fixed-interest securities in order to maximise the resilience of the Fund to a fall in the value of equities. The "Estate" is the excess of the value of the assets in the Fund over the value of the assets needed to support the current and expected future liabilities of the Fund. The mechanism to adjust the investment return earned on the portfolio of fixed-interest securities held by the Fund before allocating it to asset shares was applied; this mechanism is designed to improve the robustness of the Fund to a further deterioration in investment conditions.

Business risk

- 3.9 No additional business risks were introduced into the National Mutual With-Profit Fund during 2009. The Fund remained closed to new business (apart from increases to existing policies). No assets were acquired outside the Fund's normal investments and the Fund was not called on to provide financial assistance elsewhere. Annuities under vesting pension policies were secured outside the Fund in accordance with the terms of the Scheme.
- 3.10 The items set out in the PPFM as being charged to the Estate, such as the cost of annuity guarantees, continued so to be charged throughout the year. No new charges were made to the asset shares underlying with-profit policies.

Charges and expenses

- 3.11 The fees charged to the National Mutual With-Profit Fund for administration and investment services during 2009 were as set out in the Scheme, as was the amount charged in respect of tax. The costs allocated in addition to the regular fees were all as permitted by the Scheme.



- 3.12 The translation of these amounts to individual policies followed the Principles and Practices set out in the PPFM, these being consistent with the requirements of the Scheme. The deduction of 0.1% from the investment return allocated to asset shares, that has been in use since 2006 to allow for the additional costs of external asset management, was retained for 2009.
- 3.13 The fair value of annuity guarantees was assessed with respect to market rates in a slightly different manner than specified in the PPFM (using the top rate in the median two quartiles). This was considered to more fairly reflect the intent of the requirement in the light of available market data.

Management of the Estate

- 3.14 With the National Mutual With-Profit Fund closed to new business, the Estate is being distributed in its entirety over time to Eligible Policies. This is achieved through an enhancement to pay-outs.
- 3.15 The level of the enhancement was reviewed in September 2009. The approach adopted was consistent with the description in the PPFM, the latter being based on the principles set out in the Policyholder Circular issued at the time of National Mutual's demutualisation. The new level of the enhancement was approved by the Board, having previously been reviewed by the Fairness Committee.

Equity amongst policyholders and with shareholders

- 3.16 The grouping of policies for the purposes of determining pay-outs and the mechanism used to attribute items of experience to the different groups was unchanged throughout 2009, being consistent with the Principles and Practices set out in the PPFM. The approach to smoothing and to the distribution of the Estate similarly followed established practices, as described in the PPFM.
- 3.17 The Scheme requires the capital within Namulas Pension Trustees Limited ("Namulas"), a subsidiary of Windsor Life allocated to the National Mutual With-Profit Fund, to be reduced as soon as reasonably practicable to the lowest level permitted by law, the reduction (net of any costs incurred) being returned to the Fund. However, the capital (of around £5m) was retained in Namulas throughout 2009, due to contingent environmental liabilities under properties held by the pension schemes for which Namulas acts as trustee. The interest accruing on the capital was retained within Namulas.
- 3.18 The National Mutual With-Profit Fund was ring-fenced from the other business in Windsor Life. All the surplus emerging in it was available for distribution over time to policyholders. None of the policyholders in the Fund had any interest in any surplus arising elsewhere in the Company. The items that were allowed to be allocated to the Fund, such as the fees for administration and investment services and the amount charged for tax, were all prescribed by the Scheme.

4. Maintenance of the PPFM

- 4.1 The Fairness Committee was responsible during 2009 for reviewing the contents of the PPFM and approving any changes proposed to it.
- 4.2 The PPFM was amended with effect from 1 July 2009 to reflect changes approved by the Fairness Committee in December 2008 and which were included in the report on compliance with the PPFM for 2008. Policyholders will be formally notified of these by mail during 2010. No changes were made to Principles or Practices in 2009.



5. Policyholder communications

- 5.1 Bonus notices were sent to most holders of conventional with-profit life policies, giving the level of annual bonus added to their policy in respect of 2008. The holders of pension policies received similar information as part of their annual statements. A number of minor errors were contained in a small number of annual statements sent out during 2009 but correct annual statements will be sent out in 2010 and no policyholder was materially disadvantaged.
- 5.2 A copy of the CFPPFM (called "A Guide to how we Manage the National Mutual With-Profit Fund") was held on the Company's website during the year and reference made to it in statements issued to policyholders.

6. Conclusion

- 6.1 In the opinion of both the Windsor Life Board and the Fairness Committee, the Company complied with the material obligations associated with the PPFM for the National Mutual With-Profit Fund during the course of 2009. In particular, throughout the year, it:
- maintained appropriate governance arrangements designed to ensure that it complied with, maintained and recorded a PPFM;
 - exercised discretion appropriately in the conduct of its with-profit business; and
 - addressed appropriately any competing or conflicting rights, interests or expectations of its with-profit policyholders (or groups of policyholders) and shareholders.

28 June 2010



Annex

National Mutual With-Profit Fund

Report to Policyholders from the With-Profits Actuary For the Financial Year ended on 31 December 2009

The National Mutual With-Profit Fund Principles and Practices of Financial Management ("PPFM") is a detailed document which sets out how the Company manages its with-profits business.

The Company has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders.

The purpose of my report to the Company's with-profits policyholders is to give my opinion, as required by the rules of the Financial Services Authority, as to whether the Company has taken the interests of its with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2009.

The report is provided for the purpose set out above and should not be used as the basis to make any decisions regarding contracts with the Company, (including whether to enter into them, to continue them or to terminate them), for which decisions fuller information and qualified financial advice should be sought.

I was appointed With-Profits Actuary to Windsor Life Assurance Company Limited ("the Company") with effect from 12 April 2010. In that capacity, I advise the Board of the Company (including authorised sub-committees) on key aspects of the discretion exercised by it in respect of its with-profits business.

I have considered the Company's report ("the Report") on compliance with the PPFM for the National Mutual With-Profit Fund, to which this report is annexed, and I have reviewed the discretion exercised by the Company during 2009.

In doing this I have also considered the data in reports submitted to the Fairness Committee during 2009 and also a report regarding compliance with the PPFM for the National Mutual With-Profit Fund submitted to the Fairness Committee in March 2010 by my predecessor.

Based on the information and explanations provided to me by the Company, I am satisfied that:

- the Report fairly summarises the principal areas in which the Company exercised discretion during 2009 in the conduct of its with-profit business;
- the Company complied with the material obligations of the PPFM during 2009; and
- any significant discretion exercised by the Company during 2009 took the interests of the with-profit policyholders in the National Mutual With-Profit Fund into account in a reasonable and proportionate manner.

In arriving at my opinion, I have taken into account where relevant the rules and guidance contained in the Financial Services Authority's COBS 20 (With-profits). I have also consulted with Mr Paul Downey, who was the With-Profits Actuary for the Company throughout 2009 and on whose advice I have relied.



The Board for Actuarial Standards has issued a standard (TAS R version 2, effective from 1 April 2010) which applies to reports produced by actuaries. This report complies with that standard.

David Lightwood
Fellow of the Institute of Actuaries
With-Profits Actuary

28 June 2010