Scottish Widows With Profits Fund
Principles and Practices of Financial Management (PPFM)

1 GENERAL

1.1 Introduction

This document records the Principles and Practices of Financial Management (PPFM) according to which Scottish Widows Limited (‘the *Company*’) manages the *Scottish Widows With Profits Fund*. It covers *With Profits Policies* issued by the Scottish Widows’ Fund and Life Assurance Society (‘the *Society*’) up to 3 March 2000 and all *With Profits Policies* since then, whether issued by Scottish Widows plc or Scottish Widows Limted.(the *Company*). When preparing it, we have endeavoured to ensure that it accurately reflects how we manage the *Scottish Widows With Profits Fund*.

Terms in italics are defined in the Glossary which is found in Annex 1 of this document.

The Financial Conduct Authority (‘FCA’) requires this documentation of PPFM, in accordance with Chapter 20 of the FCA’s Conduct of Business Sourcebook. Much of the document’s form and content reflect these FCA rules.

This is a technical document that has been prepared to enable a knowledgeable observer to understand the material risks and rewards from purchasing or maintaining a *With Profits Policy* with the *Company*.

Many contracts offer a range of investment choices including investment in a *With Profits Policy*. Except where otherwise indicated, these PPFM only apply in respect of those parts of such contracts that are in the *Scottish Widows With Profits Fund.*

Where we use terms such as “appropriate”, “excessive”, “fair”, “significant”, “similar” and “material”, then, unless otherwise required by the context, we are referring to judgements or assessments made by the *Company* or the *Board* of the relevant factors or circumstances.

This is version 7.0 of th*e Scottish Widows With Profits Fund*’s PPFM, dated 1 May 2017.

1.2 Background

The *Society* demutualised on 3 March 2000 and its long term business was transferred to Scottish Widows plc and Scottish Widows Annuities Limited in accordance with a scheme of transfer. On 31 December 2015 the assets and liabilities of those two companies were transferred to Scottish Widows Limited (the *Company*) under the terms of the High Court-approved *Scheme*, in accordance with Part VII of the Financial Services and Markets Act 2000. Annex 2 includes the most relevant provisions of the *Scheme* in relation to the *Scottish Widows With Profits Fund*. The full text of the *Scheme* is available from our website near these PPFM.

In these PPFM references to *Transferred Policies* are to *Policies* transferred on 3 March 2000 from the *Society* to Scottish Widows plc. *Post 3 March 2000 Policies* are those issued subsequently, whether by Scottish Widows plc (up to 2015) or Scottish Widows Limited (from 2016).

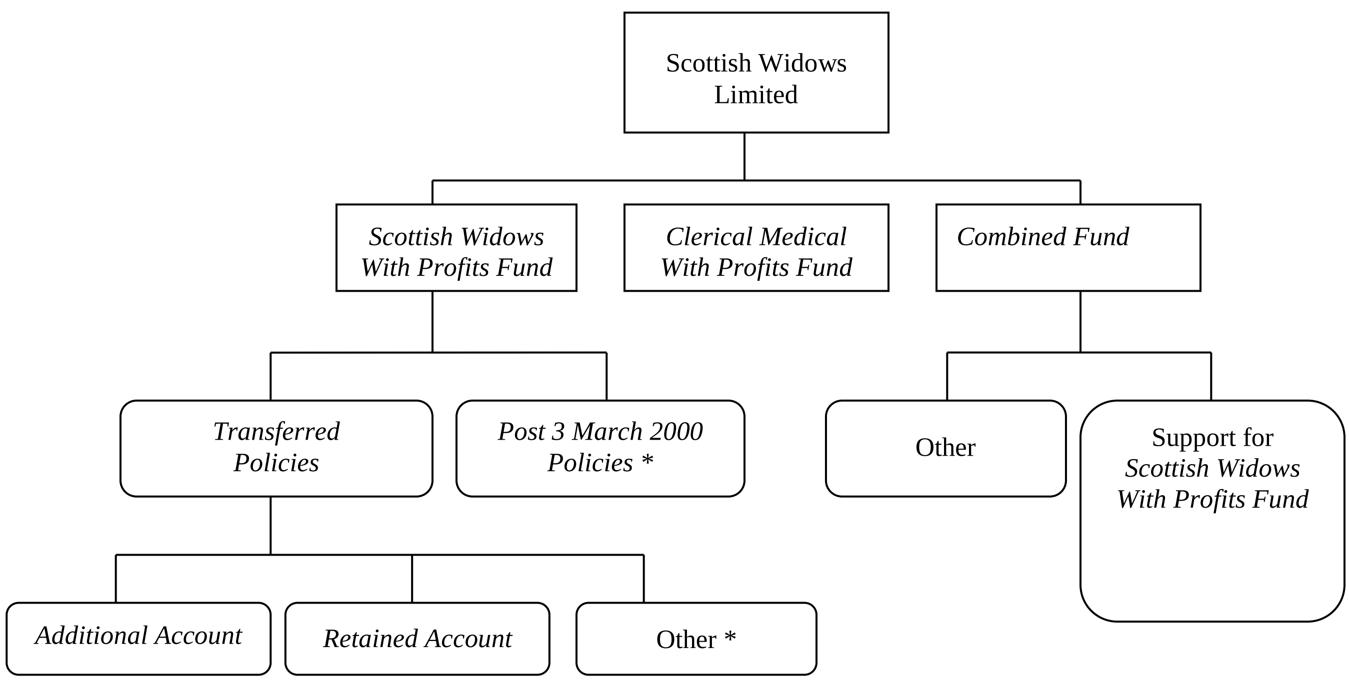
Much of the *Scheme* consists of provisions designed to protect the interests of the holders of *Transferred Policies* For instance it provides a framework for deciding how the assets backing those *Policies* are to be invested, and provides a framework for deciding the amounts payable under such *Policies.* It also sets limits on the charges we can make in respect of those *Policies*, and covers other aspects of the operation of the *Company*.

The *Scheme* also contains provisions to protect both the holders of *Post 3 March 2000 Policies* and the holders of *Transferred Policies*. These provisions cover, for instance, the investment of the assets backing all those *Policies* and the support arrangements mentioned in the next paragraph.

The *Scheme* established the *Combined Fund, the Scottish Widows With Profits Fund and the Clerical Medial With-Profits Fund* of the *Company*. Under the *Scheme* support from the *Combined Fund* is to be made available to the *Scottish Widows With Profits Fund* when appropriate. The *Clerical Medical With Profits Fund* is governed by its own PPFM, which are distinct and separate from these PPFM for the *Scottish Widows With Profits Fund.*

The Principles and Practices for *Transferred Policies* refer to the A*dditional Account* and the *Retained Account*, which are part of the *Scottish Widows With Profits Fund.* The *Additional Account* contains assets which were set aside on the demutualisation of the *Society*, with any balance after meeting certain contingencies to be distributed to *Transferred With Profits Policies.* The *Retained Account* contains assets which are to be distributed to *Transferred With Profits Policies.*

The following diagram illustrates the main relationships among the funds and accounts.



* Further details of these parts of the *Scottish Widows With Profits Fund* are in the table in section 5.2.

The *Board* is obliged to manage the with-profits business of the *Company* in accordance with the *Scheme*. The *Scheme* can be altered only by the High Court of England and Wales, other than in certain defined circumstances in which case the *Company's* regulators must be satisfied with the changes. Many elements of these Principles and Practices reflect the terms of the *Scheme.* In the event of any inconsistency between the terms of the Principles and Practices and the terms of the *Scheme*, the *Scheme* will prevail.

1.3 The *With Profits Policies*

The *Transferred With Profits Policies* were issued by the *Society* over many years, and take a variety of forms with different levels of guaranteed benefits. They include *Conventional With Profits Policies, Unitised With Profits Policies* and *UWP Annuities.*

Although there are a number of types of *Post 3 March 2000 Policies,* with very few exceptions they are all *Unitised With Profits Policies* or *UWP Annuities.*

In 2002 the *Company* started to issue *Policies* that included options to invest in two new types of *With Profits Unit,* called *With-Profits Income Units* and *With-Profits Growth Units.* The practices are different in some respects from those for other *Post 3 March 2000 Policies*.

1.4 The With-Profits Committee

We are committed to treating all of our customers fairly. To help us do this we have a With-Profits Committee. The responsibility of the Committee is to provide an independent view on the management and operations of the with-profits business. The Committee reviews how the Scottish Widows With Profits Fund is managed and scrutinises any major proposal that affects the Fund. The Committee meets separately from and provides advice to the *Company's Board.*

2 STRUCTURE OF THESE PPFM

2.1 Principles and Practices

The Principles in this document are high-level statements, which we do not expect to change often, of how we manage *With Profits Policies*.

The Practices are statements of specific practices that we follow at the date of this document in managing *With Profits Policies* but which we may change more frequently.

The Principles and Practices are shown separately in boxes. The rest of the document consists of explanatory commentary.

2.2 Layout

In general each section deals with all types of *With Profits Policy*. This has the advantages, particularly for the more knowledgeable readers for whom this document is primarily intended, of reducing the overall length of the document and making clearer where there are differences of treatment between categories of *Policy*. The main disadvantage is that it makes it a more complicated task to pick out just those parts that relate to any specific category of *Policy*. The main exception to this general pattern is that many of the Practices for two newer types of *With Profits Unit* are dealt with separately in sections 4.4 and 4.5 as indicated below.

Section 3 contains a number of Overriding Principles of very wide-ranging importance.

All of the *With Profits Policies* contain guarantees, which apply in different circumstances for different types of *Policy*. When we pay out in circumstances where these guarantees apply, the amounts that we pay are determined by those guarantees and any bonuses that we add. Section 4.2 deals with those bonuses for most types of *Policy*, while sections 4.4.1, 4.4.2, 4.5.1 and 4.5.2 deal with them for the two newer types of *With Profits Unit*.

When we pay out in circumstances where the guarantees do not apply, for instance when a *Policy* is surrendered, we determine the amounts differently. Sections 4.3, 4.4.3 and 4.5.3 cover this.

Asset Shares are an important part of our processes for determining the amount of payouts in all these circumstances. They are dealt with in section 4.1. *Asset Shares* depend on factors which often differ from one type or generation of *Policy* or *With Profits Unit* to another. Typically the factors include the premiums paid, the investment return (see sections 4.1 and 5) earned on the relevant part (often a notional part) of the *Scottish Widows With Profits Fund*, our charges and certain expenses (see section 6), and a share of the impact of some of the risks to which the *Scottish Widows With Profits Fund* is exposed (see section 7).

Smoothing is an important feature of our *With Profits Policies.* It smoothes out short-term stock market fluctuations so that amounts that we pay out are partially insulated from such fluctuations. More permanent stock market changes are inevitably reflected in payouts for policyholders. Because our policy on ‘smoothing’ differs between payouts where guarantees apply and those where they don’t, and between different types of *Policy*, we deal with smoothing as an integral element of each of the relevant parts of section 4. The main references to smoothing are in sections 4.2.3 and 4.5.2, but there are also implicit and explicit references to smoothing in other parts of section 4.

We do not hold, and do not intend to hold, an ‘inherited estate’. Section 8 is a short section that covers this and describes what we mean by this term.

Section 9 deals with the apportionment of surplus, which occurs only in respect of some of the *Transferred With Profits Policies*, between the *Scottish Widows With Profits Fund* and the shareholder.

3 OVERRIDING PRINCIPLES

The following Overriding Principles take precedence over the other Principles.

Overriding Principles

We will follow the requirements of the *Scheme*, all contractual obligations, and other legal and regulatory requirements. Those requirements will apply if there is any inconsistency between them and any other part of these PPFM.

Bonuses can only be allocated if there is distributable surplus in the *Scottish Widows With Profits Fund*.

We aim to safeguard the solvency of the *Company* without assuming that it has recourse to obtaining extra capital.

We aim to manage the business in line with the reasonable expectations of policyholders. When deciding what policyholders might reasonably expect, the factors other than contractual entitlements that we take into account include our past practice, that of the *Society*, industry practice, and representations we have made to policyholders.

Subject to the above, we aim to achieve fairness of treatment between different types and groups of *With Profits Policies*, and between them and the shareholder.

Unless the *Scheme* prevents it, the *Board* can change any of the Principles and Practices. When doing so, it will take *Appropriate Actuarial Advice*. In making its decisions the *Board* will have regard to that advice, but is not bound to follow it. When we change any of the Principles or Practices we will tell relevant policyholders in accordance with the *FCA*'s requirements at the time.

4 THE AMOUNT PAYABLE UNDER A *WITH PROFITS POLICY*

This section covers our approach to payouts under *With Profits Policies*.

We guarantee a minimum amount to pay out from the *Scottish Widows With Profits Fund* under a *With Profits Policy* (or *With Profits Unit*). However, such guarantees apply only in specific circumstances, set out in the provisions of the relevant *Policy*. Where they apply, the amounts that we pay out are determined by those guarantees and by any bonuses that we add. When deciding on bonuses we use *Asset Shares* as a guide to the overall level of payouts.

We also use *Asset Shares* as a guide to determine the amounts of payouts when guarantees do not apply.

Principles

Common bonus rates and factors are used for appropriate groupings of *Policies*, reflecting an element of cross-subsidy and pooling of risks for *Policies* with similar characteristics. A single group may also contain *Policies* with different characteristics. For instance, it may contain *Policies* or *With Profits Units* of different types, different starting or guarantee dates, different sizes, different ages of lives assured, and different types of premium.

Practices

The main methods, parameters and assumptions that we use are summarised in *Board* papers. These papers are supported by appropriate documentation of the more detailed methods, parameters and assumptions in files in the Actuarial Department.

The parameters and assumptions are derived from analysis of the experience of the *Company* and, where relevant, that of the industry generally.

Changes to methods, parameters and assumptions are documented and are subject to formal approval as part of the bonus-setting process.

4.1 *Asset Shares*

Very broadly, *Asset Shares* are an accumulation of premiums paid, less various deductions including deductions to cover expenses and tax. The accumulation is at the rate of investment return earned on the relevant part of the *Scottish Widows With Profits Fund*.

Principles

To help us to achieve the aim of fairness set out in section 3, “Overriding Principles”, we track *Asset Shares* of the *Scottish Widows With Profits Fund*. We track them for groups of

Policies in aggregate, for sample or notional *With Profits Policies* and for sample or notional *With Profits Units*.

Any changes in the methods that we use to track *Asset Shares* are decided from time to time by the *Board* having taken *Appropriate Actuarial Advice*.

We may change historical assumptions or parameters that we use when tracking *Asset Shares*. We may do this if, for instance, it would more accurately reflect the actual experience of the relevant parts of the *Scottish Widows With Profits Fund* or achieve a more appropriate apportionment of the *Scottish Widows With Profits Fund*. However, we would only do so if we considered that it was consistent with the reasonable expectations of policyholders and with the *Scheme*. In particular, because of the terms of the *Scheme*, we do not expect to change assumptions or parameters relating to periods ending on or before 3 March 2000 if it would alter the total of the *Asset Shares* relating to the *Transferred Policies*.

There may be significant differences in the mix of assets deemed to back the *Asset Shares* of different groups of *With Profits Policies* or *With Profits Units*. For instance, differences may reflect:

- major differences in the levels of guarantees and other aspects of product design between different types of *Policy*,
- how long there is to go until we expect to pay the relevant benefits or until the dates on which the guarantees under a group of *Policies* (or *With Profits Units*) apply,
- representations previously made to policyholders, and
- the terms of the *Scheme* leading to differences between the investment policies for *Transferred Policies* and *Post 3 March 2000 Policies* of the same type.

We reserve the right, if appropriate in the light of the Overriding Principles in section 3, to

- allocate a separate mix of assets for the *Asset Shares* of a new category of *Policy* in the *Scottish Widows With Profits Fund*, or
- begin to do so for groups of *Asset Shares* which are currently allocated the same mix of assets.

Practices

General

When deciding what an *Asset Share* for a particular sample or notional *Policy* or *With Profits Unit* or group of *Policies* would be, the main factors that we take into account are:

(a) in the case of a *Conventional With Profits Policy*, the premium(s) payable to date (excluding any extra amounts that the holder of the *Policy* has agreed to pay for specific additional features);
in the case of a *With Profits Unit*, the initial bid price of that unit; and
in the case of a group of *UWP Annuities*, the total adjusted premium*;

(b) the investment return on the relevant part (see below) of the *Scottish Widows With Profits Fund* over the lifetime of the *Policy* or *With Profits Unit* or group of *Policies*;

(c) in the case of *With-Profits Income Units* and *With-Profits Growth Units*:
   (i) the regular deductions that we make from *Asset Shares* as part of the process of providing for the guarantees (see section 7.2);
   (ii) the profits and losses from that process
   (iii) adjustments we may make from time to time in respect of accumulated profits or losses from smoothing; and
   (iv) for *With-Profits Income Units* only, deductions to allow for the extent to which the investment return has been reflected in the addition of new units to the relevant *Policy*;

(d) in the case of *Conventional With Profits Policies*, deductions to reflect the actual cost of life cover and to reflect relevant *Capital Fees* in accordance with the *Scheme*, the *Capital Fees* being added to the *Additional Account*;

(e) in the case of groups of *UWP Annuities*, deductions to reflect:
   (i) for *Post 3 March 2000 Policies*, the annuity payments made to date under the *Policies* in the group concerned, and
   (ii) for *Transferred Policies*, the parts of the relevant *Asset Share* corresponding to each of the annuity payments made to date under the *Policies* in the relevant group;

(f) charges and expenses, in accordance with section 6;

(g) taxation (see below);

(h) in the case of *Policies* and *With Profits Units* <u>other than</u> *With-Profits Income Units* and *With-Profits Growth Units*, profits and losses in accordance with section 7.2 to the extent that these are not otherwise allowed for in *Asset Shares*; and

(i) any adjustments that the *Board* deems necessary to limit the effects of exposure to risks to ensure consistency with the reasonable expectations of policyholders.

* The total adjusted premium for a group of *UWP Annuities* is equivalent to the total of the annuity payments that, when we set the terms of the contracts, we expected to make if there were no changes in the bid price of the relevant *With Profits Units*.

When we track the *Asset Share* for a notional *With Profits Policy* or *With Profits Unit* we ensure that as far as reasonably possible it is the same as it would have been for an actual *With Profits Policy* or *With Profits Unit*.

The *Asset Share* for each *With Profits Unit* that had been allocated to a *Transferred Policy* by the time of the transfer from the *Society*, and for each *Conventional With Profits Policy* or group of *UWP Annuities* that was transferred from the *Society*, is the amount of the *Asset Share* at the time of that transfer, accumulated in the above manner over the period since that transfer.

As well as tracking the above *Asset Shares* we track *Asset Shares* in aggregate for all the *Policies* in major categories of business. We use these aggregate *Asset Shares* to help us to check from time to time that the sample or notional *Policies* and *With Profits Units* are still appropriate for the groups they are representing. We also use them to help us to determine the profits and losses referred to in section 7.2.

Investment returns

The investment returns that we use when tracking each *Asset Share* are derived from the returns of the *Scottish Widows With Profits Fund* on the mix of different types of asset backing that *Asset Share* from time to time. For *With-Profits Income Units* and *With-Profits Growth Units* the assets are the relevant *Core Assets*.

The assets backing each *Asset Share* depend on the type of *Policy*. We allocate different mixes of assets to the *Asset Shares* of the following categories (in accordance with the above Principles):

Transferred Policies:

- *Pensionplanner Contracts* (transferred components)
- Other *Conventional With Profits Policies*, together with *Unitised With Profits Policies* and *UWP Annuities*
- *With Profits Units* reinsured for Aviva Life & Pensions UK Limited (originally sold by Royal Scottish Assurance)

Post 3 March 2000 Policies:

- *With-Profits Income Units* (separate *Core Assets* and *Guarantee Accounts*) under Flexible Options Bonds
- *With-Profits Growth Units* (separate *Core Assets* and *Guarantee Accounts*) under Flexible Options Bonds
- Other *With Profits Units* (other than those below), and *UWP Annuities*,
- *Pensionplanner Contracts* (non-transferred components)
- Sterling *With Profits Units* reinsured for LCL Assurance Company Limited (previously named Scottish Widows International Limited)
- Dollar *With Profits Units* reinsured for LCL Assurance Company Limited
- Euro *With Profits Units* reinsured for LCL Assurance Company Limited

The assets backing *Asset Shares* for both Dollar *With Profits Units* and Euro *With Profits Units* reinsured for LCL Assurance Company Limited are allocated a larger proportion of non-Sterling investments. Otherwise the asset mix is likely to vary as indicated in section 5.2.

At the end of each year, or shorter period where appropriate, we derive the actual investment returns on the relevant parts of the *Scottish Widows With Profits Fund*. When doing so we allow for both income and movements in the market values of investments, and we deduct investment dealing costs (see section 6). We may estimate the investment returns for recent, shorter, periods using a combination of available figures for actual performance and market indices. Where estimates are used, they are replaced by the accurate information when it becomes available.

Taxation

The total taxation charged to the *Scottish Widows With Profits Fund*, including potential taxation of unrealised capital gains, is calculated in accordance with the *Scheme*. We aim to attribute this taxation as fairly as reasonably practicable among the *Asset Shares* for *With Profits Policies* and the other parts of the *Scottish Widows With Profits Fund*. We take into account the differences in the categories of *Policy* and in the assets backing them. The attributed tax is then expressed as a reduction in the investment return as derived above. Where appropriate, allowance is made for tax relief on expenses and charges for expenses.

4.2 Bonuses

The two main classes of bonus that we may add to *With Profits Policies* (and *With Profits Units*) are

- *Reversionary Bonus*, which we may add from time to time as permanent increases in the amount of benefit guaranteed, and

- *Terminal Bonus* which we may add, to further increase the total benefit, when we pay out from the *Scottish Widows With Profits Fund* when guarantees apply.

Principle

Because of their importance both to the holders of *With Profits Policies* and to the financial strength of the *Company*, changes in bonus rates are approved by the *Board* where practicable and reported to the *Board* at its next meeting in all other cases.

Practice

All bonus rates and prices of *With Profits Units* are rounded.

4.2.1 *Reversionary Bonus*

Reversionary Bonuses are permanent increases in the amounts of benefit guaranteed. They can occasionally be added as a one-off amount which we refer to as ‘special bonus’. Otherwise, *Reversionary Bonus* is generally referred to as regular bonus.

Reversionary Bonuses take different forms under different classes of *Policy*. In the case of *Pensionplanner Contracts*, cash bonuses may be paid out instead.

Different types and groups of *With Profits Policies* can have different rates of *Reversionary Bonus*. This can also be the case for different groups of *WP Benefits* (or ‘increments’) set up under a single class of continuing *Conventional With Profits Policies* and for different groups of *With Profits Units* under a single class of *Policies*.

Principles

We aim to strike a balance between our freedom to invest the assets of the *Scottish Widows With Profits Fund* to give the potential for higher returns on the one hand and the level of guarantees on the other hand. If too high a proportion of the relevant assets is required to provide the guaranteed levels of benefits, the investment policy for the *Scottish Widows With Profits Fund* could become more constrained towards assets which are a closer match for the guarantees. If this happens, this could lower investment returns and lower payouts for policyholders.

We also aim to manage the rate at which we increase the amounts of benefit guaranteed, in order to prevent an excessive cost to the *Scottish Widows With Profits Fund*.

In some years there may be no *Reversionary Bonuses* added to some or all *With Profits Policies*.

When determining the range of *With Profits Policies* or parts of *With Profits Policies* over which a single bonus rate would be appropriate we have regard (among other factors) to:

- differences between different classes and groups of *Policies* (or parts of *Policies*), including the level of the charges to be taken account of in the relevant *Asset Shares*,
- differences in the past or likely future investment policy for the assets backing different classes and groups of *Policies* (or parts of *Policies*),
- actual or anticipated differences between different classes and groups of *Policies* (or parts of *Policies*) in the relative sizes of the value of benefits already guaranteed and the corresponding *Asset Shares*, and
- what we have said in communications to policyholders.

We would consider starting a new grouping of *Policies* or parts of *Policies* with its own rates of *Reversionary Bonus*, or splitting an existing grouping into separate groups with their own rates of *Reversionary Bonus*, on the basis of similar criteria.

Our Practices in setting *Reversionary Bonuses* for *With-Profits Income Units* and *With-Profits Growth Units* are different and are set out in sections 4.4.1 and 4.5.1 respectively. This section describes our Practices for other *Policies*.

Practices

<u>Separate series of rates of regular bonus (*Reversionary Bonus*)</u>

Unitised With Profits Policies and *UWP Annuities*

We set separate rates of regular bonus for *With Profits Units* in respect of the following categories of *Policy*, usually twice a year:

- Flexible Investment Bond
- Other life assurance business *Unitised With Profits Policies*
- *With Profits Units* reassured for Aviva Life & Pensions UK Limited
- Other pension business
- Jersey With-Profits Bond
- Sterling *With Profits Units* reinsured for LCL Assurance Company Limited
- Dollar *With Profits Units* reinsured for LCL Assurance Company Limited
- Euro *With Profits Units* reinsured for LCL Assurance Company Limited

Each is expressed as an annual rate of increase (if any). We apply the daily equivalent of this rate to the bid price of the relevant units each day until a new rate is set. We keep records of the most recent unrounded bid prices, and apply the daily increases in unit prices to them.

Conventional With Profits Policies

We set separate rates of regular bonus (and interim bonus) for the following categories of *Conventional With Profits Policies* towards the end of each year, subject to checks after the year end that there is sufficient distributable surplus:

- Life assurance business *Policies*;
- *Pensionplanner Contracts*;
- Other Pension business *Policies*, subdivided into
  (i) *WP Benefit*s started before 15 February 1999, and
  (ii) *WP Benefit*s started on or after 15 February 1999.

We add regular bonus (if any) at the end of each calendar year to the *WP Benefits* (except for *Pensionplanner Contracts* where it takes the form of a cash sum in the following year). Different rates of regular bonus may apply to the basic *WP Benefit* and to existing regular bonus for the same *WP Benefit*. The amount added may be less if the *Policy* (or part of a *Policy*) was not in force for the whole of the year or if less than the year's premiums were paid.

<u>Deciding rates of regular bonus</u>

When deciding each of the above rates of regular bonus (except for *Pensionplanner Contracts*):

(a) We calculate a future level of regular bonus rate which, if added each year in future, we consider would be likely to leave significant scope for *Terminal Bonuses* for the category of *Policies* in aggregate (but not for every *Policy*).

(b) We check the extent to which guaranteed levels of benefits would in future be likely to exceed the relevant *Asset Shares*. We will tend to reduce the target rate of regular bonus established in (a) if it would otherwise be likely to result in a significant cost in the short or medium term as a result of payouts exceeding *Asset Shares.*

(c) We limit changes in rates of regular bonus in line with our interpretation of the reasonable expectations of policyholders but there is no pre-set maximum rate at which we might reduce or increase rates of regular bonus.

At stages (a) to (c), the payout from a *Policy* with a *GAR* is taken to be the cash sum available at the guarantee date and not the annuity.

For *Pensionplanner Contracts* the level of guarantees is such that we do not expect to pay further regular bonuses.

4.2.2 Interim Bonus

'Interim bonus' may be added alongside any *Terminal Bonus* when we pay out under a *Conventional With Profits Policy* at a guarantee date. Although it is a form of *Terminal Bonus*, it is covered separately here.

Practices

When we set each rate of regular bonus for *Conventional With Profits Policies* we may also set rates of interim bonus to apply for the time being during the coming year.

We set rates of interim bonus at levels similar to the levels of regular bonus that we expect to set at the end of the coming year.

4.2.3 *Terminal Bonus*

This section covers the following types of bonus:

- 'final bonus', which may be payable when a *Conventional With Profits Policy* becomes a claim at a guarantee date or *With Profits Units* cease to be allocated to a *Policy* when guarantees apply;

- 'vesting bonus' which may be payable when the annuities under certain older deferred annuity contracts (which are *Conventional With Profits Policies*) *vest* on dates when their guarantees apply; and

- 'top-up bonus', which may be payable with instalments of *UWP Annuities*.

While rates of *Reversionary Bonus* are set with the aim of providing scope for future *Terminal Bonuses* (in aggregate for broad groups of *Policies*), we take actual experience into account when we set rates of *Terminal Bonus*.

Principles

Rates of *Terminal Bonus* that apply when guarantees apply are determined after consideration of the experience, as reflected in *Asset Shares*, of the relevant parts of the *Scottish Widows With Profits Fund* (and, where applicable, the *Society*) over the lifetime of the relevant *Policy*, group of *Policies*, or *With Profits Unit*. They take into account the extent to which that experience has already been reflected in the relevant guaranteed levels of benefits, including *Reversionary Bonuses*.

With the exception of any classes of *Policy* for which we have told new policyholders the contrary, we aim to use the *Terminal Bonus* system to smooth out short-term stock market fluctuations so that the amounts that we pay out are partially insulated from such fluctuations. More permanent changes in the underlying experience are inevitably reflected in payouts for policyholders, and rates of *Terminal Bonus* change to reflect this. We aim for the effects of smoothing to balance out over time, so that in the long term the holders of *With Profits Policies,* as a group, neither gain nor lose from it. We aim for smoothing not to have a material adverse effect on those who continue to hold their *Policies*. We expect to limit the extent or cost of smoothing to the *Scottish Widows With Profits Fund* over the shorter term.

We can apply different rates of *Terminal Bonus* to different groupings of *Policies*, *WP Benefit*s or *With Profits Units*. We would consider starting a new grouping of *Policies* or parts of *Policie*s with its own rates of *Terminal Bonus*, or splitting an existing grouping into separate groups with their own rates of *Terminal Bonus*, if this would help us to achieve our aims described in the Overriding Principles.

Our Practices in setting *Terminal Bonus* rates for *With-Profits Income Units* and *With-Profits Growth Units* are in sections 4.4.2 and 4.5.2. This section describes our Practices for other *Policies*.

Practices

Timing of changing rates of *Terminal Bonus*

We aim to set rates of *Terminal Bonus* (including rates of vesting bonus and top-up bonus) twice a year, but may change them at any time if, for instance, there are significant movements in stock markets or interest rates. We will consider changing *Terminal Bonus* rates outside the usual six-monthly cycle if *Asset Shares* diverge by more than 15% from the smoothed levels that we expected when we set the current rates, or if *Asset Shares* diverge by a smaller amount but we decide new rates are necessary to limit losses to the *Scottish Widows With Profits Fund*.

Separate series of rates of *Terminal Bonus* for *Unitised With Profits Policies*

We set separate series of rates of *Terminal Bonus* for the following categories:

Transferred Policies

(A) With-Profits Bonds
(B) Other life assurance business
(C) *With Profits Units* reinsured for Aviva Life & Pensions UK Limited
(D) Other pension business
(E) Jersey With-Profits Bond

Post 3 March 2000 Policies

(F) With-Profits Bonds
(G) Flexible Investment Bond
(H) Other life assurance business
(I) Pension business *
(J) Jersey With-Profits Bond
(K) Sterling *With Profits Units* reinsured for LCL Assurance Company Limited
(L) Dollar *With Profits Units* reinsured for LCL Assurance Company Limited
(M) Euro *With Profits Units* reinsured for LCL Assurance Company Limited

For each of the categories there are separate rates for each year (or in some cases part-year) when *With Profits Units* were allocated to *Policies*. Each rate applies to the bid price of the units. To set the bonus rate, we take one or more sample *With Profits Units*, representative of the units allocated in the relevant period, and follow the procedure described below.

* Within this category marked with an asterisk there are two or more sub-groups of contract with slightly differing charges applicable to their *With Profits Units*. These sub-groups have their own series of rates of *Terminal Bonus*, to reflect these different charges.

Separate series of rates of *Terminal Bonus* for *Conventional With Profits Policies*

We set separate series of rates of *Terminal Bonus* for the following categories:

(W) life assurance business;
(X) certain *Policies* issued in the years prior to 1975 under which the *WP Benefit* takes the form of a deferred annuity without any *GAR;*
(Y) *Pensionplanner Contracts;*
(Z) other pension business subdivided into
  (i) *WP Benefit*s currently or originally with regular premiums, and
  (ii) *WP Benefit*s from single premiums,
  with each of (i) and (ii) being further subdivided into a number of sub-categories by reference to significant differences in rates of premium.

All these *Policies* are *Transferred Policies* except for some parts of a small number of *Pensionplanner Contracts*.

For categories (W) and (Z) there are separate rates for each calendar year of starting.

Policies in category (Z) often include a number of *WP Benefit*s started at different times. For each such *Policy*, we apply a single rate of *Terminal Bonus* to all the *WP Benefit*s from regular premiums that started before 15 February 1999. The rate is similar to the rate appropriate to a *Policy* of that type that has only one *WP Benefit* and started at an average of the starting dates of the various *WP Benefit*s. A similar procedure applies where there are *WP Benefit*s from more than one single premium in a *Policy*. *WP Benefit*s that started on or after 15 February 1999 are treated separately, each with its own rate of *Terminal Bonus* reflecting its own date of starting.

For category (X) there are separate rates for males and females and for different ages at date of *Vesting*. The differences in the rates reflect differences in the extent to which life expectancy at different ages, and for men and women, has improved relative to that when the terms of the relevant *Policies* were set. *Terminal Bonus* is usually referred to as Vesting Bonus for this category.

To set rates for categories (W), (X) and (Z)(i) and Z(ii) above, we take one or more sample or notional (in this section "sample" includes "notional") *Policies* for each calendar year of entry. We then follow the procedure described below. All of the sample *Policies* are due to mature or *vest* in the middle of the period before the next planned review of these bonus rates, and regular premiums paid under them have not changed since the start date.

For category (Y) there are separate rates for *WP Benefit*s provided for members (of the retirement benefits schemes covered by the contract) who became scheme members in different years. To set these rates we take notional members for each year of entry and assume a representative pattern for the timing of the purchase of *WP Benefit*s over the period of membership until the guarantee date. (*Terminal Bonuses* are in cash form, and go to the retirement benefits scheme rather than to the member, so the emphasis is on fairness to the retirement benefits schemes.)

We then follow the procedure below.

Rates of *Terminal Bonus* for *UWP Annuities*

There are separate rates according to the period (year, or in some cases part-year) when the *Policy* was started. To set these bonus rates we consider, as a group, all the *UWP Annuities* from each such period. However *Policies* started in 2004 are grouped with those started in 2003 and will receive the same bonuses. We then follow the procedure below.

Procedure for setting rates of *Terminal Bonus*

This section covers *With Profits Units*, *Conventional With Profits Policies* and *UWP Annuities*.

The *Asset Shares* that we track are, depending on the type of *Policy*, for sample *With Profits Units*, for sample or notional *Policies* or *WP Benefits*, or for groups of *Policies*. Consequently, in this section where appropriate,

- "*Policy*" should be read to include "*WP Benefit*" and "unit",
- "sample" should be read to include "notional", and
- "amount we have already guaranteed to pay" should be read to include "bid price".

We carry out the following procedure a number of weeks before new rates of *Terminal Bonus* are expected to apply.

Stage 1 – reference levels

We determine a reference level for each sample *Policy*, or group of *UWP Annuities*. The main elements of the reference levels are as follows:

(a) The expected *Asset Share* for the relevant sample or group at a date approximately half-way through the period for which we are deciding the new rates of *Terminal Bonus*.

(b) An adjustment we make to the *Asset Share* for the smoothing of recent investment returns.

When making that adjustment we use long-term expected ('normal') rates of return and the actual investment returns from representative market indices over the previous 24 months (less for *Policies* started more recently). For the most recent of those months we replace most of the actual return by the normal rate of return, and for the earliest of the months we replace only a small part of the actual return by the normal rate of return. This partially smoothes out the ups and downs of the returns over those months.

If the above procedure would result in the effect of smoothing relative to the *Asset Share* being excessive, we would limit the smoothing. When setting the limit we have regard to the ability of the *Scottish Widows With Profits Fund* to meet future payouts and our aim to set rates of *Terminal Bonus* that we are reasonably unlikely to wish to change before the following 6-monthly review (see "Timing of changing rates of Terminal Bonus" at the start of this section of the description of our Practices).

One of our aims in this smoothing, including the choice of the normal rate, is that over the very long term its effect on the *Scottish Widows With Profits Fund* should be neutral.

(c) A final reduction we make that goes towards the cost to the *Scottish Widows With Profits Fund* of guarantees.

We review the scales of these reductions at least every three years. Our aim when deciding on their levels is that future reductions should balance out, over many years if necessary, some or all of the extra amounts that we pay out when reference levels are less than the corresponding guaranteed payments, but only to the extent that the extra amounts result from volatility of asset values. When taken together, the reductions and those extra amounts are another form of smoothing.

There are different scales of reductions for different categories of *Policy* and unit.

For each sample *Policy* or group of *UWP Annuities*, we calculate a percentage. This is the percentage by which we estimate that the reference level will exceed, at a date half-way through the period for which we are deciding the new rates of *Terminal Bonus*, the amount we have already guaranteed to pay (plus any interim bonus that we expect to add). For this purpose:

- for units allocated to Pensionbuilder *Policies* before 1 July 1994 (later than that for a few such *Policies*), the amount we have already guaranteed to pay ignores any minimum overall increase in value (between allocation and payout) that may be specified for such units under the terms of the relevant *Policies,*

- for a *Policy* with a *GAR*, the amount we have already guaranteed to pay is the cash sum available at the guarantee date and not the annuity alternative,

- for a *Policy* in category (X) or (Y), we value the guaranteed *WP Benefit* allowing for expected financial conditions and the life expectancy of annuitants, using our latest best-estimates of future mortality, and

- for a group of *UWP Annuities*, the amount we have already guaranteed to pay is the total of all expected future payments at the guaranteed levels. This is determined taking into account the life expectancy of the annuitants concerned, using the assumptions we made when the *UWP Annuities* started if this was before 9 May 2000 and using our latest best-estimates of future mortality for later start dates.

<u>Stage 2</u> – combining categories of *Policy*

For each potential rate of *Terminal Bonus* for which there is more than one sample *Policy*, we combine the relevant percentages from Stage 1 into a single percentage. We do it in a way that does not lead to an increase or reduction in the total payouts expected during the period for which we are deciding *Terminal Bonus* rates.

<u>Stage 3</u> – smoothing by period of entry

This stage applies only for life assurance business *Conventional With Profits Policies* and for *WP Benefit*s started before 15 February 1999 under pensions business *Conventional With Profits Policies*.

For each series of rates of *Terminal Bonus* we smooth the variations in percentages from one year of entry to the next. In this process each percentage is influenced by the percentage for the previous and following years of entry. As in stage 2, we carry out these adjustments with the aim of them not increasing or reducing the total payouts for the category of *Policy* concerned during the period for which we are deciding *Terminal Bonus* rates.

Stage 4 – Setting to zero

If any percentage resulting from stages 1 to 3 is less than zero it is set equal to zero.

Stage 5 – Distributions from the *Additional Account* and *Retained Account*

For *Transferred Policies*, we may increase the reference levels and percentages derived from the above stages to make a distribution from the *Additional Account* and the *Retained Account*.

When deciding on the amount of any distributions from the *Additional Account* we take into account what we consider to be a prudent estimate of the likely ultimate cost of the contingencies and purposes for which the *Additional Account* was set up. The with-profits section of our website shows whether a distribution from the *Additional Account* is currently being used to increase payouts, and if so how much.

At the date of this document distributions from the *Retained Account* are increasing payouts by up to around 2% in respect of premiums paid by 3 March 2000. We expect to be able to maintain that level but will publish the actual rate of distribution on the with-profits section of our website.

Stage 6 – other adjustments

Finally, to give a set of rates of *Terminal Bonus*, we compare the percentages with the rates of *Terminal Bonus* that we believe policyholders might reasonably expect taking into account, for example, recent illustrations (of possible future payouts) that we have issued, recent investment conditions or, for whole of life *Policies* under category (W), an addition to provide life protection benefits. We may adjust the percentages as a result.

We do not restrict the extent to which payouts can rise or fall from one change in rates of *Terminal Bonus* to the next.

Target Ranges

By following the stages described above, we expect the payout from any representative sample *Policy* (as defined under the "Procedure for setting rates of Terminal Bonus") to fall within a target range of between 80% and 120% of a value called the 'Adjusted Unsmoothed Asset Share'. The Adjusted Unsmoothed Asset Share is calculated as the *Asset Share* on the sample *Policy* on the day of the claim less the reduction referred to in Stage 1(c) above plus any distributions referred to in Stage 5 above. In extreme investment conditions it is possible that payouts will fall outside of this range, but we expect all payouts to fall within the ranges most of the time.

Our expected target ranges do not apply to *UWP Annuities*, *Pensionplanner Contracts*, policies under category (W) for which payouts are increased in Stage 6 above to provide an element of life protection benefits, or to any sample *Policy* for which the percentage is set equal to zero at Stage 4 above.

The ranges reflect the maximum extent of the difference between payouts and the Adjusted Unsmoothed Asset Shares that we expect to arise. In practice the majority of payouts are usually clustered around 100% of the Adjusted Unsmoothed Asset Share. The variation around 100% that does arise is due to a combination of the smoothing of investment returns (Stage 1(b) above) and other variations that can arise as a result of Stages 2 and 3 above. These stages cover the grouping of *Policies* that have different characteristics such as size and product sub-type, and that started in adjacent years or in different periods within a year. Due to this grouping of *Policies* the payout for a sample *Policy* will reflect the fortunes of the wider group, rather than the investment returns earned over the Policy's exact period of investment and the individual characteristics of the *Policy* (for example its size). This is another form of smoothing which, like the smoothing of investment returns in Stage 1b, we consider to be of benefit to policyholders as a whole.

Bearing in mind the benefits that policyholders can gain from smoothing, and that the target range describes the maximum possible difference between payouts and the Adjusted Unsmoothed Asset Shares rather than a typical difference, we consider the ranges to be appropriate and fair. Illustrations that we provide of future benefits reflect the grouping of *Policies* that we apply and so reflect how the payout might be positioned within the target range.

4.3 Payouts where guarantees do not apply

This section and sections 4.4.3 and 4.5.3 cover circumstances when we pay out from the *Scottish Widows With Profits Fund* when guarantees do not apply. Such circumstances include surrenders (including transfers out) or partial surrenders, switches, early retirements, and cancellation of *With Profits Units* to pay for a charge. Although it is not possible to surrender *UWP Annuities*, some can be converted into conventional annuities.

Principles

The rates and factors that we use to determine what we pay out from the *Scottish Widows With Profits Fund* where guarantees do not apply are determined after consideration of the experience, as reflected in *Asset Shares*, of the relevant parts of the *Scottish Widows With Profits Fund* (and, where applicable, the *Society*) over the lifetime of the relevant *Policy*, group of *Policies*, or *With Profits Unit.*

We aim to pay out amounts that do not have a material adverse effect on continuing *Policies*.

For *With Profits Units* we are likely to use little smoothing except where we decide that the amount that we pay out for a *With Profits Unit* is to be the same as if guarantees had applied or where we have told new policyholders that smoothing is likely to apply.

For *Conventional With Profits Policies* we are likely to use little smoothing except where we are paying out shortly before dates when guarantees apply.

Our Practices for the setting of payouts from *With-Profits Income Units* and *With-Profits Growth Units* when guarantees do not apply are in sections 4.4.3 and 4.5.3. This section describes our Practices for other *Policies.*

Practices

General

Changes to the amounts payable under the practices set out below are approved by senior executives of the *Company*, including at least one executive director.

The target ranges given in section 4.2.3 and the exceptions also apply to payments made where guarantees do not apply (except that in these circumstances no element of life protection benefit is included). A further exception applies if a *Conventional With Profits Policy* under category (Z) is cashed in soon after it starts; in these cases our practice can mean paying out sums that materially exceed the target ranges.

With Profits Units
(other than *With-Profits Income Units and With-Profits Growth Units*)

We pay out from the *Scottish Widows With Profits Fund*

- the bid value of the *With Profits Unit*
- plus any *Terminal Bonus*
- less any *Market Value Reduction*.

At the date of this document rates of *Terminal Bonus* in circumstances where guarantees do not apply are the same as those where the guarantees apply.

A Market Value Reduction (*MVR*) is a reduction we sometimes make to payouts if a policy is cashed-in or switched from a with-profits investment, for example, after a period of falling stock markets. We set separate rates of *MVR* in much the same way as when we set the rates of *Terminal Bonus* for circumstances where the guarantees apply, using the same sample units. However we may set different rates of *MVR* for units allocated to *Policies* during different parts of a year even if the same *Terminal Bonus* rate applies to all the units allocated in the year concerned.

For each sample unit we set an indicative maximum level. The main elements of the indicative maximum level are

- the *Asset Share,*
- any adjustment that we make for a distribution from the *Additional Account* and the *Retained Account*, and
- any adjustment we make for the smoothing of recent investment returns (this adjustment is similar to that used in Stage 1(b) of the procedure in section 4.2.3 for setting rates of *Terminal Bonus* but is based on indices over the previous 6 months rather than 24 months).

A further adjustment is made if necessary to ensure that each indicative maximum level is between 100% and 105% of *Asset Share* after the adjustment (if any) for a distribution from the *Additional Account* and the *Retained Account*.

We check to see if the indicative maximum level is less than the total of the bid price and any *Terminal Bonus*. If the indicative maximum level is less, we express the shortfall as a percentage of the bid price. We use these percentages as the basis for *MVRs*, although we may reduce them by rounding or making other adjustments.

There is a separate series of rates of *MVR* for each series of rates of *Terminal Bonus.*

A *MVR* can more than offset the total of the regular bonuses already added and any *Terminal Bonus*.

We withdraw each *MVR* not later than 3 months after it has been introduced and whenever relevant rates of *Terminal Bonus* change. We may at any time replace a *MVR* by a new *MVR*, which may be equal to the replaced one. For instance, we consider replacing *MVR*s at any time if, for sample units, the difference between the amounts that would be paid out from the *Scottish Widows With Profits Fund* and their *Asset Shares* is greater than 5%, or if otherwise necessary to avoid an excessive level of profit or loss to the *Scottish Widows With Profits Fund*.

For certain *Policies* we may apply individually-calculated *MVR*s instead of the rates of *MVR* dealt with above. These *Policies* are:

- Group Pensionbuilder contracts, and
- those contracts (of other types) which contain specific provision for individually-calculated *MVR*s.

<u>*UWP Annuities*</u>

When we determine the amount available from a *UWP Annuity* to purchase a replacement conventional annuity, we aim to pay

- an appropriate proportion of the *Asset Share* of the converting *Policy's* group,
- less an allowance for future charges that we had expected to receive,
- less any further adjustments to ensure fairness to the holders of continuing *Policies.*

<u>*Conventional With Profits Policies*</u>

Instead of *Terminal Bonus*, we apply other factors to give the amount that we pay out when guarantees do not apply.

For each of the categories of *Conventional With Profits Policy* listed in section 4.2.3 other than category (Y) *Pensionplanner Contracts*, we set separate factors for each combination of start year and the future year when guarantees would apply. We set the factors for each such combination to target a proportion of *Asset Share* based on one or more sample or notional *Policies*. The proportion is typically greater than 100% just after the start, and averages around 95% during the rest of the first two thirds of the *Policy* term. Over the final third of the term, the proportion is set so that payments run into expected levels for the guarantee dates, though any significant excess of guarantees over *Asset Share* would only be reflected in payments made close to the guarantee dates. The *Asset Shares* used in the first two thirds of the *Policy* term are adjusted for the smoothing of recent investment returns. This adjustment is similar to that used in Stage 1(b) of the procedure for setting rates of *Terminal Bonus* in section 4.2.3, but is based on indices over the previous 6 months rather than 24 months and is limited to a maximum of 5%.

Where appropriate, the factors are then combined in a manner similar to that described under Stage 2 of the procedure for setting rates of *Terminal Bonus* in section 4.2.3. We may then adjust them to obtain a smoother progression for *Policies* starting in different years. Finally, the factors are increased to allow for any distributions from the *Additional* Account and the *Retained Account*.

There are *Policies*, including altered *Policies*, whole of life *Policies* and *Policies* with guaranteed early encashment options, for which the above approach is not appropriate, and different factors need to be applied. For such *Policies* we adhere as closely as is appropriate and reasonably practicable to the considerations underlying the above approach. For whole of life *Policies* there is no addition for life protection benefits corresponding to that described in Stage 6 of the procedure for setting rates of *Terminal Bonus* in section 4.2.3.

We review factors formally at least twice a year but we may change them at any time. As a guideline, we would consider a review in the interim if the *Asset Shares* for the relevant combinations of one or more sample or notional *Policies* diverge by more than 5% from the smoothed levels on which we based the current factors, or if otherwise necessary to avoid an excessive level of profit or loss to the *Scottish Widows With Profits Fund*.

For *Pensionplanner Contracts* we normally target 95% of notional *Asset Shares* for a surrender value covering a number of members of a retirement benefits scheme. For such surrender values we allow for market movements up to the date of the surrender. When a transfer value is payable in respect of one or only a few members, we usually value the deferred pensions (being given up) using adjusted current premium rates, with the *Terminal Bonus* (if any) appropriate to an immediate pension equal in value to the deferred pension.

4.4 Practices specific to *With-Profits Income Units*

4.4.1 *Reversionary Bonus*

Reversionary Bonus is added on a regular basis and is referred to as 'regular bonus'.

Practices

Separate rates of regular bonus and how we apply them

We set separate rates of regular bonus for groups of *With-Profits Income Units* added to *Policies* in different periods. The periods are usually six months long. For units added to *Policies* on or after 23 March 2005 we set different rates of regular bonus (reflecting the different charges that apply) according to whether the relevant *Policy* started before that date or later.

We add regular bonus (if any) monthly. One twelfth of each rate of regular bonus is applied monthly to the relevant *With-Profits Income Units* until the relevant rate is replaced, and results in new units being added to *Policies*.

Deciding rates of regular bonus

We usually decide levels of regular bonus twice a year for each group of units as follows:

(a) We start with the expected yield on the relevant *Core Assets* and make allowances for tax, for charges and expenses in accordance with section 6 and for the regular deductions that are part of the process of providing for guarantees (see section 7.2).

(b) We take a sample unit in the group of units, and compare its *Asset Share* with its bid price. If the *Asset Share* is larger or smaller, we increase or decrease the result of (a) so as to distribute the excess or make good the shortfall over a number of years. We do this to gradually bring the *Asset Share* closer to the bid price of the units.

(c) We normally aim to limit the change (if any) in the annual rate of regular bonus for the group of units to a maximum 0.5% of their value.

4.4.2 *Terminal Bonus*

Practices

Timing of changing rates of *Terminal Bonus*

We do not aim to smooth investment returns for *With-Profits Income Units*, and so change rates of *Terminal Bonus* whenever we decide that they are no longer appropriate; as a guideline, we would consider a change if, for sample units, the difference between the amounts that would be paid out from the *Scottish Widows With Profits Fund* and their *Asset Shares* is greater than 2.5%. In any event we review them at least twice a year. Although we aim not to smooth investment returns, small smoothing profits or losses may occur. From time to time an adjustment may be made to the *Asset Shares* to reflect them.

The sample units

There are separate rates of *Terminal Bonus* for each period (usually six months) when units were added to *Policies*. For units added to *Policies* on or after 23 March 2005 we set separate rates of *Terminal Bonus* according to whether the relevant *Policy* started before that date or later. For each past period we take one representative sample *With-Profits Income Unit* added in that period for *Policies* started before 23 March 2005 and, if the period started on or after 23 March 2005, one representative sample unit for *Policies* started before that date and one sample unit for *Policies* that started later.

Procedure for setting rates of *Terminal Bonus*

For each sample unit, shortly before new rates of *Terminal Bonus* are expected to apply, we calculate the percentage by which the relevant *Asset Share* for that unit exceeds the bid price. The percentage is zero if the bid price of the unit will be more than the *Asset Share.*

The percentage, after rounding, gives the relevant rate of *Terminal Bonus.*

We do not restrict the extent to which payouts can rise or fall from one change in rates of *Terminal Bonus* to the next.

Target Ranges

By following the procedure described, we expect the payout from any representative sample unit to fall within a target range of percentages of the *Asset Share*. The target range is 97% to 103%. This range reflects that we do not aim to smooth investment returns for *With-Profits Income Units*, with the intention that the regular bonus (and income) from *With-Profits Income Units* will reflect the expected yield on the relevant *Core Assets* and the aim that the regular bonus will only need to be changed gradually (see section 4.4.1 above).

If the bid price of the unit is more than the *Asset Share* then the target range does not apply.

4.4.3 Payouts where the guarantees do not apply

Practices

Changes to the amounts payable under the practices set out below are approved by senior executives of the *Company*, including at least one executive director.

We pay out from the *Scottish Widows With Profits Fund*
- the bid value of the *With-Profits Income Unit*

- plus any *Terminal Bonus*
- less any *Market Value Reduction*.

At the date of this document rates of *Terminal Bonus* in circumstances where the guarantees do not apply are the same as those where the guarantees apply and the target ranges are the same as described in the previous section.

A Market Value Reduction (MVR) is a reduction we sometimes make to payouts if a policy is cashed-in or switched from a with-profits investment, for example, after a period of falling stock markets. We set separate rates of *MVR* in much the same way as when we set the rates of *Terminal Bonus* for circumstances where the guarantees apply, using the same sample units. We check to see if the *Asset Share* for each sample unit is less than the bid price. If it is, we express the shortfall as a percentage of the bid price. We use these percentages as the basis for *MVR*s, although we may reduce them by rounding or making other adjustments.

We withdraw each *MVR* not later than 3 months after it has been introduced and whenever relevant rates of *Terminal Bonus* change. We may at any time replace a *MVR* by a new *MVR*, which may be equal to the replaced one. We would consider a change if, for sample units, the difference between the amounts that would be paid out from the *Scottish Widows With Profits Fund* and their *Asset Shares* is greater than 2.5%.

4.5 Practices specific to *With-Profits Growth Units*

4.5.1 *Reversionary Bonus*

Reversionary Bonus is added on a regular basis and is referred to as 'regular bonus'.

Practices

Separate rates of regular bonus and how we apply them

We usually set rates of regular bonus for *With-Profits Growth Units* twice a year. We set separate rates for units allocated to *Polices* before 23 March 2005 and those allocated later.

Each is expressed as an annual rate of increase (if any). We apply the daily equivalent of this rate to the bid price of the relevant units each day until a new rate is set. We keep records of the most recent unrounded bid price, and apply the daily increases in unit prices to them.

Deciding rates of regular bonus

We use the following process to decide each of the rates:

(a) The starting point for each rate is to determine approximately 3/4 of the average annual rate of return earned on the *Core Assets* over the previous 2 years net of allowances for tax, for the relevant charges and expenses in accordance with section 6 and for the regular deductions that are part of the process of providing for guarantees (see section 7.2). However, for units allocated to *Policies* on or after 23 March 2005, the 2-year averaging period starts on 23 March 2005 if that was less than 2 years ago, and in that case we use an expected return for any part of the period that is in the future when we are deciding the rates.

(b) We restrict the result of (a) as necessary so that it is not more than 1% (of the bid prices) higher or lower than the corresponding rate of regular bonus for the previous period.

(c) We normally reduce the result of steps (a) and (b) if the 'aggregate asset shares' for the *With-Profits Growth Units* concerned falls short of the total of the bid prices of those units.

(d) We then restrict the result to a maximum rate of 5% pa.

4.5.2 *Terminal Bonus*

Practices

For *With-Profits Growth Units*, the amount of *Terminal Bonus* is determined by reference to

Overall Yields as described below.

There are separate Overall Yields for each half year when *With-Profits Growth Units* were allocated to *Policies*. For units allocated during the first half of 2005, separate Overall Yields also apply for units allocated before 23 March 2005 and those allocated later. For each of these past periods we take one representative sample *With-Profits Growth Unit* allocated in that period.

Timing of changing rates of Overall Yields

We aim to set Overall Yields twice a year, but may change them at any time if, for instance, there are significant movements in stock markets or interest rates. We would consider a change if, for sample units, the difference between the amounts that would be paid out from the *Scottish Widows With Profits Fund* and their *Asset Shares* is greater than 25%.

Procedure for setting amounts of *Terminal Bonus*

We carry out the following procedure a number of weeks before the new Overall Yields are expected to apply.

Stage 1 – Reference levels

For each sample unit we estimate a reference level whose main elements are:

(a) The expected *Asset Share* for the relevant sample unit at the end of the period for which we are deciding the new Overall Yields.

(b) An adjustment we make to the *Asset Share* for the smoothing of recent investment returns.

When making that adjustment we use a combination of a long-term expected ('normal') rate of return and the actual investment return on the relevant *Core Assets* in the *Scottish Widows With Profits Fund*. For this purpose we consider a 24-month period ending at the end of the period for which we are deciding the new Overall Yields (less than 24 months for newer units). For the more recent of those months and the future months we replace most of the actual return by the normal rate of return, and for the earliest of the months we replace only a small part of the actual return by the normal rate of return. This partially smoothes out the ups and downs of the returns over those months. We have no set limit on the extent of this smoothing.

One of our aims in this smoothing, including the choice of the normal rate, is that over the very long term its effect on the *Scottish Widows With Profits Fund* should be neutral. From time to time adjustments may be made to the *Asset Shares* to reflect any accumulated profits or losses from smoothing.

Stage 2 – Overall Yield

For each sample unit we calculate the Overall Yield as the level compound yearly rate that would increase its initial bid price up to the reference level over the relevant interval. This interval lasts from the initial allocation of the sample unit to the last day of the period for which we are deciding the new Overall Yield.

Application of Overall Yield

To determine the amount of *Terminal Bonus* for a unit we take the relevant Overall Yield and compare

(i) the initial bid price of the unit increased at the rate of Overall Yield from the day that the unit was allocated to the relevant *Policy* until the day its allocation is being cancelled, and
(ii) the bid price of the unit on the day when its allocation is being cancelled.

If (i) is larger than (ii), the difference is *Terminal Bonus*. If (i) is less than (ii), there is no *Terminal Bonus*.

We do not restrict the extent to which payouts can rise or fall from one change in rates of Overall Yield to the next.

Target Ranges

By following the procedure described, we expect the payout from any representative sample unit to fall within a target range of percentages of the *Asset Share*. The target range is 80% to 120%. This range reflects that we aim to hold in the region of 85% of the *Core Assets* in shares and property, which can produce volatile returns in the short-term. The smoothing that we apply to these returns, described in Stage 1(b) above, can lead to payouts that are higher or lower than the *Asset Share*. We consider this smoothing of the progression of payouts to be beneficial for policyholders as a whole.

If, in the above comparison, (i) is less than (ii) then the target range does not apply.

4.5.3 Payouts where the guarantees do not apply

Practices

Changes to the amounts payable under the practices set out below are approved by senior executives of the *Company*, including at least one executive director.

We pay out from the *Scottish Widows With Profits Fund*
- the bid value of the *With-Profits Growth Unit*,
- plus any *Terminal Bonus*,
- less any *Market Value Reduction*.

At the date of this document rates of Overall Yield, and hence any *Terminal Bonus*, in circumstances where guarantees do not apply are the same as those that apply when the guarantees apply and the target ranges are the same as described in the previous section.

A Market Value Reduction (MVR) is a reduction we sometimes make to payouts if a policy is cashed-in or switched from a with-profits investment, for example, after a period of falling stock markets. An *MVR* may be made up of a 'Basic *MVR*', an 'Additional *MVR*', or a combination of each. It can more than offset the total of the regular bonuses already added and any *Terminal Bonus*.

- Basic *MVR*

  To determine the amount of Basic *MVR* for a unit we take the relevant Overall Yield and compare

  (i) the initial bid price of the unit increased at the rate of Overall Yield from the day that the unit was allocated to the relevant *Policy* until the day its allocation is being cancelled, and
  (ii) the bid price of the unit for the day when its allocation is being cancelled.

  If (i) is less than (ii), the difference is Basic *MVR*. If (i) is greater than (ii), there is no basic *MVR.*

- Additional *MVR*

  We regularly monitor investment conditions and the rate at which policyholders are moving out of *With-Profits Growth Units*. We may introduce an Additional *MVR* at any time if we believe it to be necessary to maintain a fair level of payouts to those who continue with their *With-Profits Growth Units*.

  When we introduce an Additional *MVR* for the units to which a rate of Overall Yield applies, we check to ensure that it does not result in total potential payouts in respect of the units being lower than the *Asset Shares* corresponding to those units.

  We withdraw each Additional *MVR* not later than 3 months after it has been introduced and whenever relevant rates of Overall Yield change. We may at any time replace an Additional *MVR* by a new Additional MVR, which may be equal to the replaced one. We would consider a change if, for sample units, the difference between the amounts that would be paid out from the *Scottish Widows With Profits Fund* and their *Asset Shares* is greater than 5%.

5 INVESTMENT STRATEGY

5.1 General

Paragraph 23.1.1 of the *Scheme* states principles on which the investment policy for the assets of the *Scottish Widows With Profits Fund* as a whole is to be based.

Paragraph 23.1.2 of the *Scheme* states principles on which the investment policy for the assets backing the *Asset Shares* of the *Transferred With Profits Policies*, the *Additional Account* and the *Retained Account* is to be based. It refers to a *Notional Mutual Company*.

Principles

Investment policy is decided by the *Board* having taken *Appropriate Actuarial Advice*.

When developing investment policy the overall aim is to seek to optimise the investment return earned on the investments of the *Scottish Widows With Profits Fund* whilst achieving fairness among the different *With Profits Policies* invested in the *Scottish Widows With Profits Fund* and having regard to:

(i) the *Scheme* (including its support arrangements),

(ii) the financial security of the *Scottish Widows With Profits Fund*,

(iii) the rules and guidelines of our regulators,

(iv) ensuring that the contractual obligations to the holders of *Policies* in the *Scottish Widows With Profits Fund* are met,

(v) the use where appropriate of derivatives to improve efficiency of the management of the *Scottish Widows With Profits Fund* and to control risk.

The degree to which investment policy relies on assets outside the *Scottish Widows With Profits Fund* is partly determined by the size of the *Support Account*, which forms part of the Notional Mutual Company. In addition, for both *Transferred With Profits Policies* and for *Post 3 March 2000 With Profits Policies*, it is supported by other assets of the *Combined Fund* in that the capital requirements set for the *Combined Fund* take account of the investment policy of the assets of the *Scottish Widows With Profits Fund* as described in the Practices below.

Limits on exposure to any one counterparty are set from time to time.

Practices

<u>Investment Mandates</u>

The investment policy decided by the *Board* for each part of the *Scottish Widows With Profits Fund* takes the form of an ‘Investment Mandate’ to the investment manager.

- The Investment Mandate sets out a ‘benchmark’ percentage share for different categories of asset.

- The Investment Mandate also allows the investment manager to depart from the benchmark percentages within specified maximum and minimum limits for each asset category.

These aspects of investment policy are reviewed formally by the *Board* at least once a year (and by an investment committee made up mainly of senior executives at least twice a year).

Counterparty exposure limits are set by an *Investment Committee* or suitably qualified senior management and, for corporate bonds and money market instruments, may take account of creditworthiness.

The *Scottish Widows With Profits Fund* maintains a high level of liquidity through, for instance, holding money market instruments and UK Government Bonds.

For corporate bonds our aim is to achieve a diversified portfolio consisting mainly of ‘investment grade’ securities. The performance of this portfolio is monitored against a benchmark based entirely on market indices for investment grade securities. We do not automatically sell bonds if downgradings lead to them ceasing to be of investment grade.

Derivatives may be held within the *Asset Shares* or *Additional Account* for the purposes of efficient portfolio management or to manage the risks to the *Scottish Widows With Profits Fund* from guarantees. Derivatives may also be held in the *Guarantee Accounts* for *With-Profits Income Units* and *With-Profits Growth Units* as part of the process of providing for the guarantees.

With the aim of improving the return earned on the *Scottish Widows With Profits Fund*, the assets of the *Scottish Widows With Profits Fund*, including those representing the *Asset Shares*, may be used to participate in securities lending programmes. (Securities lending involves the transfer of title of assets to a borrower for an agreed duration, in exchange for an income payment; it can provide a modest enhancement to investment returns). The income received by the *Company* will be allocated to the part of the *Scottish Widows With Profits Fund* that is providing the relevant assets, and that part will also bear the risk of participating. We would only participate in strongly collateralised or indemnified programmes.

<u>Investment instruments</u>

The *Scottish Widows With Profits Fund* can use investment instruments that are of a new type, or are of a type not already authorised for use within that fund, only with the approval of the *Board*.

5.2 Deciding the investment mix

Practices

<u>Formal Review</u>

Because of the terms of the *Scheme*, when we review investment policy we determine the investment policies for the assets backing *Transferred With Profits Policies* first. We do this on the *Notional Mutual Company* basis set out in paragraph 23 of the *Scheme*. We then determine the investment policies for the *Post 3 March 2000 With Profits Policies*.

The table below indicates some key features of the investment policy for the major parts of the *Scottish Widows With Profits Fund*.

The table does not cover liabilities of the *Scottish Widows With Profits Fund* to creditors other than policyholders, such liabilities being backed by assets with broadly matching characteristics.

	Part of the *Scottish Widows With Profits Fund*	**Investment mix**
Assets held in respect of *Transferred Policies*	*Asset Shares* for *Pensionplanner Contracts* and units reinsured for *Aviva Life & Pensions UK Limited*	High proportion in fixed-interest investments, with the balance mainly in equities.
	Assets in respect of non-profit *Policies* and annuities in payment other than *UWP Annuities*	Liabilities broadly matched with fixed-interest investments.
	Additional Account	The *GAO Hedge*, plus other investments with a mix as for the average for the *Asset Shares* of *Transferred With Profits Policies*.
	Retained Account	As for the average for the *Asset Shares* of *Transferred With Profits Policies*.
	Asset Shares for the remaining *Transferred With Profits Policies*	Invested mainly in equities, property and fixed-interest investments. An upper limit on equities and property as described below.
Assets held in respect of *Post 3 March 2000 With Profits Policies*	Assets in respect of *With-Profits Income Units*	See below for details.
	Assets in respect of *With-Profits Growth Units*	See below for details.
	Asset Shares for the remaining *With Profits Policies* that are not *Transferred Policies*	Normally the same mix as for the equivalent *Transferred With Profits Policies*. See below.
	*Smoothing and Guarantee Account**	Cash deposits or similar assets.

* The *Smoothing and Guarantee Account* is the amuont accumulated from past profits (net of losses) from smoothing, including the form of smoothing described in Stage (1c) under "Procedure for setting rates of *Terminal Bonus" in Section 4.2.3*, in respect of *Post 3 March 2000 With-Profits Policies.*

Assets held in respect of *Transferred With Profits Policies*

The *GAO Hedge* protects the *Scottish Widows With Profits Fund* from much of the effect of interest rate falls on the cost of *GARs* and is fully allocated to the *Additional Account*. There are no plans to sell it, unless it were to be replaced by assets providing equivalent protection.

An upper limit is set on equities and property (and any other smaller asset classes of similar risk) for the *Asset Shares* for the 'remaining' *Transferred With Profits Policies* (see the table above). First we identify the highest equity and property (and any other relevant asset class) content with which the *Notional Mutual Company* would continue to meet regulatory prudential requirements (those provided for in the *Scheme*) in the event of reasonably foreseeable changes in investment conditions that might occur (on the basis that we are not able to adjust the portfolio before the period of adverse conditions begins). With the aim of optimising longer term performance, we are likely to set an upper limit for equity and property (an any other relevant assets) content that is lower than that highest identified level, to reduce the risk of forced sales of these assets if financial conditions were to deteriorate. We also set a benchmark proportion for equities and property (and other relevant assets) as part of the process by which the performance of the investment manager will be judged. The benchmark is likely to be a little lower than the upper limit and may be varied from time to time based on our strategic assessment of investment markets.

Criteria for the adjustment of the benchmark and upper limits in response to changing market levels may also be set.

With-Profits Income Units and *With-Profits Growth Units*.

For each of these types of *With Profits Unit* there are separate investment policies for the *Core Assets* and the *Guarantee Account* backing that type of unit.

For *With-Profits Income Units*, we aim to hold in the region of 50% of the *Core Assets* in lower-risk fixed-interest bonds issued by companies with 'investment grade' credit ratings. We aim to invest the rest of the *Core Assets* in potentially higher-return, but higher-risk, types of asset. These types of asset include fixed-interest bonds issued by other companies, and property.

For *With-Profits Growth Units*, we aim to hold in the region of 85% of the *Core Assets* in shares and property. We aim to invest the rest of the *Core Assets* in lower-risk assets such as fixed-interest bonds issued by governments, and cash deposits.

The *Guarantee Accounts* for *With-Profits Income Units* and *With-Profits Growth Units* are memorandum accounts within the *Scottish Widows With Profits Fund*. They form part of the process of providing for the guarantees that we make in connection with those units.

The assets and liabilities of each of the *Guarantee Accounts* consist of a combination of short-term bonds and deposits that the account invests in, together with derivative contracts which we may from time to time enter into on its behalf.

The purpose of these derivative contracts is to increase the money available in the relevant account when poor performance of the relevant *Core Assets* increases the likely cost of the guarantees; they reduce the money available when the investment performance is good and little support is needed.

<u>Other *Post 3 March 2000 With Profits Policies*</u>

We aim to set the same investment policy for the assets backing these *With Profits Policies* as for the corresponding *Transferred With Profits Policies* subject only to differences resulting from the nature of liabilities. However;

- we would restrict the maximum equity content (and the benchmark) for those assets if necessary in our opinion to ensure the *Company* as a whole would continue to meet regulatory prudential requirements in the event of reasonably foreseeable changes in investment conditions; and
- we would consider restricting investment mix for these *Policies* if otherwise the implied support for them from outside the *Scottish Widows With Profits Fund* would in our opinion be significantly higher, proportionately, than for the equivalent *Transferred With Profits Policies*.

5.3 Assets that would not normally be traded

Under the terms of demutualisation certain assets in this category were transferred into the *Scottish Widows With Profits Fund*.

Principle

Any new assets in this category would have to satisfy the requirements in paragraph 23 of the *Scheme*.

Practices

The only material asset in this category is the *GAO Hedge* referred to above. It would not be sold unless it were to be replaced by assets providing equivalent protections to the *Scottish Widows With Profits Fund.*

6 CHARGES AND EXPENSES

We make charges to recover most of our expenses, although some of our expenses are deducted directly from the *Scottish Widows With Profits Fund*.

Expenses that are deducted directly from the *Scottish Widows With Profits Fund* are mainly investment dealing expenses, commission payments in connection with *Conventional With Profits Policies*, and our expenses when the benefits under *Conventional With Profits Policies* are increased at the request of the holders of the relevant *Policies.*

Charges are amounts, provided for in the terms of *With Profits Policies* or in the *Scheme*, that we deduct from the *Scottish Widows With Profits Fund* in return for meeting other expenses relating to those *Policies*. The shareholder may make a profit or loss from these.

In this section we describe the way in which we apply charges and apportion expenses to *Asset Shares.*

Principles

The *Scheme* limits the charges and expenses which can be deducted from the *Scottish Widows With Profits Fund*.

We aim for each *With Profits Policy* to bear a share (having regard to any representations made to the policyholder) of the total charges and expenses levied on the *Scottish Widows With Profits Fund.*

Subject to the *Scheme* and to the terms of the relevant *Policies,* and having regard to statements previously made to policyholders, we may change the levels of charges if in our opinion this would achieve a more appropriate balance between policyholders and the shareholder or among different categories and generations of policyholders.

In this section, we deal with the amounts we pay from the *Scottish Widows With Profits Fund*. In some cases, further charges are made outside the *Scottish Widows With Profits Fund*.

Practices

General

Where we use outsourced services the costs are paid out of the charges deducted from the *Scottish Widows With Profits* Fund, and variations in the actual cost of those services have no effect on those charges.

Tax charged to the With Profits Fund is calculated in accordance with the *Scheme.*

Transferred Policies

For *Transferred Policies* we deduct from the *Scottish Widows With Profits Fund* all of the charges and expenses that are provided for in the *Scheme*.

When we track sample *Asset Shares,* we allow for charges and expenses as follows:

(i) for *With Profits Units* and *UWP Annuities*: charges as set out in Schedule 3 Part A of the *Scheme*;

(ii) for *Conventional With Profits Policies*: administration charges, commission, investment management charges, and the expenses of setting up increments, all in accordance with Schedule 2 of the *Scheme* (in broad terms administration expenses are based on costs in 1998,adjusted for cost inflation and changes in volumes since then, while investment management charges are set at 0.07% of relevant assets per annum, or the actual cost to the Company if lower); and

(iii) certain investment dealing and management costs referred to in Paragraph 34.1.21(u) of the *Scheme.*

Post 3 March 2000 Policies

The form of the charges and type of expenses that we allow for when we track *Asset Shares* for *With Profits Units* and *UWP Annuities* are the same as those in respect of equivalent *Transferred Policies*. The amounts are charged at levels consistent with the information given previously to policyholders and investment dealing expenses.

The charges and expenses that we deduct from the *Scottish Widows With Profits Fund* in respect of such *Policies* are consistent with those that we allow for in *Asset Shares*.

7 BUSINESS RISKS

In this section we deal with the exposure of the *Scottish Widows With Profits Fund* to various types of business risk, such as:

- maintaining and acquiring *With Profits Policies*
- profits and losses arising from our management of *With Profits Policies* including the operation of guarantees, options, smoothing, mortality and persistency
- profits and losses from non-profit *Policies* in the *Scottish Widows With Profits Fund*
- compensation costs
- any risks from investments in subsidiary companies owned by the *Scottish Widows With Profits Fund*.

We also describe how we monitor these and other risks such as changes in taxation or other legislation or regulation, and how the profits and losses are apportioned.

Finally we describe the nature and extent of shareholder commitment to support the *Scottish Widows With Profits Fund*, including when and how that commitment would take effect. The *Scheme* governs the extent of support that must be provided to the *Scottish Widows With Profits Fund*. The mechanism by which this support is reflected in investment policy is set out in section 5. Annex 2 includes the specific restrictions in the *Scheme* that ensure that an adequate level of support for the *Scottish Widows With Profits Fund* is maintained in the *Combined Fund*.

Principles

The *Board* maintains a risk management structure appropriate to the size and complexity of the *Company* and the *Scottish Widows With Profits Fund*.

The *Scheme* governs the extent to which the *Scottish Widows With Profits Fund* is exposed to business risk (including any compensation costs).

We aim to maintain a sound and prudent approach to the management of the *Scottish Widows With Profits Fund* when considering the nature and extent of risks taken. Risks associated with existing business are closely monitored.

New business can only be written in the *Scottish Widows With Profits Fund* if we are required to do so under the terms of a *Policy* or in our opinion it will not prejudice the reasonable expectations of the holders of *With Profits Policies*.

Profits and losses arising within the *Scottish Widows With Profits Fund* from the management of *Policies and With Profits Units* will generally be shared among particular groups of *With Profits Policies* and *With Profits Units*. These groupings can change from time to time.

7.1 Allocation of liabilities and the monitoring and control of risk

Practices

The risk management structure includes regular reporting to the *Board* and any appropriate *Board* committees. The *Board* receives a formal *Own Risk and Solvency Report* on the *Company* annually.

Generally, the *Scheme* allocates liabilities to the fund to which the relevant *Transferred Policy* has been allocated by the *Scheme*.

We do not charge liabilities for actual or alleged mis-selling of *With Profits Policies* after 3 March 2000 to the *Scottish Widows With Profits Fund*.

Liability for actual or alleged mis-selling, or other business risks such as negligence, breach of contract or fraud, by or on behalf of the *Society* up to midnight 3 March 2000 is allocated to the *Scottish Widows With Profits Fund.*

The *With Profits Actuary* provides an annual certification to the Board as to whether or not, the provisions of the *Scheme* in relation to the *Scottish Widows With Profits Fund* have been given effect to in all material respects.

At the date of this document it is expected that the only new business into the *Scottish Widows With Profits Fund* will be new members to existing group pension schemes, additional single premiums paid into existing policies and increases to levels of existing regular premiums. The levels of new business being written at the date of this document are low and are expected to remain low.

The terms of many *Policies* allow us to close access to the *Scottish Widows With Profits Fund* for some or all of future premiums and for future switches from unit-linked funds. We have set no minimum proportion or scale of new business or future premiums or switches of a with-profits type below which we would consider closing access to the *Scottish Widows With Profits Fund* for these new investments.

The *Scottish Widows With-Profits Fund* may close or merge with the *Clerical Medical With-Profits Fund*, if it (or either fund in the case of merger) falls below £500m in value (which is not expected to occur until 2035 or later). The Fund will be closed or merged only if it is expected that there would be no material adverse impact on the benefit expectations of holders of *With Profits Policies*. A certificate from an independent actuary and non-objection from our regulators would be required.

We may use reinsurance arrangements. To control the risk of default by the reinsurer, which could create losses for the *Scottish Widows With Profits Fund*, the credit-worthiness of the reinsurance company would be assessed carefully before any reinsurance agreement is entered into, and would continue to be monitored.

7.2 Profits and Losses within the *Scottish Widows With Profits Fund*

Practices

All or part of the actual and expected profits and losses to the *Scottish Widows With Profits Fund* from the following and similar sources:

- the level of payouts (whether made on maturity, surrender or otherwise) made under *With Profits Policies* in relation to the corresponding *Asset Shares*, and
- profits and losses from mortality of lives assured and annuitants under certain *With Profits Policies*

will generally be shared among *With Profits Policies.*

There are two exceptions to this general treatment of such profits and losses:

- those from *Transferred With Profits Policies*, other than those that arise from death claims, are credited to and deducted from the *Additional Account*; and
- those from *Post 3 March 2000 With Profits Policies*, other than those that arise from death claims or regular withdrawals, are separately accumulated within the *Scottish Widows With Profits Fund* if they arise from payments made on dates when guarantees apply .

Profits and losses from *Policies* in the *Scottish Widows With Profits Fund* which are not *With Profits Policies* may also be shared among *With Profits Policies*, but will usually be credited to and deducted from the *Additional Account*. The amount of this business in the *Scottish Widows With Profits Fund* could increase over time as annuities are taken under *Policies* with *GAR*s.

None of the above profits and losses are smoothed or subject to minimum levels before they are taken into account.

The profits and losses arising from a particular type of *With Profits Policy* that are shared among *With Profits Policies* are generally shared amongst the *Asset Shares* relating to *Policies* of similar types.

However, the *Board* may decide to limit the impact of such profits and losses to ensure consistency with its view of the reasonable expectations of policyholders. In this case, they may:

- allocate the excess from *Post 3 March 2000 Policies* to the above separate accumulation within the *Scottish Widows With Profits Fund,* and/or
- spread some of those profits and losses over a wider group of *With Profits Policies.*

Transferred Policies are unlikely to share in the profits and losses from *Post 3 March 2000 Policies*, and vice versa.

UWP Annuities purchased before 9 May 2000 do not share in profits and losses from mortality.

In accordance with a commitment that we made on 31 January 2002 when we announced a change in practice for the *Policies* with *GAR*s, costs arising from that change in practice are not deducted from any *Asset Shares* but are charged to the *Additional* Account. If at any time the *Additional Account* has insufficient assets to cover costs that are allocated to it in accordance with the *Scheme* then the costs will be met from assets of the *Combined Fund*

Flexible Options Bond

As part of the process of providing for the guarantees that we make in connection with *With-Profits Income Units* and *With-Profits Growth Units*, we make regular deductions from *Asset Shares* of the sample units of these types. These deductions are at a single (variable) rate for all units of the relevant type. We credit the relevant *Guarantee Account* with corresponding amounts. For each *Guarantee Account*, these amounts represent what we expect to be the net cost of the payouts relative to the *Asset Share* of the relevant units. From time to time we carry out valuations of the *Guarantee Accounts*, allowing for continuation of the current levels of regular deductions and for our latest estimates of the future relevant profits and losses. If a valuation shows a material surplus or deficit for a *Guarantee Account*, we bring that *Guarantee Account* back into balance. To do this, we adjust the relevant sample *Asset Shares* appropriately and/or the future level of the relevant deductions as appropriate.

From time to time the *Asset Shares* may be adjusted in respect of any accumulated profits or losses from smoothing.

7.3 Support to the *Scottish Widows With Profits Fund*

The Scheme contains extensive provisions for support to be provided to the *Scottish Widows With Profits Fund*. Those provisions contain requirements relating to the extent of the support to be made available to the *Scottish Widows With Profits Fund* by the shareholder, together with requirements for how and when that support is to be made available. Extracts from the *Scheme* are included in Annex 2.

As indicated in section 5.1, the investment freedom of the *Scottish Widows With Profits Fund* is determined by reference to the *Support Account* and the regulatory capital in the *Combined Fund.*

Practices

In following the requirements of the *Scheme*,we aim to ensure that the surplus assets avialable in the Combined Fund are greater than those required from the *Combined Fund* to support the investment freedom of the *Scottish Widows With Profits Fund.* .

The *Scheme* also provides two tests, the Statutory Test and the TCF Test, which operate as follows.

- The Statutory Test applies on each occasion a valuation is carried out under regulations. It identifies whether the value of assets of the *Scottish Widows With Profits Fund* is at least as great as that Fund's liabilties, where those are assessed by applying the relevant prudential rules of our regulator. The test is applied separately for the parts of the Fund that relate to *Transferred Policies* and *Post 3 March 2000 Policies*. If there is a shortfall of assets a contingent loan would be made, up to the level of assets held by *Scottish Widows* outside Fund, if it was required and permitted under regulations.

- The TCF Test is carried out at least annually. It identifies whether the value of assets of the *Scottish Widows With Profits Fund* exceeds the amount that the *Board* determines is required at the given time to treat holders of *With-Profits Policies* fairly (the 'Required Amount'). The value of assets would be considered to be less than the Required Amount if at any time projections over a two-year period indicate that there are insufficient assets held in the *Smoothing and Guarantees Account* to cover losses arising in that period in respect of *Post 3 March 2000 With-Profits Policies* which are not met from the *Asset Shares* of the relevant *Policies*, or from the assets held in respect of *With-Profits Income Units* or *With-Profits Growth Units*, in accordance with this PPFM and policy terms and conditions. If there is a shortfall of assets a contingent loan would be made, up to the level of assets held by *Scottish Widows* outside the *Scottish Widows With Profits Fund*, provided that this is permitted under regulations.

If a contingent loan is made under either of these tests then the *Board* will decide in advance how the assets are to be invested. Repayment of the contingent loan is conditional on the relevant test being satisfied immediately after repayment, or if required to be repaid by regulation. Repayment will include the investment return earned on the loaned assets while they were held in the *Scottish Widows With Profits Fund.*

8 INHERITED ESTATE

We do not aim to hold an inherited estate. By inherited estate we mean assets held in the *Scottish Widows With Profits Fund* that we do not intend to distribute to the current holders of *With Profits Policies*, and consequently the *Additional Account* and the *Retained Account* are not considered to be part of an inherited estate.

Principles

We do not aim to hold in the *Scottish Widows With Profits Fund* any significant, long term excess of assets over and above the amounts required from time to time to meet:

- the reasonable expectations of the holders of *With Profits Policies* and such other *Policies* as are allocated to the *Scottish Widows With Profits Fund*, and
- any regulatory requirements which can only be met by holding such an excess.

9 APPORTIONMENT OF SURPLUS BETWEEN THE *WITH PROFITS FUND* AND SHAREHOLDERS

Principles

The *Combined Fund* is entitled to one ninth of the value of bonuses and any other surplus allocated to the *Conventional With Profits Policies* as set out in Paragraph 29.1 of the *Scheme*.

The cost of this entitlement in respect of *Transferred With Profits Policies* is taken from the *Additional Account* and is not deducted from the *Asset Shares* of *Transferred With Profits Policies*.

The *Combined Fund* does not receive any proportion of the value of bonuses allocated on *With Profits Units.*

Practices

The proportion of the value of the relevant bonuses and surpluses that is transferred out of the *Scottish Widows With Profits Fund* is one-ninth. For this purpose:

- the value of *Reversionary Bonuses* is calculated on a basis that is consistent with the regulatory valuation of the liabilities of the *Scottish Widows With Profits Fund*, which allows for the taxation of the *Scottish Widows With Profits Fund*;
- when calculating the value of *Terminal Bonus* we exclude the value of *Terminal Bonuses* and other payments allocated from the *Additional Account* and the *Retained Account* (and amounts equivalent to those excluded prior to our change of practice on 31 January 2002 in relation to GARs); and
- on each occasion when a surrender value is paid, we deem the proportion of the value that represents a final distribution of bonus or surplus to be the corresponding proportion for a *Conventional With Profits Policy* that is maturing on that day but is otherwise similar to (and with the same starting date as) the *Policy* being surrendered.

Taxation borne by the *Company* on the transfers described in this section is not borne by the *Scottish Widows With Profits Fund,* and is not reflected in payouts under *With Profits Policies*.

ANNEX 1: GLOSSARY

Additional Account is a memorandum account of that name, defined under paragraph 24 of the *Scheme* and forming part of the *Scottish Widows With Profits Fund,* containing assets which were set aside on the transfer of insurance business to Scottish Widows plc from the *Society* with the aim of paying additional *Terminal Bonus* under *Transferred With Profits Policies* to the extent not required to meet contingencies.

Appropriate Actuarial Advice means the *Board* having taken advice from:

(a) if and to the extent that the matter will or may have an effect on the security or benefit expectations of any policyholder within the *Scottish Widows With Profits Fund,* the *With Profits Actuary*; or

(b) the *Chief Actuary* in relation to other actuarial matters (including, for the avoidance of doubt, policyholder security or benefit expectations); or

(b) both (as the case may be); and

(c) such additional external actuarial guidance (if any) as the *Board* determines in its absolute discretion to obtain;

Asset Shares means asset shares determined at the relevant time in accordance with the Principles of Financial Management set out in the *Scheme (*Very broadly, Asset Shares are an accumulation of premiums paid plus the investment return on those premiums, less various deductions including deductions to cover expenses and tax. The rate of investment return is the rate of return earned on the relevant part of the *Scottish Widows With Profits Fund).*

Board means the Board of Directors of the *Company*.

Capital Fees means fees of 0.3% per annum deducted from the *Asset Shares* of *Conventional With Profits Policies* other than annuities in payment under *Pensionplanner Contracts***.**

Chief Actuary means the person appointed by the *Board* from time to time to perform, during the period prior to 7 March 2016, the "Actuarial" controlled function (CF12) and in the period after and including 7 March 2016, the "Chief Actuary" controlled function (SIMF20) or the equivalent successor function.

Combined Fund means the separate fund of that name to be maintained by the *Company* pursuant to the *Scheme* and consists of all of the assets and liabilities of the *Company*, other than those attributed to the *Scottish Widows With Profits Fund* or the *Clerical Medical With Profits Fund*.

Company means Scottish Widows Limited, company number 3196171 and having its registered office at 25 Gresham Street, London, EC2V 7HN.

Conventional With Profits Policy means any *With Profits Policy* which is neither a *Unitised With Profits Policy* nor a *UWP Annuity*.

Core Assets means certain assets, as set out in section 5.2 of these PPFM, in the *Scottish Widows With Profits Fund* that back the *Asset Shares* of *With-Profits Income Units* and *With-Profits Growth Units*.

FCA means the Financial Conduct Authority or any successor organisation.

GAO Hedge means the notes issued by the European Investment Bank and the European Bank for Reconstruction and Development purchased by the *Society* pursuant to agreements entered into on 15 June 1999 or, if those notes are sold, the assets held in their place that provide equivalent protections to the *Scottish Widows With Profits Fund*.

GAR means a guaranteed annuity rate applicable when a *Policy* gives the holder the right to elect to convert a cash value into an annuity at a guaranteed rate or, in *Policies* other than *Pensionplanner Contracts,* to convert an annuity into a cash sum at a guaranteed rate.

Guarantee Account means a memorandum account, being part of the *Scottish Widows With Profits Fund,* which forms part of the process of providing for guarantees provided in connection with *With-Profits Income Units* and *With-Profits Growth Units,* as described in section 7.2 of these PPFM.

Investment Committee means a committee of senior managers with authority to set and monitor adherence to guidelines including limits on the exposure of the *Scottish Widows With Profits Fund* to individual counterparties.

Market Value Reduction (MVR) means a reduction sometimes made to payouts if a policy is cashed-in or switched from a with-profits investment, for example, after a period of falling stock markets. It is guaranteed not to apply in some circumstances (for example at maturity).

Membership Compensation means compensation for loss of membership rights on the demutualisation of the *Society*.

Notional Mutual Company means the modelling device of that name set out and defined in paragraph 23 of the *Scheme*.

Own Risk and Solvency Assessment means the report of the same name that is required to be produced under Solvency II regulations.

Pensionplanner Contract means a contract with the trustees of a defined-benefits retirement benefits scheme bearing a designation between Bond No. PW 1 and Bond No. PW9999, Bond P1 and Bond P9999, Bond P(W)1 and Bond P(W)9999, Bond WP1 and Bond WP9999, Bond CW1 and Bond CW9999 or Bond G1 and Bond G9999.

Policy means any contract of insurance within the meaning set out in the Financial Services and Markets Act 2000 Order 2001 (SI 2000/2361) which forms part of the *Combined Fund* or *the Scottish Widows With Profits Fund* or, where such a contract is in part in the *Scottish Widows With Profits Fund* and in part in the *Combined Fund,* each of those parts.

Post 3 March 2000 Policy means a *Policy* that is not a *Transferred Policy*.

Post 3 March 2000 With Profits Policy means a *With Profits Policy* that is not a *Transferred With Profits Policy*.

Retained Account is a memorandum account of that name, set up on the transfer of insurance business to Scottish Widows plc from the *Society* and forming part of the *Scottish Widows With Profits Fund* with the aim of paying additional *Terminal Bonus* under *Transferred With Profits Policies* to the extent not required to meet contingencies and other amounts defined in Paragraph 25 of the *Scheme*.

Reversionary Bonus means a type of bonus taking the form of a permanent increase in the amount of benefit guaranteed under a *With Profits Policy*.

Scheme means the High Court approved Scheme pursuant to Part VII of the Financial Services and Markets Act 2000 by which the Long Term Business of Scottish Widows plc was transferred to the *Company* on 31 December 2015.

Smoothing and Guarantees Account refers to assets held in the *Scottish Widows With-Profits Fund* which have accumulated from past profits (net of losses) from smoothing, including the form of smoothing described in Stage (1c) under "Procedure for setting rates of *Terminal Bonus*" *in Section 4.2.3,* in respect of *Post 3 March 2000 With-Profits Policies.*

Society means Scottish Widows' Fund and Life Assurance Society, company number Z2 and having its registered office at 15 Dalkeith Road, Edinburgh, EH16 5BU.

Support Account is a memorandum account of that name, defined in paragraph 26 of the *Scheme*, by reference to which the investment policy of the *Scottish Widows With Profits Fund* is determined. The aggregate amount of the *Support Account* and the *Additional Account* is normally constrained to lie between 10% and 20% of the aggregate of the *Asset Shares* of the *Transferred With Profits Policies*.

Terminal Bonus means an amount that is added when an amount becomes payable under a *With Profits Policy* and is not guaranteed in advance.

Transferred Contract is any contract of insurance transferred to Scottish Widows plc on the demutualisation of the *Society* on 3 March 2000 excluding, in the case of a contract providing benefits for members of a retirement benefits scheme, any parts of such a contract that relate to members who were not covered by the contract at the time of that transfer.

Transferred Conventional With Profits Policy means a *Transferred Policy* which is a *Conventional With Profits Policy*.

Transferred Policy means a *Policy* which forms the whole or part of a *Transferred Contract*.

Transferred With Profits Policy means a *With Profits Policy* which forms the whole or part of a *Transferred Contract*.

Unitised With Profits Policy means (i) a contract of insurance; or (ii) that part of any contract of insurance, in either case in relation to which the benefits payable are determined by reference to the value of *With Profits Units* allocated to that *Policy*.

UWP Annuity means an (i) annuity contract; or (ii) that part of any annuity contract which in either case is in payment in relation to which the benefits payable are determined by reference to the value of *With Profits Units*.

Vest means, in respect of an annuity under a *Policy,* to come into payment.

With Profits Actuary means, in relation to the *Scottish Widows With Profits Fund*, the person appointed from time to time to perform the "With Profits Actuary" controlled function (during the period prior to 7 March 2016, CF12A, and in the period after and including 7 March 2016, SIMF21) or the equivalent successor function.

With Profits Business means all *With Profits Policies* and *With Profits Units*.

Scottish Widows With Profits Fund means the separate fund of that name to be maintained by the *Company* pursuant to the *Scheme*.

With-Profits Growth Unit is a type of *With Profits Unit*.

With-Profits Income Unit is a type of *With Profits Unit*.

With Profits Policy means that part of any contract of insurance (excluding Investor Series 1 *Policies*) which at the relevant time confers on the holder a right to share in the profits of the *Scottish Widows With Profits Fund*, and including:

(a) a *Unitised With Profits Policy*;

(b) a *UWP Annuity*; and

(c) that part of any contract of insurance where either the benefits provided or the contribution required to be made vary by reference to bonuses declared on that *Policy*,

together with any non-profit benefits attached to that contract of insurance for which no separate premium is identified.

With Profits Unit means a notional unit whose value varies by reference to bonuses declared by the *Company* for the purposes of calculating benefits payable under *Policies*.

WP Benefit means the whole or part of the benefits under a *Conventional With Profits Policy,* being (where it is not the whole of such a *Policy*) distinguishable from the remainder of that *Policy*. In the case of such a *Policy* under which the level of premiums has been increased (including the payment of a single premium after the start of the *Policy*), each such increase gives rise to another *WP Benefit.*

Where we use terms such as “appropriate”, “excessive”, “fair”, “significant”, “similar” and “material”, then, unless otherwise required by the context, we are referring to judgements or assessments made by the *Company* or the *Board* of the relevant factors or circumstances.

ANNEX 2: EXTRACTS FROM THE *SCHEME*

“24.6 To the extent that the balance of the Scottish Widows Additional Account applied in accordance with paragraph 24.5 is insufficient to satisfy the Liabilities referred to in paragraph 24.5, such Liabilities shall be met from the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies to the extent that the Transferee Board, having taken account of Appropriate Actuarial Advice, determines that such action is not inconsistent with the TCF Requirements. In the event the Transferee Board, having taken account of Appropriate Actuarial Advice, determines that such action would be inconsistent with the TCF Requirements, such Liabilities shall be met from the Combined Fund***.”***

“RESTRICTIONS ON DIVIDENDS

30.1 No dividend or other distribution shall be paid by the Transferee from the Combined Fund if the effect of the payment of such dividend or other distribution would be:

30.1.1 to reduce the excess of the Regulatory Value of the Assets allocated to the Combined Fund over the Regulatory Liabilities allocated to the Combined Fund; below the aggregate value of the Scottish Widows WPF Support Account and the Scottish Widows WPF Further Support Account less that part of the value of (i) any Assets made available under paragraphs 28.1, 28.2 or 28.6 and (ii) any Return Adjustments arising pursuant to any arrangement under paragraphs 28.1, 28.2 or 28.6, and retained in the Scottish Widows With Profits Fund, which the Transferee Board, having taken account of Appropriate Actuarial Advice, considers may reasonably be attributed to the Pre-SW Scheme Transferred With Profits Policies.

30.1.2 to reduce the Regulatory Value of the Assets allocated to the Combined Fund below that which the Transferee Board, having taken account of Appropriate Actuarial Advice, believes should be retained within the Combined Fund in order to ensure that the Transferee has sufficient Assets to satisfy the TCF Requirements in relation to holders of Policies of the Transferee in the light of the Transferee's Liabilities under in force business and the new business that the Transferee expects to write over the next year."

“26 SCOTTISH WIDOWS WPF SUPPORT ACCOUNT

26.1 The Scottish Widows WPF Support Account may (at the discretion of the Transferee Board, having taken account of Appropriate Actuarial Advice), cease to be maintained if the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies fall below £1,000 million at three consecutive Year Ends and the Transferee Board, having taken account of Appropriate Actuarial Advice, determines pursuant to paragraph 23.1.2(A) that the provisions of that paragraph would not be in the interests of the holders of Pre-SW Scheme Transferred With Profits Policies.

26.2 The Scottish Widows WPF Support Account shall be credited with:

26.2.1 an amount representing the same positive rate of return (if any) as the average rate of return credited to the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies from time to time; and

26.2.2 any amounts credited to it in accordance with paragraph 26.4.1 or 27.

26.3 The Scottish Widows WPF Support Account shall be debited with:

26.3.1 an amount representing the same negative rate of return (if any) as the average rate of return debited from the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies from time to time; and

26.3.2 any amounts debited from it in accordance with paragraph 26.4.2 or 27.

26.4 At each Year End arising after the Effective Date:

26.4.1 if (as at the relevant Year End) the aggregate amount of the Scottish Widows WPF Support Account and the Scottish Widows Additional Account is less than 10% of the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies, an amount equal to the value of such shortfall shall be credited to the Scottish Widows WPF Support Account and debited from the Scottish Widows WPF Further Support Account;

24.4.2 to the extent that:

(A) the aggregate amount of the Scottish Widows WPF Support Account and the Scottish Widows Additional Account exceeds 20% of the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies (as at the relevant Year End); and

(B) the Notional Mutual Company would not thereafter be insolvent on a statutory basis (as determined in accordance with paragraph 26.5),

an amount not exceeding the value of such excess may be debited from the Scottish Widows WPF Support Account and credited to the Scottish Widows WPF Further Support Account.

26.5 The Notional Mutual Company shall be insolvent on a statutory basis if the Regulatory Liabilities of the Notional Mutual Company exceed the Regulatory Value of Assets of the Notional Mutual Company.”

“28 SUPPORT TO THE SCOTTISH WIDOWS WITH PROFITS FUND

Statutory Test

28.1 If a Statutory Deficit is determined by the Transferee Board, having taken account of Appropriate Actuarial Advice (and having regard to the TCF Requirements), to have arisen in the Scottish Widows With Profits Fund then, subject to paragraphs 28.3 and 28.6, the Combined Fund may make Assets available to the Scottish Widows With Profits Fund on a contingent basis (a **"Contingent Loan"**) such that:

28.1.1 the Regulatory Value of the Assets made available shall be at least equal to the amount of the Statutory Deficit;

28.1.2 making such Assets available shall not give rise to a Liability of the Scottish Widows With Profits Fund or an asset of the Combined Fund;

28.1.3 repayments of a Contingent Loan shall occur only in accordance with paragraph 28.5; and

28.1.4 amounts from time to time representing the balance of a Contingent Loan shall be increased or, as the case may be, decreased by Return Adjustments.

TCF Test

28.2 The Transferee Board shall, taking account of Appropriate Actuarial Advice, determine at least once in every calendar year whether a TCF Deficit has arisen in the Scottish Widows With Profits Fund. If a TCF Deficit is determined by the Transferee Board, having taken account of Appropriate Actuarial Advice, to have arisen in the Scottish Widows With Profits Fund then, subject to paragraphs 28.3 and 28.6, the Combined Fund shall make Assets available to the Scottish Widows With Profits Fund on a basis such that:

28.2.1 the Regulatory Value of the Assets made so available shall be at least equal to the amount of the TCF Deficit;

28.2.2 repayments of the Assets made so available shall occur only in accordance with paragraph 28.4; and

28.2.3 amounts from time to time representing the balance of the Assets made so available shall be increased or, as the case may be, decreased by Return Adjustments.

Limitation on Support

28.3 Assets need not be made available in accordance with the requirements of paragraph 28.1 or 28.2 to the extent that making such Assets available would result in a Combined Fund Deficit. For this purpose a Combined Fund Deficit which shall be calculated by the Transferee Board, having taken account of Appropriate Actuarial Advice, shall exist if the Regulatory Liabilities of the Combined Fund plus the Solvency Capital Requirement of the Transferee (less that part of the Scottish Widows With Profits Fund's allocated Solvency Capital Requirement which is covered by Assets of the Scottish Widows With Profits Fund in excess of that Fund's Regulatory Liabilities and less that part of the Clerical Medical With Profits Fund's allocated Solvency Capital Requirement which is covered by Assets of the Clerical Medical With Profits Fund in excess of that Fund's Regulatory Liabilities) exceed the Regulatory Value of the Assets allocated to the Combined Fund and outstanding amounts previously made available pursuant to paragraph 28.6 shall be deemed (however in fact provided) to have been made available by the Combined Fund to the extent that corresponding Assets are made available from the Combined Fund to another member of the Group without reducing the Assets of the Combined Fund.

Transfer of Assets to the Combined Fund

28.4 Assets made available to the Scottish Widows With Profits Fund on the basis described in paragraph 28.2 shall be transferred to the Combined Fund either in whole or in part to the extent that the Transferee Board, having taken account of Appropriate Actuarial Advice, determines that following such Assets being transferred the value of the Assets allocated to the Scottish Widows With Profits Fund is greater than or equal to the Required Amount.

28.5 Assets made available to the Scottish Widows With Profits Fund on the basis described in paragraph 28.1 shall be transferred to the Combined Fund either in whole or in part to the extent that the Transferee Board, having taken account of Appropriate Actuarial Advice, determines that, following such Assets being transferred:

28.5.1 a Statutory Deficit would not result as a result of such transfer (provided that such determination shall be made on the basis that any bonus which is to be declared on the basis of the relevant valuation of the Scottish Widows With Profits Fund is deemed to have been declared prior to such Assets ceasing to be made available); and

28.5.2 a TCF Deficit would not occur as a result of such transfer.

28.6 Where Assets are to be made available to the Scottish Widows With Profits Fund under paragraph 28.1 or 28.2, LBG may procure instead that Assets are made available to the Scottish Widows With Profits Fund, sufficient to fulfil the requirements under this paragraph 28, in any manner that it in its absolute discretion sees fit, provided that the Transferee Board, having taken account of Appropriate Actuarial Advice, shall be satisfied that any arrangements (which may include, without limitation, the making of a loan from the Combined Fund to any member of the Group) do not fail to satisfy the TCF Requirements in respect of the policyholders of the Transferee."

"23 PRINCIPLES OF FINANCIAL MANAGEMENT

23.1 The Transferee shall manage the Scottish Widows With Profits Fund in a sound and prudent manner and in accordance with the SW WPF's established principles and practices as updated from time to time. In addition, it will apply the following principles which, in the event of a conflict, shall prevail:

23.1.1 the investment policy shall have regard to the nature of the liabilities of the Scottish Widows With Profits Fund and shall seek to optimise the investment return earned on the investments of the Scottish Widows With Profits Fund whilst recognising the need to safeguard the financial security of the Scottish Widows With Profits Fund.

23.1.2 the investment policy for the Assets or notional Assets backing the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies, the Scottish Widows Additional Account and the Scottish Widows Retained Account (such investment policy to be determined separately for the Assets or notional Assets backing the Asset Shares and each account), and the bonus philosophy in respect of the Pre-SW Scheme Transferred With Profits Policies:

(A) shall (until such time as the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies fall below £1,000 million at three consecutive Year Ends and the Transferee Board, having taken account of Appropriate Actuarial Advice, determines that following the provisions of this paragraph 23.1.2(A) would not be in the best interests of the holders of Pre-SW Scheme Transferred With Profits Policies) be determined as if the Pre-SW Scheme Transferred With Profits Policies and the Assets or notional Assets backing the Asset Shares of such Policies, the Scottish Widows Retained Account and the Scottish Widows Additional Account, together with Assets equal in value to the amount of the Scottish Widows WPF Support Account (but in relation to the Scottish Widows WPF Support Account only to the extent that there are Assets in the Combined Fund exceeding the Regulatory Liabilities of the Combined Fund with a Regulatory Value equal to the amount of such account for the time being) comprised a *Notional Mutual Company* subject to such constraints as may be necessary to ensure that such Notional Mutual Company would remain solvent in reasonably foreseeable circumstances and on the assumption that such Notional Mutual Company is not required to maintain its Solvency Capital Requirement and for this purpose the Scottish Widows WPF Support Account shall be assumed to be invested in Assets of the same mix as those representing the Asset Shares of the Pre-SW Scheme Transferred With Profits Policies;

(B) shall have regard to the TCF Requirements in respect of the holders of Pre-SW Scheme Transferred With Profits Policies (as modified by this Scheme);

(C) shall recognise that the Scottish Widows WPF Support Account is a memorandum account which, in this context, exists only to support the investment policy and bonus policy for Pre-SW Scheme Transferred With Profits Policies; and

(D) Asset Share records shall be maintained and referred to in setting Terminal Bonus rates in order to ensure equity between different groups of holders of Pre-SW Scheme Transferred With Profits Policies. Asset Shares shall be accumulated in a manner consistent with SW's asset share methodology immediately prior to the Effective Date, by reference to the financial position, performance and experience of the Pre-SW Scheme Transferred With Profits Policies, the assets backing the Asset Shares of those Policies and Policies from time to time allocated to the Scottish Widows With Profits Fund that are not Scottish Widows With Profits Policies, provided that:

(1) no deduction shall be made from the Asset Shares of Pre-SW Scheme Transferred With Profits Policies in respect of the Combined Fund's entitlement to distributions of amounts from the Scottish Widows With Profits Fund pursuant to paragraph 29;

(2) no deduction shall be made from the Asset Shares of Pre-SW Scheme Transferred With Profits Policies in respect of any charge, transfer or bonuses paid from the Scottish Widows With Profits Fund in respect of Policies which are not Pre-SW Scheme Transferred Policies;

(3) Capital Fees shall continue to be deducted from the Asset Shares of Pre-SW Scheme Transferred With Profits Policies which are Conventional With Profits Policies

23.1.3 profits and losses arising on Policies from time to time allocated to the Scottish Widows With Profits Fund that are not Scottish Widows With Profits Policies may be allocated to the Asset Shares of Scottish Widows With Profits Policies, or to the Scottish Widows Additional Account, in such manner as the Transferee Board, having taken account of Appropriate Actuarial Advice, considers appropriate."

SCHEDULE 3

FEES RELATING TO UNITISED WITH PROFITS POLICIES

PART A

SCOTTISH WIDOWS UWP POLICIES

The fees referred to in paragraph 21.4 are amounts calculated by applying the following percentage rates to the Asset Shares of With Profits Units and UWP Annuities:

		Rate per annum
Life		
With Profits Bond	- if Bond started before 3 February 1997	0.75%
	- if Bond started on or after that date	0.85%
Jersey With Profits Bond		1.00%
All other types of life Unitised With Profits Policy (NUAC)		
	- for ordinary units	0.75%
	- for accelerator units	0.50%
Pension		
Pension builder (all types of)		0.875%
All other types of pension Unitised With Profits Policy (NUPC)		
	- for ordinary units	0.875%
	- for plus units	zero

UWP Annuities	0.875%