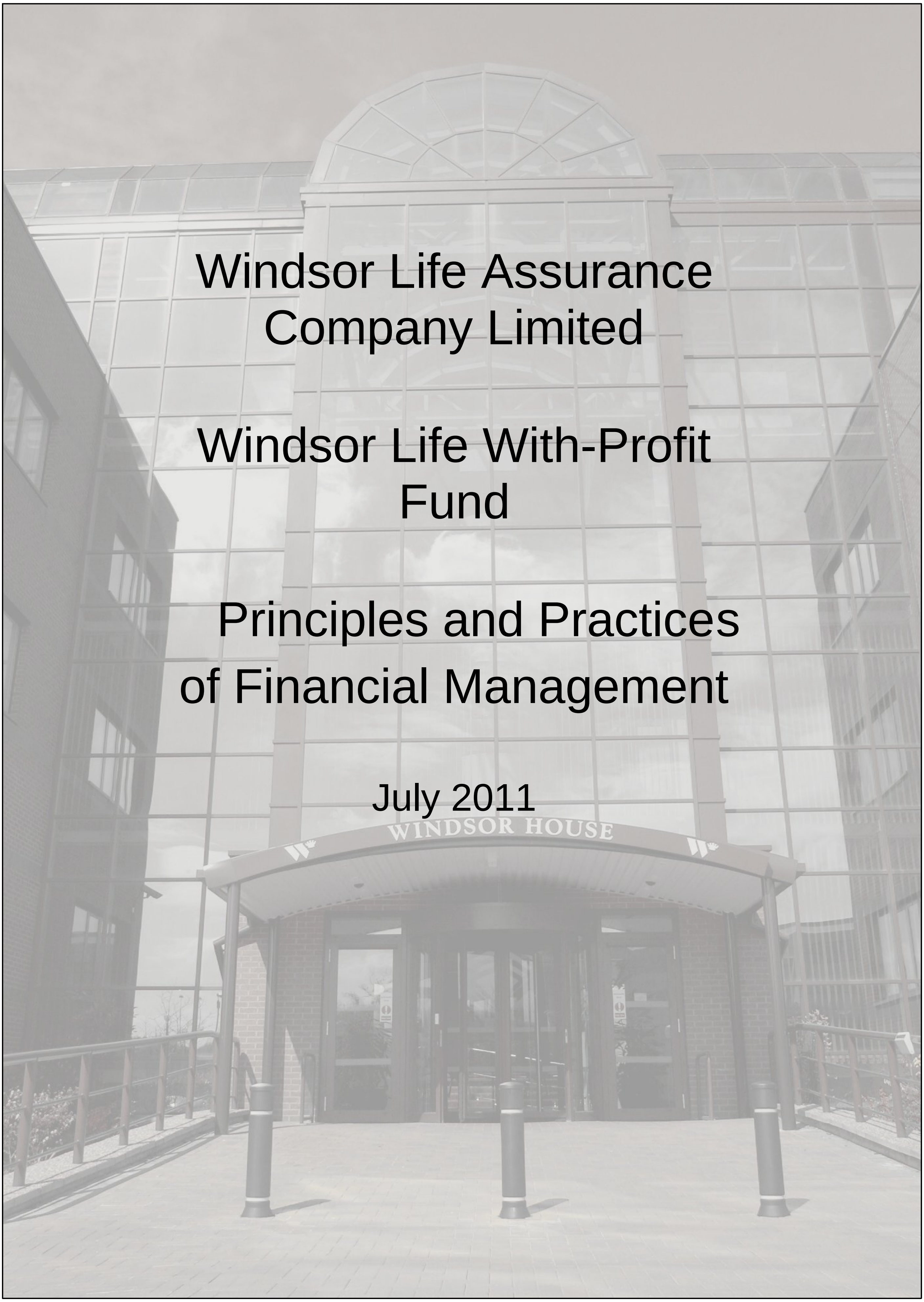
Windsor Life Assurance Company Limited

Windsor Life With-Profit Fund

Principles and Practices of Financial Management

July 2011



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1. INTRODUCTION

The Conduct of Business sourcebook (“COBS”) of the Financial Services Authority (“FSA”) requires firms to establish and maintain the Principles and Practices of Financial Management (“PPFM”), according to which the business of each of its with-profit funds is conducted. This document sets out the PPFM that Windsor Life Assurance Company Limited (“Windsor Life” or the “Company”) applies in managing the Windsor Life With-Profit Fund (“WPF”).

Principles are statements that reflect the general approach adopted in managing the with-profit business and are expected to be enduring. From time to time, however, the Board of Directors of Windsor Life (“the Board”) may decide that the Principles should be changed. The procedures that will be followed when a Principle is changed are set out in Section 13.1.

Practices are statements of specific practice employed in managing the with-profit business. They reflect current approaches given the current regulatory framework and the particular circumstances and economic conditions affecting the with-profit business. Practices are likely to be revised in response to changes in the business and economic environment, as well as changes in the regulatory framework or developments of new methods and techniques within the life insurance industry. The procedures that will be followed when practices change are described in Section 13.2.

From time to time the FSA may publish new regulatory rules and guidance or amend existing rules and guidance. The PPFM will be updated as necessary to comply with FSA rules and guidance.

Section 2 gives some background to the history and structure of Windsor Life and the WPF. Section 3 sets out the overarching principles for management of the WPF. Sections 4 to 12 describe the Company’s approach to a range of key issues affecting the WPF. Section 14 is a glossary of terms used within this document. References to and use of the concept of fairness or treating policyholders fairly in this document relates to the obligations created by Principle 6 of the Principles for Businesses to, amongst other things, treat customers fairly.

Appendix A covers the small amount of Deposit Administration and Guaranteed Fund business within the WPF.

2. BACKGROUND

2.1 Company Information

Windsor Life was incorporated in England in 1963 and is authorised by the FSA to carry out long-term insurance business.

Windsor Life has been part of a group whose objectives include the acquisition of other life companies with the aim of merging the businesses with Windsor Life. This has led to a number of transfers of business as mentioned throughout this section. These transfers were sanctioned by the court on the dates shown in the glossary and have affected the WPF to the extent explained below.

The Company principally wrote non-profit business with a very small amount of with-profit business until 1992, when the businesses of Gresham Life Assurance Society Limited ("Gresham Life") and Gresham Unit Assurance Limited ("Gresham Unit") were transferred to Windsor Life. Gresham Life was a with-profit company with a small amount of non-profit business. At the time of the transfer the long-term business was allocated into two sub-funds, the WPF and the Non-Profit Fund ("NPF"). The WPF comprised all of the long-term business of Gresham Life plus some non-profit business from Gresham Unit and Windsor Life. The allocation of the non-profit business to the WPF was a form of investment whereby the WPF purchased the stream of margins from that business.

At the time of the transfer Windsor Life set up certain Guiding Principles for managing the business. The Guiding Principles have been modified over the years, principally by the Guiding Principles scheduled to the GAN Scheme and NM Life and NM Pensions Scheme of transfers referred to below. The Guiding Principles are considered in Section 3.

In 1993, the long-term business of Aetna Life Insurance Company Limited ("AETNA") was transferred to Windsor Life.

In 1995, the businesses of Crown Life Assurance Company Limited ("Crown Life") and Crown Life Pensions Limited ("Crown Pensions") were transferred to Windsor Life. In 1996, part of the long-term business of Combined Life Assurance Company Limited ("Combined Life") was transferred to Windsor Life. In both cases, the pensions business was transferred to the WPF as an investment.

In 1996, the small amount of with-profit business within the NPF (which had existed prior to 1992) was moved to the WPF together with its backing assets.

In 1998, the businesses of Gan Life & Pensions plc (“Gan Life”) and Aegon Life Assurance Company (UK) Limited (“Aegon Life”) were transferred to Windsor Life. Aegon Life had a small amount of with-profit business, which was allocated to the WPF.

The unit-linked pensions business of Gan Life was allocated to the WPF; in this case the purchase of the embedded value was achieved through a contingent loan arrangement. Under this arrangement, Windsor Life’s parent company LAHC (renamed Admin Re UK in 2008) made a contingent loan to Windsor Life to fund the purchase of the embedded value.

In 2005 the long-term business of Reassure UK Life Assurance Company Limited and Virgin Money Life Limited were transferred into Windsor Life (none of this business was allocated to the WPF).

In 2007 the businesses of NM Life Limited (“NM Life”) and NM Pensions Limited (“NM Pensions”) were transferred to Windsor Life.

All the long-term business of NM Life was allocated to the NPF (via the respective Schemes of transfer).

The NM Life and NM Pensions Scheme allocated the long-term business of NM Pensions between three sub-funds; the WPF, the NPF and a new sub-fund called the National Mutual With-Profit Fund (“NMWPF”). A separate document sets out the PPFM that Windsor Life applies in managing the NMWPF.

The with-profit business of NM Pensions was allocated to:

- the NMWPF in the case of all conventional with-profit business; or
- the WPF in the case of all unitised with-profit business. The with-profit investment of this business is wholly re-insured back to the NMWPF. The PPFM of the NMWPF defines how the with-profit investment element of this business is conducted; it is not defined by this document. The surplus arising on this business in the WPF is treated in the same manner as the surplus arising on the non-profit business in the WPF. This business is assumed to be non-profit business in the remainder of this document.

The non-profit business of NM Pensions was allocated between the WPF, the NPF and the NMWPF.

At the same time as the transfer (31 December 2007), the contingent loan made by LAHC to Windsor Life, when the unit-linked pensions business of Gan Life was allocated to the WPF, was removed.

Prior to the transfer of the business of NM Pensions, the WPF benefited from 100% of the stream of margins from the non-profit business in the WPF (excluding the Gan Life unit-linked pension business) and 0.25% of the stream of margins from the Gan Life unit-linked pension business. Following the transfer the WPF benefits from 15.75% ("WPF Release Amount Percentage") of the stream of margins from all non-profit business in the WPF (including the Gan Life unit-linked pensions business and that business transferred from NM Pensions). The WPF Release Amount Percentage was calculated so that the value of the stream of margins from non-profit business that the WPF benefits from was expected to be unaffected by the transfer.

Since 1992, the WPF has sold some with-profit business, consisting largely of with-profit bonds from 1993 and with-profit annuities from 2000, plus a small amount of endowment business. The WPF has also sold some non-profit business since 1993. New business policy is discussed in more detail in Section 11.

2.2 Structure of With-profit Contracts

2.2.1 *Types of With-profit Contracts*

There are three main versions of with-profit contracts within the WPF:

- Conventional with-profit ("CWP") policies
- Unitised with-profit ("UWP") policies
- With-profit annuity ("WPA") policies

For CWP policies, a guaranteed amount is payable on a specified event or date stated in the policy terms and conditions. This amount may be expressed as a lump sum amount or as an annual pension. The guaranteed amount can be increased by the addition of Bonuses, as described in Section 2.2.2. In some contracts a different guaranteed amount is payable on death of the policyholder.

UWP policies are contracts under which premiums are used to purchase with-profit units. These units are allocated to policies as premiums are paid, and in some cases may be cancelled to meet expense charges, the cost of life cover or other benefits as set out in the policy terms and conditions. The units have a bid price which increases as Bonuses are added. The bid value of units forms the basis of determining policy benefits on surrender, Maturity or retirement. In some contracts a different guaranteed amount is payable on death of the policyholder.
WPA policies are single premium contracts where an annuity is purchased which is payable for the remaining life of the policyholder; in some cases the annuity commences after a deferred period agreed at outset. The level of annuity guaranteed at the start of the contract will be increased in line with any Bonus rates declared.

There is also a small amount of Deposit Administration and Guaranteed Fund business where policyholders receive credited interest at rates set at the discretion of the Board from time to time. See Appendix A for a description of this business and the PPFM relating to it.

2.2.2 *Types of Bonuses*

Bonuses are additions to the benefits payable on with-profit policies and usually take the form of Regular Bonuses, which are added throughout the policy term, and Terminal Bonuses, which are added at the date of claim. A further type of Bonus, an Interim Bonus, may also be added at the date of claim.

Regular Bonuses increase the level of Guaranteed Benefits on a policy and so increase the value of a policy over time. Once added they cannot subsequently be taken away. Regular Bonuses may be added in a variety of ways:

- For CWP policies, Regular Bonuses are declared as percentages of the basic benefit and attaching Regular Bonuses, and are added yearly. For certain contracts, different rates are applied to different components of the Guaranteed Benefit.
- For UWP policies, Regular Bonuses are normally declared in the form of daily increases in the price of with-profit units.
- For WPA policies, the Bonuses are added on the policy anniversary each year and are expressed as a percentage of the guaranteed annuity and attaching Regular Bonuses.

Terminal Bonuses (also referred to as final bonuses) may be added to policyholders' benefits at the date of claim. Terminal Bonuses are not guaranteed. The rate of any Terminal Bonus payable may be changed by the Board, upon receiving actuarial advice, at any time.

For CWP policies, final bonuses are currently expressed as:

- a percentage of basic benefit, or
- a percentage of attaching Bonuses, or
- a percentage of total Guaranteed Benefits.

Normally these percentages vary by year of entry and for some pensions contracts by age at retirement.

For UWP policies, final bonuses are currently expressed as a percentage of the nominal value of units and these can vary by year of entry.
Terminal Bonuses are not paid on WPA policies.

Interim Bonuses are paid on some classes of CWP business at the date of claim. If paid, the Interim Bonus is added in respect of the period between the end of the year to which the last Regular Bonus declaration relates and the date of claim.

The levels of Bonuses payable on policies in the WPF are determined by the Board upon receiving actuarial advice, and depend on the profits arising in the WPF over time. It is possible that if profits are insufficient then Bonuses in one or more years could be zero. Windsor Life's approach to Bonus declarations is described in more detail in Section 5.

2.2.3 Market Value Reductions

In some circumstances, an adjustment may be applied to claims on UWP policies, which reduces the claim value to below the nominal value of attaching with-profit units. Such an adjustment is known as a Market Value Reduction ("MVR"). The Company applies MVRs in order to protect the interests of continuing policyholders in the fund.

The Company will normally consider applying an MVR when the market value of the assets backing UWP policies is below the nominal unit value, unless the volume of surrenders of UWP policies is not considered to be sufficiently material. The rate of any MVR applying from time to time may be varied by the Company. The rate of MVR may be different for different policy types and unit series, and may vary according to the period over which the policy has been invested in the fund, and the size of the policy, which is surrendering. Practices in setting the level of MVR are covered in Section 4.

On some policy types, the Company has guaranteed that it will not apply an MVR in certain circumstances, such as on death, at Maturity, or for some with-profit bonds on partial withdrawals up to a specified amount. Windsor Life's approach to the application of MVRs is described in more detail in Section 4.

2.2.4 *Claim benefits*

In general, the circumstances in which claims arise on policies in the WPF can be categorised in three ways, that is, maturities, surrenders and death claims.

For life policies (other than whole-of-life policies), the Maturity date means the date stated in the policy schedule as the date on which the policy proceeds are finally paid. For pensions policies, it means the contractual retirement date or the date stated in the policy schedule. Claim payments at the Maturity date will not be less than any applicable guaranteed minimum amount (which may be increased by Regular Bonuses). Maturity claim payments may also be increased by Terminal Bonuses, but will not be reduced by the application of an MVR.

Surrender claims occur when a policyholder elects to take some or all of the benefits other than on the contractual Maturity date. For example, on pensions policies, early or, in some circumstances, late retirements are regarded as surrenders, as are transfers to another company. For life policies, partial or full withdrawals other than at the Maturity date are classed as surrenders. On whole-of-life policies, any claim other than a death claim is a surrender claim, as there is no contractual Maturity date. Surrender claim payments are generally not guaranteed in advance and may be less than any guaranteed amounts payable on Maturity. They may have been increased by Terminal Bonuses or, in the case of UWP policies, reduced by application of an MVR.

The term death claims is used in this document to describe claims on death or on the occurrence of certain other events, such as diagnosis of a defined serious illness for certain policies. Death claim benefits depend on the contractual terms of each policy type, as defined in the policy terms and conditions. They may be increased by Terminal Bonuses, but will not be reduced by application of an MVR. The way in which Windsor Life determines the appropriate amount of payouts in respect of claims of each type is described in more detail in Section 4.

2.2.5 *Smoothing*

Windsor Life regards smoothing as a normal part of the operation of with-profit business. Essentially, the purpose of the smoothing process is to reduce the impact on claim payments of fluctuations in asset values and other factors affecting the WPF. Windsor Life applies smoothing by means of the Bonus mechanism, including, for example, limiting the changes from year to year in Bonus levels and setting Bonus scales which apply to groups of policies rather than individual policies. Changes are carefully controlled to ensure that policyholders are treated fairly (as per Principle 6 of the Principles for Businesses).

The degree to which Windsor Life can reasonably apply smoothing depends on the available financial resources of the WPF and on the economic circumstances. In adverse circumstances the Board may, upon receiving actuarial advice, substantially reduce or cease to apply smoothing on certain (or all) groups of policies. Where smoothing is applied, it works both within groups of policies (for example, where the payouts may not reflect exactly the characteristics of an individual policy and its contribution to the WPF) and across different periods (for example, where changes in payouts from year to year may differ from changes in the value of the underlying assets). Windsor Life's approach to smoothing is described in more detail in Section 5.

2.2.6 *Investments*

Windsor Life uses a mix of investments to support the with-profit business in the WPF, including equity-type assets (such as UK and overseas shares, as well as property), fixed interest type assets (such as Government and corporate bonds) and investments in other life assurance business (predominately unit linked business). The Company may change the mix of assets or use different assets in accordance with its overall investment strategy from time to time. The investment strategy is set by the Board upon receiving actuarial advice with the overall aim of ensuring the adequacy of the available resources within the WPF to meet at least the guaranteed level of benefits and maximise additional returns subject to an acceptable level of risk. The investment strategy for the WPF is described in more detail in Section 6.

2.2.7 *The Estate*

The Estate is the excess, if any, of the value of assets in the WPF over the value of assets needed to support the current and expected future liabilities of the WPF. The Estate is the means by which Windsor Life is able to provide smoothing of payouts on with-profit business and otherwise support the operation of the WPF. As the volume of new with-profit business is small compared to the amount in-force, the Company will seek to make an appropriate distribution of the Estate. Windsor Life's plans for managing the Estate are discussed in more detail in Section 12.

2.3 With-profit Governance

The Board has overall responsibility for managing the with-profit business, including setting Bonus rates. Windsor Life has established procedures in order that the Board can satisfy itself at regular intervals that the with-profit business is being managed in accordance with the PPFM.

A Governance Committee was established in March 2004 to consider the interests of policyholders and provide advice to the Board on whether the management of with-profit business is in line with the Company's PPFM and if any changes are needed to ensure this. A With-Profits Actuary was also appointed to advise the Board on their use of discretion in managing with-profit business.

2.4 Sharing of surplus arising

Each year an amount of surplus arising is recognised in the WPF, which is used to fund the Cost of Bonuses to policyholders and make a transfer to shareholders through a payment to the NPF. Shareholders receive a transfer from the WPF equal in value to $1/9^{th}$ of the Cost of Bonuses to policyholders. The Cost of Bonuses is calculated as the aggregate of:

- The increase in the regulatory liabilities for CWP business and WPA business in respect of Regular Bonuses
- The increase in the face amount of bid value of units for UWP business in respect of Regular Bonuses, or the discounted amount in certain circumstances (for example where capital units are allocated to policies)
- The cash payment made in respect of Terminal Bonuses or Interim Bonuses to policyholders for CWP and UWP business.

Note that under the NM Life and NM Pensions Scheme, 15.75% (the WPF Release Amount Percentage) of the Surplus arising on all non-profit business in the WPF is retained and is available to support Bonus payments to policyholders.

3. GUIDING PRINCIPLES

3.1 Introduction

Windsor Life operates the WPF in accordance with certain Guiding Principles that were established in 1992, when the WPF was created (subsequently the Guiding Principles were amended in 1998, 2005 and 2007).

The Guiding Principles set out the shareholder commitment to the WPF.

- The NPF will be managed to minimise the risk of WPF free assets being required to meet the NPF margin of solvency. If at any time the free assets of the WPF are required to meet the NPF margin of solvency then certain conditions apply which include the NPF being required to compensate the WPF on terms contained within the Guiding Principles.

Section 3.2 below sets out certain overarching principles, which apply to the management of the business.

3.2 Overarching Principles

1. The business of Windsor Life will be managed to ensure that all relevant legal and regulatory requirements will be met, and that adequate financial resources will be maintained to meet the requirements of UK regulations.
2. Subject to the requirements of 1. above, the WPF will be managed with the objective of ensuring that the contractual terms set out in policy terms and conditions, including the payment of any Guaranteed Benefits, are met.
3. The WPF will be managed with the objective of treating all policyholders (having regard both to the relevant interests of any policyholders leaving the fund and those remaining) and shareholders fairly given the financial resources of the fund and the liabilities of it.
4. Payments to policyholders will be smoothed, and fairness will be assessed across broad groups of policyholders and generations of policyholders. Smoothing will aim to even out the effect of the experience of the WPF over time and to reflect the pooled experience of different policy groups within the WPF. The degree of smoothing will reflect the financial resources available within the WPF.
5. The WPF will be managed in compliance with the Schemes. The Schemes will take precedence if a conflict arises between them and a principle or practice in this document or these overarching principles (unless amendments to the Schemes receive court approval).

4. AMOUNTS PAYABLE ON CLAIMS

4.1 Principles

1. The amounts payable on Maturity or death under a policy will not be less than any guaranteed amounts payable under the circumstances in which the claim arises, as set out in the relevant policy terms and conditions.
2. Surrender value bases will be determined from time to time by the Board upon receiving actuarial advice and reviewed regularly with the aim of ensuring policyholders leaving the WPF and those remaining are treated fairly. Except to the extent, if any, set out in the policy terms and conditions, surrender values are not guaranteed. Where there is any conflict between the interests of those policyholders surrendering and those remaining, priority will normally be given to the latter.
3. Except in circumstances where they are determined by reference to guaranteed amounts, Windsor Life will aim to apply smoothing to claims payments by means of the Bonus mechanism. The degree to which smoothing can be applied from time to time will depend on the current and projected future financial position of the WPF and will be determined by the Board upon receiving actuarial advice.
4. Amounts payable on Maturity, surrender or death claims may be increased by the application of a Terminal Bonus. For UWP the amount payable on a surrender claim may be reduced by the application of an MVR. For all policy types, Terminal Bonuses and MVRs, if applied, will be set having regard to Asset Shares (see 4.2.2 below), the underlying level of guarantees and the financial circumstances of the WPF at the time of the claim.
5. As a consequence of the degree of approximation inherent in the application of Bonuses, MVRs and smoothing, Windsor Life will determine payouts having regard to the average levels of benefits across groups of policies rather than to individual policies, except in respect of policies where guaranteed minimum payout levels apply.
6. Subject to having sufficient resources within the WPF, the Company will over the longer-term aim to pay, on average, 100% of Asset Share on Maturity or surrender of a policy. Maturity and Surrender payouts are determined to be consistent with the Target Range (where appropriate).
7. Material changes to methods and assumptions used to determine amounts payable on claims are subject to agreement of the Governance Committee following a report by the With-Profits Actuary.

4.2 Practices

4.2.1 *Calculation of death and Maturity payouts for with-profit policies*

The guaranteed amount payable on death or Maturity is calculated as follows:

- For CWP policies, the guaranteed amount is generally the aggregate of the original sum assured on death or Maturity and the annual Bonuses added over the duration of the policy. For some pension policies, the guarantee is expressed as an annual pension rather than a lump sum. For UWP policies, the guaranteed amount is the bid value of the with-profit units.
- For some policies, the guaranteed payment on death may be higher than the guaranteed payment on Maturity.
- Some policies have guaranteed annuity rates applicable when converting cash into pension at retirement.

Subject to a minimum of this guaranteed amount, Windsor Life's long-term aim is to pay 100% of Asset Shares on death or Maturity. A Final Bonus may therefore be declared to reflect the difference between Asset Shares and Guaranteed Benefits for a group of policies. MVRs are not applied on death or Maturity.

The terminal bonus rates are set such that, where appropriate, Maturity payouts are consistent with the Target Range.

For Maturity payouts for most business the Target Range is between 80% of Asset Share and 120% of Asset Share. This range is a target and it is not guaranteed that the payout will fall within this range.

For CWP policies the Asset Share is calculated for each individual policy in accordance with 4.2.2.1 and is not subject to smoothing.

For UWP policies the Asset Share is calculated for model policies in accordance with 4.2.2.2 and is not subject to smoothing. Using a model policy approach for UWP policies will not have any material effect on the Maturity payout.

The Target Range is not appropriate for the following:

- Whole-of-life policies.

- Policies that have been subject to material alteration – for example Paid-Up policies. For Paid-Up policies the terminal bonus rates paid at Maturity are based on those paid at the maturity of a similar premium-paying policy with the same duration in force.

Policies with guaranteed benefits on maturity exceeding the upper bound of the Target Range are not considered to have breached the Target Range.

CWP whole-of-life policies receive terminal bonus rates paid on death based on those paid at the maturity of CWP endowment policies with the same duration in force.

For each product class the Company determines a set of model policies. For each model policy an Asset Share is calculated as the accumulation of premiums paid less expenses and other charges and cost of mortality benefits plus contributions from miscellaneous sources. This model Asset Share is then projected and used to determine Bonus rates as described in Section 5. The Asset Share calculation is described in more detail below.

4.2.2 *Asset Share methodology and basis*

In order to set Bonuses, Asset Shares are calculated on a set of model policies which are broadly representative of the portfolio. The purpose of this calculation is to assess the contribution a policy has made to the WPF during its lifetime. The calculation therefore uses a methodology and basis intended to mirror the historical cashflows in and out of the WPF attributable to the policy in question. A number of different approaches to calculating Asset Shares are used, reflecting the different origins of the business.

4.2.2.1 *CWP and WPA Asset Share methodology*

For CWP and WPA business, Asset Shares are derived as an accumulation of:

- Premiums Paid
- Plus investment return
- Less expenses
- Less the cost of life cover or other risk benefits
- Less any benefits taken
- Less adjustments for tax
- Less shareholders' share of profits

- Plus contributions from the Estate.

These items are discussed in greater detail in Sections 4.2.2.3 to 4.2.2.10 below.

4.2.2.2 *UWP Asset Share methodology*

For UWP contracts, the Asset Share calculations are simplified. Windsor Life does not model the whole contract but merely its investment component.

This consists of:

- Invested premium (that is, premiums allocated to units after any deduction of bid/offer spread)
- Plus investment return
- Less charges and tax
- Plus contributions from the Estate.

These items are discussed in greater detail in Sections 4.2.2.3, 4.2.2.5 and 4.2.2.10 below.

4.2.2.3 *Investment return credited to Asset Shares*

For each class of with-profit business a notional asset allocation is maintained. Investment returns are calculated for each asset class and using the asset allocation proportions the investment return is calculated for that block of with-profit business.

4.2.2.4 *Expenses charged to Asset Shares – CWP and WPA*

Expense allowance scales are maintained for each CWP and WPA product. The scales are calculated in respect of each calendar year taking account of the nature of the expenses incurred, that is initial expenses, maintenance expenses and fund related expenses. The scales are intended to broadly reflect the level of expenses attributable to each product over the long term.

4.2.2.5 *Charges to Asset Shares for UWP products*

i) For most UWP policies, the charge to Asset Share is calculated as follows:

- Shareholders' transfers of 1/9th Cost of Bonus

- Plus an expense allowance
- Plus fund related expenses

For life contracts, the expense allowance is reduced to allow for tax relief. Any difference between the total expense allowances and the total actual expenses falls to the Estate.

ii) For ex-Aegon policies and Preserve and Profit Bonds (series 6 and above), the charges are expressed as a fixed percentage of Asset Shares, as shown below:

Table 4.1 With-profit contracts with fixed charges	
Preserve & Profit Bonds Series 6 and above	0.95%
Ex- Aegon UWP Life	0.75%
Ex- Aegon UWP Pension Initial II	4.25%
Ex- Aegon UWP Pension Accumulator II	1.00%
Ex- Aegon UWP Pension Initial III	4.00%
Ex- Aegon UWP Pension Accumulator III	0.75%

iii) Taxation for life policies

For Life policies, tax on investment income and capital gains is also allowed for at the relevant rates. Where life company tax rules defer or spread the tax over a number of years, then an appropriate reduced rate is applied.

4.2.2.6 *Cost of mortality and other risk charges*

For CWP and WPA business, a deduction is made from Asset Shares for the historic cost of providing death and any other risk benefits, where these benefits are in excess of Assets Shares. For classes of business where benefits on death are less than Asset Share, the adjustment is positive and is added when accumulating the Asset Share.

This cost is determined by using a mortality rate derived from a standard mortality table considered suitable for that purpose and applying this rate to the difference between the death benefit and the Asset Share.

The actual mortality experience may be more or less favourable than assumed, and such mortality profits or losses fall to the Estate.

For UWP policies, no risk charges are deducted from the Asset Share calculation.

The Company does not currently charge the cost of providing additional policy guarantees, such as guaranteed annuity options, to Asset Shares. Any cost arising in the WPF as a result of meeting these guarantees falls to the Estate. If the relative size of the Estate decreases in future, this approach may be revised.

4.2.2.7 *Benefit outflows*

When calculating Asset Shares for WPA policies, it is necessary to reduce the Asset Share each time an annuity payment is made.

In the case of Preserve & Profit Bonds, the policyholder is entitled to make regular income withdrawals of up to 7.5% of unit value, determined at outset. In the Asset Share calculations for the model policies, an average level of regular withdrawals is assumed. Bonus rates derived on these principles are then expressed as a percentage of the individual unit fund in the usual way. The Company does not aim to make any surrender profits so Asset Shares do not need to be adjusted to reflect payment of surrender benefits.

4.2.2.8 *Adjustments for tax*

Taxation is allowed for within the Asset Share calculation to reflect the marginal level of tax that the WPF would bear in respect of the revenue items related to that policy. Where the tax rules require spreading of tax or tax relief over a period of seven years, this is allowed for in the calculations by discounting the tax.

For Life policies, tax on investment income and capital gains and tax relief on expenses is allowed for. Where tax is deferred or spread over a number of years, then an appropriate reduced rate is applied.

4.2.2.9 *Shareholder share of profits*

A deduction is made from the CWP Asset Share to cover the shareholders' share of profits. This represents 1/9th Cost of Bonuses in respect of that policy.

For UWP policies, this cost is allowed for as part of the charges discussed in Section 4.2.2.5.

4.2.2.10 *Contributions from the Estate*

The Company makes contributions from the Estate to Asset Shares. These are expressed as a percentage of Asset Share. The level of contribution is set each year based on the financial condition of the WPF and is described in more detail in Section 12, which relates to management of the Estate. Contributions from the Estate also reflect profits made from miscellaneous sources which are not directly included in the Asset Share calculations.

4.2.3 *Calculation of surrender payouts under with-profit policies*

For Surrender payouts for most business the Target Range is between 80% of Asset Share and 120% of Asset Share. In the calculation of Asset Share a suitable allowance is made for the costs of administering the surrender. This range is a target and it is not guaranteed that the payout will fall within this range.

For CWP policies the Asset Share is calculated for each individual policy in accordance with 4.2.2.1 and is not subject to smoothing.

For UWP policies the Asset Share is calculated for model policies in accordance with 4.2.2.2 and is not subject to smoothing. Using a model policy approach for UWP policies will not have any material effect on the Surrender payout.

The Target Range is not appropriate for the following;

- CWP whole-of-life policies where the Asset Share can be variable. CWP whole-of-life policies receive terminal bonus rates paid on Surrender based on those paid at the maturity of CWP endowment policies with the same duration in force.
- Policies that have been subject to material alteration – for example Paid-Up policies. For Paid-Up policies the terminal bonus rates paid on Surrender are based on those paid at the maturity of a similar premium-paying policy with the same duration in force.

Policies with guaranteed benefits on surrender exceeding the upper bound of the Target Range are not considered to have breached the Target Range.

4.2.3.1 *CWP surrender values*

For CWP policies (other than Deferred Annuities), a formulaic approach is used whereby the basic benefits are reduced to reflect premiums paid compared to premiums payable, attaching Bonuses are added in full, then the resulting value is discounted to allow for early encashment. Terminal Bonus, if any, is also included at the applicable rates.

For Deferred Annuities, a formulaic approach is used whereby the basic benefits and attaching Bonuses are reduced to reflect premiums paid compared to premiums payable and the resulting value is discounted to allow for early encashment. Terminal Bonus, if any, is also included at the applicable rates.

Although the Company will only carry out a formal review of the surrender basis infrequently (usually every 5 years), it is subject to change more frequently if circumstances are such that it is in the interests of remaining policyholders to do so.

The review will consist of comparing the aggregate surrender values with the aggregate Asset Shares for particular classes or groups of policyholder with the aim that payouts are broadly equal to 100% of Asset Shares over the longer term.

4.2.3.2 *UWP Surrender Values*

On surrender of a UWP policy, the amount payable will be the value of units (adjusted by surrender penalties applied to units, in some cases) plus any Terminal Bonus or less any MVR. Where a policy would be eligible for Terminal Bonus on Maturity, then it is added on surrender at the same rate.

For partial withdrawals (up to a specified amount) on some with-profit bonds a MVR is guaranteed not to be applied.

The value of the unitised fund is compared to the aggregate Asset Shares for a product class and if it is significantly higher then an MVR may be introduced.

Once introduced an MVR is then subject to frequent review. The rate of the MVR applied to a policy may change at any time and is determined by the Board upon receiving actuarial advice. The MVR for Preserve and Profit Bonds is normally reviewed at the same time as Terminal Bonus rates for this product (see 5.2.2) and is applied as a negative Terminal Bonus rate. However, it may be reviewed more frequently if considered necessary to protect the interests of the remaining policyholders in the Fund.

At each review the Asset Shares and unit values (including existing MVRs) are compared for groups of policies and if the difference exceeds 5% in aggregate then the MVRs will be altered. If the difference is less than 3% the MVRs will not be altered and in between 3% and 5% the Board will exercise its judgement taking into consideration factors such as the volatility of the markets.

The Board may override these calculations by applying a lower MVR or no MVR at all if it considers that there would be no adverse impact on other policyholders or any significant financial impact on the fund as a whole.

An individual UWP policy will not be subject to a Terminal Bonus and an MVR at the same time.

4.2.4 *Controls and documentation*

Windsor Life maintains appropriate systems in order to determine claim values for with-profit policies. The appropriateness of these systems is regularly reviewed and, accordingly, they may be upgraded or replaced from time to time, but Windsor Life will ensure that this does not affect its ability to comply with the PPFM.

The Company maintains documents on the methodology and assumptions used to determine Asset Shares and the Bonus rates derived from them. These contain detailed assumptions for each product type and the results of recent calculations. The assumptions are reviewed each year by the With-Profits Actuary and agreed with the Governance Committee. Changes may, for example, be made to the methodology in the event that:

- New techniques are developed that become standard industry practice
- Changes are made to relevant legislation
- The changes to methodology correct an error or improve accuracy going forwards.

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

In addition, there are times when the Asset Share systems are updated and such updated systems can produce different results. In such cases the Company will ensure that any changes are fair to policyholders, by requiring the With-Profits Actuary to report on the impact of such changes to the Governance Committee and obtaining the agreement of the Governance Committee on the implementation of such changes.

5. BONUS AND SMOOTHING POLICY

5.1 Principles

1. All Bonus rates will be kept under regular review and revised when appropriate in order to manage the business in line with the principles below and the overarching principles and to maintain equity between policyholders of different generations and bonus series. A new bonus series may be created if reasonable equity could not be maintained by linking the business to an existing bonus series.
2. Regular Bonuses will be added, when appropriate, to provide policyholders with additional Guaranteed Benefits. However, when necessary, the Board will restrict the build up of guarantees in order to protect the solvency of the WPF, measured against a target solvency rate, and to ensure that a reasonable balance can be achieved between the proportions of Regular and Terminal Bonuses payable at Maturity or on retirement. This may mean a Regular Bonus of zero in one or more years until the solvency position has been restored to an acceptable level or to prevent it falling to an unacceptable level.
3. Terminal Bonus rates will be determined for each Bonus series in order to broadly reflect the excess, if any, of the payout target over the amount already guaranteed by the addition of Regular and Interim Bonuses.
4. Windsor Life will aim to smooth payouts to with-profit policyholders to provide the stability characteristic of a with-profit contract. This is done by smoothing Bonus rates rather than smoothing the underlying Asset Share or smoothing payouts from year to year.

5.2 Practices

5.2.1 *Approach to setting Regular Bonus rates*

The Company aims to set the Regular Bonus rates at a level such that projected Asset Shares will exceed the Guaranteed Benefit levels at Maturity, taking account of recent investment experience and possible future adverse investment conditions, thus allowing a margin for a Terminal Bonus where appropriate.

5.2.1.1 *CWP Business*

Currently Regular Bonus rates are declared each year and once added to the policy form a permanent addition to the Guaranteed Benefits.

For products with a facility for Terminal Bonus, Regular Bonus rates are set by considering a set of model policies of different durations which are all due to mature in 10 years' time. Asset Shares and benefits are projected over the 10 year period to Maturity. The projections are first carried out assuming that the current Regular Bonus rate is not changed. Best estimate assumptions are used to provide an estimate of likely future Terminal Bonus levels. Projections are then carried out using a variety of adverse investment assumptions (that is, considering falls in asset values and changes in yields). The aim is to set the Regular Bonus at a level that allows the payment of Terminal Bonus in most circumstances. If this is not the case with the current Regular Bonus rate, the projections will be repeated using a lower Bonus rate. The Bonus rate that meets this criterion is known as the Supported Bonus Rate.

For products that have no Terminal Bonus, projections are similarly carried out for model policies maturing up to 10 years into the future and the level of Bonus required to pay 100% of Asset Shares at Maturity is determined. This gives the Supported Bonus Rate.

If the Supported Bonus Rate and the current Bonus rate are close (currently that is within 0.25%) then no change will be made, otherwise the Board determines a smoothed Bonus rate equal to 60% of the supported rate plus 40% of the current rate. The rate declared is the smoothed Bonus rate rounded appropriately, subject to a minimum of zero.

Interim Bonus rates are declared at each bonus declaration and are generally, but not always, set equal to the Regular Bonus declared at that time. However, Interim Bonus rates are not guaranteed and could be changed at any time.

5.2.1.2 *UWP business*

Regular Bonus rates are in the form of daily increases in the price of with-profit units and once added to the policy form a permanent addition to the Guaranteed Benefits. The Regular Bonus rate may be altered at any time. Currently the Company reviews the rate twice a year and at other times if circumstances warrant it, for example, when investment markets are volatile.

Regular Bonus rates are set by considering a set of model policies due to mature in 10 years' time and projecting Asset Shares and unit fund to Maturity. The projections are first carried out assuming that the current Regular Bonus rate is not changed. Best estimate assumptions are used to provide an estimate of likely future Terminal Bonus levels. Different Regular Bonus rates are used until the projected Terminal Bonus rate in 10 years' time is equal to a target level. The target level will be set by the Board upon receiving actuarial advice at a level normally between 0% and 25% of Asset Shares. This gives the Supported Bonus Rate for each product.

If the Supported Bonus Rate and the current Bonus rate are close (currently that is within 0.25%) then no change will be made, otherwise the Company determines a smoothed Bonus rate equal to 60% of the supported rate plus 40% of the current rate. The new rate is the smoothed Bonus rate rounded appropriately, subject to a minimum of zero.

5.2.1.3 *WPA business*

The guaranteed annuity amount increases each year on the policy anniversary at the rate of Bonus applicable at the time. The rates are reviewed annually and at other times when circumstances warrant it, for example in adverse or volatile market conditions.

As described above for CWP and UWP business, benefits and Asset Shares are projected over the lifetime of the model policies. The Supported Bonus Rate is then derived for each Bonus series. If this is similar to the current Bonus rate (that is, within 0.25%) then no change is made, otherwise the Company determines a smoothed Bonus rate equal to 60% of the supported rate plus 40% of the current rate. The new rate is the smoothed Bonus rate rounded appropriately, subject to a minimum of zero.

A different Bonus series may apply where the supported Bonus is significantly different for tranches of business.

5.2.2 *Approach to setting Terminal Bonus rates*

Terminal Bonus rates are set to provide a long-term average of 100% of Asset Shares at Maturity.

Terminal Bonus is currently reviewed quarterly. A review may also take place at any time if a significant event has occurred. Examples include a large fall in the stock market, a business risk that might have a significant impact on the fund, or changes in regulatory rules or guidance.

"Supported Terminal Bonus rates" are calculated for a sample set of model policies by comparing the Asset Shares with the Guaranteed Benefits plus attaching Bonuses. New Terminal Bonus rates are then set equal to the supported rates, subject to modification following analysis of the change in payouts. The change in payouts at any one review may be subject to a cap to prevent large changes in payouts at any one declaration, while targeting payouts of no less than 90% and no more than 110% of Asset Shares, based on model policies. There is no explicit upper limit on the acceptable change in payouts at a single declaration although changes are generally unlikely to exceed 5% at any one declaration in normal circumstances, or 10% if warranted by more exceptional circumstances. The derived rates are then rounded and smoothed to produce a smoothed progression for successive inception years.

5.2.3 *Effects of smoothing*

The smoothing policy has the effect of dampening changes in payouts from year to year and protecting policyholders from the impact of the short-term fluctuations in asset markets.
The cost of smoothing is borne by the Estate and the current approach to smoothing is expected to be covered by the current available Estate. In the event that the Estate diminishes in relative terms, it may be necessary to reduce the scale of smoothing.

Subject to having sufficient resources within the WPF, the Company will over the longer-term aim to pay, on average, 100% of Asset Share on Maturity or surrender of a policy (subject to a minimum of guaranteed amounts where applicable). In practice the effect of smoothing is such that the company aims to pay out between 80% of Asset Share and 120% of Asset Share as described in sections 4.2.1 and 4.2.3.

6. INVESTMENT STRATEGY

6.1 Principles

1. Investment policy for the WPF is the overall responsibility of the Board.
2. The assets of the WPF may be allocated to notional asset pools deemed to back the different classes of business and liabilities within the WPF. The investment strategy for each of the resulting pools is determined separately. No reliance is placed on assets outside the WPF.
3. The investment strategy for the assets backing all classes of with-profit business will be determined by the Board after taking into account:
    - The current and projected financial position of the WPF
    - The level of guarantees for each class of with-profit business
    - The expected return, volatility and liquidity of asset classes
    - Representations made to policyholders
    - Advice from the With-Profits Actuary and Governance Committee.
4. Subject to the above factors, the aim of the investment strategy is to maximise investment return subject to a degree of risk, which is acceptable in the opinion of the Board having taken advice from the With-Profits Actuary.

6.2 Practices

6.2.1 *Asset Allocation*

For each with-profit class of business, an asset allocation policy is determined. This is based on the characteristics of the business, such as the average term to Maturity and level of guarantees.

For the purposes of managing the assets, they are subdivided into asset funds, typically:

- Equities (UK)
- Equities (overseas)
- Property
- Deposits
- Short Fixed Interest
- Medium Fixed Interest
- Long Fixed Interest.

This list of asset funds may vary from time to time according to the investment strategy. Investment guidelines exist for each asset fund and the fund managers are monitored to ensure that they operate within these guidelines. For fixed interest assets, these guidelines cover counter-party exposure limits, credit risk and duration. For equity funds, the Company sets benchmarks and for UK equities controls tracking error using recognised statistical approaches.

6.2.2 *Asset Liability Matching*

For non-profit liabilities, the Company's strategy is to invest in assets which suitably match the liabilities. In the case of unit-linked (and index-linked) liabilities, assets are held to match the liabilities as closely as possible. In the case of non-profit non-linked liabilities (e.g. annuities in payment), fixed interest assets are held with an average duration that has regard to the expected duration of the liabilities.

For the assets backing the with-profit business, the investment strategy consists of a mix of equities, property and fixed interest assets. The level of equity investment is a reflection of the level of guarantees inherent in the product class, while the fixed interest assets are chosen to reflect the duration of the liabilities.

6.2.3 *Risk control*

When investing in fixed interest assets, each asset is assigned a credit rating. If a credit rating is available from a recognised rating agency then this is used; otherwise an internal rating determined by our investment advisers is used. Only securities rated A or above can be purchased. However, existing investments that have been downgraded can be held, subject to overall limits.

In determining the counter-party exposures that are acceptable, the Company has regard to the quality of the counter-party, the solvency position of the WPF and the impact on Asset Shares if the counter-party fails. Currently, as a general rule, counter-party exposures will not exceed 2.5% of with-profit assets, unless the asset is government backed.

6.2.4 *Liquidity*

Most assets within the WPF backing policy liabilities are readily realisable. The least liquid assets are property, which can take some months to sell. The amount of property held is at a level such that distressed selling is very unlikely to occur, in particular the current investment guidelines restrict the level of property to no more than 20% of with-profit liabilities. The most liquid assets are cash instruments and gilts, which are held at levels sufficient to meet likely short-term cash flows at all times. The Company does not expect to have to sell assets at distressed prices. The Investment Committee aims to minimise the likelihood of having to sell assets at distressed prices through the investment strategy.

The Estate invests in the residual assets of the WPF, which include the Embedded Value Asset, this being the value of 15.75% (the WPF Release Amount Percentage) of future surplus arising from non-profit business. Other than the surplus emerging every year, the Embedded Value Asset is very illiquid, and can only be realised through financial arrangements such as Financial Reinsurance.

6.2.5 *Derivatives*

Derivative assets and other instruments would only be used for a specific purpose such as protecting the WPF against adverse market conditions or for efficient portfolio management or to hedge guarantees or options within the liabilities. Using derivatives requires Board approval and a report from the With-Profits Actuary assessing the potential impact on policyholders and on the WPF.

6.2.6 *Assessing new asset instruments*

If the Company wished to invest in a new instrument it would be assessed by the Investment Committee, but would also need Board approval supported by a report from the With-Profits Actuary. In assessing the appropriateness of such assets the following factors would be taken into account: the likely impact on investment performance; the volatility of the assets; any underlying risks; the impact on valuation rules and any potential impact on policy benefits.

6.2.7 *Assets not normally traded*

The Company does not have a policy of investing in assets not normally traded. However, certain fixed assets such as the office furniture do fall into this category but these are not held within the WPF. The Embedded Value Asset cannot be traded in the normal way and is a significant proportion of the total WPF assets. Possible methods of unlocking the value of this asset are discussed in 6.2.4 above.

6.2.8 *Review of investment strategy*

The Company's investment strategy is formally reviewed annually by the Investment Committee and at other times when considered necessary, for example when asset prices are moving sharply or if liabilities are changing significantly due to new business or policy surrenders. In reviewing the investment strategy the Investment Committee will take advice from the With-Profits Actuary and the Governance Committee. The current benchmark for the investment mix is published on our website.

The Investment Committee meets monthly and formally reviews the performance of assets within the WPF quarterly.

7. BUSINESS RISK

7.1 Principles

1. The WPF is subject to business risks arising from acquiring and maintaining with-profit and non-profit business. The WPF does not undertake other business ventures.
2. As far as possible the Company will protect all generations and classes of with-profit policyholders from business risks by charging any costs arising from such risks to the Estate rather than to Asset Shares. If the relative size of the Estate falls below a level at which the Board, upon receiving actuarial advice, deems it imprudent to continue this approach, any costs arising from such risks will be allocated to Asset Shares.
3. The Company will manage the risks associated with writing new business by only accepting new non-profit business if the expected return is judged sufficient to compensate for such risks.
4. The Company will manage the risks associated with the existing business by monitoring experience in respect of specific risk factors and quantifying their potential impact. These factors will be taken into account in determining the level of the Estate contribution to Asset Shares.
5. Where appropriate, the Board will take action to reduce exposure to the risks arising from existing business.

7.2 Practices

7.2.1 *New business risk*

Section 11 discusses the approach to limiting new business volumes in order to control exposure to new business risk.

7.2.2 *Vesting annuities*

Non-profit annuities under vesting pension policies in the Windsor Life With-Profit Fund are currently set up outside the Fund. This is achieved by transferring the appropriate retirement fund value (or, in the case of a policy with an annuity guarantee, the fair cost of the annuity) to the fund of Windsor Life in which the annuity is to be established.

The basis used to determine the fair cost is currently set with the aim of producing annuity rates consistent with the open market option annuity rate at the upper end of the second quartile of a suitable market rate comparison table (allowing for any restrictions on the availability of the open market option annuity rates and for any other differences relevant when making a comparison). The market rates are adjusted to allow for the postcode rating group of the annuitant. This approach will be reviewed periodically and may change in the future.

7.2.3 *Existing business risk*

Examples of existing business risk include the following:

- The risk that the margins on non-profit business are not sufficient to cover future adverse experience
- Longevity risk associated with annuity business
- The risk that guaranteed annuity options and other guarantees associated with the with-profit policies cannot be met from the Estate
- Investment risk associated with unfavourable fund performance
- Miscellaneous business risks from factors such as expenses, mortality, taxation, systems failure and the regulatory environment
- Risks relating to the cost of guarantees in Deposit Administration and Guaranteed Fund business

The Company will monitor these existing business risks and any others arising in future. Appropriate courses of action may include:

- Providing a capital support facility to the WPF to eliminate any deficit arising from the non-profit business in the WPF (other than the element in respect of the WPF Release Amount Percentage). This capital support facility is prescribed by the NM Life and NM Pensions Scheme and would require transferring suitable assets or assigning appropriate embedded value from elsewhere in the company to the WPF.
- Limiting Bonus declarations where necessary to control the level of with-profit guarantees
- Reducing the Estate contribution to Asset Shares in order to protect the solvency of the WPF
- Matching liabilities with appropriate assets and otherwise managing the level of investment risk undertaken by the WPF
- Setting up explicit reserves such as the existing reserve for guaranteed annuity options

- Entering into an appropriate reinsurance treaty
- Using hedging exposure to reduce a specific risk
- Determining that the cost (or profit) resulting from the adoption of a particular business risk should be borne by the NPF rather than the WPF

Before embarking on a course of action such as those outlined above, the Company will perform a cost/benefit analysis to assess the suitability of the action and obtain suitable advice, including actuarial advice, if deemed appropriate.

As far as possible the Company will protect all generations and classes of with-profit policyholders from business risks by charging any costs arising from such risks to the Estate rather than to Asset Shares. The Company will manage the risks associated with the existing business by monitoring experience in respect of specific risk factors and quantifying their potential impact. These factors will be taken into account in determining the level of the Estate contribution to Asset Shares.

8. CHARGES AND EXPENSES

8.1 Principles

1. Expenses will be charged to the WPF. In determining the level of expenses to be charged to the WPF the Company aims to;
    a. Comply with the Fixed Expense Agreement
    b. Subject to a, treat WPF policyholders fairly.

8.2 Practices

Types of expenses

Expenses are allocated in accordance with the following practices and taking account of advice from the With-Profits Actuary;

8.2.1 Investment related expenses are charged to the WPF as appropriate.

8.2.2 Acquisition expenses are allocated to the WPF, but only to the extent that the expected margins from any new business written in the WPF covers such expenses (otherwise any excess will be allocated to the NPF).

8.2.3 Commission is charged (as appropriate) to the WPF.

8.2.4 The WPF will no longer be charged one-off expenses (for example, development expenses).

8.2.5 For the remaining business in the WPF, expenses are charged by;

8.2.5.1 A fixed scale of “weighted” charges (the weightings represent the relative levels of maintenance required for each policy type) as follows:

Contract Type	Life & PHI policies			Pension Policies		
	Regular	Paid Up	Single	Regular	Paid Up	Single
Unit linked	1.00	0.50	0.50	1.50	0.50	0.50
Unit linked pension review augments	-	-	-	-	-	0.25
With-profit contracts	1.00	0.50	0.50	1.50	0.50	0.50
DSS rebate policies	-	-	-	1.00	0.50	-
Annuities	-	-	0.60	-	-	0.60
Other Non-Profit contracts	0.50	0.40	0.40	0.50	0.40	0.40

This fixed scale of weighted charges is multiplied by a “unit cost” for the calendar year. The unit cost for a particular calendar year is determined by the “unit cost” for the 2004** calendar year expenses (£38.19) increased on 1st January each year by an appropriate inflation measure (using the increase for the 12 months to 1st July of the preceding year).

8.2.5.2 For a small number of policy types the expenses will be charged as follows;

Contract type	Annual expense allowances
PHI in payment	5% of payments
Waiver in payment	10% of payments
Riders and extra premiums	10% of premiums
Unsecured Pensions (drawdown)	£104.71*
Group Managed Funds	£623.36*

* This amount was appropriate for the 2007** calendar year and will be increased on 1st January each year by an appropriate inflation measure (using the increase for the 12 months to 1st July of the preceding year).

** Note that the fixed scale of weighted charges was originally set up with reference to 2004 expenses with some additional products included following the NM Life and NM Pensions Scheme in 2007.

8.2.6 The Company normally uses RPIX+1% p.a. (RPIX defined as 'All Items Retail Prices Index excluding Mortgage Interest Payments' produced by the Office for National Statistics) as an appropriate inflation measure. This may be changed if this measure is not considered appropriate, following advice from the With-Profits Actuary. The principle to be followed in deriving a more appropriate inflation measure will be a measure of inflation in both prices and earnings combined in the UK economy.

Outsourcing of services

8.3 The Company has procedures in place whereby outsourcing arrangements are assessed both in terms of cost/benefit analysis and risk impact, prior to proceeding.

8.4 Any major outsourcing arrangements are subject to an annual review and will include appropriate termination clauses. The termination clause would typically give the Company the right to terminate with a notice period of normally 3 to 6 months; however the actual notice period could be longer if considered appropriate by the Risk Committee.

9. TAXATION

The basis of tax charged to the WPF is consistent with the Guiding Principles established in 1992 when the WPF was set up.

9.1 Principles

A charge in respect of tax will be deducted from the WPF each financial year and credited to the NPF, which will bear the tax charge from the whole of the long-term fund. The charge in respect of tax to the WPF will be determined as if that fund were a separate proprietary life insurance company, subject to the following points:

- Any profits transferred to the NPF from the WPF will be treated as if they were transfers to shareholders' funds.
- The charge in respect of tax may be reduced to take account of the utilisation by Windsor Life of capital gains losses attributable to the WPF.
- If unusually large amounts of gains are realised in the WPF in a particular financial year then the tax rate used for the purpose of calculating the charge may be reduced to such rate as the Board shall judge to be fair to the WPF, taking account of advice from the With-Profits Actuary.
- As the charge in respect of tax will be deducted at the end of the financial year it will be adjusted to allow for any timing differences between the date of such deduction and the date upon which tax would otherwise be due.

9.2 Practices

The tax charge is calculated each year as if the WPF were a separate company, with certain modifications. The main modification is where excess capital losses are realised within the WPF. In such an instance the excess may be offset against realised capital gains within the NPF.

The WPF will pay tax resulting from the transfer of profits from WPF to NPF (including tax on the shareholders' proportion of the bonus).

The Board assumes overall responsibility for the calculation of tax and will obtain advice from the With-Profits Actuary.

10. EQUITY BETWEEN SHAREHOLDERS AND POLICYHOLDERS

10.1 Principles

84.25% of the surplus arising on most of the non-participating business in the WPF is allocated to shareholders. The remaining surplus arising in the WPF, from whatever source, is shared between policyholders and shareholders in the proportions 90% and 10%, respectively.

10.2 Practices

10.2.1 *Emergence of surplus*

84.25% of the surplus arising on the non-profit business in the WPF is transferred to the NPF or Shareholder Fund as prescribed by the NM Life and NM Pensions Scheme.
All other surplus arising within the WPF is divided between with-profit policyholders and shareholders in the proportions 90% and 10% respectively. Surplus arises from a number of sources but is essentially a result of the difference between actual experience and the assumptions used to value policyholder Guaranteed Benefits, principally in the areas of investment return, expenses, mortality and tax.

10.2.2 *Surplus allocated to policyholders*

Surplus is allocated to with-profit policyholders in the form of Regular, Interim and Terminal Bonuses, determined by the Board upon receiving actuarial advice. The amount of surplus allocated to shareholders corresponding to these Bonuses is charged to Asset Shares.

10.2.3 *Surplus allocated to shareholders*

Surplus allocated to shareholders is calculated by multiplying the value of surplus allocated to policyholders each year by 1/9.

In the case of Terminal Bonuses, the surplus allocated to shareholders is a percentage of face value or, in some circumstances, discounted value.

In the case of UWP Regular Bonuses, the surplus allocated to shareholders is a percentage of face value or, in some circumstances, discounted value. A suitable adjustment is made to the surplus allocated to shareholders to allow for the application of any MVR.

In the case of CWP and WPA Regular Bonuses, the value of the Regular Bonus is discounted to allow for the period until it is due for payment, at the interest rate used to determine the regulatory liability. This value is therefore dependent on the valuation discount rate used as well as the amount of Bonus declared. This discount rate is governed by rules and guidance issued by the regulator and reflects financial conditions at the date of the valuation.

Tax in respect of the transfer of shareholders' surplus is met by the WPF.

Terminal Bonuses are not granted to UWP policies if an MVR is applied. This prevents a shareholder transfer being made in respect of these policies.

A small number of products have a guaranteed rate of Bonus interest. The amounts in respect of the guaranteed rate of Bonus interest are not part of the Cost of Bonus calculation and therefore do not give rise to shareholder transfers.

11. NEW BUSINESS

11.1 Principles

1. The WPF will write new business when the Board considers upon receiving advice from the With-Profits Actuary that suitable opportunities are available to do so.
2. The volume of new with-profit business underwritten by the WPF will be controlled with the aim of ensuring that the Estate is capable of absorbing the potential costs of risks associated with the new business.
3. Volumes of new business will be controlled to protect the interests of different generations of with-profit policyholders and to ensure that they are treated fairly.

11.2 Practices

11.2.1 *New non-profit business*

The WPF will only accept new non-profit business in the future if the returns are judged sufficient to compensate for the risks associated with it. Profits or losses arising from these risks will be borne by the Estate and will only be charged to Asset Shares if the Estate proves insufficient.

11.2.2 *New with-profit business*

The WPF will only accept new with-profit business to the extent that the Estate can bear the potential costs of the risks associated with guarantees and smoothing. These costs will be borne by the Estate or the Asset Shares of the new business and only charged to other Asset Shares if the Estate proves insufficient.

11.2.3 *Control of new business volumes*

At the launch of a new with-profit product, a volume capacity limit will be set by the Board after receiving advice from the With-Profits Actuary. This will be subject to periodic review. In providing advice the With-Profits Actuary will use modelling and stress testing techniques to assess, in expected and adverse conditions:

- The level of risk for existing policyholders associated with guarantees, smoothing and other business risks that may be introduced or increased.
- The impact on the investment policy of the WPF given the capital requirements of the product.

- The impact on the solvency position of the WPF given the capital requirements of the product.
- The potential impact to incoming policyholders of the existing risks within the WPF.
- The impact on the Estate.

12. MANAGEMENT OF THE INHERITED ESTATE

12.1 Principles

1. The Estate is the excess, if any, of the value of assets in the WPF over the value of assets needed to support the current and expected future liabilities of the WPF. It is invested in the residual assets of the WPF, including the Embedded Value Asset.
2. While the Company is open to new business, the Estate is available to support the operation of the with-profit business, and where possible to enhance Asset Shares.
3. The Company aims to keep the size of the Estate within a target range (see 12.2.3 below) relative to the size of the liabilities. Changes to the target range will require the approval of the Board, taking account of advice from the Governance Committee and the With-Profits Actuary.
4. There are no other constraints on the distribution of the Estate.
5. If the Company was to close to new business on a permanent basis, Windsor Life would aim to distribute the remaining Estate fairly and evenly over the lifetime of the remaining policies.

12.2 Practices

12.2.1 *Calculation of the Estate*

The Estate is calculated by subtracting the realistic liabilities from the realistic assets.

Realistic assets consist of the sum of:

- Market value of assets
- 15.75% (the WPF Release Amount Percentage) of the embedded value of non-profit business.

Realistic liabilities consist of the sum of:

- Asset Shares
- Additional cost of guarantees and smoothing
- Statutory value of non-profit liabilities
- Current liabilities

- Any other financial costs arising from the management of the WPF or relating to policies within it.

The size of the Estate is calculated every year using, where necessary, assumptions determined by the Board having taken advice from the With-Profits Actuary.

12.2.2 *Use of the Estate*

The Estate is available to support the operation of the with-profit business. It may be used for the following purposes:

- To meet the cost of providing the guarantees inherent in with-profit business
- To meet the cost of smoothing
- To meet the cost of guaranteed annuity options, in the event that this exceeds existing reserves
- To provide the WPF with capital to allow it take on new business risks and support existing business risks
- To provide the WPF with the freedom to invest in assets expected to maximise the returns for with-profit policyholders
- To enhance Asset Shares and hence benefit payments for with-profit policyholders.

12.2.3 *Target size of the Estate*

Windsor Life aims to keep the size of the Estate within a target range relative to the size of the liabilities. Currently, the target maximum is 40% of aggregate Asset Shares plus any additional cost of guarantees and smoothing. The target minimum is 10% of the same measure.

If the Estate falls below the target minimum or is projected to fall below it within 10 years, Windsor Life may reduce Asset Share enhancements (to a negative figure if necessary, that is, a charge to the Asset Share) in order to boost the size of the Estate.

If the Estate rises above the target maximum, Windsor Life will implement a distribution plan aiming to bring it below the maximum level within five years.

12.2.4 *Distribution of the Estate*

Provided the Estate exceeds the target minimum, a contribution will be made from the Estate to enhance Asset Shares, as described in the Asset Share calculation in Section 4.

This will lead to increased Bonus levels and an associated shareholder transfer. Thus, in the long term, the Estate is expected to be distributed in the 90:10 proportions described in Section 10.

The Estate is invested in the residual assets of the WPF, which includes the Embedded Value Asset. The lack of liquidity of this asset may limit Windsor Life's ability to distribute the Estate. This may be resolved through financial arrangements such as financial reinsurance. The Company will consider such arrangements if it is considered to be in the interests of policyholders as a whole.

13. **AMENDMENTS TO THE PPFM**

13.1 Amendment to the Principles

Windsor Life may amend the Principles set out in this document, after seeking advice from the With-Profits Actuary on the matter, if the Board is of the opinion that there is a need to:

- Respond to changes in the business or economic environment;
- Protect the interest of the policyholders;
- Correct an error or omission in the PPFM, to improve clarity or presentation of the PPFM without materially affecting its substance or to make an immaterial change.

The Board will have due regard to the reasonable expectations of existing and future policyholders, having taken advice from the With-Profits Actuary, when approving an amendment.

Policyholders will be provided with 3 months notice prior to any change in the Principles contained in this document, unless an alternative arrangement is agreed with the FSA or unless the change is to correct an error or omission in the PPFM, to improve clarity or presentation of the PPFM without materially affecting its substance or is immaterial. This notice may be contained in any annual statements that are provided to policyholders, subject to adherence to the 3 month notice period (or any other period agreed with the FSA) if applicable. It is expected that changes to the Principles will be infrequent.

13.2 Amendment to the Practices

The With-Profits Actuary will be responsible for regular monitoring of the practical application of the PPFM to the business. Changes to the Practices will be recorded in this document and all previous versions will be kept for at least five years.
Policyholders will not be given prior notice of changes to Practices, although they will be informed within a reasonable timescale after any change has been made unless the change is to correct an error or omission in the PPFM, to improve clarity or presentation of the PPFM without materially affecting its substance or is immaterial. This notice may be contained in any annual statements that are provided to policyholders.

13.3 Procedures for amending Practices

Prior to amending any Practices within the PPFM the Board shall seek advice from the With-Profits Actuary regarding the proposed changes, the reasons for the changes, any potential impact on policyholders and an opinion on whether such changes are consistent with the Principles. Practices can be changed to better achieve the with-profit principles, to correct errors or omissions, to improve clarity or presentation without materially affecting substance or if the change is immaterial. Parameters or assumptions not specified within the PPFM, but relevant to the methods described in the PPFM may be amended from time to time. The Governance Committee will consider any changes of significance, taking advice from the With-Profits Actuary. In all cases the Company will document such changes and how they are consistent with the PPFM.

14. GLOSSARY OF TERMS

AETNA Scheme	The scheme of transfer for the transfer of the long-term business of AETNA Life Insurance Company Limited to Windsor Life which was sanctioned by the court on 8th December 1993 and took effect on 31st December 1993.
ARUK	Admin Re UK Limited owns the entire share capital of Windsor Life Assurance Company Limited. Before October 2008, its name was Life Assurance Holding Corporation Limited (LAHC).
Asset Liability Matching	The practice of investing in assets that closely match the characteristics of the liabilities they are backing described in paragraph 6.2.2.
Asset Share	The accumulated value of the historic cash flows relating to a policy. Used to assess the contribution the policy has made to the WPF.
Board	The Board of Directors of Windsor Life from time to time.
Bonus	A method of distributing surplus arising in the WPF to policyholders.
Combined Life Scheme	The scheme of transfer for the transfer of the long-term business of Combined Life Assurance Company Limited to Windsor Life which was sanctioned by the court on 27th November 1996 and took effect on 30th November 1996.
Company or **Windsor Life**	Windsor Life Assurance Company Limited (Company number 00754167).
Cost of Bonus	The cost of distributing regular, interim or Terminal Bonuses to with-profit policies.
Crown Life Scheme	The scheme of transfer for the transfer of the long-term business of Crown Life Assurance Company Limited and Crown Life Pensions Limited to Windsor Life which was sanctioned by the court on 15th November 1995 and took effect on 31st December 1995.
CWP	A conventional with-profit policy is one with a defined lump sum payable on death or Maturity, increased by the addition of Bonuses during the policy lifetime.
Deposit Administration	Deposit Administration pension contracts are non-profit policies whose funds increase in line with credited interest rates set at the discretion of the Company.
Deferred Annuities	Pension contracts where benefits and regular bonuses are defined at retirement age.
Embedded Value Asset	The value to the WPF of the future surplus arising from non-profit business.
Estate	The excess, if any, of the value of assets in the WPF over the value of assets needed to support the current and expected

future liabilities of the WPF.

Fixed Expense Agreement	The Fixed Expense arrangements contained in Schedule 2 to the Reassure/Virgin Scheme. The Fixed Expense Agreement is designed to protect the WPF against diseconomies of scale.
FSA	The Financial Services Authority.
GAN Scheme	The scheme of transfer between, amongst others, GAN and the Company, which was sanctioned by the court on 23rd November 1998 and took effect on 30th November 1998.
Governance Committee	The role of the Governance Committee is to consider the interests of policyholders and provide advice to the Board on the management of with-profit business. From March 2004 – February 2005 the internal name for the Governance Committee was the With-Profits Committee. From February 2005 onwards the internal name for the Governance Committee is the Fairness Committee.
Guaranteed Benefits	The guaranteed minimum level of benefits payable on a claim under a life insurance or pension policy, as defined in the policy terms and conditions.
Guaranteed Fund	The Guaranteed Fund is a fund available as an investment link for certain non-profit pension policies. The units in this fund increase in line with credited interest rates set at the discretion of the Company.
Guiding Principles	The guiding principles contained in Schedule 4 to the Gresham Scheme of Transfer and Schedule 1 to the GAN Scheme and amended in the Reassure/Virgin Scheme and NM Life and NM Pensions Scheme.
Gresham Scheme	The scheme of transfer between, amongst others, Gresham and the Company which was sanctioned by the court on 30th November 1992 and took effect on 1st December 1992.
Interim Bonus	A Bonus which may be added to a with-profit policy at the claim date in respect of the time which has elapsed since the last Regular Bonus declaration.
Investment Committee	A sub-committee of the Board which is authorised to operate and monitor the investment programme for the funds under management from time to time.
Maturity	The maturity date specified in the policy terms and conditions when payment of policy benefits becomes due. In the case of pensions policies, the maturity date is called the selected retirement date or normal retirement date.
MVR	A market value reduction may be applied to surrender claims on UWP policies to reduce the claim value to below the nominal value of the attaching with-profit units, to reflect market conditions.
NM Life and NM Pensions	The scheme of transfer of the long-term insurance business from

Scheme	NM Life and NM Pensions to Windsor Life which was sanctioned by the Court on 11 December 2007 and took effect on 31 December 2007.
NMWPF	The National Mutual With-Profit Fund of Windsor Life, containing with-profit and non-profit business.
NPF	The Non-Profit Fund of Windsor Life, containing non-profit business.
PPFM	The Principles and Practices of Financial Management is a set of principles and practices according to which the with-profit business of the Company is conducted.
Reassure/Virgin Scheme	The scheme of transfer of the long-term businesses of Reassure UK Life Assurance Company Limited (“Reassure UK Life”) and Virgin Money Life Limited (“Virgin Money Life”) to Windsor Life which was sanctioned by the court on 23 November 2005 and took effect on 23 December 2005 (Virgin Money Life business) and 30 December 2005 (Reassure UK Life business).
Regular Bonus	A Bonus added to a with-profit policy at regular intervals throughout the term, increasing the Guaranteed Benefits.
Risk Committee	A sub-committee of the Board responsible for managing the Company’s risk strategy.
Schemes	The NM Life and NM Pensions Scheme, Reassure/Virgin Scheme, GAN Scheme, Gresham Scheme, Combined Life Scheme, Crown Life Scheme, AETNA Scheme and any further schemes by which business is transferred to the Company and which are relevant to the management of the WPF.
Supported Bonus Rate	The future Regular Bonus rate which is supported by the underlying Asset Shares as described in Section 5.
Target Range	Subject to certain exceptions, a firm is required by COBS 20.2.5R to set a target range for maturity and surrender payments. This is a range by which maturity and surrender payments must be benchmarked. The range must be specified in the PPFM and the business must be managed in accordance with this range to comply with the relevant FSA rules.
Terminal Bonus	A Bonus added to a with-profit policy at the claim date. Also called final bonus.
UWP	A unitised with-profit policy is one with benefits expressed in terms of a number of with-profit units.
With-Profits Actuary	The role of With-Profits Actuary is to advise the Board on their use of discretion in managing with-profit business as defined by the FSA. The With-Profits Actuary is appointed by the Company.

WPA	A with-profit annuity is a single premium contract where a guaranteed annuity increases in line with declared Bonuses and is payable for the remaining life of the policyholder.
WPF	The Windsor Life With-Profit Fund of Windsor life, containing with-profit and non-profit business.
WPF Release Amount Percentage	15.75%, i.e. one minus the Release Amount Percentage (where the Release Amount Percentage is as defined in Schedule 7 of the NM Life and NM Pensions Scheme and is 84.25%).

APPENDIX A

A.1 Deposit Administration and Guaranteed Funds

A.1.1 Summary of Business

Early in 1995, LAHC purchased Crown Pensions and Crown Life. The long-term business was then transferred to Windsor Life on the 31st December 1995. The Crown Pensions business contained some Deposit Administration (“DA”) and Guaranteed Fund (“GF”) contracts, which were allocated to the WPF.

The DA products and GF products are non-profit business and do not share in the profits of the WPF. The benefits payable under these policies are based on unit values, which increase in line with interest rates set by the Company from time to time. This Appendix describes the basis upon which the Company exercises its discretion.

A.1.2 Principles

1. Separate pools of assets are notionally allocated to back each of the DA and GF classes of business within the WPF. The investment strategy of each pool will reflect the nature of the business.
2. Interest will be added at the declared rate to increase the accumulated value of the account under these policies. The interest rate will depend on the performance of the underlying investments and could vary, but will not be less than any minimum guaranteed.
3. Amounts payable on Maturity or death will not be less than any guaranteed amounts payable, as set out in the policy terms and conditions.

A.1.3 Practices

A.1.3.1 *Interest Rates*

For DA products, interest will be added on a monthly basis using the declared rate of interest.
For GF products interest is added on a daily basis.
The interest rate will depend on the performance of the underlying investments and could vary.

A.1.3.2 *Guaranteed Interest Rate*

There is an underlying guaranteed minimum interest rate throughout the term of the policy. The guaranteed minimum interest rate is 4% p.a. for DA policies and 5% p.a. for GF policies.
For some DA products the guaranteed minimum interest rate is 2% if the policy is made paid-up.
For some regular premium GF products, the guaranteed minimum interest rate is 1.5% for any units purchased in the first two years.

A.1.3.3 *Charges*

Annual management charges of 1% and 2% apply to the GF and DA business respectively. These charges may be varied in future, although they will only be increased if the charges are otherwise insufficient to cover the on-going expenses estimated to relate to these contracts.

A.1.3.4 *Determining the rates and smoothing*

Rates are reviewed every quarter by the With-Profits Actuary. To determine the rates the Company maintains a notional fund and a corresponding unit fund, for each class. The notional funds are increased each year in line with attributed fund performance less charges, and the unit fund is increased in line with rates of added interest declared by the Company.
These values are then projected forward over a period of 10 years from the review date to determine the interest rate that is supported over that period.
If this supported rate is within 0.25% of the current rate then no change will be made at the review, otherwise the Company determines a smoothed interest rate equal to 60% of the supported rate plus 40% of the current rate. The rates declared by the Company will be these smoothed interest rates rounded appropriately, subject to a minimum of the appropriate guaranteed minimum rate.

A.1.3.5 *Investment strategy*

The investment strategy aims to reflect the nature of the liabilities, in particular the high level of guarantees associated with this business. The investments will consist of fixed-interest stocks, equities and other investments chosen for security and return. The proportion of equities would not normally be more than 35% and the investment mix is reviewed at least annually by the Investment Committee taking account of advice from the With-Profits Actuary.