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Principles and practices of financial management of with-profits business

Effective 1 October 2024

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1 Introduction

1.1 The document has been prepared in accordance with the requirements of COBS 20.3 of FCA's Conduct of Business Sourcebook and details the Principles and Practices of Financial Management (PPFM) of with-profits business currently adopted by Scottish Equitable plc.

1.2 The purpose of the document is to help further the understanding of current and potential with-profits investors as to the way in which Scottish Equitable plc ('the **Firm**') manages its with-profits business and provide details on the governance procedures for such business.

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

1.4 An annual report will be produced by the **Firm** confirming whether, throughout the financial year to which the report relates, the **Firm** believes it has complied with the PPFM and setting out the reasons for that belief.

1.5 Annexed to the report detailed in 1.4 will be a statement from the **Firm's with-profits actuary** as to whether, in his opinion and based on the information and explanations provided to him by the **Firm**, the report detailed in 1.4 and the discretion exercised by the **Firm** over the period in question have taken into account the interests of with-profits policyholders in a reasonable and proportionate manner.

1.6 In accordance with the **Firm's** governance arrangements, Scottish Equitable Policyholders Trust Limited has agreed to act as the independent With-Profits Committee in accordance with regulatory requirements.

1.7 Further information can be obtained from Aegon and Scottish Equitable Pensions and Bonds, SUNDERLAND, SR43 4DS.

1.8 Explanations of words and phrases highlighted in **bold** are given in the glossary at the end of the document. Words in the singular include the plural and the opposite also applies.

2 Variation provision

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

2.2 Notwithstanding the foregoing:

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

2.2.2 The Directors are obliged at all times to manage the with-profits business of the **Firm** in accordance with the **Scheme** approved by the Court of Session that authorised and gave effect to the transfer of business from Scottish Equitable Life Assurance Society to the **Firm** with effect from 31 December 1993.

2.2.3 The Directors are obliged to give effect to legal and regulatory requirements as they apply to the **Firm**.

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3 Principles - With-profits business with investment guarantees

3.1 General

3.1.1 At 31 December 1993, the assets and liabilities of Scottish Equitable Life Assurance Society were transferred to the **Firm** under a Scheme of Transfer pursuant to Section 49 of the Insurance Companies Act 1982 ('the **Scheme**').

3.1.2 As a result of the **Scheme**, the **long-term insurance fund** of the **Firm** was notionally divided into a **With-profits subfund (WPSF)** and a **Non-profit subfund (NPSF)**. The purpose of establishing the **WPSF** and **NPSF** is for internal accounting purposes only (with a view to establishing respective policyholder entitlements from time to time) and is not intended to denote any separation of ownership. Additionally, a **shareholder's** fund was created, whose assets do not form part of the **long-term insurance fund**.

3.1.3 The **WPSF** contains all with-profits business that was in-force as at 31 December 1993. Subsequent new with-profits business (excluding single premiums and increments under in-force **traditional with-profits** policies) has been written in the **NPSF** with the **investment element** of such business being transferred to the **WPSF**. With-profits policyholders participate in the investment profits/losses arising in the **WPSF** as well as any profits/losses that arise on non-profit business in the **WPSF** (for example certain annuities), as stipulated in the **Scheme**.

3.1.4 At 30 June 2017, almost all of the assets and liabilities associated with the immediate and deferred annuity policies of the **WPSF** were transferred out of the **Firm** under a Scheme of Transfer pursuant to Part VII of the Financial Services and Markets Act 2000. Following this transfer, with-profits policyholders have no significant participation in the profits and losses that arise on non-profit immediate and deferred annuity policies but continue to participate in any profits and losses that arise on other annuity related risks, for example **Guaranteed Annuity Options (GAOs)** and **Guaranteed Minimum Pensions (GMPs)**.

3.1.5 The **shareholder** has no financial interest in the **WPSF** beyond an annual management charge that is taken from the assets backing **unitised with-profits** policies and an agreed level of annual expense and investment related expenses (as provided for in the **Scheme**) from the assets backing traditional (non-unitised) policies.

3.1.6 The **Scheme** establishes the principles governing the management of with-profits business within the **WPSF**.

3.1.7 Within the **WPSF**, a number of individual with-profits funds have been notionally created with specific characteristics. These are typically related to the levels of guarantee on offer (and consequently the asset mix of the fund) and whether the business is life or pensions.

3.1.8 The **Firm** no longer writes new with-profits business with investment guarantees that may attract **annual and final bonus** additions, apart from, potentially increments, renewal premiums and new entrants to occupational pension schemes that were in force as at 30 September 2002. Consequently, the in-force block of such business is now in decline.

3.1.9 "**Firm**" in this document refers to Scottish Equitable plc.

3.1.10 No with-profits business with investment guarantees is written as **stakeholder business**.

3.2 The amount payable under a with-profits policy

3.2.1 Amounts payable under with-profits policies are guided by the calculation of **asset shares** (see 4.2), as indicated in the **Scheme**.

3.2.2 At the point of demutualisation on 31 December 1993, Aegon NV (the **shareholder**) made a **capital contribution** of £208m to the **WPSF**. This contribution was for the benefit of with-profits policyholders and £160m of it has been used to enhance **asset shares** in accordance with the **Scheme**. The **shareholder** has also made subsequent **capital contributions** to the **WPSF** that are also for the benefit of with-profits policyholders. These contributions may be used to enhance **asset shares** in future but there is no requirement to do so under the **Scheme**.

3.2.3 To the extent considered appropriate, the investment returns that underpin the calculation of **asset shares** are adjusted to make some allowance for the expected costs of guarantees and costs for the use of capital.

3.2.4 Consistent with the concepts of pooling and smoothing, bonus rates are not set by reference to individual policy **asset shares**, rather by reference to the **asset shares** of groups of individual policies with similar characteristics (for example by in-force duration to the last whole year).

3.2.5 The methods used to set payouts to policyholders aim to ensure that payouts represent fair value in relation to the investment returns achieved and the risks borne by the **WPSF**.

3.2.6 Any changes to the methods used to set payouts require the approval of the **Board**.

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

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

3.3 Overriding principle

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

3.3.2 When determining **annual bonus** and **final bonus** rates and **MVRs** from time to time in accordance with the Overriding principle, the **Firm** shall have regard to **asset shares** and **smoothed asset shares** (see 3.5.1) and the other matters and provisions described in these Principles and in the Practices annexed. The concepts of **asset share** and **smoothed asset share** do not, however, represent policyholder entitlement but are a guide to meeting the objective that bonus declarations, from time to time, accord with the Overriding Principle.

3.3.3 In approaching the question of bonus declarations, it is considered significant that policyholders are entitled to 100% of profits or losses emerging in the **WPSF** and no part accrues for the benefit of **shareholders** in the **Firm**. Accordingly, the scope for any conflict of interest between **shareholder** and policyholder in determining bonus policy is thereby reduced.

3.4 The approach to setting annual bonus rates

3.4.1 The general aim in setting **annual bonus** rates is for, at the point a claim arises, less than 100% of **asset shares** to be targeted as coming from a combination of **guaranteed benefits** and **annual bonus** additions. The higher the proportion of the backing assets invested in equities, the lower this target percentage and vice versa. For some contracts, this target percentage may be 100%.

3.4.2 Different rates of **annual bonus** apply depending on the characteristics of individual products or funds (for example guaranteed growth rates, investment mix, tax).

3.4.3 Within a specific fund or contract, the same rate of **annual bonus** typically applies to all policies, irrespective of when investments were made. This could change if the **asset shares** of particular **cohorts of policyholders** were low relative to their **guaranteed benefits**. In such a circumstance, it could be appropriate for lower **annual bonus** rates to apply to that **cohort**.

3.5 The approach to setting final bonus rates and/or MVRs

3.5.1 **Asset shares** are calculated for groups of policies with similar durations, except that investment returns are normally smoothed. This results in **smoothed asset shares**.

3.5.2 **Final bonuses** are then normally declared or applied having regard to any excess, for groups of policies, of 100% of **smoothed asset shares** above **guaranteed benefits** (including **annual bonus** additions). This principle applies to all claim types, including surrenders.

MVRs are then normally applied having regard to any shortfall, for groups of policies, of 100% of **smoothed asset shares** below corresponding unit values (including **annual bonus** additions). This principle only applies to claim types under which an **MVR** may be applied (for example surrenders).

3.5.3 The different rates of **final bonus** applying will be determined at the discretion of the **Firm** having regard to the characteristics of individual products or funds (for example guaranteed growth rates, investment mix, tax).

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

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

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

3.6 The approach to smoothing

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

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

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

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

3.7 Investment strategy

3.7.1 The investment strategy under an individual with-profits fund (see 3.1.7) is linked to the associated level of guarantee (including **annual bonus** additions to date). The assets backing funds with high guarantees typically invest heavily in fixed interest securities of an appropriate duration. In funds that have lower levels of guarantee, the **Firm** would normally aim to invest more in equities.

3.7.2 In certain circumstances the **Firm** may rely on assets held within the **NPSF** or **shareholder's** fund in order to maintain the investment strategy in the **WPSF**. This is consistent with the measurement of solvency at a global level rather than at **WPSF** level.

3.7.3 It may be appropriate to utilise **derivatives** to protect the **WPSF** against adverse market movements (for example equity falls or changes in fixed interest yields). It may also be appropriate to utilise **derivatives** for short-term asset allocation purposes or to increase diversification by gaining exposure to different asset classes or for efficient portfolio management.

3.7.4 Exposures to individual **counterparties** (including **derivative** exposures) across the assets of the entire **Firm** will normally be spread appropriately in order to reduce risk.

3.7.5 The **WPSF** would not usually expect to invest in assets that would not normally be traded because of their importance to the **Firm**.

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3.8 Business risk

3.8.1 The **WPSF** is not exposed to any of the business risks associated with the writing of new policies. All such risks are borne by the **NPSF**. Under the **Scheme**, certain liabilities emerging in respect of business undertaken prior to 1 January 1994 will be met by the **WPSF**. This mainly relates to liabilities which may arise from or in connection with the conduct of business by Scottish Equitable Life Assurance Society prior to its demutualisation as set out more fully in the **Scheme**.

3.8.2 The **Firm** no longer writes new with-profits business with investment guarantees. The capital required to cover **regulatory solvency requirements** on new with-profits business (without investment guarantees) is held in the **NPSF**.

3.9 Management and administration expenses

3.9.1 All expenses are met from the **NPSF**.

3.9.2 On traditional (non-unitised) policies, the **WPSF** pays an agreed level of expenses to the **NPSF** in accordance with the **Scheme**.

3.9.3 On unitised policies, the **WPSF** pays an annual management charge to the **NPSF**. In accordance with policy conditions and the **Scheme**, the level of charge is equal to that taken from equivalent unit-linked funds. Apart from on certain business lines, charges can be reviewed from time to time.

3.9.4 From the **estate**, a deduction is made for investment related expenses in a manner that the **Firm** deems appropriate in accordance with the approach set out in the **Scheme**. The level of deduction made, as a percentage of the assets under management, is determined in arrears.

3.10 Management of the estate

3.10.1 The **Firm** aims to distribute any **WPSF estate** equitably to with-profits policyholders (excluding those funds that offer no investment guarantees) in accordance with the Overriding Principle.

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

3.10.3 The **shareholder** has no entitlement to any **WPSF estate**.

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

3.10.5 The **estate** may be used to meet the costs of certain guarantees.

3.11 Volumes of new business and arrangements on stopping taking new business

3.11.1 No new with-profits business with investment guarantees is written in the **WPSF**, apart from, potentially increments, renewal premiums and new entrants to occupational pension schemes that were in force as at 30 September 2002 (see 3.8.2).

3.11.2 The volume of increment, renewal and single premium business plus new occupational scheme entrants investing in with-profits funds with guarantees is kept under review.

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3.12 Equity between the with-profits fund and the shareholder

3.12.1 In accordance with the **Scheme**, all investment profits (and losses) on assets notionally allocated to the **WPSF** are held for the benefit of with-profits policyholders.

3.12.2 With-profits policyholders have no entitlement to profits (or losses) that arise from assets notionally allocated to or business conducted in the **NPSF**, which accrue for the benefit of the **shareholder**. However, assets in the **NPSF** and **shareholder's** fund are available to support **WPSF** solvency should there be insufficient assets within the **WPSF** to meet its liabilities and vice versa.

4 Practices - With-profits business with investment guarantees

4.1 General

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

4.1.2 The **Firm** writes no new with-profits business with investment guarantees, apart from, potentially increments, renewal premiums and new entrants to occupational pension schemes that were in force as at 30 September 2002.

4.1.3 Within the **WPSF**, assets are notionally allocated to with-profits funds with particular characteristics as follows. Any references to guarantees are in the context of the specific points in time where guarantees may apply (for example maturity, death, retirement at selected retirement date, regular income withdrawals, withdrawals at a specific anniversary).

4.1.3.1 Traditional with-profits (TWP)/Unitised with-profits (WPE, WPC and WWP)
This includes all traditional (non-unitised) with-profits business whether life or pensions. It also includes **unitised with-profits** (WPE, WPC and WWP) business.

The WPE fund was first made available under unitised pension contracts during 1984 and was completely closed to all future premiums on 31 October 1999. All **unitised with-profits** life business under policies sold in connection with mortgages was written in the WPC fund. **Unitised with-profits** business written under the **Firm's** Passport for Life contract is linked to the WWP fund.

Guarantees on offer at outset under **TWP** contracts were typically in the range 2% – 5.5% each year.

Guarantees under the WPE, WPC and WWP funds (which also apply to **annual bonus** additions to date) are around 5.5%, 3.9% and 2.7% each year respectively.

4.1.3.2 Unitised with-profits (WP1)
The WP1 fund was available under new unitised pension contracts from 1 January 1996 to 31 October 1999, at which point it was closed to all future premiums.

The WP1 fund offers a guaranteed rate of return of 4% each year in the unit value (which also applies to **annual bonus** additions to date).

4.1.3.3 Unitised with-profits (WP2)
The WP2 fund was available under new unitised pension contracts from 1 February 1996 to 30 September 2002, at which point it was closed to new business.

The WP2 fund offers a guaranteed rate of return of 0% per year in the unit value (in other words guaranteed return of capital including **annual bonus** additions to date).

4.1.3.4 Unitised with-profits (DAF)
The DAF fund was available under new unitised pension contracts from 3 June 1996 to 30 September 2002, at which point it was closed to new business.

The DAF fund offers a guaranteed rate of return of 0% each year in the unit value (in other words guaranteed return of capital including **annual bonus** additions to date).

4.1.3.5 Unitised with-profits (DA2)
The DA2 fund was available under new unitised pension contracts from 1 September 1999 to 30 September 2002, at which point it was closed to new business.

The DA2 fund offers a guaranteed rate of return of 3% each year in the unit value (which also applies to **annual bonus** additions to date).

4.1.3.6 Unitised with-profits (WPB)
The WPB fund was available under new with-profits bond contracts from 1 November 1996 to 30 September 2002, at which point it was closed to new business.

The WPB fund offers a guaranteed rate of return of 0% each year in the unit value (in other words guaranteed return of capital including **annual bonus** additions to date).

4.1.3.7 Unitised with-profits - Deposit administration (Reflex DA)
The Reflex DA fund is available under the **Firm's** Reflex contracts and offers a guaranteed rate of return of 5% each year in the unit value (which also applies to **annual bonus** additions to date). This contract was closed to new business in 1984.

4.1.3.8 Unitised with-profits – Deposit administration (Others)
Other deposit administration contracts are SE Funding (SEF), Barclays Retirement Accumulator Plan (BRAP), Money Plus and Money Purchase Plan, which guarantee a return of capital including **annual bonus** additions to date. These contracts were all closed to new business by February 1987.

4.1.4 The asset mixes of each of the **notional subfunds** in 4.1.3 are different. In general, the higher the rate of guarantee, the greater proportion of the backing assets is likely to be invested in fixed interest securities.

4.1.5 **Guaranteed annuity options (GAOs)** exist under a number of pension contracts, as do **guaranteed minimum pensions (GMPs)** guarantees under certain Individual Buyout contracts, the costs of which are met from the **WPSF**.

4.1.6 One of the principles underpinning the **Scheme** (see 3.1.1) is that each of the **WPSF** and **NPSF** (while, essentially, both parts of a single **long-term insurance fund**) should be self-sufficient in capital terms. Reference is made in 3.2.2 to the substantial **capital contributions** paid by Aegon NV to the **WPSF**. It is not anticipated that any further support will be necessary.

4.2 The amount payable under a with-profits policy

4.2.1 The amounts payable to policyholders are guided by the calculation of **asset shares**, which would normally be calculated on a monthly basis but no less frequently than annually.

4.2.2 For **unitised with-profits** policies, **asset shares** reflect the accumulation of premiums applied plus **capital contribution** enhancements (where appropriate) plus distributions from the **estate** less **contract charges** less contributions towards the expected costs of guarantees less investment expenses less costs for the use of capital less any partial withdrawals made by the policyholder, at the rate of investment return on the underlying assets notionally backing the relevant policies, adjusted for tax where appropriate.

4.2.3 For **traditional (non-unitised) with-profits** policies, **asset shares** reflect the accumulation of premiums applied plus **capital contribution** enhancements (where appropriate) plus distributions from the **estate** less **contract charges** less expenses less contributions towards the expected costs of guarantees less costs for the use of capital at the rate of investment return on the underlying assets notionally backing the relevant policies, adjusted for tax where appropriate. In this calculation, non-investment related expenses are fixed in accordance with the approach detailed within the **Scheme**. Investment related expenses are calculated in a manner that the **Firm** deems reasonably appropriate in accordance with the approach set out in the **Scheme**.

4.2.4 The key parameters underpinning the calculation of **asset shares** are:

4.2.4.1 Investment returns
The investment returns underpinning the **asset share** calculations vary by **notional subfund** (see 4.1.3). The same return is applied to all investments within each **notional subfund** as described in section 4.1.3.

4.2.4.2 Taxation
Investment returns are adjusted for taxation where appropriate, based on estimates of the rate of taxation actually paid by the **Firm** over the appropriate periods.

4.2.4.3 Expense deductions (TWP policies)
The approach to expenses is detailed within the **Scheme** (see section 4.9.1).

4.2.4.4 Annual management charge (unitised policies)
This charge is consistent with that taken from unit-linked funds and is fixed contractually between the policyholder and the **Firm** (generally with powers for the **Firm** to increase that charge thereafter).

4.2.4.5 Capital contribution enhancements
At the point of demutualisation on 31 December 1993, the **shareholder** made a **capital contribution** of £160m to the **WPSF** that has been used to enhance **asset shares** (see 3.2.2).

4.2.4.6 Costs of guarantees
Details on costs of guarantees are given in section 4.5.1.

4.2.4.7 Costs for the use of capital
Details on costs for the use of capital are given in section 4.5.2.

4.2.4.8 Distributions from the estate
Details on **estate** distribution are given in section 4.10.

4.2.5 The determination of amounts payable to with-profits policyholders in respect of guaranteed or contractual benefits or by way of bonus declarations (which are at the absolute discretion of the **Board** having regard to the surplus available for distribution and in accordance with the Overriding Principle) have regard to methods of

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assessment approved by the **Board**. Documentation of the methods, parameters and assumptions used to set **annual bonus**, **final bonus** and **MVRs**, and the calculation systems which implement the methods, is retained by the **Firm**.

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

4.3 The approach to setting annual bonus rates

4.3.1 Different rates of **annual bonus** apply to individual **notional subfunds** (see 4.1.3). Furthermore, within the **TWP** subfund, different rates of **annual bonus** apply to life, pensions regular premium and pensions single premium business.

4.3.2 The approach to setting **annual bonus** rates takes account of:

4.3.2.1 The relationship between **asset shares** and accrued **guaranteed benefits** at the date at which affordable bonus rates are calculated.

4.3.2.2 An assumed future rate of return on and the volatility of the assets backing each individual subfund and the consequent level of projected **asset shares** relative to **guaranteed benefits**.

4.3.2.3 The impact of the **annual bonus** declaration on the **Firm's** level of **excess regulatory capital**, consistent with 4.3.2.1 and 4.3.2.2.

Exceptions to this approach arise under SEF, BRAP, Money Plus and Money Purchase Plan, where **annual bonus** rates are related to the rate of return on the **WPSF's** fixed interest investments in the previous calendar year, less 0.5%. As the **annual bonus** rate cannot be negative, we allow for the smoothing of investment losses over time. We aim to apply smoothing in a manner that has a neutral impact over time.

4.3.3 While the same rate of **annual bonus** currently applies to all policies within an individual subfund, irrespective of when investments were made, it may be appropriate in future to have more than one rate of **annual bonus** within an individual subfund that varies by in-force and outstanding duration.

4.3.4 Under current practice, **annual bonus** rates on contracts investing in the following subfunds are declared in arrears, normally once a year on 31 December:

TWP, WPE, WPC, WWP, WP1 and Deposit Administration (Reflex contracts)

Interim bonus rates for the same contracts are normally declared twice a year on 1 April and 31 December respectively. The 1 April declaration applies to appropriate claims in the period 1 April to 31 December and the 31 December declaration applies to appropriate claims in the period 1 January to 31 March.

4.3.5 Under current practice, **annual bonus** rates on contracts investing in the following subfunds are declared in advance, normally once a year on 1 April:

WP2, DAF, DA2, WPB and Deposit Administration (Others)

Unit prices of these funds normally change each business day on a basis consistent with the pre-declared rates of **annual bonus**.

4.3.6 There are no restrictions on the amount by which **annual bonus** rates may change from one declaration to the next.

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4.4 The approach to setting final bonus rates and/or MVRs

4.4.1 Different rates of **final bonus** and **MVRs** apply to individual **notional subfunds** (see 4.1.3). Furthermore, within the **TWP** subfund, different rates of **final bonus** apply to life, pensions regular premium and pensions single premium business. No concept of **MVRs** exists under **TWP** policies, although the surrender value basis for such policies can vary (see 4.4.9.2).

Within each **unitised with-profits** subfund, rates of **final bonus** and **MVR** vary depending on the year and month in which an investment is made. Within the **TWP** subfund, rates of **final bonus** vary depending on the in-force duration expressed in whole years.

4.4.2 The starting point is to calculate **asset shares** as described in Section 4.2 except that investment returns are normally smoothed, resulting in **smoothed asset shares**. The smoothing process is described in section 4.6.

4.4.3 **Final bonuses** are then normally declared or applied having regard to any excess, for groups of policies, of 100% of **smoothed asset shares** above **guaranteed benefits** (including **annual bonus** additions). This applies to all claim types, including surrenders.

MVRs are then normally applied having regard to any shortfall, for groups of policies, of 100% of **smoothed asset shares** below corresponding unit values (including **annual bonus** additions). This only applies to claim types under which an **MVR** may be applied (for example surrenders).

In practice, within each **unitised with-profits** subfund some additional second-order rounding of affordable **final bonus** rates and/or **MVRs** also takes place that aims to be cost-neutral. The same applies to **traditional with-profits** business, except that **final bonus** rates may be smoothed further, typically over a 5-year period. For example, the **final bonus** rate applicable under a **traditional with-profits** investment that has been in-force for 20 years is the average of the **final bonus** rates that would otherwise be calculated in respect of policies that have been in force for 18, 19, 20, 21 and 22 years respectively. Additionally, we would normally apply limits to the maximum change in **final bonus** rates under **traditional with-profits** investments from one quarterly rate review to the next (see 4.4.7).

4.4.4 The cost of smoothing is expected to be neutral over the long-term. However, under certain scenarios this may become more positive or negative than expected (see 4.6.2).

4.4.5 Were the normal smoothing mechanisms described in 4.4.2 – 4.4.4 to jeopardise the solvency position of the **WPSF**, payouts could then be allowed to fall below 100% of **unsmoothed asset shares**. Payouts could also rise further above 100% of **unsmoothed asset shares** in order to avoid a **tontine effect** as the funds run down.

4.4.6 The **Firm** expects to review **final bonus** rates and **MVRs** quarterly. In times of significant market volatility, these reviews could become more frequent. Conversely, in times of stable markets, these reviews could become less frequent. The fact that **final bonus** rates and **MVRs** are not normally reviewed on a daily basis implicitly introduces an additional element of smoothing.

4.4.7 The following overriding restrictions normally apply on the degree to which payouts may change on similar policies from one bonus declaration to the next:

- At the point of a quarterly rate review, we would not normally allow payouts under **unitised with-profits** investments to increase or decrease by more than 7.5%.
- From one quarterly rate review to the next, we would not normally allow **final bonus** rates under **traditional with-profits** investments to increase or decrease by more than 15%, or 10% of the previous rate (rounded to the lower 5%) if this represents a greater change.

In times of significant market volatility, rate reviews could be more frequent than quarterly (see 4.4.6).

4.4.8 The circumstances by which the **Firm** may deviate from the normal practice described above include, but is not restricted to, the correction and closure of historic terminal bonus rate errors. Such an error would normally be corrected if the impact on the amount payable was material.

4.4.9 Traditional with-profits (TWP)

4.4.9.1 **Final bonus** rates under **TWP** contracts apply at policy level, apart from certain group pension contracts where individual benefit slices can exist within a single policy, which then attract **final bonus** rates based on their individual characteristics.

4.4.9.2 On early surrender or transfer, formulaic calculations are applied to both the guaranteed maturity benefits (including accrued **annual bonus** additions) and any **final bonus** likely to be available at the rates then current, in order to derive a surrender or transfer value. These formulae, which require assumptions to be made about future investment returns, **annual bonuses** and mortality rates, will change from time to time. We expect to review the appropriateness of these formulae on an annual basis.

4.4.9.3 In calculating **final bonuses**, the **Firm** does not usually differentiate between claim types (for example between maturities, deaths and surrenders).

4.4.9.4 The **Firm** has set the following current target range around **unsmoothed asset share** for the maturity payments that it will make on **TWP** contracts.

All **TWP** life and pensions contracts: 70% - 180%

In setting this range, the **Firm** expects that 90% of maturity payments will fall within the range. In circumstances where a maturity payment falls outwith this range because there is an excess of **guaranteed benefits** above **smoothed asset share** at the point a claim arises, the claim value is deemed to fall within the range.

4.4.9.5 Small **TWP** contracts may be excluded from the target range referred to in 4.4.9.4. This is because **TWP asset shares** must allow for expenses that are fixed in accordance with the **Scheme** at levels that are independent of policy size.

4.4.10 Unitised with-profits

4.4.10.1 Under **unitised with-profits** policies, investments of similar durations across all policies within a **notional subfund** are grouped together for the purpose of calculating **final bonus** rates and/or **MVRs**. In practice, this means that a range of **final bonus** rates and/or **MVRs** can apply to individual investments within a single policy.

4.4.10.2 **Final bonus** rates and **MVRs** would normally be calculated based on year and month of investment. Accordingly, it is possible that both **final bonuses** and **MVRs** could apply within an individual policy if more than one investment had been made into that policy.

4.4.10.3 In calculating **final bonus** and/or **MVRs**, the **Firm** does not usually differentiate between claim types (for example between maturities, deaths and surrenders) other than to the degree that **MVR**-free terms exist.

4.4.10.4 **MVRs** may be applied on certain claims under the following **unitised with-profits** funds: WP1, WP2, DAF, DA2 and WPB. A facility which is effectively equivalent to a **MVR** exists for the WPE, WPC and WWP funds. No facility to apply **final bonus** or **MVRs** exists under Other Deposit Administration contracts and no facility to apply **MVRs** exists under Reflex Deposit Administration contracts.

4.4.10.5 When a partial withdrawal is made that exceeds the corresponding **smoothed asset share** on account of **MVR**-free terms being offered, the excess paid does not reduce the **smoothed asset share** associated with the remainder of the policy.

4.4.10.6 The **Firm** has set the following current target ranges around **unsmoothed asset share** for the maturity payments that it will make on each of its unitised with-profits funds.

WPE, WPC, WWP, WP1, WP2, DAF, DA2 and WPB funds: 85% - 115%
Deposit Administration contracts: 80% - 120%

In setting these ranges, the **Firm** expects that 90% of maturity payments will fall within the ranges. In circumstances where a maturity payment falls outwith the appropriate range because there is an excess of **guaranteed benefits** above **smoothed asset share** at the point a claim arises, the claim value is deemed to fall within the appropriate range.

4.4.11 The **Firm** manages its with-profits business with the longer-term aim that it will make aggregate maturity payments equal to 100% of **unsmoothed asset shares**. Any excess of **guaranteed benefits** above **smoothed asset shares** at the point a claim arises plays no part in the maintenance of this longer-term aim: for this purpose, relevant payouts are assumed to be equal to 100% of **smoothed asset shares**.

4.5 Costs of guarantees and the cost of capital

4.5.1 Deductions for the cost of guarantees

4.5.1.1 **Stochastic modelling** techniques are used in order to assess the cost of **GAOs** and **GMPs**, which involve the simulation of future investment returns and interest rates. By running a large number of simulations, the expected cost of **GAOs** and **GMPs** arising at the point of vesting can be determined.

4.5.1.2 **Stochastic modelling** techniques are also used in order to assess the cost of with-profits growth guarantees. This involves the simulation of future investment returns, which enables a comparison to be made of **asset shares** against **guaranteed benefits** at guaranteed points. By running a large number of simulations, the expected cost of shortfalls arising at the guarantee points can be determined.

4.5.1.3 In arriving at **asset shares** (and having regard, generally, to investment returns available to be applied thereto), a monthly deduction may be made from the investment return underpinning the calculation of the **asset shares** of all with-profits policies offering investment guarantees that covers part of the combined expected future cost of **GAOs, GMPs** and with-profits growth guarantees. The balance of the expected future costs is met from the **estate**.

4.5.1.4 The level of deduction described in 4.5.1.3 can be varied from time to time although no retrospective alterations would be made at the point of change. The level of deduction currently applicable is contained within the fund factsheets on the Aegon website. A reference link is available from Section 8 of this document ("Useful links").

We would expect to discuss the ongoing level of deduction, from time to time, with the FCA and PRA.

4.5.1.5 Subject to a regular assessment of economic conditions, the expected emergence of guarantee costs and the level of **excess regulatory capital** in the **WPSF** (see 3.10.2), the **Firm** aims to enhance the investment returns underpinning the calculation of **asset shares** from the **estate**. Such increases to investment returns may be achieved through making annual additions and/or an enhanced return included within **asset shares** only at the point of claim. Subject to the provisions of 4.10.6 – 4.10.9, the **Firm** would currently expect the level of enhancement from the **estate** to exceed any deductions for guarantee costs made in accordance with 4.5.1.3 above.

4.5.2 Cost of capital support

4.5.2.1 Capital support may be required, for example, to meet regulatory requirements or to allow greater investment freedom. Further deductions may be made from the investment returns applicable to the determination of **asset shares**, from time to time, to help meet the cost of providing this capital support.

4.5.2.2 No such deductions are currently being incorporated within the calculation of **asset shares**.

4.6 The approach to smoothing

4.6.1 The normal process underpinning the calculation of **smoothed asset shares** within each **notional subfund** is as follows:

4.6.1.1 **Smoothed asset shares** are dependent on the relationship between **unsmoothed asset shares** and corresponding policy values. Under **unitised with-profits** policies, policy value reflects the nominal value of units; under **traditional with-profits** policies it reflects the **guaranteed benefits** at maturity, including **annual bonus** additions to date, assuming that all contractual premiums are paid.

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4.6.1.2 Under investments that have been in force for 2 whole years or more, **smoothed asset shares** are dependent on the actual policy value/**unsmoothed asset share** relationship at the point of calculation and over the previous 2 years and the expected policy value/**unsmoothed asset share** relationship over the next 2 years.

4.6.1.3 Under investments that have been in force for 1 whole year, **smoothed asset shares** are dependent on the actual policy value/**unsmoothed asset share** relationship at the point of calculation and over the previous year and the expected policy value/**unsmoothed asset share** relationship over the next year.

4.6.1.4 In the calculation of **smoothed asset shares**, no smoothing takes place on investments that have been in force for less than 1 year.

4.6.1.5 In the calculation of **smoothed asset shares**, any estimates of future investment return are consistent with the asset mix of the subfund in question, after adjusting for charges/expenses, tax and for contributions towards the expected cost of guarantees and cost of capital as appropriate. Similarly, the corresponding estimates of policy value require assumptions to be made about future bonus rates that are consistent with the practices detailed in section 4.3.

4.6.1.6 The implication of paragraphs 4.6.1.1 – 4.6.1.5 is that, depending on the in-force duration, we normally allow for smoothing by combining the actual investment returns in the 1-2 years immediately prior to a claim being made with the expected investment returns in the 1-2 years immediately after.

4.6.2 Positive contributions are made to the **estate** if payouts to policyholders are less than **unsmoothed asset shares** and vice-versa. The **Firm** monitors the resulting impact on policyholder payouts. The effect of smoothing is expected to be neutral over the long-term. The exception to this is where payouts equal **guaranteed benefits** and **guaranteed benefits** exceed **unsmoothed asset shares**. In this circumstance, the excess cost above the payout that would otherwise be made in the absence of guarantees is excluded from this analysis.

4.6.3 Within each **notional subfund**, the same smoothing strategy applies to all generations of policyholders.

4.7 Investment strategy

4.7.1 Assets within the **WPSF** fall into one of the following sectors:

- UK equities
- Overseas equities
- Fixed interest
  - (1) Backing **asset shares**
  - (2) Within the **estate**
  - (3) Backing **new generation with-profits** (see sections 5 and 6)
- Property
- Cash
- Others

4.7.2 Each of the **notional subfunds** within the **WPSF** buys units in each of the above sectors. Hence for the purpose of calculating **asset shares**, the characteristics, in particular the investment returns, of (say) the UK equities and fixed interest securities (1) held by each **notional subfund** are identical.

4.7.3 The **Firm** may match expected future guaranteed cashflows across the whole portfolio of **WPSF** liabilities (excluding WP2 and WPB funds – see 4.1.3) with interest and capital payments from its block of fixed interest securities. The **Firm** may however choose not to match expected future guaranteed cashflows (or may choose to match only partially) if it considers that other valid investment considerations predominate. The fixed interest return credited to the **asset shares** of all with-profits policies is consistent with the weighted average investment return across the entire **WPSF** fixed interest (1) portfolio.

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

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

4.7.6 The **Firm** would not usually expect to invest in assets that would not normally be traded.

4.7.7 The fixed interest fund backing **asset shares** is invested in a combination of UK government securities ('gilts') and other fixed income assets (which includes **sovereigns**, **sub-sovereigns** and **corporate bonds**). The target range for the gilt holdings is 30%-50% of the fixed interest fund. We would normally expect to hedge all overseas currency risk under non-sterling denominated fixed interest securities.

4.7.8 Each of the **notional subfunds** has a target range for the percentage of the backing assets that are normally invested in a combination of equities and property [**equity backing ratio** (**EBR**)]. Current target **EBRs** are as follows:

TWP: 10% - 20%
WPE, WPC and WWP: 0%
WP1, DAF and DA2: 15% - 25%
WP2 and WPB: 65% - 75%
Deposit Administration: 0%

It is possible that short-term market fluctuations could lead to these ranges being temporarily breached. If so, the **Firm** would normally expect to bring **EBRs** back within range as soon as practicable thereafter.

These ranges may vary from time to time, as the **Firm** deems appropriate. A table of current asset mixes by **notional subfund** is available on the **Firm's** website and will be updated every three months. Any significant change in asset mixes will be communicated separately to individual policyholders.

4.7.9 The **Firm** would normally expect the overseas component of its equity investments to lie within the range 30% - 50% of equity investments (excluding any property investments).

4.7.10 The **Firm** would normally expect the property component of its equity investments to lie within the range 0% - 17.5% of total equity and property investments.

4.7.11 The conditions in which it may be appropriate to utilise **derivatives** are given in section 3.7.3. The control environment for the use of **derivative** instruments involves: approval by a senior investment manager that the initial investment is within permitted parameters; segregation of duty between those who authorise deals and those who trade deals; and monthly discussion of **derivative** reports.

4.7.12 Formal reviews of the investment strategy of each subfund would normally be made yearly.

4.7.13 Any transfer of assets to the **WPSF** for the purpose of maintaining the **Firm's** investment strategy in the **WPSF** must be in accordance with the terms of the **Scheme**.

4.8 Business risk

4.8.1 From 1 January 1994 the **WPSF** has not been exposed to any of the business risks associated with the writing of new policies. All such risks are borne by the **NPSF**.

4.8.2 The way in which historic guarantees impact on the calculation of **asset shares** is detailed in section 4.5.

4.8.3 Any currently unrecognised business risks that might fall to the **WPSF** could impact on future returns to with-profits policyholders. This would depend on the nature of any such risks and their size.

4.9 Management and administration expenses

4.9.1 Traditional with-profits (TWP)

The deductions from **asset shares** are defined in the **Scheme**. For regular premium and single premium/paid-up policies, the **Scheme** specifies the levels to apply from 1 January 1994, which then increase each year thereafter in line with the National Average Earnings index.

From August 2010, the National Average Earnings index has been withdrawn and superseded by the Average Weekly Earnings index. Increases for **TWP** management and administration expenses from 1 January 2011 onwards are in line with the Average Weekly Earnings index.

Further deductions are made for investment related expenses in a manner that the **Firm** deems appropriate in accordance with the approach set out in the **Scheme**. The level of deduction made, as a percentage of the assets under management, is determined in arrears.

4.9.2 Unitised with-profits

As per the **Scheme**, an annual management charge is taken from **asset shares** at a rate equal to that taken from equivalent unit-linked funds, a common rate of which is currently 1% per annum.

4.9.3 Estate

A deduction is made for investment related expenses in a manner that the **Firm** deems appropriate in accordance with the approach set out in the **Scheme**. The level of deduction made, as a percentage of the assets under management, is determined in arrears.

4.9.4 The risk that expenses exceed the levels as calculated in 4.9.1 or the annual management charge as calculated in 4.9.2 is borne by the **NPSF**.

4.10 Management of the estate

4.10.1 The **estate** has been used to cover the cost of all investment guarantees (including **GAOs** and **GMPs** guarantees) incurred prior to 1 January 2004.

4.10.2 The cost of guarantees arising in connection with **GAOs**, **GMPs** and with-profits growth guarantees from 1 January 2004 onwards will be partially met from the **estate** (see 4.5.1).

4.10.3 The **estate** may be used to meet other costs of appropriate guarantees and business risks if and when they arise in future or to enhance payouts.

4.10.4 The investment policy for the **estate** is driven by the nature of the assets & liabilities in the **WPSF**, with the aim of ensuring that the **estate** is not unduly exposed to individual risks.

Except when investment in equity helps to cover changes in equity-exposed guarantee costs, the investment policy for the **estate** is not normally to have any material investment in equity over anything other than a short period of time.

4.10.5 The **estate** has been used to purchase **interest rate swaps and swaptions** as the **WPSF** has exposure to interest rate falls (for example, on its **GAO** liabilities). The **estate** has also been used to purchase **equity put options** in connection with with-profits growth guarantees.

4.10.6 The **Firm** aims to distribute the **estate** equitably to with-profits policyholders over time. Subject to an annual assessment of economic conditions, the expected emergence of guarantee costs and the level of **excess regulatory capital** in the **WPSF** (see 3.10.2), this will normally be achieved through an increase to the investment return underpinning the calculation of **asset shares**. Such increases to investment returns may be achieved through making annual additions and/or an enhanced return included within **asset shares** only at the point of claim.

4.10.7 The appropriate level of such distributions for a particular calendar year will normally be determined at the end of that year when making an annual addition or at the end of the previous year when enhancing the returns included within **asset shares** only at the point of claim.

4.10.8 As part of the **Management Actions** available to it, the **Firm** reserves the right to remove some or all of the increases referred to in 4.10.6 in the event of adverse financial conditions arising, or in the event of adverse non-financial circumstances affecting the fund, such action being necessary or desirable in relation to meeting ongoing **regulatory solvency requirements** or the equitable operation of the fund.

This removal of these increases shall not extend to the £160m enhancement to **asset shares** referred to in 3.2.2.

4.10.9 Other **Management Actions** available to the **Firm** in adverse circumstances include, but are not limited to: Reductions to the rate of **annual bonus;** reductions in the rate of any ongoing distributions from the **estate** described in 4.10.6; reductions in the proportion of assets invested in equities and non-government bonds below the ranges set out in 4.7; increasing the deduction for guarantee costs described in 4.5.1 either as an ongoing annual deduction or by making individual ad-hoc deductions.

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4.10.10 For testing the ability of the **WPSF** to meet **regulatory solvency requirements** the **Firm** assumes that in adverse circumstances a range of **Management Actions** would be implemented. This includes assuming that all past annual additions to **asset shares** from the estate described in 4.10.6 would be removed as described in 4.10.8; and that following this, ongoing or individual ad-hoc deductions for guarantee costs (as described in 4.5.1 and 4.10.9) would be made, totalling up to 20% of **asset shares**.

4.10.11 Examples of the type of risks that could lead to the adverse circumstances described in 4.10.8 to 4.10.10 include but are not limited to increases in guarantee costs or **regulatory solvency requirements** resulting from poor investment returns, increases in how long people are expected to live and increases in the number of customers choosing to exercise **guaranteed annuity options**.

4.10.12 The **Firm** expects that, over the long-term, the distributions from the **estate** referred to in 4.10.6 will exceed the deductions referred to in 4.5.1 and 4.10.8 to 4.10.10, resulting in a net increase in the investment return underpinning the calculation of **asset shares** at the point of claim. However, this is not guaranteed and will depend on the factors highlighted in 4.10.6 to 4.10.11. In particular, fluctuations in the level of increase could occur on an annual basis.

4.11 Volumes of new business and arrangements on stopping taking new business

4.11.1 No new with-profits business with investment guarantees is written in the **WPSF**, apart from, potentially increments, renewal premiums and new entrants to occupational pension schemes that were in force as at 30 September 2002.

4.12 Equity between the with-profits fund and the shareholder

4.12.1 In accordance with the **Scheme**, the **shareholder** does not participate in any profits arising in the **WPSF**.

4.12.2 Notwithstanding the notional division of assets between the **WPSF** and **NPSF** as described in 3.1.2, the Firm reserves the right to establish arrangements where assets of the **WPSF** are loaned to the **NPSF** or assets of the **NPSF** are loaned to the **WPSF**. Any such loans would be expected to be repaid in full over an agreed term with appropriate compensation. Any loan from the **WPSF** to the **NPSF** would require the approval of the **Board** which would be required to consider such a loan to be in the best interests of **WPSF** policyholders taking into account how the assets would otherwise be invested, the term of the loan, the compensation payable to the **WPSF** and the risks involved.

4.12.3 The provisions of 4.12.2 above do not apply to short term accounting balances that arise between the **WPSF** and **NPSF** as part of the normal operation of the **Firm**.

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5 Principles - With-profits business without investment guarantees

5.1 General

5.1.1 With-profits funds without investment guarantees are written by the **Firm**. These funds are known as **New generation with-profits (NGWP)** funds and were launched on 30 September 2002.

5.1.2 These funds have different Principles and Practices to other with-profits business. This is consistent with their structure, which contains no investment guarantees and under which payouts are not affected by guarantee costs on other with-profits business. **NGWP** is classified as Class III insurance business (linked long term) within the calculation of the **Firm's regulatory solvency requirements**.

5.1.3 The assets within each **NGWP** fund are ring-fenced from other **NGWP** funds and from other **notional subfunds** within the **Firm**.

5.1.4 There are four **NGWP** funds: Life Growth, Life Cautious, Pensions Growth and Pensions Cautious. A **Stakeholder** equivalent version of the Pensions Growth fund also exists, the Stakeholder Pensions Cautious fund having been closed in February 2021.

5.1.5 The **stakeholder** fund is subject to **stakeholder** provisions, which are not set out in this document.

5.1.6 With effect from 31 July 2013, the **Firm** no longer writes new with-profits business without investment guarantees, apart from existing regular premiums and contractual increases under those policies.

5.2 The amount payable under a with-profits policy

5.2.1 There is no concept of **annual bonuses**, **final bonuses** or **market value reductions** under any of the **NGWP** funds.

5.2.2 Policyholder benefits are determined by reference to a unit price, which is published daily.

5.2.3 The unit price for each **NGWP** fund is based on the following:

5.2.3.1 The actual return earned on the backing assets (net of tax where appropriate).

5.2.3.2 The long-term **expected growth rate** for the fund in question.

5.2.3.3 Smoothing profits and losses that arise on claims.

5.2.3.4 The level of annual management charge.

5.2.4 In certain circumstances, smoothing adjustments, which may be positive or negative, may be applied to claim values in order to ensure equity amongst participating policyholders and to maintain fund stability.

5.2.5 Any changes to the methods used to set payouts require the approval of the **Board**.

5.2.6 No changes would normally be made to any historic assumptions or parameters underpinning the calculation of unit prices or smoothing adjustments, unless an error was subsequently discovered.

5.3 The approach to smoothing

5.3.1 The impact of smoothing is reflected in the combination of the unit price and any smoothing adjustments that might apply. As only assets within each **NGWP** fund are available to meet claims as they fall due, the cost of smoothing will be neutral over the lifetime of each fund.

5.3.2 A more favourable approach to smoothing may be adopted on certain types of claim as opposed to others (for example, deaths and maturities may be treated more favourably than surrenders).

5.4 Investment strategy

5.4.1 The investment strategy under each individual **NGWP** fund is consistent with representations made to policyholders (for example in Key Features documents), in particular regarding the proportion of the fund that will be invested in real assets (equities and property) – the **equity backing ratio (EBR)**.

5.4.2 The target **EBRs** for the Growth Funds are higher than the corresponding Cautious Funds.

5.4.3 The **Firm** does not rely on assets outwith each individual **NGWP** fund in order to maintain the investment strategy within the fund.

5.4.4 It may be appropriate to utilise **derivatives** to protect the **NGWP** funds against adverse market movements (for example equity falls or changes in fixed interest yields). It may also be appropriate to utilise **derivatives** for short-term asset allocation purposes or to increase diversification by gaining exposure to different asset classes or for efficient portfolio management.

5.4.5 Exposures to individual **counterparties** (including **derivative** exposures) across the assets of the entire **Firm** will normally be spread appropriately in order to reduce risk.

5.4.6 The **NGWP** funds would not usually expect to invest in assets that would not normally be traded because of their importance to the **Firm**.

5.5 Business risk

5.5.1 The **NGWP** funds are not exposed to any of the business risks associated with the writing of new policies. All such risks are borne by the **NPSF**.

5.5.2 The capital required to cover **regulatory solvency requirements** on **NGWP** business is held in the **NPSF**.

5.6 Charges and expenses

5.6.1 All expenses are met by the **NPSF**.

5.6.2 An annual management charge is paid out of the **NGWP** funds to the **NPSF**. In accordance with policy conditions and the **Scheme**, the level of charge is equal to that taken from equivalent unit-linked funds. Apart from on certain business lines, charges can be reviewed from time to time.

5.7 Management of the estate

5.7.1 The level of **estate** has no impact on payouts to **NGWP** policyholders.

5.8 Volumes of new business and arrangements on stopping taking new business

5.8.1 As a result of closing to new business, the **NGWP** fund will begin to contract and we have taken additional management actions to help stabilise the fund. It will eventually become necessary to fully close each fund and switch all remaining assets into an alternative fund.

5.8.2 In the event of a decision being made to fully close a **NGWP** fund the **firm** may make changes to the way amounts payable are determined, to ensure a fair and orderly wind-up of the fund.

5.9 Equity between the with-profits fund and the shareholder

5.9.1 The **shareholder** has no financial interest in the **NGWP** funds beyond the annual management charge taken by the **NPSF**.

6 Practices - With-profits business without guarantees

6.1 General

6.1.1 Since 30 September 2002, all new with-profits business has been written into the **NGWP** funds.

6.1.2 No investment guarantees exist under the **NGWP** funds.

6.1.3 The **NGWP** funds on offer are: Life Growth, Life Cautious, Pensions Growth and Pensions Cautious. A **Stakeholder** equivalent version of the Pensions Growth fund also exists, the Stakeholder Pensions Cautious fund having been closed in February 2021.

6.2 The amount payable under a with-profits policy

6.2.1 There is no concept of bonuses under the **NGWP** funds and a smoothed unit price is calculated on a daily basis for each fund, which depends on the actual return achieved relative to a published expected return plus the daily smoothing profits and/or losses that arise on claims.

6.2.2 The unit price can fall as well as rise.

6.2.3 Expected long-term growth rates are agreed for the funds. These can be varied prospectively (they would normally be subject to an annual review and require **Board** approval were they to change). **Expected growth rates (EGR)** are before deduction of the annual management charge. In the case of the Life Growth and Cautious funds, they are after deduction of an estimate of the amount of tax payable under the funds.

6.2.4 The expected rates in 6.2.3 are then converted to daily equivalent rates and compared with the actual earned rate on each day (in the case of the Life funds, after deduction of an estimate of the amount of tax payable). The unit price then increases/decreases on a daily basis by the expected daily growth plus/minus 50% of the difference between the actual and expected growth less the daily equivalent rate of annual management charge. The figure of 50% can be varied, subject to **Board** approval.

6.2.5 Under the following circumstances the unit price would not be calculated in accordance with 6.2.4:

6.2.5.1 If the smoothed value of the fund exceeds the actual value of the fund by more than 5% then we will adjust the smoothing approach to replace 10% of the normal smoothed return with the lower of the actual investment return or the **EGR**.

6.2.5.2 If the smoothed value of the fund is less than the actual value of the fund by more than 5% then we will adjust the smoothing approach to replace 10% of the normal smoothed return with the higher of the actual investment return or the **EGR**.

6.2.5.3 If the **Board** approves changes relating to the closure of a **NGWP** fund in accordance with 6.7.

6.2.6 On each individual day, a smoothing profit or loss will occur on claims depending on the difference between the smoothed unit value and the underlying unsmoothed value of the backing assets. Consistent with 6.2.4, 50% of any smoothing profit or loss is currently fed back into the calculation of the unit price.

6.2.7 Claim values may be adjusted by **smoothing increases** or **smoothing reductions** in certain circumstances. This is necessary to ensure that payouts to policyholders are fair in all circumstances.

6.2.8 Except in the circumstances described in 6.7, no **smoothing increases** or **smoothing reductions** will currently be applied on claims under any of the **NGWP** funds providing that, at **cohort** rather than individual policy level, the ratio of smoothed unit value to the unsmoothed value of the backing assets is in the range 80% to 130%.

6.3 Investment strategy

6.3.1 Assets within the **WPSF** fall into one of the following sectors:

- UK equities
- Overseas equities
- Fixed interest
  - (1) Backing **asset shares**
  - (2) Within the **estate**
  - (3) Backing **NGWP**
- Property
- Cash
- Others

6.3.2 Each of the **NGWP** funds within the **WPSF** buys units in each of the above sectors. Hence for the purpose of calculating investment returns and smoothed unit prices, the characteristics of (say) the UK equities and fixed interest securities (3) held by each **NGWP** fund are identical.

6.3.3 The fixed interest returns credited to each **NGWP** fund is based on the returns of a pool of fixed interest securities specific to **NGWP** and invested in a combination of UK government securities ('gilts') and other fixed income assets (which includes **sovereigns**, **sub-sovereigns** and **corporate bonds**). The target range for the gilt holdings is 0%-20% of this fixed interest fund. We would normally expect to hedge all overseas currency risk under non-sterling denominated fixed interest securities.

6.3.4 The **Firm's** general policy is to hold an appropriate spread of assets between **counterparties** in order to reduce risk. Additionally, the **Firm** would normally expect at least 90% of its fixed interest securities to have credit ratings of BBB or higher. The **Firm** would not normally expect to become a forced seller of fixed interest securities should credit ratings on investments held fall from BBB or higher to below BBB.

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

6.3.6 The **NGWP** funds would not usually expect to invest in assets that would not normally be traded.

6.3.7 Each of the **NGWP** funds has a target range for the level of investment in each asset class. Current target ranges are as follows:

6.3.7.1 Life Growth and Pensions Growth
UK and Overseas Equities: 80% - 90%
UK and Overseas Fixed Interest: 10% - 20%
Cash and Others: 0% - 5%

6.3.7.2 Life Cautious and Pensions Cautious
UK and Overseas Equities: 35% - 45%
UK and Overseas Fixed Interest: 55% - 65%
Cash and Others: 0% - 5%

These ranges may vary from time to time, as the **Firm** deems appropriate. A table of current asset mixes by **NGWP** fund is available on the **Firm's** website and will be updated every three months. Any significant change in asset mixes will be communicated separately to individual policyholders.

6.3.8 The **Firm** would normally expect the overseas component of its equity investments to lie within the range 30% - 50%.

6.3.9 The conditions in which it may be appropriate to utilise **derivatives** are given in section 5.4.4. The control environment for the use of **derivative** instruments involves: approval by a senior investment manager that the initial investment is within permitted parameters; segregation of duty between those who authorise deals and those who trade deals; and monthly discussion of **derivative** reports.

6.3.10 Formal reviews of the investment strategy of each **NGWP** fund would normally be made yearly.

6.3.11 No transfer of assets can be made from outwith the **NGWP** funds for the purpose of maintaining the investment strategy in the **NGWP** funds.

6.4 Business risk

6.4.1 The **NGWP** funds are not exposed to any of the business risks associated with the writing of new policies. All such risks are borne by the **NPSF**.

6.5 Charges and expenses

6.5.1 As per the **Scheme**, an annual management charge is taken from the **NGWP** funds at a rate equal to that taken from equivalent unit-linked funds.

6.5.2 Other than on certain business lines, the annual management charge can be reviewed from time to time. However, the risk that expenses exceed the annual management charge is borne by the **NPSF**.

6.6 Management of the estate

6.6.1 The level of **estate** has no impact on payouts to **NGWP** policyholders.

6.7 Volumes of new business and arrangements on stopping taking new business

6.7.1 The **NGWP** funds generate no capital strains in the **WPSF** nor do they participate in any **estate**. However, the **Firm** no longer writes new with-profits business without investment guarantees, apart from contractual increases under policies in-force as at 31 July 2013. Consequently, the in-force block of such business is now in decline.

6.7.2 It will eventually become necessary to fully close each fund and switch all remaining investments into an alternative unit-linked fund, which will not be a with-profits fund. Any decision to fully close a **NGWP** fund will be approved by the **Board** and will be communicated to policyholders in advance of closure.

6.7.3 In the event that the **Board** approves the full closure of a **NGWP** fund the **Firm** may make immediate changes to the way the fund operates to ensure an orderly and equitable wind-up of the fund. Any such changes would apply for a limited time period (normally between three and six months) from the decision being made to close the fund until the date of final closure. These changes may include:

6.7.3.1 Changes to the approach to smoothing described in 6.2, or the cessation of all smoothing so that future movements in the daily unit price reflect 100% of the actual return achieved on the underlying assets (with the normal deduction for the annual management charge and, in the case of the Life funds, an estimate of the tax payable).

6.7.3.2 Changes to the circumstances under which a **smoothing increase** or **smoothing reduction** may apply from those described in 6.2.8, so that a **smoothing increase** or **smoothing reduction** can be applied at any time when the smoothed unit value is different from the unsmoothed value of the backing assets at fund level. This will ensure that the **Firm** is able to fairly distribute the assets in the fund.

6.8 Equity between the with-profits fund and the shareholder

6.8.1 In accordance with the **Scheme**, the **shareholder** has no financial interest in the **NGWP** funds beyond the routine level of annual management charges taken.

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7 Glossary of terms

This section explains the words and phrases highlighted in **bold** throughout the document.

Annual bonuses	Amounts, which when added to policies, constitute guarantees at specific points in time as per the policy conditions. Bonus rates are normally reviewed annually.
Asset shares	Used as a guide to setting bonus rates – see 4.2. Sometimes referred to as **unsmoothed asset shares**.
Board	The Board of Directors of Scottish Equitable plc, or a committee of this body acting under its delegated authority.
Capital contributions	Contributions made by the shareholder to the **WPSF** since 31 December 1993 in return for an increasing share (now 100%) of future profits on unitised and non-profit business.
Cohorts of policyholders	Groups of policyholders with similar characteristics (for example same year and month of policy commencement or premium payment).
Contract charges	Charges as defined in the policy conditions (for example an annual management charge). **MVRs** are not included in this definition.
Corporate Bonds	Bonds issued by public or private corporations.
Counterparty	An organisation or individual with which the **Firm** has made investments or against whom it has rights whether in pursuance of a contract entered into by the insurer or otherwise.
Derivatives	Financial instruments that are either contracts for differences, futures or options.
Endowment	A traditional with-profits life insurance policy designed to pay a lump sum after a specified term or upon death.
Equity backing ratio (EBR)	The proportion of assets held in a mix of equity and property. In practice, due to the way in which equity investments are managed, the equity content will include a small amount of cash, which would not normally exceed 3% of the value of the equity holdings.
Equity put options	**Derivative** contracts that give the right to sell equities at a pre-determined price and therefore provide protection against falls in equity markets.
Estate	The excess, on a realistic basis, of assets within the **WPSF** over and above the amount required to meet liabilities.
Excess regulatory capital	The excess of assets over the sum of liabilities and the regulatory solvency requirements.
Expected growth rate (EGR)	The EGR for each fund is our estimate of the long-term rate of return for each fund’s investment

Final bonuses	Non-guaranteed amounts that may be added to **guaranteed benefits** (including **annual bonus** additions) when a claim arises.
Firm	Is Scottish Equitable plc.
Guaranteed minimum pensions (GMPs)	Guarantees provided by the **WPSF** under certain Buyout contracts relating to the purchase of GMPs at state pension age.
Guaranteed benefits	Amounts guaranteed to be paid at specific points in time in accordance with the policy conditions at the point of payment of a premium or a series of premiums.
Guaranteed annuity options (GAOs)	An option, which exists under certain pension contracts, to convert the fund available at retirement to an annuity on guaranteed terms as set out in the policy conditions.
Interest rate swaps	The exchange of unknown series of future cashflows for certain series of future cashflows at specified future dates (and vice versa).
Interest rate swaptions	In this instance, options to exchange unknown series of future cashflows for certain series of future cashflows at specified future dates.
Investment element	That part of a unitised with-profits policy on which **guaranteed benefits**, **annual bonuses**, **final bonuses** and **MVRs** are based.
Long-term insurance fund	A fund maintained in accordance with FCA and PRA rules into which long-term insurance business must be written.
Management Actions	Actions that the **Firm** reserves the right to take in adverse circumstances to help ensure the equitable operation of the fund and that the **estate** can continue to cover **regulatory solvency requirements**.
Market value reductions (MVRs)	A reduction in the value of units under a unitised with-profits policy that may apply when a claim arises at a point where no guarantee exists.
New generation with-profits (NGWP)	With-profits funds under which there is no concept of **annual bonuses** or **final bonuses**, with benefits being determined by reference to a smoothed unit price that normally changes on a daily basis.
Non-profit subfund (NPSF)	That part of the **Firm's long-term insurance fund** into which no with-profits business is ultimately written.
Notional subfund	A notional subdivision of the **WPSF** into a smaller fund with specific characteristics (for example a different rate of guaranteed growth to other notional subfunds). Bonus declarations are specific to each notional subfund.
Regulatory solvency requirements	The minimum excess of assets over liabilities that must be maintained in accordance with the requirements of the Prudential Regulation Authority.

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Scheme	The legal document approved by the Court of Session that authorised and gave effect to the transfer of business from Scottish Equitable Life Assurance Society to the Firm with effect from 31 December 1993.
Shareholder	Is Aegon NV.
Smoothed asset shares	**Asset shares** adjusted for smoothing of investment returns, which are then used as a guide to setting bonus rates.
Smoothing increases	Can only apply under the **NGWP** funds. May be applied to claim or fund values in order to ensure equity amongst participating policyholders and to maintain fund stability.
Smoothing reductions	Can only apply under the **NGWP** funds. May be applied to claim or fund values in order to ensure equity amongst participating policyholders and to maintain fund stability.
Sovereigns	Bonds issued by a central government other than the UK.
Stakeholder business	A pension scheme established in accordance with the Stakeholder Pension Schemes Regulations 2000.
Stochastic modelling	The simulation of future outcomes (for example investment returns) using financial models that can be used to assess the likelihood of specific events occurring.
Sub-sovereigns	Bonds issued by entities with an explicit or implicit central government guarantee.
Tontine effect	The effect associated with a declining fund, where the last remaining policyholder is entitled to the remaining surplus in the fund.
Traditional with-profits (TWP)	A with-profits policy that, in accordance with the policy conditions, offers a level of **guaranteed benefit** in return for the payment of a premium or an agreed series of premiums. Offers no facility to switch into a unit-linked contract. These contracts include both **Endowment** and **Whole of Life** policies.
Unitised with-profits	A with-profits policy that, in accordance with the policy conditions, offers a level of **guaranteed benefit** (with the exception of **NGWP**) linked to the payment of each individual premium. **Guaranteed benefits** (including **annual bonus** additions) are expressed in terms of a unit value. Generally, it offers the facility to switch into a unit-linked contract (but not always).
Unsmoothed asset shares	See **asset shares**.
Whole of Life	A traditional with-profits life insurance policy designed to pay a lump sum upon death.

With-profits actuary	An actuary appointed under chapter 4.3.16 of the Supervision manual of the Financial Conduct Authority.
With-profits subfund (WPSF)	That part of the **Firm's long-term insurance fund** into which all with-profits business is ultimately written.

8 Useful links

Annual report to with-profits policyholders	Annual report
Current bonus rates	Bonus rates
Customer friendly PPFMs	Customer friendly PPFMs
New generation with-profits fund factsheets	NGWP fund factsheets
Solvency and Financial Condition Report (SFCR)	Scottish Equitable plc's annual SFCR reported publicly and to the Prudential Regulation Authority
Traditional with-profits fund factsheet	TWP fund factsheet
Unitised with-profits fund factsheets	UWP fund factsheets
With-profits terms of reference	Terms of reference

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